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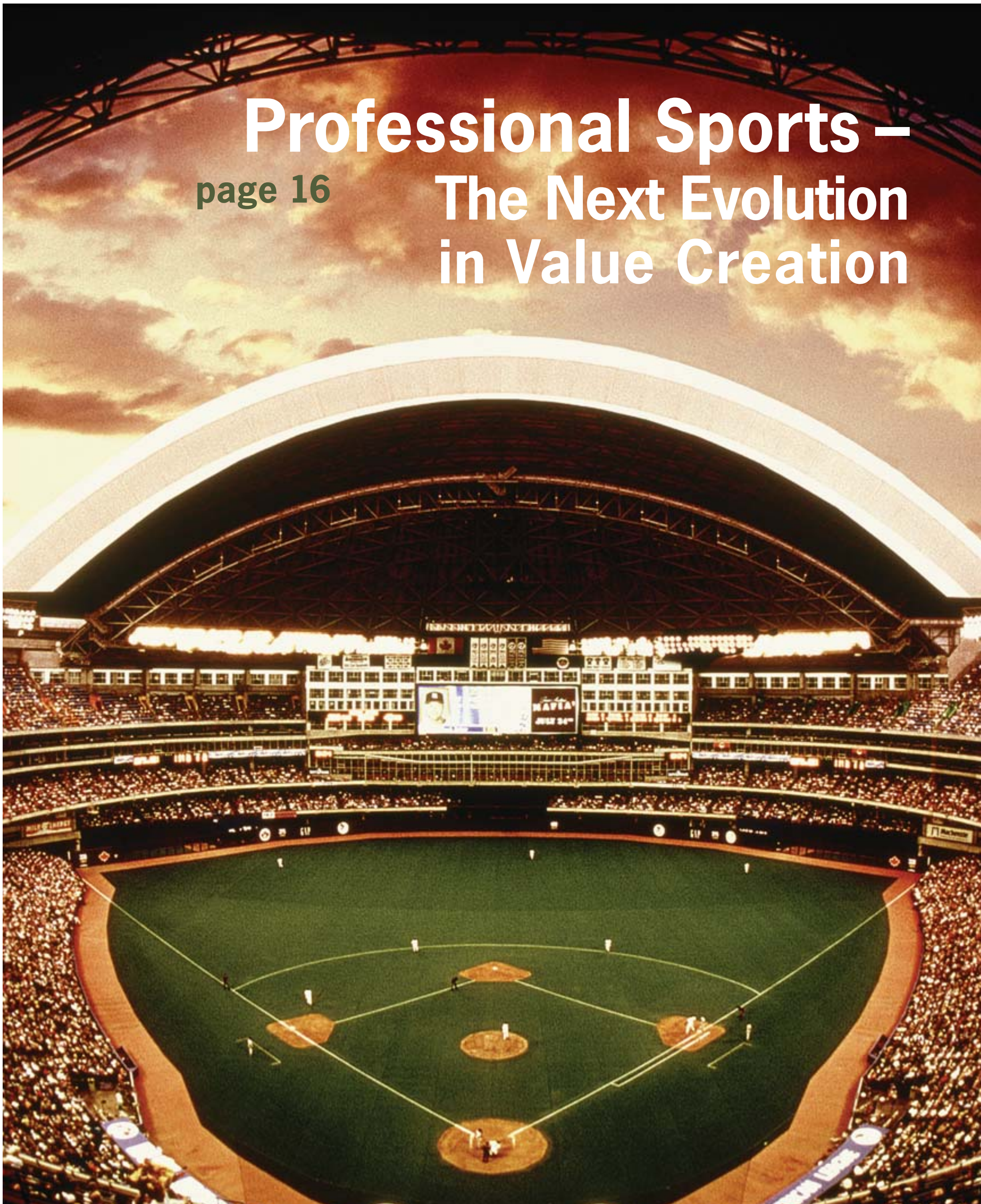

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Solvency Opinions –
As Much of a Tool for Sellers as They Are for Buyers in Highly Leveraged Transactions?

