

PUBLIC COMPANY AND CAPITAL MARKETS ALERT

August 8, 2008

SEC STAFF PUBLISHES UPDATES DISCLOSURE INTERPRETATIONS

by Mark Hoffman and Barbara Nepf

The SEC's Division of Corporation Finance has updated its Compliance & Disclosure Interpretations (C&DIs) regarding Regulation S-K. Although many of the items were republished without change, several were revised and a few are entirely new. Some of the most useful guidance appears in C&DIs relating to compensation disclosures. The following is a brief overview of a few of the compensation issues addressed:

- The term “benchmarking” generally refers to the use of compensation data from other companies “as a reference point on which – either wholly or in part – to base, justify or provide a framework for a compensation decision.” Simply reviewing broad-based surveys generally is not considered “benchmarking.”
- If performance targets are not material in the context of the compensation policies or decisions, they need not be disclosed in the CD&A. If the targets are material, disclosure is required unless it would reveal confidential commercial or financial information or trade secrets and result in competitive harm. The test for “competitive harm” is whether a third party could use the targets to extrapolate information regarding the issuer's business or strategy and use it to the issuer's disadvantage.
- Disclosures regarding the compensation committee must include a discussion of any role of compensation consultants in setting executive or director compensation. In contrast, the CD&A should discuss the consultant's role only if it was material in the compensation-setting process.

The C&DIs also include updated interpretations on a number of other issues which will be of interest to our clients. Given the number of changes, we will not attempt to address them all here, but we encourage you to review these C&DIs as you prepare new filings. Some of the more important discussions cover:

- the application of “smaller reporting company” rules to majority-owned subsidiaries
- the application of Item 303 (MD&A) to smaller reporting companies
- the treatment of net exercises, settlements, and forfeitures under Item 703
- errors in CEO/CFO certifications that would require filing an amended periodic report
- excluding a recently acquired entity from management's evaluation of disclosure controls and procedures, and
- item 308T(b) disclosure in Forms 10-Q.

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MERGERS AND ACQUISITIONS NEWSLETTER

March 31, 2009

DELAWARE SUPREME COURT PUTS BRAKES ON EXPANSION OF DIRECTOR PERSONAL LIABILITY

by Michael Hutchings

The Delaware Supreme Court underscored that disinterested directors' actions in responding to acquisition proposals continue to be protected by the business judgment rule¹ when, on March 25, 2009,² it overturned the Chancery Court's controversial 2008 decision denying summary judgment in favor of the directors of Lyondell Chemical Company on *Revlon* claims³ arising from Lyondell's \$13 billion sale to Basell AF.⁴

In overturning *Ryan v. Lyondell*, the Supreme Court illuminated three important concepts: first, *Revlon* duties requiring that the board seek to get the best price reasonably available do not arise simply because a company is in play; second, there is no single blueprint for directors to fulfill their *Revlon* duties; and third, an imperfect attempt to carry out *Revlon* duties does not constitute bad faith (and a breach of the directors' duty of loyalty).

BACKGROUND OF MERGER

Before the merger, Lyondell Chemical Company was the third largest independent, publicly traded chemical company in North America. During the summer of 2006, Basell approached Lyondell with a proposal to purchase all of Lyondell's outstanding stock for between \$26.50 and \$28.50 per share. Lyondell, an adequately funded and healthy enterprise, was not seeking to merge with another company at that time, and its board of directors⁵ rejected the offer as inadequate and determined that it was not interested in selling. During the next year, Lyondell

prospered and no potential acquirors expressed interest in the company. However, in the spring of 2007, an affiliate of Basell filed a Schedule 13D with the Securities and Exchange Commission disclosing its right to acquire an 8.3 percent block of Lyondell stock owned by the second largest stockholder of Lyondell. The Schedule 13D also disclosed Basell's interest in a possible acquisition transaction with Lyondell.

In response to the Schedule 13D, Lyondell's board immediately convened a special meeting. The board recognized that the Schedule 13D signaled to the market that the company was in play, but the directors decided not to take any action at that time. On July 9, 2007, Basell's owner contacted Lyondell's CEO and increased his offer for Lyondell to \$40 per share in cash. Following negotiations between Basell's owner and Lyondell's CEO, Basell increased its offer to \$48 per share, which represented a 45 percent premium over the closing share price on the day before the public became aware of Basell's interest in Lyondell. The deal would require no financing contingency, but Lyondell would have to agree to a \$400 million break-up fee and sign a merger agreement by July 16, 2007.

The Lyondell board met on July 10, 2007, to review and consider Basell's offer. The meeting lasted slightly less than an hour, during which time the board reviewed valuation material that had been prepared by Lyondell management, discussed the Basell offer and discussed the likelihood that another party might be interested in Lyondell. The Lyondell board met again the following day, again for less than an hour, to consider the Basell

proposal and how it compared to the benefits of remaining independent. The Lyondell board decided that it was interested, authorized the retention of a financial advisor and instructed the Lyondell CEO to negotiate with Basell.

