INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

ASPEN PUBLISHERS

Volume 22 Number 10, October 2008

Delaware Court Gives Huntsman a Boost

Page 2

RANDALL W. BODNER, **CHRISTOPHER G. GREEN** and **C. THOMAS BROWN** examine the Delaware Chancery Court's decision in *Hexion Specialty Chemicals, Inc. et al. v. Huntsman Corp*, a strong ruling in favor of a seller in the context of a pending merger.

SEC Website Guidance

Page 12

ALAN SINGER and **JUSTIN W. CHAIRMAN** of Morgan Lewis & Bockius LLP explore the SEC's guidance on company Web site disclosure, including whether such disclosure is a sufficient method for public disclosure under Regulation FD and for which companies.

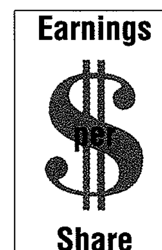
Public Offerings by Securities Exchanges, Alternative Trading Systems, and Broker-Dealers

Page 24

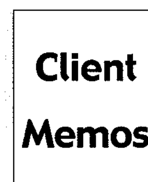
JAMES H. BALL and **JIHAY ELLIE KWACK** of Milbank, Tweed, Hadley & McCloy LLP discuss the unique issues that arise in connection with securities offerings by securities exchanges, alternative trading systems and broker-dealers.

DEPARTMENTS

Exculpated conduct under Section 102(b)(7) in DELAWARE .... Page 28



An update on fair value accounting .... Page 33



Valuable, practical advice .... Page 38

Wolters Kluwer
Law & Business

MERGERS & ACQUISITIONS

Delaware Chancery Court Gives Huntsman Merger a Boost

In a significant ruling on a party's ability to abandon a merger, the Delaware Chancery Court has issued a strong opinion in favor of the seller. In Hexion V. Huntsman, it rejected the buyers efforts to abandon or modify merger terms negotiated prior to the onset of the credit crisis and market downturn.

by Randall W. Bodner, Christopher G. Green, and C. Thomas Brown

The Delaware Chancery Court has rejected the most recent in a series of efforts by parties to pending merger agreements to abandon or modify merger terms negotiated prior to the onset of the national credit crisis and the market downturn. Vice Chancellor Lamb's opinion in the *Hexion v. Huntsman*[1] case offers important lessons in Delaware M&A law, and is particularly instructive to deal lawyers advising merger parties.

Recent Deal-Break Efforts Set the Stage

Hexion Specialty Chemicals, Inc. (Hexion), a portfolio company of the private equity firm Apollo Capital Management (Apollo), signed a $10.6 billion merger deal with Huntsman Corporation (Huntsman) in July, 2007, and expected to close in early summer, 2008. But when Huntsman announced worse-than-expected results for the first quarter of 2008, Hexion expressed doubts about the deal and embarked on an effort to avoid closing. Hexion commissioned a report from a valuation firm that opined that the combined entity would be insolvent. Hexion then filed a declaratory judgment action in the Delaware Chancery Court. Its complaint asked the Court to relieve Hexion of its obligations under the agreement on the ground that Huntsman had suffered a material adverse event, entitling Hexion to walk away. Hexion argued, in the alternative, that the combined entity would be insolvent. This would leave the funding banks free to deny financing under the terms of their debt commitment letters, in turn leaving Hexion unable to fund the transaction. In that event, Hexion argued, it would be liable only for liquidated damages in the form of a $325 million reverse break-up fee.

Huntsman countersued, asserting that Hexion had committed a "knowing and intentional" breach of its covenant to exercise "reasonable best efforts" to "arrange and consummate" financing to close the deal. Huntsman argued that Hexion's "knowing and intentional" breach entitled Huntsman to either specific performance of Hexion's obligation to close, or to uncapped damages to be "based on the consideration that would otherwise have been payable to stockholders" of Huntsman. At stake at trial for Hexion was the significant difference between, on the one hand, a walk-away right or a tolerable break-up fee of $325 million; and on the other hand, either specific performance to close the deal or uncapped damages that could be measured in the billions of dollars.

The Huntsman trial commenced on the heels of several recent widely-publicized efforts by acquirers to escape closing on pending merger deals on the original terms negotiated prior to the market downturn. For example, The Finish Line's $1.3 billion acquisition of Genesco fell into doubt when The Finish Line's financing bank, UBS, said it would refuse to fund after Genesco posted low earnings. Similarly, Cerberus Capital attempted to avoid closing its $4 billion purchase of United Rentals after the credit markets tightened. In both cases, the target companies brought suits to attempt to force the deals to close at the original price, and each accused its putative acquirer of unfair dealing.

