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February 28, 2011

Delaware Court Upholds Airgas Poison Pill Defense, Affirming Right of Board to Continue Saying “No”

Air Products v. Airgas

By Michael G. O'Bryan

In *Air Products v. Airgas*, issued on February 15, the Delaware Court of Chancery declined to order the Airgas board to redeem the poison pill and other defenses that were preventing Air Products from moving forward with its long-running hostile tender offer, despite the court's finding that a majority of Airgas' shares were held by merger arbitrageurs and others who would likely tender into Air Products' offer.

On a general level, the court found that “a [corporate] 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.” In effect, the court found that, while a board cannot “*just say no*” to a tender offer, without doing anything more, a board can steadfastly “say no” if it is “acting in good faith, after reasonable investigation and in reliance on outside advisors” and can show that the tender offer poses a “legitimate threat to the corporate enterprise.” In such a situation, the board can force a bidder to proceed via the corporation's electoral process and endeavor to elect a board majority that would redeem the pill and allow the offer to proceed.

The court emphasized that this did not mean that a board can “just say never”; rather, such actions by a board will be subject to “exacting judicial scrutiny” by a court that will examine the board's actions and motives. The judge also expressed his “personal” skepticism over the wisdom of upholding a poison pill for so long, after fulfilling what the judge believed to be the purpose of the pill, despite the law's support.

The decision reflects the flexibility afforded to, and the responsibility imposed on, a corporate board by Delaware law to manage and make decisions with respect to the corporation, and the continued effectiveness of a poison pill when used by a target board acting in a good faith belief that a tender offer price is inadequate.

BACKGROUND.

The fight for Airgas began more than a year ago, with Air Products making a public offer to buy all the shares of Airgas and commencing its all-cash, fully-financed hostile tender offer in February 2010 after the Airgas board rejected its offer. Air Products initially offered \$60 per share, and during the course of the fight raised its bid to \$70 per share, calling this its “best and final” offer.

The court noted that Airgas' board is comprised of independent, outside directors, other than Airgas' CEO. The court also noted that Airgas had several defenses against the offer, including:

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- a staggered board,
- a poison pill (adopted in May 2007, prior to Air Products' approaches),
- the effects of Delaware's business combination statute (Section 203 of the Delaware General Corporation Law), and
- a supermajority merger approval provision in its certificate of incorporation.

During the fight for Airgas, Air Products pursued numerous tactics, including a proxy contest, nominating 3 directors to fill the seats on Airgas' board up for election at the September 2010 annual meeting. The Air Products candidates won, and took their seats on the Airgas board.

Air Products also proposed at the annual meeting an amendment to Airgas' bylaws that would accelerate Airgas' next annual meeting to January 2011, so Air Products could nominate another class of directors. The proposal was approved by the Airgas shareholders, and upheld by the Delaware Chancery Court, but then deemed invalid by the Delaware Supreme Court, which found that the bylaw was inconsistent with Airgas' charter because it would "impermissibly shorten[] the directors' three year staggered terms" and "amount[] to a *de facto* removal without cause" of directors without the supermajority vote required by the Airgas charter.

The Air Products nominees on the Airgas board hired a new financial advisor and reviewed the situation of the company. They then opted to vote with the rest of the board in rejecting the Air Products offer, and in fact were "some of the most vocal opponents" of the offer.

STANDARD OF REVIEW.

The court reviewed the board's refusal to redeem the poison pill under the *Unocal* heightened scrutiny standard that generally applies to a board's maintenance of defensive measures and response to a request to redeem a poison pill. Applying that standard, the court found:

1. The board had demonstrated reasonable grounds for believing that a "threat" to Airgas existed. The board had undertaken a reasonable investigation, including the use of three outside, independent advisors, and had a reasonable basis for believing that the price offered by Air Products was inadequate. The court concluded that holders of a majority of the Airgas shares, including merger arbitrageurs focused on the short-term, rather than long-term, value of the company, might be willing nonetheless to tender their shares to Air Products, a concept identified by the court as "substantive coercion." The court noted that the board was not relying on a claim that the shareholders might tender their shares in "mistaken" views as to valuation, since Air Products' tender offer had been open for more than a year and the shareholders had been given adequate information with respect to the board's perspective on the value of the stock.

The presence of a majority of outside independent directors on the Airgas board, coupled with the directors' reliance on legal and financial advisors, was seen by the court as constituting a *prima facie* showing of a good faith and reasonable investigation.

2. Maintaining the poison pill, along with the other defenses, was not preclusive of Air Products' offer, and further was a proportionate response to the perceived threat, since obtaining control by Air Products still was "realistically attainable" through proxy contests. The court noted that proxy contests could take substantial time (through at least the next annual meeting, or even two more annual meetings, given the position with respect to the offer of the Air Products nominees who had been elected to the Airgas board), but that a "delay" in obtaining control did not render the poison pill

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invalid. The court further noted that the board was not using the poison pill to “cram[] down” a “management-sponsored alternative – or any company changing alternative,” but was using it to “maintain[] the status quo, running the company for the long-term....”

Court Skepticism. In upholding the poison pill, the court stated that it was applying the law of Delaware as recognized by the state’s Supreme Court. However, the court noted its own skepticism over maintaining the Airgas pill at this point in the process of the offer. The court stated that “in my personal view, Airgas’ poison pill has served its legitimate purpose.... Airgas’ use of its poison pill -- particularly in combination with its staggered board -- has given the Airgas board over a full year to inform its stockholders about its view of Airgas’ intrinsic value.... And it has helped the Airgas board push Air Products to raise its bid by \$10 per share....” The court thus acknowledged various useful roles of a poison pill, even though the court believed that at some point those roles might be fulfilled.

CONCLUSION.

The court concluded by noting that poison pills do not have an “expiration date,” since otherwise they would not be effective.¹ However, the court continued, this does not mean that boards can “just say never.” Rather, it means that Delaware will respect reasonably exercised board discretion, so long as the board is acting in good faith and in accordance with the board’s fiduciary duties. In terms of another famous Delaware M&A doctrine, if a company is not in “*Revlon* mode” by having put itself up for sale, then the board “is not under any *per se* duty to maximize shareholder value in the short run,” and can pursue long-run goals on behalf of the corporation.

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¹ More literally, pills are written with a particular duration (such as 3 years), chosen by the board at the time the pill is adopted. The board, though, has the ability to consider extending the duration of the pill if circumstances warrant.