From July 12 through July 15 the parties negotiated the terms of a merger agreement, Basell conducted due diligence, the Lyondell financial advisor prepared a fairness opinion and Lyondell conducted its regularly scheduled board meeting. The Lyondell board discussed the Basell proposal again and instructed its CEO to try to negotiate for better terms.⁶ Basell unequivocally rejected nearly all of these additional requests, however it agreed to reduce the break-up fee from \$400 million to \$385 million.

On July 16, 2007, the Lyondell board met to consider the merger agreement. Lyondell's management, as well as its financial and legal advisors, presented reports analyzing the merits of the deal. The advisors explained that, under terms of the merger agreement, Lyondell would be able to consider any superior proposals that might be made after it signed the merger agreement. In addition, Lyondell's financial advisor reviewed various valuation models and opined that the proposed merger was fair. The financial advisor's managing director even described the merger price as "an absolute home run." The financial advisor also identified other possible acquirors and explained why it believed no other entity would top Basell's offer.

After considering the presentations, the Lyondell board voted to approve the merger and recommend it to Lyondell's stockholders. At a special stockholders' meeting held on November 20, 2007, the Lyondell stockholders voted overwhelmingly in favor of the deal⁷ and the merger was completed on December 20, 2007.

THE CHANCERY SUIT

In a class action filed on behalf of the stockholders of Lyondell, Walter E. Ryan, Jr. challenged the \$13 billion cash merger alleging disclosure violations and breaches of the fiduciary duty of loyalty.⁸ The claims for breach of the duty of loyalty were based on the process by which the directors approved the sale of the company. Specifically, Ryan claimed that the Lyondell directors did not fulfill their *Revlon* duties because they failed to employ a sale process reasonably designed to obtain the best price reasonably available for the stockholders.

Although most of Ryan's claims were dismissed on summary judgment, his *Revlon* claim survived.

To obtain money damages on that claim, however, it was Ryan's burden to overcome the protection of Lyondell's Section 102(b)(7) charter provision by demonstrating that the board failed to act in good faith in approving the merger.⁹

The Chancery Court found that, despite the 45 percent premium the purchase price represented over the pre-announcement stock price and overwhelming stockholder approval, the process undertaken by the Lyondell directors to approve the merger may have been fatally flawed. As a result, the Chancery Court denied the Lyondell directors' motion for summary judgment and held that Ryan could proceed to trial on his *Revlon* claims. The Chancery Court was very critical of the Lyondell board's apparent handling of the merger with Basell. The Chancery Court noted that, even in light of the "blowout" premium¹⁰ offered by Basell, the board's two months of "slothful indifference," despite knowing that the company was in play, along with the board's actions to "do nothing, hope for an impressive-enough premium, and buy a fairness opinion" raised a legitimate question whether the board acted in bad faith by disregarding a known duty to act and failed faithfully to engage in the sale process in a manner consistent with *Revlon*.

THE DELAWARE SUPREME COURT

The Delaware Supreme Court disagreed with the Chancery Court and, on March 25, 2009, overturned the Chancery Court decision denying summary judgment to the Lyondell directors on the *Revlon* claims. The Supreme Court explained that the Chancery Court denied summary judgment to the Lyondell directors on the *Revlon* claims based on a mistaken view of the law. The Supreme Court found that the Chancery Court was mistaken when (i) it imposed *Revlon* duties on the Lyondell directors before they either decided to sell, or before the sale had become inevitable, (ii) it read *Revlon* as creating a set of requirements that must be satisfied during the sale process and (iii) it equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of one's duties that constitutes bad faith.

First, the Supreme Court found that *Revlon* duties requiring that the board seek to get the best price reasonably available do not arise simply because a company is in play. The Chancery Court found that the directors' failure to act during the two months after the filing of the Basell Schedule 13D was "failing"

and that it warranted a denial of the directors' motion for summary judgment. The Supreme Court disagreed and explained that the duty to seek the best price available applies only when a company "embarks on a transaction – on its own initiative or in response to an unsolicited offer."¹¹ Although Basell's Schedule 13D filing put the Lyondell directors, and the market in general, on notice that Basell was interested in acquiring Lyondell, it did not create a duty for the Lyondell directors to take any action. Their wait-and-see approach was an entirely appropriate exercise of business judgment. The Supreme Court determined that the time for action under *Revlon* did not begin until the directors began negotiating the sale of Lyondell.