Randy Bodner is a partner at Ropes & Gray LLP in Boston, MA, and the head of the firm's Securities Litigation Practice Group. Chris Green and Thomas Brown are associates at Ropes & Gray. The statements contained in this article do not necessarily represent the views of Ropes & Gray LLP or its clients, and are not intended to constitute, and do not constitute, legal advice.

Both the Genesco and United Rentals cases went to trial, producing mixed results for the parties. In the Genesco case, on the basis of strong language in the merger agreement obliging the purchaser to close, the Tennessee Chancery Court ordered The Finish Line to close in the event its financing was available.[2] The Finish Line was then obliged to fight a suit brought by its own bank in New York, setting up a trial to determine whether the combined entity would be solvent.[3] The case settled on the morning trial was to begin, with Genesco agreeing to accept its contractual breakup fee and taking a substantial equity investment from The Finish Line. In the United Rentals case, the Delaware Chancery Court did not order Cerberus to close, but instead ordered the private equity firm to pay a breakup fee of $100 million, 2.5 percent of the total deal value. Although certainly not inexpensive, many have viewed these as tolerable results for the buyers seeking to escape closings. The Finish Line, facing an order to close, avoided the risk of full expectancy damages; and Cerberus paid a $100 million breakup fee rather than closing on a $4 billion deal.

Hexion sought essentially the same reasonably tolerable exit price that Cerberus and The Finish Line secured. While Hexion undoubtedly recognized that there was a substantial likelihood that it would pay the breakup fee, it sought to avoid an order either compelling it to close the deal or to pay an uncapped, potentially multi-billion dollar damage award. But after a six-day trial, Vice Chancellor Lamb held that Hexion's unilateral effort to avoid closing by manufacturing an "unreliable" insolvency opinion constituted a "knowing and intentional" breach of the Hexion's obligation to use reasonable best efforts to arrange for financing. The ruling leaves Hexion liable for uncapped damages, which under the terms of the merger agreement, are to be "based on the consideration that would have otherwise been payable to the stockholders" of Huntsman.[4] The Court did not order Hexion to close in view of what Vice Chancellor Lamb found to be an "impenetrable" provision of the agreement by which the parties agreed that Hexion could not be ordered to close. Instead, the Court required Hexion to use best efforts to secure financing and "to make an informed judgment about whether to close the transaction (in light of, among other things, the findings and conclusions in [the Court's] opinion)[.]"[5]

On its face, Vice Chancellor Lamb's ruling stands as the most favorable result for a target company seeking to enforce the terms of a merger agreement struck prior to the onset of the credit crisis. But for all who have watched the many recent deal-break efforts unfold, including private equity firms, target companies, funding banks, and investors, the ruling poses two questions: (1) What does the ruling mean for this deal? and (2) What does the ruling mean for Delaware law?

Background of the Deal

Hexion, along with several other suitors, aggressively courted Huntsman early in the summer of

© 2008 Aspen Publishers.
All Rights Reserved.

INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

INSIGHTS (ISSN No. 0894-3524) is published monthly by Aspen Publishers, 76 Ninth Avenue, New York, NY 10011. POSTMASTER: Send address changes to **INSIGHTS**, 7201 McKinney Circle, Frederick, MD 21704.
To subscribe, call 1-800-638-8437. For customer service, call 1-800-234-1660.

For article reprints and reprint quotes contact *Wrights Reprints* at 1-877-652-5295 or go to *www.wrightsreprints.com.*

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other professional assistance is required, the services of a competent professional person should be sought.

—From a *Declaration of Principles* jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

www.aspenpublishers.com

2007.[6] In June of that year, Huntsman initially signed a $25.25 per share deal with the Dutch chemical manufacturer Basell Holdings BV (Basell). But on July 12, Huntsman announced that it would terminate that deal in order to accept a $28 per share offer from Hexion. Huntsman paid Basell a breakup fee of $200 million and accepted Hexion's offer.[7] Hexion's price represented a 48.1 percent premium over Huntsman's $18.90 share price at close of business on June 25, 2007, the day before the Basell deal was announced.[8]

Given that Huntsman was withdrawing from a secure deal with Basell, Huntsman bargained for particularly favorable terms calculated to maximize the likelihood of closing. Three components of the merger agreement were particularly important in this regard: (1) the Material Adverse Event (MAE) provision; (2) the financing provisions; and (3) the available remedies in the event of a breach.

