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## *Air Products v. Airgas: Rumors of Death of the Poison Pill Have Been Greatly Exaggerated*

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On February 15, 2011, in *Air Products and Chemicals, Inc. v. Airgas, Inc., et al*, Chancellor Chandler of the Court of Chancery of the State of Delaware upheld the Airgas board's use of a poison pill to block a structurally non-coercive, all-cash, all-shares, fully financed tender offer directed to the corporation's stockholders, even after a full year had gone by since an earlier Air Products offer was made public, the staggered incumbent board had already lost one election contest, and the stockholders arguably were fully informed as to the target board's views on the inadequacy of the offer. The case highlighted a classic governance battle over whether in such a context the board gets to decide when and if the corporation is for sale, or whether the stockholders must be given the chance to decide whether to take the offer. While finding that a board cannot "just say no" to such an offer, the Court confirmed that a board found to be acting in good faith, after reasonable investigation and reliance on outside advisors, and which articulates and convinces the Court that a hostile tender offer poses a legitimate threat to the corporate enterprise, may address that perceived threat by blocking the tender offer and forcing the bidder to elect a board majority that supports its bid. The Court, while expressing misgivings about the state of the law and the ongoing utility of the pill in this particular context, found that the Airgas board met its *Unocal* burden to articulate a legally cognizable threat (the inadequate price, coupled with the fact that a majority of Airgas's stockholders likely would tender into the offer) and implemented defensive measures that fall within the range of reasonable responses to such a threat.

### **Background**

Airgas had been the subject of a hostile takeover attempt by its primary competitor, Air Products, since October 2009. On February 11, 2010, Air Products made its first tender offer for 100% of the shares of Airgas at \$60 per share. Between that time and Airgas's September 15, 2010 annual meeting, Air Products twice raised its bid, ultimately to \$65.50 per share. Each bid by Air Products was rejected by the Airgas board of directors as undervaluing the company.

As part of its takeover attempt, Air Products launched a proxy contest to seize control of Airgas's staggered board by nominating a short slate of three candidates at its 2010 annual meeting, each of which were elected. Air Products also proposed an amendment to the Airgas bylaws that would require the 2011 annual meeting to be held in January, the effect of which would have cut the traditional three year term for the 2008 class of directors by approximately eight months and provided Air Products with the opportunity to gain control of the Airgas board without waiting the customary twelve months between annual meetings.

By a slim majority, the Airgas stockholders voted in favor of the proposed bylaw amendment. Airgas challenged the passage of the proposal, arguing that it was inconsistent with the staggered board bylaw and that it could only be enacted if approved by 67% of the shares entitled to vote at the annual meeting (and not a simple majority). In October 2010, the Delaware Chancery Court agreed with Air Products that the bylaw amendment did not conflict with the Airgas charter. One month later, the Delaware Supreme Court reversed the Chancery Court, invalidating the bylaw amendment on the grounds that it impermissibly truncated the three-year staggered terms and constituted a de facto removal without cause of those directors without the supermajority vote required by the charter.

On December 9, 2010, Air Products raised its bid again, this time to \$70 per share, which it deemed its "best and final" offer. On December 22, the Airgas board rejected the offer as "clearly inadequate." Air Products asked the Delaware Chancery Court to invalidate the Airgas poison pill, arguing that the pill had served its purpose and the Airgas shareholders should now be allowed to choose for themselves on the deal.

### Summary of Decision

After a thorough discussion of prior Delaware poison pill precedent, Chancellor Chandler analyzed whether the board had met its burden under the governing *Unocal* standard. The Court found that the Airgas board undeniably made a prima facie showing of good faith and reasonable investigation, as the current board is comprised of a majority of outside independent directors (including three recently-elected insurgent directors nominated by Air Products who, ironically, supported continued use of the pill to block the offer), the board relied on three separate outside financial advisors and outside legal counsel, including separate legal counsel for the three directors nominated by Air Products. The Court found that the board's process "easily passes the smell test."