Second, the Supreme Court found that there is no single blueprint for directors to fulfill their *Revlon* duties. The Chancery Court denied summary judgment to the directors because it believed they did not fulfill their *Revlon* duties when they did not confirm that they had obtained the best price reasonably available by conducting an auction, by conducting a market check, or by demonstrating an "impeccable knowledge of the market."¹² The Supreme Court disagreed with the Chancery Court and explained that there is only one *Revlon* duty – to get the best price for the stockholders at a sale of the company. The Supreme Court went on to explain that no court can tell directors exactly how to accomplish that goal, because the directors will be facing a unique combination of circumstances, many of which will be outside their control. The Supreme Court further explained that "there is no single blueprint that a board must follow to fulfill its duties."¹³

Third, the Supreme Court found that an imperfect attempt to carry out *Revlon* duties does not constitute bad faith (and a breach of the directors' duty of loyalty). The Chancery Court denied summary judgment to the directors because it felt that the *Revlon* sale process must follow one of three courses, and the Lyondell directors did not follow one of these. As a result, the Chancery Court determined that the directors' failure to take specific steps during the sale process could have demonstrated a conscious disregard of their duties, leading to a breach of the duty of loyalty. The Supreme Court disagreed with the Chancery Court and explained that, even though the Lyondell directors did not conduct an auction or a market check, and they did not satisfy the Chancery Court that they had "impeccable"

market knowledge, the directors' failure to take any specific steps during the sale process could not have demonstrated the conscious disregard of their duties necessary for a finding that the directors acted in bad faith. The Supreme Court noted that "directors' decisions must be reasonable, not perfect,"¹⁴ and if the directors failed to do all that they should have done under the circumstances, at most they would have breached their duty of care. Only if the directors knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.

TAKEAWAYS

The Chancery Court's denial of summary judgment to the Lyondell directors last year caused much consternation in the legal and business communities because the Chancery Court declined to defer to the business judgment of an experienced and independent board of directors. While it was at least conceivable that the directors did not exercise sufficient care in conducting the sale process, the Chancery Court denied summary judgment because it found that the directors' lack of care might also have exhibited a failure of good faith – action for which the directors could not be exculpated from damages under Section 102(b)(7). This holding threatened to merge the concepts of gross negligence and bad faith and would have expanded the range of conduct that could result in personal liability for directors.

However, the Delaware Supreme Court has calmed much of the clamor by overturning the Chancery Court's decision and clarifying the relatively limited circumstances under which a director might be subject to personal liability for his or her conduct in negotiating and approving a sale transaction. The Supreme Court reinforced the principle that Delaware directors are entitled to exercise their business judgment in deciding how to maximize shareholder value in a sale transaction. In addition, the Supreme Court denied the attempted erosion of the Section 102(b)(7) protections for directors from personal liability for claims that are really duty of care claims. Only in cases where directors knowingly fail to undertake their duties in a sale process will the directors be liable for a breach of the duty to act in good faith.

¹ The business judgment rule is a presumption that in making a business decision the directors of a company acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del., 1984). Absent specific circumstances, such as evidence of self-dealing by directors or the limited circumstances in which heightened duties or a heightened standard of review is applied, Delaware courts will refrain from substituting their own judgment for that of a company's board of directors.

² *Lyondell Chemical Co. v. Ryan*, C.A. No. 3176 (Del. March 25, 2009).

³ "Revlon duties" generally require directors, when a board undertakes a sale of control of a company, to set their singular focus on seeking and attaining the highest value reasonably available to the stockholders. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

⁴ *Ryan v. Lyondell Chemical Co.*, C.A. No. 3176-VCN (Del. Ch. July 29, 2008).

⁵ Lyondell's board of directors consisted of its CEO and 10 independent directors, each of whom was active, sophisticated and generally aware of the value of Lyondell and the conditions of the markets in which Lyondell operated.

⁶ The Lyondell board specifically wanted to try to get a higher price, a go-shop provision during which Lyondell would be allowed to seek other buyers after signing the agreement, and a reduced break-up fee.

⁷ The merger was approved by more than 99 percent of the voted shares.

⁸ Ryan specifically alleged that (a) the merger price was grossly insufficient, (b) the directors were motivated to approve the merger for their own self-interest, (c) the process by which the merger was negotiated was flawed, (d) the directors agreed to unreasonable deal protection provisions and (e) the proxy statement omitted numerous material facts.

⁹ Section 102(b)(7) of the Delaware General Corporation Law provides that a company's certificate of incorporation may include a provision eliminating or limiting the personal liability of a director to the company or its stockholders for monetary damages for breaches of fiduciary duties as a director, provided that such provision shall not eliminate or limit director liability for a breach of the duty of loyalty. A failure to act in good faith would lead to a breach of the duty of loyalty, and, as a result, would render Lyondell's Section 102(b)(7) provision limiting director liability ineffective to protect Lyondell's directors for their actions in approving the merger with Basell.

¹⁰ This is how the Lyondell board characterized the premium.