The MAE Provision

The merger agreement defines a material adverse event narrowly:

> any occurrence, condition, change, event or effect that is materially adverse to the financial condition, business, or result of operation of [Huntsman]; *provided, however*, that in no event shall any of the following constitute a material adverse event: (A) any occurrence, condition, change, event or effect resulting from or relating to changes in general economic or financial market conditions, except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on [Huntsman] as compared to other [chemical companies]; (B) any occurrence, condition, change, event or effect that affects the chemical industry generally . . . except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on [Huntsman] as compared to other [chemical companies].[9]

Critically, the provision contained no bright-line metric by which to measure a decline as "materially adverse." So while the provision would offer Hexion a potential cost-free out, there was a low likelihood the provision would be triggered.

The Financing Provisions

Hexion structured the transaction as an all debt, no equity deal: Apollo put no money directly into the deal, and was not a party to any contract. Hexion thus would shoulder the costs on its own. To that end, Hexion obtained debt commitment letters from Deutsche Bank and Credit Suisse sufficient to pay the entire merger consideration.[10]

Notwithstanding the reliance on debt financing to consummate the deal, the agreement did not contain a "finance out" clause. That is, the absence of financing would not relieve Hexion of its obligations under the agreement.[11] Indeed, the agreement required Hexion to "use its reasonable best efforts" to "arrange and consummate" the committed financing,[12] and failing that, to obtain alternative financing on reasonably similar terms.[13] Hexion also was obliged to keep Huntsman informed "with respect to all material activity" concerning the status of financing.[14] Should the banks ultimately refuse to honor their commitment letters, Huntsman could require Hexion to file suit against the banks for specific performance or damages.[15] The closing conditions specified that Hexion would deliver a solvency letter to Huntsman, prepared by a mutually agreeable appraiser, at or before closing.[16] As discussed below, Vice Chancellor Lamb's ruling against Hexion would turn most significantly on these express affirmative obligations.

Remedies under the Agreement

As is customary, the agreement contained a liquidated breakup fee—in this case $325 million—payable to the non-breaching party in the case of termination.[17] In the vast majority of merger agreements damages are capped in this manner. Cerberus, for example, relied on just such a provision to limit the damages it owed United Rentals.

But the agreement also contained an additional, and relatively unusual, damages provision. The

Huntsman agreement provided that no termination of the merger agreement

> shall relieve any party from liability for any damages (including, in the case of [Huntsman], claims for damages *based on the consideration that would have otherwise been payable to the stockholders of the Company . . .*) for a *knowing and intentional breach* of any covenant hereunder.[18]

Thus, in the event Hexion committed a "knowing and intentional breach," Hexion could be liable not only for the breakup fee, but also for damages equal to the loss of the merger premium payable to Huntsman's stockholders. This term was remarkably favorable to Huntsman in two critical respects.

First, the provision vastly expands the potential cost of a breach to Hexion. In this regard, Hexion faced far greater downside risk than other buyers typically face when seeking to escape closing. To be sure, there is room for dispute as to precisely what the damages calculation would properly be under the provision. But setting that question aside, it is clear that, whatever the proper measure, the figure would dwarf the breakup fee.

Second, the provision overcomes a significant legal problem that stockholders of target companies have faced as deals have broken following the onset of the credit crisis. Only the company, not its stockholders, is a party to the merger agreement. Stockholders thus have no right to sue for merger consideration, even if an acquirer wrongfully terminates.[19] But because only the stockholders, not the company, are paid consideration by the acquirer, the damage suffered by the company is limited to mere transaction costs. Huntsman overcame this problem by contracting for the right to pursue damages to be measured by the expectations of its stockholders. In the event of a knowing and intentional breach, Huntsman could thus pursue the full expectancy damages of its stockholders.

The Market Turns, the Credit Crisis Hits, and Hexion Seeks an Out

In the months following the announcement of the merger agreement, neither the parties nor the banks publicly expressed any doubts about the health of the target or the viability of the deal. But on April 22, 2008, Huntsman announced "disappointing" first quarter earnings.[20] Hexion recalculated its deal model and determined that its returns might be as little as a third of its original expectation.[21] Hexion consulted counsel. Hexion and its counsel engaged a valuation firm to form "two teams: (1) a litigation consulting team; and (2) an opinion team."[22] On June 18, 2008, the opinion team released a report stating that a combined Hexion-Huntsman entity as envisioned by the merger agreement would be insolvent under any of the three applicable legal tests.[23] The team did not consult with Huntsman management in developing its assumptions and conclusions.[24]

Armed with this insolvency opinion, and again without consulting Huntsman, Hexion filed suit in the Delaware Chancery Court seeking a declaration that Huntsman had suffered a material adverse event, or that the combined Hexion/Huntsman entity would be insolvent making financing impossible.[25] Huntsman, in turn, sought a declaration that Hexion had "knowingly and intentionally" breached the merger agreement.[26] The trial commenced on September 8, 2008.[27]

The Court Holds Hexion to its Deal

Following a six-day trial, and only three weeks after the trial began, Vice Chancellor Lamb issued a 90-page opinion firmly in favor of Huntsman. The ruling awarding Huntsman potentially uncapped, full contract damages is predicated on three principal findings.