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Bidding wars are nothing new in the merger and acquisition landscape. However, when the bidders plan to finance the transaction primarily with debt, rather than cash or its own stock, the purchase consideration is often stretched to a point which raises questions about the feasibility of financing such a transaction. In such situations, the question of solvency is relevant and is subjected to analysis, especially from the perspective of the buyers and its lenders. Moreover, business combinations between large companies often lead to substantial regulatory scrutiny, which significantly extends the time to close, thus increasing the completion risk of the transaction. However, solvency issues are less frequently analyzed to the same degree by the seller, who may be more focused on the fairness of the consideration being received. Therefore, having its own solvency analyses performed before entering into a purchase agreement would provide the board of the seller with better corporate governance comfort and greater insight regarding the degree to which the company's operating results could decline during the longer regulatory review period without jeopardizing the ability of the buyer to finance the transaction at the agreed upon price. The following recent transaction exemplifies the importance of such points.

The proposed transaction between Huntsman Corporation ("Huntsman" or the "Company"), a global manufacturer and marketer of differentiated chemicals, and Hexion Specialty Chemicals, Inc. ("Hexion"), an entity owned by an affiliate of the private equity firm Apollo Management L.P. ("Apollo"), highlights the need for the seller to be as concerned with issues of solvency as the buyer. The proposed deal contemplated a $10.6 billion transaction financed entirely with debt and with the expectation of a longer than normal time horizon to close due to regulatory concerns in the U.S. and EU. Although Huntsman (seller) sought and received a fairness opinion[1], the scenario that subsequently unfolded might serve to reinforce the view that the boards of selling companies would be well served to analyze prospective solvency issues in addition to the typical analysis relating to issues of fairness.

Background of the Proposed Merger

In February of 2007, Jon Huntsman, Chairman of the Board of Huntsman, commented publicly that the Company was interested in entertaining offers for the Company. As Huntsman was marketed for sale, a bidding war ensued between Apollo on behalf of Hexion, one of the world's largest producers of resins for industrial applications, and Basell AF ("Basell"), one of the world's largest producers of polypropylene and advanced polyolefins products.

1 In fact, both Huntsman and Hexion received fairness opinions from two different advisors.

On the afternoon of June 25, 2007, Apollo submitted a revised proposal on behalf of Hexion to purchase Huntsman at a price of $26.00 per share (a premium of 37.6%), and Basell submitted a revised proposal to purchase Huntsman at a price of $25.25 per share (a premium of 33.6%). Later that same day, after considering, among other things, the proposed terms of the merger agreements of Apollo and Basell, including the lower price per share associated with the Basell offer, weighed against the lower regulatory risk and thus shorter anticipated time to close, Huntsman's transaction committee recommended that the board of directors approve the Basell merger agreement.

That same evening, knowing that Huntsman had approved the Basell proposal, Apollo indicated to Huntsman's representatives that it was prepared to offer $27.00 per share. Despite the higher bid by Hexion, on June 26, 2007, Basell and Huntsman issued a joint press release announcing that they had entered into a definitive merger agreement.

On July 5, 2007, upon receiving a copy of Apollo / Hexion's revised bid, representatives of Basell delivered a written communication to Huntsman's transaction committee arguing that the Basell proposal was superior to the Hexion proposal because, in their view (i) it delivered value to Huntsman stockholders sooner, without extended regulatory or financing delays (ii) it provided a shorter time frame to close which reduced the risk that Huntsman would incur a material adverse effect, which would provide the buyer with the ability to terminate the agreement, and (iii) the Basell merger agreement had less completion risk than the Hexion proposal. Basell argued that although the Hexion proposal offered a higher price per share, they believed the Hexion price should be discounted to reflect the delay and completion risks inherent in the Hexion proposal.

Ultimately, on July 12, 2007, through subsequent negotiations between Huntsman and Apollo, Huntsman announced that it had entered into an agreement with Hexion whereby Hexion would purchase Huntsman for $28.00 per share (a premium of 48.1%).