Noting that the first prong of *Unocal* also requires a board to show that its good faith and reasonable investigation ultimately gave the board grounds to conclude that a threat to the corporate enterprise existed, much of the opinion addresses whether such a threat is posed in this circumstance. While a variety of potential "threats" had been argued in litigation, the Court found that the only threat actually discussed by the board was the allegedly inadequate price of the offer, coupled with the fact that a majority of the stock was by this point held by arbitrageurs who might be willing to tender into such an "inadequate" offer. The Court found that the tender offer was not structurally coercive (that is, there was no risk of disparate treatment of non-tendering stockholders); nor did the offer present the threat of opportunity loss (i.e., that a hostile offer might deprive the target stockholders of the opportunity to select a superior alternative offered by management or another bidder), particularly in light of the passage of time that the board had to consider the offer and explore other alternatives.

Observing that the Airgas board had more time than any litigated poison pill in Delaware history, the Court noted that the board had more than a year to inform the stockholders about its view of the company's intrinsic value and the inadequacy of the offer, time that had actually resulted in increases in the offer. Chancellor Chandler further expressed that he had "a hard time believing that inadequate price alone (according to the target's board) in the context of a non-discriminatory, all-cash, all-shares, fully financed offer poses any 'threat' -- particularly given the wealth of information available to Airgas's stockholders at this point." Nevertheless, he acknowledged that under existing Delaware law, inadequate price has been recognized as posing the threat of "substantive coercion" and, while stating his personal view that "Airgas's poison pill has served its legitimate purpose," Chancellor Chandler wrote that he was "constrained by Delaware Supreme Court precedent to conclude that defendants have met their burden under *Unocal* to articulate a sufficient threat that justifies the continued maintenance of Airgas's poison pill." The Court found specifically that the board acted in good faith and relied on the advice of its financial and legal advisors in coming to the conclusion that

the Air Products offer is inadequate. Indeed, the board believed in good faith that the offer price was “inadequate by no small margin,” i.e., that the company was worth at least \$8 more than the \$70 per share offer. Emphasizing that the Court could not substitute its business judgment for that of the target board, the Court went on to interpret prior precedent and dictum as indicating that “a board that has a good faith, reasonable basis to believe a bid is inadequate may block that bid using a poison pill, irrespective of stockholders’ desire to accept it.”

Having concluded that Airgas’s burden under *Unocal* has been met, the Court acknowledged that Delaware law has recognized Airgas’s defenses -- including the poison pill and staggered board -- as reasonable responses to the threat posed by an inadequate offer -- even an all-cash, all-shares offer. The Court also noted that in last year’s *Selectica* decision, the Delaware Supreme Court had held that the combination of a classified board and a rights plan was not preclusive, because the combination may only delay, but not prevent, a hostile acquirer from obtaining control of the board. Because obtaining control of the Airgas board at some point in the future was realistically attainable, the defensive measures here were not preclusive. Nor did it coerce or cramdown a particular management alternative.

The Court concluded with this clarifying admonition: “To be clear, . . . this case does not endorse ‘just say never.’ What it does endorse is Delaware’s long understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions).”

### Impact of the Decision

The *Airgas* decision reinforces the importance of a thorough, reasoned board process, board independence, and the role of independent financial and legal advice in enabling the board to meet its burden of showing good faith and reasonable investigation in the context of defending poison pills and other defensive measures employed to address a corporate threat. The decision provides a clear example that the board may not rely on arguments and justifications of purported threats that are mere afterthoughts of creative litigators, but rather will be confined to those threats actually perceived and considered at the time of the board’s decision. At the same time, while pundits had predicted that this governance clash between stockholders and directors might lead to the demise of the poison pill, under current Delaware law, the poison pill, even coupled with a staggered board, remains a viable option to consider under appropriate circumstances.



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