There Was Not a Material Adverse Event

Examining the MAE provision, Vice Chancellor Lamb first made clear that it is the burden of the party invoking the MAE provision to prove that there has been a material adverse event.[28] In attempting to carry its burden, Hexion pointed to Huntsman's first quarter results, and specifically to the decline in Huntsman's earnings per share, and Hexion relied on negative projections going forward. Vice Chancellor Lamb rejected Hexion's reasoning both as to the relevant time period and the proper metric to assess a company's financial condition for MAE purposes.

As to the time period, Vice Chancellor Lamb held that "[i]n the absence of evidence to the contrary, a corporate acquirer may be assumed to be purchasing the target as part of a long-term strategy."[29] Accordingly, when determining whether an MAE has occurred, the Court must look at a "commercially reasonable period," likely to be measured in "years rather than months."[30] In other words, short-term downturns in performance (even substantial ones) do not provide prospective buyers with an escape hatch; rather, buyers looking to invoke MAE clauses must be able to prove that the fall-off in a target's performance is both material and long-lasting.

Short-term downturns in performance (even substantial ones) do not provide prospective buyers with an escape hatch.

As to the proper metric, Vice Chancellor Lamb rejected Hexion's reliance on earnings per share as a proper measure of Huntsman's financial condition. He noted that EPS numbers are directly linked to a target's underlying capital structure. But in a cash-out merger, capital structure is changed. The Court thus concluded that EBITDA, a figure which is independent of capital structure, is a better basis for determining long-term health in a MAE analysis.[31] Relying on that metric, and noting that Huntsman's first quarter 2008 EBITDA was only 7 percent less than its first quarter 2007 EBITDA, and that its 2007 EBITDA was only 3 percent less than its 2006 EBITDA, Vice Chancellor Lamb concluded that, insofar as this factor was concerned, there was no material adverse event.

In the course of his MAE analysis, Vice Chancellor Lamb also rejected Hexion's argument that Huntsman's failure to meet its earnings forecasts was good evidence that it had suffered an MAE. He noted that the parties had expressly disclaimed any reliance on earnings projections.[32] Further, if Hexion were as concerned with quarterly results as its argument suggested, it could easily have structured the deal to provide for that, say in the form of an "earn out" clause.[33] Indeed, "[c]reative investment bankers and deal lawyers could have structured, at the agreement of the parties, any number of potential terms to shift to Huntsman some or all of the risk that Huntsman would fail to hit its forecast targets. But none of those things happened."[34]

Vice Chancellor Lamb also rejected Hexion's argument that reduced projections for future earnings also constituted an MAE. Such projections are, to be sure, relevant in an MAE analysis.[35] But the Vice Chancellor noted that earnings projections can vary widely based on underlying assumptions. Combined with an inherent and suspect pessimism in its assumptions, "[t]he fact that Hexion offered little detail as to how it arrived at its projections for Huntsman's business also diminishes the weight the projections deserve."[36] The Court also observed that Hexion's own deal models had accounted for potential future earnings "significantly" below the "current analyst estimates for Huntsman 2009 EBITDA."[37]

A "Knowing and Intentional Breach" of Hexion's Financing Obligation

After rejecting Hexion's MAE argument, the Court turned to the related questions of: (1) whether Hexion could avoid closing on the ground that the combined entity would be insolvent, and the banks would thus be relieved of their obligation to fund under their debt commitment letters; or (2) whether, as Huntsman would have it, Hexion's unilateral and calculated effort to obtain an insolvency opinion in order to attempt to trigger the banks' walk-away right constituted a "knowing and intentional breach" of Hexion's affirmative obligation to use reasonable best efforts to arrange financing.

