

WSGR ALERT

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DELAWARE SUPREME COURT INVALIDATES BYLAW AMENDMENT THAT SHORTENS TERM OF DIRECTORS ON A STAGGERED BOARD BY AMENDING ANNUAL MEETING DATE

Summary

On November 23, 2010, the Delaware Supreme Court invalidated a bylaw amendment that accelerated the next annual meeting of Airgas by eight months and cut short the term of directors serving on the company's staggered board.

Air Products and Chemicals, a hostile bidder for the company, proposed the bylaw amendment at the Airgas annual meeting in September 2010, at which Air Products' slate of three directors was elected to the Airgas board of directors. The bylaw amendment would have permitted Air Products to elect another slate of three directors to the Airgas board (and to potentially obtain majority control of the board) just four months later, in January 2011.

The Delaware Supreme Court held that the term of a class of directors ending "at the annual meeting in the third year following its election" means that the class of directors is elected to serve "a three-year term," and cannot be cut short by a stockholder-approved bylaw amendment.

Background

On October 8, 2010, the Delaware Chancery Court upheld the validity of a stockholder-approved bylaw amendment accelerating the timing of Airgas' annual meeting by eight months. In the context of Air Products' hostile bid for Airgas, Air Products engaged in a proxy contest, and was successful in placing three of its nominees on the Airgas nine-

member classified board at Airgas' September 2010 annual meeting. The Airgas charter provision providing for a classified board, mirrored in the Airgas bylaws, states that each class of directors serves until the "annual meeting of stockholders to be held in the third year following the year of their election." At the 2010 annual meeting, Air Products also proposed an amendment to the Airgas bylaws that would schedule subsequent Airgas annual meetings for January of each year, starting with the 2011 annual meeting. The acceleration of the annual meeting schedule would have permitted the election of three additional Air Products directors to the Airgas board only four months after the 2010 annual meeting. The bylaw amendment was approved by 51.8 percent of shares voted at the annual meeting, representing only 45.8 percent of the total number of shares entitled to vote. Airgas challenged the validity of the bylaw amendment, claiming that it was inconsistent with Section 141(d) and (k) of the Delaware General Corporation Law (DGCL), and with the provision in Airgas' charter requiring supermajority approval of any alteration, amendment, or repeal of Airgas' staggered board provision. The Delaware Court of Chancery rejected Airgas' claims, finding no conflict with the Airgas supermajority vote provision or the DGCL. The Delaware Chancery Court's ruling was based on its conclusion that the language in Airgas' staggered board provision was ambiguous, and that ambiguous terms should be construed "in favor of the stockholder electoral rights" and against the board. Thus,

the court found that Airgas' staggered board provision could not be interpreted to require a three-year term for directors.

Delaware Supreme Court's Analysis

While agreeing with the lower court's finding that the staggered board language in the Airgas charter was facially ambiguous, the Delaware Supreme Court steered away from the Chancery Court's reasoning in favor of stockholder electoral rights. Instead, the court turned to "overwhelming extrinsic evidence," including industry practice and understanding of similar charter provisions, to reach its conclusion that the provision "intends to provide that each class of directors is elected for a three-year term." The court also noted that a three-year term need not be "measured with mathematical precision." The court chose not to define what deviation from 365 days would be permissible, but determined only that four months does not qualify as "annual." The Delaware Supreme Court concluded that the bylaw amendment would impermissibly shorten such a three-year term, and that, by shortening the time between annual meetings to four months, the proposed bylaw provision constituted a "*de facto* removal" of Airgas' directors without cause, which would be inconsistent with the underlying intent of Section 141 of the DGCL and the supermajority vote required under Airgas' charter.

Conclusion

This is an important decision by the Delaware Supreme Court to overturn a Chancery Court

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Delaware Supreme Court Invalidates Bylaw Amendment . . .

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decision and to prevent the substantial weakening of the defenses of companies with staggered boards. If you have questions regarding this WSGR Alert or any related matter, please contact any member of the firm's M&A practice listed below.

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Please visit <http://courts.delaware.gov/opinions/download.aspx?ID=146690> to view the court's opinion in *Airgas, Inc. v. Air Products and Chemicals, Inc.*, C.A. No. 5817 (Del. Sup. Ct. Nov. 23, 2010).

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