

Vincent G. Caracciolo and Tara Cummins

Overruled

In our recent publication, "*Ryan v. Lyondell: Does the End Justify the Means?*" we discussed an interlocutory appeal by the Delaware Chancery Court, in a case concerning a hurried merger between two companies. The opinion was worrisome because of the breadth of action the court appeared to require from boards considering merger activity.

Briefly recapped, the case arises from the acquisition of Lyondell Chemical Company. Despite a 45% premium on the purchase price, shareholder plaintiffs brought a variety of allegations, all of which were rejected at trial, with the exception of claims for breach of fiduciary duty.

Denying an interlocutory appeal on a summary judgment motion, the Chancery Court heavily criticized board defendants for taking a "wait and see" approach after initial purchase interest was expressed. The court's opinion weighed heavily on the board's duty to take reasonable steps to achieve the highest possible price per share for a merger, a so-called "Revlon duty." The court reasoned that the failure of the board to commence immediate, active consideration of a potential merger might constitute bad faith.

The opinion was troubling insofar as it imposed an exigent and rigorous standard of conduct for boards after initial merger interest. On appeal, however, the Delaware Supreme Court has reversed, granting summary judgment for the defendant-appellant and overriding the Chancery Court's emphasis on active and immediate processes.

Timing is Everything

The Delaware Supreme Court's opinion hinges on two significant issues: 1) when are Revlon duties triggered, and 2) what actions must a board take to fulfill Revlon duties?

The Delaware Supreme Court opines that Revlon duties are triggered not when a company is "in play" but rather when a company "embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control." The court finds Revlon duties were triggered not during the board's "wait and see" period, but rather when back and forth negotiations began. Therefore, the lower court's focus on the lack of action during the wait and see period is inapposite.

The final issue, therefore, becomes how the court should determine whether, during the relevant period, the directors satisfied the Revlon mandate. If the facts as presented and inferences therefrom do not evidence bad faith, then summary judgment is appropriate.

The Delaware Supreme court granted summary judgment, noting that “[d]irectors decisions must be reasonable, not perfect” and criticized the Chancery court for an approach that was apparently too comprehensive:

“Instead of questioning whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price, the inquiry should have been whether those directors utterly failed to attempt to obtain the best sale price.”

It would appear, therefore, that the issue hinges not on the overall thoroughness of board process and consideration, but rather whether reasonable process or activity existed. Said the court:

“There is only one Revlon duty – to “[get] the best price for the stockholders at a sale of the company. No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control.”

Lessons Learned

This decision is a positive development for boards of directors because it clarifies the discharge of Revlon duties and takes a significantly more relaxed approach. The court reminds us that “Directors’ decisions must be reasonable, not perfect.”

In the case at issue, the directors were “disinterested and independent” [not conflicted] and they were aware of the company’s value. In addition, they were assisted by financial and legal advisors. As such, the court confirmed that they should not be second guessed for good, fair results that followed appropriate procedures. Prudent directors are, of course, mindful of their fiduciary duties, proactive in their approach to corporate governance, and serious in their deliberations.

The Delaware Supreme Court ruling is a good result in favor of the directors; reversing the trial court and remanding for the entry of a judgment in favor of the directors. Nonetheless, the cost to the directors and company in time and defense costs to achieve such a result was high.

It is common for plaintiffs to attempt to second guess directors and officers regularly. Statutory law, common law and solid pro-director court decisions help to protect directors from the impact of such second guessing. Strong, immutable corporate indemnification agreements with directors further serves to protect against personal financial loss. More and more, however, the correct D&O insurance product customized for boards of directors or individual directors serve as front line protection of directors—not only from many forms of judgments and settlements, but also from ever increasing legal bills.

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