As to the first question, Vice Chancellor Lamb found that the insolvency opinion was unreliable, and it could not therefore support a finding that the combined entity would be insolvent.[38] The Court was careful, however, not to reach the ultimate question as to whether the combined entity would, in fact, be solvent under the applicable tests. The Court found that the insolvency opinion was fraught with biased numbers, unduly pessimistic assumptions about EBITDA, and unfair presentations of pension liabilities and the potential proceeds of antitrust divestitures. The Court criticized, at notable length, the inherent conflict at the valuation firm

that generated the insolvency opinion. While purporting to produce an "objective opinion," the firm's analysts worked closely with Hexion's counsel and all were well aware that the principal objective was to support Hexion's effort to avoid closing. And, despite forming two teams purportedly separated by a Chinese wall, several analysts, including the lead valuation partner, were involved in both valuation and litigation analyses.[39]

The Vice Chancellor was particularly critical of Hexion's counsel for developing such a deliberate and aggressive strategy to scuttle the deal.

As to the second question—whether Hexion breached its obligation to use reasonable best efforts to consummate financing—Hexion contended that it did not know that obtaining the insolvency opinion would constitute a breach, and in order to commit a "knowing and intentional breach," one must not only commit the act, but one also must know that the act constitutes a breach. Vice Chancellor Lamb flatly rejected that notion, saying it was "simply wrong," and noting that "if a man takes another's umbrella from the coat check room, it may be a defense to say he mistakenly believed the umbrella to be his own," but it is "no defense to say he had not realized that stealing was illegal" or that "it was not his 'purpose' to break the law."[40] The Court thus construed "knowing and intentional breach" to mean the "taking of a deliberate act, which act constitutes in and of itself a breach of the merger agreement, even if breaching was not the conscious object of the act."[41]

The Court went on to observe that Hexion's commissioning of the insolvency opinion and subsequent campaign to avoid closing the deal had put its present funding at risk and undermined its ability to obtain alternative financing. The Court further noted that Hexion had done so without any indication from its original banks that they would refuse to fund, and without any attempt to consult with Huntsman's Board of Directors to clarify facts and consider solutions. Taken together, the Court concluded that these actions constituted a knowing and intentional breach of Hexion's obligation to use its best efforts to obtain and consummate financing, and to keep Huntsman apprised of potential problems with financing. In a portion of the ruling that undoubtedly will be the subject of extensive commentary, the Vice Chancellor was particularly critical of Hexion's counsel for developing such a deliberate and aggressive strategy to scuttle the deal. The evidence of knowing and intentional breach was, he said, "overwhelming."[42]

Uncapped Damages, but No Order to Close

Having held that Hexion breached the agreement, Vice Chancellor Lamb turned to the question as to what remedies Huntsman was entitled. The principal question was whether Huntsman was entitled to an order compelling Hexion to close. Interpreting the "impenetrable" remedies provision, and relying on extrinsic evidence of the parties' intent, Vice Chancellor Lamb held that the parties intended that in no event would Huntsman be awarded an order requiring Hexion to close the transaction. The Vice Chancellor held that the parties did intend, however, that Hexion could be ordered to specifically perform all of its obligations under the agreement, including using reasonable best efforts to consummate financing, and that a failure to do so would result in uncapped, full contract damages in accordance with the terms of the agreement.

What Does the Ruling Mean for the Huntsman Merger?

The immediate question for the parties and investors is what the ruling means for the future of the Huntsman deal, and what the possible and likely outcomes might be. The more long-term questions that private equity firms, target companies, banks, and their counsel will be asking are: (1) What does the ruling mean for Delaware law precedent? and (2) What will the effect be on M&A deals going forward?

The ruling does not resolve all uncertainty about the deal. As the Vice Chancellor observed:

> [T]here remain substantial obstacles to closing. Some of these result from the current unsettled

credit environment, others result from the difficult macroeconomic conditions facing [the parties'] businesses. Some other of those obstacles appear to result from the course of action the buyer and its parent have pursued in place of the continued good faith performance of the buyer's contractual obligations.[43]

Since the order issued, Hexion has obtained antitrust approval for the merger, and has given no indication that it does not intend to market the deal debt and close at $28.[44] Huntsman stock traded on either side of $11 per share on Friday, October 3, 2008, the day after Hexion announced the antitrust clearance. The markets clearly remain uncertain, and some might say they have reason to be so given the number and range of possible outcomes. As in the Genesco-Finish Line case, all eyes likely now will turn to the banks and their willingness to fund. Before trial, neither bank commented publicly on solvency. At trial, a representative of Credit Suisse indicated "eagerness" to avoid funding the deal, but stated that the bank is "prepared to fund that commitment if a compliant solvency certificate can be provided."[45] Thus far, Deutsche Bank has remained silent.

