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DELAWARE COURT UPHOLDS USE OF POISON PILL DEFENSE IN HOSTILE TAKEOVER CONTEXT
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The Delaware Court of Chancery recently reaffirmed the validity of the poison pill as a permissible defensive measure for Delaware corporations faced with a takeover proposal found to be inadequate by the target corporation's board of directors. In *Air Products & Chemicals, Inc. v. Airgas, Inc.*,[1] Chancellor Chandler declined to require the board of Airgas, Inc. ("Airgas") to redeem the company's poison pill in the face of an all-cash public tender offer by market competitor Air Products and Chemicals, Inc. ("Air Products"). The Court held that while a board of directors cannot "just say never" to a sale of the company, the board can implement defensive measures to prevent consummation of such a transaction if it is "acting in good faith, after reasonable investigation and in reliance on outside advisors" and can show that an unsolicited takeover bid poses a "legitimate threat to the corporate enterprise." The ruling is particularly significant since it addresses the delicate issue of the allocation of power between directors and stockholders, with the Court, under these facts, concluding that the power to defeat an inadequate hostile tender offer ultimately lies with the board.

The battle for control of Airgas spanned the course of several years. In the Fall of 2009, Air Products privately approached Airgas regarding a potential acquisition. After numerous rejections by the Airgas board, Air Products launched a public tender offer for all outstanding shares of Airgas stock in February 2010 at $60 per share, a price which the Airgas board advised stockholders to be too low. Undaunted, Air Products simultaneously pursued other tactics to gain control of Airgas, including a proxy contest to elect three directors to fill the board seats up for election at Airgas's annual meeting and proposing an amendment to Airgas's bylaws that would accelerate Airgas's annual meeting by nearly seven months, enabling Air Products to more quickly replace existing Airgas directors with its own nominees.[2] Following multiple increases in the offering price, the Airgas board met again in December 2010 to consider Air Products's best and final offer of $70 per share. After considering the advice and recommendations of three independent financial advisors, the Airgas board—which by that time included the three newly-elected Air Products nominees—unanimously determined the price to still be inadequate and recommended to stockholders that they not tender their shares. Following the Court's decision to uphold Airgas's poison pill, Air Products withdrew its tender offer.

In evaluating the validity of the Airgas poison pill,[3] the Court addressed the fundamental question of when, if ever, a board must abandon the corporation's long-run strategy in order to maximize short-term value. While stating that a board may not "just say never" to a sale of the company, the Court held that a board of directors may reject an unsolicited takeover bid in order to pursue the corporation's long-term objectives, so long as the board is found to be acting in good faith and in accordance with its fiduciary duties. Because of "the omnipresent specter" of entrenchment in takeover situations, the Court noted that the *Unocal*[4] standard of enhanced judicial scrutiny—not the business judgment rule—would apply to a board's decision to maintain a

[1] C.A. No. 5249-CC (Del. Ch. Feb. 15, 2011), available at http://courts.delaware.gov/opinions/download.aspx?ID=150850.
[2] Our previous client alerts discussing the Airgas bylaw amendments are available at http://www.wcsr.com/resources/pdfs/cs101810.pdf and http://www.wcsr.com/resources/pdfs/cs120310.pdf.
[3] In addition to the poison pill, Airgas's other defensive measures included a staggered board and supermajority merger shareholder approval provision.
[4] *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

poison pill when faced with a request to redeem the rights. Under the *Unocal* standard, directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed, and they must demonstrate that their defensive response was reasonable in relation to the threat posed.

Specifically, the first prong of the *Unocal* standard is a process-based review that requires directors to demonstrate good faith and reasonable investigation in their determination that an unsolicited takeover bid presents a threat to corporate policy and effectiveness. Here, the Court found that the presence of a majority of outside independent directors on the Airgas board, together with the board's reliance on three outside, independent financial advisors (as well as independent legal advisors) in evaluating the Air Products bid, constituted a *prima facie* showing of good faith and reasonable investigation. Additionally, the Court noted that because Airgas's stock was largely held by merger arbitrageurs who had short-term interests and would be willing to tender into an inadequate offer, the Airgas board had reasonable grounds for perceiving a threat to corporate policy and effectiveness.

The second prong of the *Unocal* standard requires a court to engage in a substantive review of the company's defensive measures in order to determine whether such measures are proportional to the threat posed. In evaluating the proportionality of defensive measures, the court will first ask whether the defensive measures are either preclusive or coercive, and if not, whether the defensive measures fall within a range of reasonable responses to the perceived threat. In *Airgas*, the Court found that Airgas's defensive measures were not coercive because the Airgas board was not attempting to "cram down a management sponsored alternative" to the Air Products bid, but rather "simply [wanted] to maintain the status quo and manage the company for the longer term." Citing the Delaware Supreme Court's recent decision in *Versata Enterprises, Inc. v. Selectica*,[5] the Court also noted that the combination of a classified board and a poison pill plan do not constitute a preclusive defense. Specifically, the Court found that Airgas's defensive measures served only to delay, rather than prevent, a successful proxy contest for control of the Airgas board—a fact that was emphasized by the election of the slate of three Air Products nominees at the last Airgas annual meeting.

Despite questioning the continuing usefulness of the Airgas poison pill, the Court ultimately upheld the board's decision not to redeem the pill and endorsed "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." In this case, the record demonstrated that Airgas's board, composed of a majority of outside, independent directors, acted in good faith and with numerous outside advisors to conclude that the Air Products offer was clearly inadequate, and the non-preclusive defensive measures adopted by Airgas were a proportionate response to the threat posed by the inadequate offer—facts that led the Court to laud the Airgas board as "a quintessential example" of a board acting in good faith and fulfilling its fiduciary duties in the context of a hostile takeover.

Contact Information

If you have any questions regarding the recent Delaware Court of Chancery case, please contact Elizabeth C. Southern, http://www.wcsr.com/elizabethsouthern, the principal drafter of this alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: http://www.wcsr.com/profSearch?team=corporateandsecurities.

[5] 5 A.3d 586 (Del. 2010).