Aftermath Post Announcement

With Huntsman's financial condition trending worse than anticipated, and its stock price steadily declining since the announcement of the proposed merger, Hexion filed a public complaint against Huntsman on June 18, 2008 with the Court of Chancery of the State of Delaware. Accompanying the complaint was a solvency opinion from an independent third party. Hexion asserted that:

> Pursuant to Section 3.2(e) of the merger agreement, Hexion and its merger sub represented and warranted that the aggregate proceeds contemplated by the commitment letter will be sufficient for merger sub and the surviving corporation to pay the required amounts. Hexion and merger sub no longer believe in good faith that this representation is true and do not believe in good faith that it will be true as of the closing date. Hexion and merger sub do not believe that they will be able to obtain all of the financing contemplated by the commitment letter on the terms described therein because the amount of such financing will be insufficient to pay the required amounts and, for this and other reasons, after giving effect to the merger, Hexion would be insolvent.
>
> Hexion and merger sub also believe that if the conditions to closing were measured as of June 18, 2008, a material adverse effect has occurred and that the condition set forth in Section 6.2(e) of the merger agreement would not be satisfied.

Subsequent to Hexion's complaint Huntsman's stock price plummeted and closed at $12.86. On June 23, 2008, Huntsman filed a petition in the District Court of Montgomery County, Texas indicating that the Apollo entities, among other things, committed fraud and tortuous interference with a contract. Huntsman sought to have the court order Hexion to proceed with the agreed upon deal, or alternatively to have the court award them $3 billion in damages, plus the $100 million breakup fee to be paid to Basell by Huntsman. On September 29, 2008, the court ordered Hexion to use its best efforts to complete the deal and the judge would extend the termination date if necessary. The court withheld judgment on whether the combined entity would be solvent or insolvent at closing, saying that issue should be considered only if all the other conditions to closing are met, at which time Hexion would be obligated to call upon its lenders and a solvency letter or opinion would be delivered to the lending banks.

The Takeaway

What, if anything, could Huntsman have done differently in the negotiation process and what should Board members at companies contemplating a sale in leveraged transactions learn from this situation? Would it have been helpful to Huntsman to have sought an independent solvency analysis at the time of the transaction negotiation, in addition to the fairness opinions, to help in its evaluation of the proposed Hexion deal vis-à-vis the proposed Basell deal?

Given the changes in Huntsman's performance between the time of the merger announcement and Hexion's June 2008 complaint, a solvency analysis in July 2007 would likely have been significantly different than such an analysis performed in June 2008. However, a solvency analysis performed contemporaneous to the deal negotiations may have provided the decision makers at Huntsman with an added perspective and understanding of how much "cushion" the combined company would have with respect to (i) the fair saleable value of its assets in comparison to the stated value of its liabilities (ii) the ability to meet its obligations as they become absolute, and (iii) the reasonableness of the level of capital for operation as proposed. The key question being just how much of a downturn in the Company's results could be experienced without jeopardizing the ability of Hexion to finance the transaction at the agreed upon price. A strong case could be made that such an analysis would have served to help the Huntsman board better evaluate the deals and probe the vulnerabilities therein.[2]

A solvency analysis would also have provided the Huntsman board with another arrow in their quiver to defend the fact that they had acted in good faith, on an informed basis, and in the best interest of the Company and its shareholders in evaluating the offers. While the decision in the *Smith v. Van Gorkom*[3] case may have established the fairness opinion as a de facto requirement in change-of-control transactions, the outcome of the Huntsman / Hexion negotiations might reinforce the notion that a fairness opinion is not enough for the board of a selling company in a highly leveraged transaction.

Since in the Hexion / Basell / Huntsman situation the prospective buyers are both privately held, the information necessary for the seller to perform a detailed solvency analysis on the prospective combined entity may have been more difficult, if possible at all, to procure.[4] In any acquisition process, the flow of due diligence information is generally fairly heavily one-sided, with the buyer receiving the necessary information about the seller. However, in highly leveraged situations it may be in the best interest of all parties for the seller to have access to information from the buyer necessary to have an independent third party perform a solvency analysis on the seller's behalf before entering into a purchase agreement (particularly in situations where the time to close is expected to be longer than normal due to regulatory review considerations).

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[2] Our analysis of the Huntsman / Hexion situation is taken entirely from reading press reports and regulatory filings related to the deal. It is entirely possible that Huntsman did indeed use some form of a solvency analysis in their evaluation of the Basell and Hexion bids that simply has not been publicly disclosed.

[3] *Smith v. Van Gorkom* (1985) Delaware Supreme Court

[4] It should be noted that the solvency opinion commissioned by Hexion was prepared without consultation with Huntsman management regarding their views as of June 2008 on the prospective operating performance of Huntsman and the proposed combined entity.