The proper measure of "consideration damages" remains unclear, adding yet another layer of complexity.

For its part, Huntsman has wasted no time in ensuring that the banks remain at the table. The day after the Chancery Court ruled, Huntsman obtained a temporary injunction against both banks in a Texas court.[46] Relying on Huntsman's right under the merger agreement to timely information about financing, the Court ordered the banks not to take any action "that could reasonably be expected to materially impair, delay, terminate, or prevent consummation of the financing contemplated by the [commitment letter]."[47] The parties in Texas are to appear for a hearing on October 8th.

Taken together, the Delaware and Texas actions leave several potential outcomes for the deal. There is the straightforward possibility that the banks and Hexion could show up and close the deal on the original terms. There is, of course, the possibility that the parties renegotiate the terms of the deal, as has been the case with the great majority of pending mergers during the credit crisis. Alternatively, the banks could bring a declaratory judgment action seeking a declaration that the combined entity will be insolvent, thereby giving the banks the right under the terms of their debt commitment letters to refuse to provide financing for the deal. If the banks failed to secure such a declaration, the deal would close on its original terms. But if the banks were to prevail, they could then walk away, leaving Hexion unable to close and faced with an uncapped damages claim to be determined by Vice Chancellor Lamb.

In this latter event, the possibilities become more complex. Given its knowing and intentional breach, Hexion may be faced with not only damages based on the "consideration that would have otherwise been payable to the stockholders of [Huntsman]," but also liquidated damages, which Huntsman could demand under the contract upon exercising its termination right.[48] Such a two-part award is conceivable because the availability of uncapped damages for a "knowing and intentional breach" is independent of liquidated damages when a party exercises a right to terminate.[49] Although the Chancery Court might deem liquidated damages an unavailable double recovery in such circumstances, the merger agreement can be read to allow for awards under both measures.[50] The proper measure of "consideration damages" remains unclear, adding yet another layer of complexity. One possibility is the premium over the undisturbed Huntsman price before the Basell acquisition was announced. That would be $9.10 per share, or approximately $2 billion. Alternatively, the measure could be the premium Hexion offered beyond the Basell deal price. That would be $2.75 per share—a relatively tame $600 million.[51] In any case, the number would far exceed the $325 million breakup fee.

Another hypothetical outcome after a declaration of insolvency is that Hexion would only have to pay liquidated damages. To achieve that result, Hexion would have to demonstrate full, good faith compliance with the Delaware order. Hexion would argue that its initial "knowing and intentional"

breach was cured because it sought to "arrange and consummate" financing, forestalling any liability on that basis. The ultimate failure to close would then be assigned to the failure of financing that occurred after Hexion complied with the order. Although technically possible, this outcome is extremely unlikely. It would seem to cut against the Court's finding that Hexion effectively poisoned the well on any other financing for the deal.[52]

Significance for Delaware Law and Future M&A Deals

Market participants and commentators undoubtedly will have varying opinions on the significance of the *Huntsman* decision. Some will regard it as a critical line-in-the-sand decision in which the Delaware Chancery Court announced its emphatic disapproval of the recent flurry of efforts to escape or substantially modify merger terms. Others, though, will note that the merger terms on which the *Huntsman* decision turned were particularly favorable to the target company, and the case is ultimately a factually-intensive application of nuanced facts to relatively off-market terms. There likely is truth in both views. But apart from handicapping the decision's ultimate place in Delaware law, there are several notable practical takeaways.

Materially Adverse Events

The decision confirms that parties seeking to excuse performance on the ground that a MAE has occurred bear a "heavy burden." The decision maintains the Chancery Court's record of never having held that a MAE has occurred in the context of a merger agreement, a record that Vice Chancellor Lamb said "was not a coincidence." He confirmed the standard established in *In re IBP, Inc. Shareholders Litigation*,[53] where the MAE analysis turns on whether there has been an adverse change to the company's "long-term earnings power, which one would expect to be measured in years rather months." The Court noted that parties enter into merger agreements with an intent to combine for long-term benefits, and the event must therefore be "significantly durational" and "expected to persist significantly in the future."[54]

The market would undoubtedly view a 7 percent decline in Huntsman's EBITDA over several consecutive quarters to be "materially adverse." But the Court has been clear not to adopt the market view of what is "material" in this context. In view of this latest rejection of a buyer's effort to invoke a MAE provision, parties to merger agreements ought to assume that a material adverse event will have to be an event that was not foreseen, if not unforeseeable, at the time of contracting, and one could reasonably infer from the *Huntsman* decision that a 10 percent decline in EBITDA may not be sufficiently material. The *Huntsman* decision confirms that buyers seeking to preserve the option to abandon a merger agreement are well advised to negotiate MAE provisions that have bright-line metrics that define what constitutes a "material adverse event," rather than relying on a judge to define the term for, and likely against, them.