¹¹ *Lyondell v. Ryan*, pp. 14-15.

¹² *Lyondell*, p. 17.

¹³ *Barkan v. Amsted Industries, Inc.*, 567 A.2d at 1287.

¹⁴ *Lyondell*, p. 18.

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CORPORATE GOVERNANCE ALERT

April 17, 2009

SEC STAFF PUBLISHES ADDITIONAL GUIDANCE ON AFFIRMATIVE DEFENSES TO INSIDER TRADING LIABILITY

by Sanjay M. Shirodkar and Nicolas Morgan

The Division of Corporation Finance has updated its Exchange Act Rules Compliance and Disclosure Interpretations (C&DIs) to provide additional guidance on Rule 10b5-1.

These new C&DIs incorporate the Rule 10b5-1 interpretations previously addressed by the SEC staff in its Fourth Supplement to the Manual of Publicly Available Interpretations in May 2001. The C&DIs update some of the old interpretations that were divided into the following categories: Rule 144, Trusts, Options, Loans and Pledges, Written Trading Plans and 401(k) Plan Transactions.

The C&DIs also include some important new guidance:

- The cancellation of one or more plan transaction affects the availability of the Rule 10b5-1(c) defense. C&DI 120.19 explains that the cancellation of one or more plan transactions is considered an “alteration or deviation” from the plan which automatically terminates the plan. In addition, the C&DI notes that in establishing a new contract after terminating a prior plan, “all surrounding facts and circumstances, including the period of time between the cancellation of the old plan and the creation of the new plan” are relevant in determining the person’s “good faith” intent.
- New C&DI 120.20 indicates that the Rule 10b5-1(c) affirmative defense is not available as an affirmative defense in instances where a person establishes a Rule 10b5-1 written trading plan while aware of material nonpublic information, even if the plan is structured so that the plan transactions will not begin until after the material nonpublic information is made public.
- New C&DI 220.01 provides timely guidance on what happens when a person enters into a written trading plan with a broker, when the broker subsequently goes out of business. This interpretation indicates that the initial trading plan is not considered cancelled if the plan is transferred to a new broker, so long as the timing of such transfer does not cancel any transaction scheduled under the initial plan and the new broker effects the sales in accordance with the terms of the initial plan. Interestingly, the interpretation does not require that the person not be aware of material nonpublic information at the time he or she transfers the initial plan to the new broker.
- New C&DI 220.02 provides additional guidance on the manner in which a company can effect a stock repurchase plan in accordance with Rule 10b5-1(c) and 10b-18.

The clarification by the SEC staff comes at a time of heightened and well-publicized scrutiny by the Enforcement Division of the SEC regarding trading activity in and around Rule 10b5-1 plans. For example, in a case filed March 4, 2009, against the former CEO, COO and CFO of a public company, the officers were alleged to have created 10b5-1 plans “within days” of participating in what the SEC called “misleading” conference calls with analysts about earnings information. According to the SEC’s complaint, the officers created the 10b5-1 plans while in possession of material nonpublic information about the company’s earnings, and the newly created plans essentially guaranteed the immediate sale of company stock. As a result of settling the action with the SEC, each of the former officers disgorged all gains, paid civil penalties and agreed to be subject to a federal court injunction.

In light of the clarifications by the Division of Corporation Finance and the heightened scrutiny by the Enforcement Division, careful consideration should be given to the timing of the creation, alteration or suspension of any Rule 10b5-1 stock sale plans.

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CORPORATE GOVERNANCE ALERT

April 1, 2009

NASDAQ EXTENDS SUSPENSION OF LISTING REQUIREMENTS

by Andrew D. Ledbetter

Given the continued extraordinary market conditions, Nasdaq has extended its prior suspension of the following continued listing requirements through Sunday, July 19, 2009:

- \$1 Minimum Closing Bid Price
- Minimum Market Value of Publicly Held Shares

Nasdaq previously suspended these continued listing requirements from October 16, 2008 through April 19, 2009. In its filing with the SEC to extend this suspension through July 19, 2009, Nasdaq noted that market conditions have not improved and that the number of securities trading below \$1, and between \$1 and \$2, on Nasdaq has increased since the initial suspension. Nasdaq expressed its continued belief that “there was no fundamental change in the underlying business model or prospects for many of these companies, and that a decline in general investor confidence has resulted in depressed pricing for companies that otherwise remain suitable for listing.”

Suspension of these two continued listing requirements means that issuers will not be cited for new deficiencies under these requirements and, with respect to prior deficiencies, companies will remain at the stage in any compliance period or hearings process that such companies were in as of October 16, 2008. Enforcement of these continued listing requirements and the time allowed under compliance periods and hearings processes for prior deficiencies are scheduled to resume on Monday, July 20, 2009.

Issuers should note that they remain subject to delisting for failure to satisfy any other listing requirements.

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