"Reasonable Best Efforts"

While "reasonable best efforts" clauses are common in merger agreements, there is very little Delaware case law interpreting them. The *Huntsman* decision provides some guidance. Hexion agreed to use its "reasonable best efforts" to do "all things necessary, proper or advisable" to arrange and consummate the financing for the transaction. The Court held that "reasonable best efforts" were equivalent to "commercially reasonable" efforts, and went on to explain that a party need not ignore its own interests or "spend itself into bankruptcy" to meet that standard, but a party must take the interests of the counterparty into account. Indeed, many practitioners will read the *Huntsman* decision to impose an affirmative obligation under a "reasonable best efforts" clause to work proactively with the counterparty to attempt to overcome conditions or terms that threaten or weaken the viability of the deal.

In view of that holding, parties to merger agreements must be mindful not to run afoul of any similar covenant when considering various strategies to seek to abandon or modify merger terms. This is particularly the case in this environment when there remain pending mergers that were negotiated prior to the market downturn. For parties to those putative mergers and their counsel, the portion of the

Huntsman opinion itemizing the details of Hexion's and its counsel's effort to prove up "insolvency" and thereby escape closing is required reading.

"Knowing and Intentional" Breaches

Many parties to merger agreements and their counsel have been unclear as to what constitutes a "knowing and intentional breach" in the context of a merger agreement. Some have thought it was akin to a "willful breach." What little case law there is interpreting that term has held that a "willful" breach must have some component of malice or deceit. Others might have thought, as Hexion's counsel argued, that the breaching party must have known that the act in question constituted a breach of the agreement. The *Huntsman* decision resolves that open question. The Court held that a "knowing and intentional" breach is the "taking of a deliberate act, which act constitutes in and of itself a breach of the merger agreement, even if breaching was not the conscious object of the act." Thus, malice or deceit is not required, nor is knowledge that one's act constitutes a breach.

Shifting of Burdens

Vice Chancellor Lamb shifted the usual burden of proof on damages from Huntsman to Hexion. In the event the banks obtain a finding of insolvency and Huntsman then seeks a damages award against Hexion in the Chancery Court, Vice Chancellor Lamb has now held that Hexion has the burden of proving that its knowing and intentional breach did *not* cause damages; that is, that the breach was not the reason the banks were ultimately able to abandon the terms of their debt commitment letters. But how can Hexion prove that negative? That standard is undoubtedly crafted for the purpose of signaling to all involved parties that Hexion will have limited ability (at best) to avoid damages in any subsequent proceeding.

Such burden-shifting has importance beyond this specific case. Many merger parties and investors have undertaken technical legal analysis as to what remedies are available to non-breaching parties in the context of merger agreements, particularly those who have been involved in, or invested in, any of the several dozen mergers that have been pending throughout the market downturn and credit crisis. To the extent that analysis has concluded, for a variety of reasons, that the non-breaching party would have difficulty proving that any breach caused meaningful damages, Vice Chancellor Lamb's burden-shifting stands as a reminder and a warning—courts have the ability and, at times, the inclination to fashion remedies and standards, as required. Overly technical legal analysis concerning available remedies runs the risk of misguiding parties involved in the transaction or investors who are handicapping possible outcomes and trading accordingly.

Conclusion

How this transaction will now unfold remains to be seen. But there can be no question that the *Huntsman* decision is among the strongest rulings in favor of a seller in the context of a pending merger, and it is a must-read for M&A lawyers assisting clients in navigating circumstances that threaten putative mergers.

NOTES

1. *Hexion Specialty Chemicals, Inc. et al. v. Huntsman Corp.*, C.A. No. 3841-VCL (Del. Ch. Sept. 29, 2008). Hereinafter, Slip Opinion.
2. *Genesco, Inc. v. The Finish Line, Inc.*, No. 07-2137-II(III) (Tenn. Ch. Dec. 27, 2007) (Ellen Hobbs Lyle, C.).
3. *UBS Securities, LLC v. The Finish Line, Inc.*, No. 07-cv-10382-LAP (S.D.N.Y. Nov. 15, 2007) (complaint).
4. Agreement and Plan of Merger among Hexion Specialty Chemicals, Inc., Nimbus Merger Sub Inc., and Huntsman Corporation, Dated as of July 12, 2007 (Merger Agreement), § 7.2(b). The Merger Agreement is included as Appendix A to Huntsman's Schedule 14A (the Merger Proxy), filed with the SEC on September 12, 2007.
5. Slip Opinion at 88.
6. Merger Proxy at 19–25.
7. Kevin Kingsbury and Ana Campoy, "Why Apollo Was So Keen to Acquire Huntsman," *Wall Street Journal* (July 13, 2007). Hexion covered half of Huntsman's breakup fee with Basell. Merger Proxy at 32.
8. Merger Proxy at 40. The commitment letters themselves have yet to be made public.
9. Merger Agreement § 3.1(a)(ii) (emphasis in original).
10. *See* Merger Agreement § 3.2(e).
11. Slip Opinion at 9.
12. Merger Agreement § 5.13(a).
13. *Id.*, § 5.13(c).
14. *Id.*, § 5.13(b).

15. *Id.*, § 7.4.

16. Merger Agreement §§ 5.13(f) & 6.3(c). Notably, though, Huntsman negotiated for its Chief Financial Officer to provide the solvency certificate required by the banks' commitment letters. *See* Slip Opinion at 9 n.5.

17. The Merger Agreement technically defines Hexion's breakup fee as $325 million, and Huntsman's as $225 million plus a "Reimbursement Amount," equal to $100 million. Merger Agreement, Preface & § 7.3. The $100 million represented the amount Hexion paid toward Huntsman's breakup fee with Basell. Merger Proxy at 10–11.

18. *Id.*, § 7.2(b) (emphasis added).

19. *See Consolidated Edison, Inc. v. Northeast Utilities*, 426 F.3d 524 (2d Cir. 2005) (expectancy interest of stockholders in merger premium does not vest until closing).

20. Slip Opinion at 10.

21. *Id.* at 10 & n.8.

22. *Id.* at 12.

23. *Id.* at 14. The three insolvency tests are the balance sheet test, the ability to pay debts test, and the capital adequacy test.

24. *Id.* at 15.

25. *Id.* at 6, 22.

26. *Id.* at 6.

27. *Id.* at 7.

28. *Id.* at 42.

29. *Id.* at 39.

30. *Id.*

31. *Id.* at 43.

32. *Id.* at 45. *See* Merger Agreement § 5.11(b)(i). At trial, an Apollo representative admitted under cross examination that "Apollo never fully believed Huntsman's forecasts." Slip Opinion at 47.

33. Slip Opinion at 45–46.

34. *Id.* at 46.

35. *Id.* at 48.

36. *Id.* at 50.

37. *Id.*

38. *Id.* at 15.

39. *See id.* at 13–15.

40. Slip Opinion at 57–58.

41. *Id.* 59–60.

42. *Id.* at 77.

43. *Id.* at 5.

44. Darrell A. Hughes, "FTC Clears Hexion-Huntsman Merger," *Wall Street Journal* (October 3, 2008).

45. Slip Opinion at 80 n.114.

46. *Huntsman Corp. v. Credit Suisse Sec. (USA) LLC & Deutsche Bank Sec., Inc.*, No. 08-09-09258 (Tex. Dist. Ct. Sept. 30, 2008). After a hearing on October 16, 2008, the Texas Court issued a further temporary injunction pending trial, prohibiting the banks from instituting a suit contending that the combined entity would be solvent. Huntsman also has filed a separate suit in Texas against Apollo and its two lead partners, Leon Black and Joshua Harris, alleging fraudulent misrepresentation and tortious interference with contract related to the termination of Huntsman's earlier deal with Basell. *Huntsman Corp. v. Leon Black* (Tex. Dist. Ct. 2008).

47. *Id.*

48. Merger Agreement § 7.2(b).

49. *See id.* § 7.3.

50. Merger Agreement § 7.3(f).

51. These ranges are based on the 222,017,164 outstanding common shares of Huntsman as of the date of the Merger Proxy. *See* Merger Proxy at 89 n.2. It does not account for the effect of any convertible or preferred shares.

52. Huntsman would argue that Hexion is estopped from making such an argument based on, among other things, the doctrine of unclean hands. This also highlights the strategic question Hexion and its counsel would face in any solvency litigation: How to advance its position without running afoul of the Delaware order. This, combined with the Texas suits, gives Huntsman enormous leverage.

53. *In re IBP, Inc. Shareholders Litigation*, 789 A. 2d 14 (Del. Ch. 2001).

54. Slip Opinion at 40.