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Can a Poison Pill Provide Long-Lasting Relief?

by Robert A. Schreck, Jr.

The Delaware Court of Chancery recently ruled in favor of Airgas and the continued enforceability of its Rights Agreement or "Poison Pill." Air Products and Chemicals Inc. sued to have the Rights Agreement set aside, so that its cash tender offer for all of the outstanding shares of Airgas could continue. The ruling supports the right of a board of directors to "Just Say No" to an unwanted takeover attempt and affirms the use of a Rights Agreement as an effective defensive tactic to prevent a hostile bidder from making an end run around the board.

For nearly three decades, companies have turned to the Poison Pill as a defense mechanism to stop hostile takeovers. The Poison Pill is a tactic that forces a bidder to negotiate with the board of directors, rather than taking the bid directly to the stockholders. The premise is that directors are in a better position to evaluate and negotiate a sale of the company. The Rights Agreement enforces this approach by granting stockholders, other than the bidding group, the right to purchase a large number of additional shares at a bargain price, if a bidding group crosses a trigger level of ownership, often 20 percent. If the Poison Pill deploys, it will dilute the bidder's stock holdings and make the takeover prohibitively expensive.

Chancellor Chandler's opinion in *Air Products & Chemicals, Inc. v. Airgas, Inc.,* (C.A. No. 5249-CC Del. Ch. Feb. 15, 2011) reluctantly affirmed the validity of the Airgas Poison Pill after enhanced scrutiny. Director decisions are protected from second guessing after the fact by the Business Judgment Rule, which presumes that disinterested directors made an informed decision in good faith and reasonably believed they were acting in the best interest of the corporation. In the case of a hostile tender offer, however, Chancellor Chandler subjected the Airgas board's decision to enhanced judicial scrutiny, requiring the target board to demonstrate that it had "reasonable grounds for believing a danger to corporate policy and effectiveness existed" and that the response was reasonable in relation to the threat posed. The Airgas board, consisting of a majority of outside directors, used financial advisors to assist it in concluding that the price offered by Air Products was inadequate, and used outside counsel to assist it in demonstrating that its process and investigation were reasonable. The Court also found that the decision not to neutralize the Poison Pill was a reasonable and proportional response to the threat. The board was entitled to decide to maintain the status quo and run the company for the long-term, implementing its business plan to increase stockholder value. The hostile bidder and stockholders had alternatives, such as electing a new board, to pursue their goals, so the Rights Agreement was not preclusive.

In the face of an enforceable Poison Pill, Air Products withdrew its tender offer. Air Products must now rely upon a proxy contest to take control of the board of directors and then act to neutralize the Rights Agreement. Airgas has a staggered board with approximately one-third of the directors up for election each year. Air Products successfully elected a slate of directors at the last annual meeting and, if it is able to duplicate that success, its candidates will represent a majority of the board. So, while the Poison Pill may not in the end prevent this takeover, it has clearly served its purpose by preventing the hostile bidder from going directly to the stockholders. However, it is worth noting that all three of Air Products' director nominees sided with the continuing directors in the unanimous determination that the offer was inadequate.

Over the years, the Rights Agreement concept has evolved. Many Rights Agreements now being implemented include what are referred to as "TIDE" provisions. The acronym stands for [T]hree year [I]ndependent [D]irector [E]valuation, meaning that every 3 years the Rights Agreement is reviewed by a committee of the board's independent directors, and such directors have the authority to revoke the Poison Pill. While not required by law, corporate governance best practices now dictate that, time permitting, a Rights Agreement be submitted to stockholders for approval. Some Rights Agreements outline what constitutes a qualified offer which must be submitted to stockholders for their consideration, i.e., a fully-financed all-cash offer above a certain specified premium. These Poison Pills are referred to a "Chewable" Pills. The board must assess whether continued reliance on a Poison Pill is a reasonable response to a change in control overture. The ruling in this case indicates that the board of directors may know better, but cannot stand by its decision forever.

The ruling in favor of Airgas demonstrates that a Rights Agreement or a Poison Pill is still a very effective defensive mechanism. It means that the path to stockholders must go through the board of directors. It gives the board of directors the opportunity to become involved in the process. When coupled with a staggered board, it requires a hostile bidder to prepare for a long campaign.

The Top Five (Avoidable) Antitrust Traps in M&A Transactions

by Jon B. Dubrow, Joseph F. Winterscheid and Carla A. R. Hine

In M&A transactions, the parties are often focused on negotiating the transfer of assets or equity, and may treat antitrust as a mere procedural milestone. Parties may neglect potential antitrust concerns until after the agreement is negotiated. By that point, however, important negotiating and strategic planning opportunities may have been lost, and substantive antitrust defense of a deal may be compromised by imprudent document creation or other missteps along the way. Neglecting antitrust considerations until late in the transaction planning process may lead to unnecessary expense and delay. Five avoidable antitrust pitfalls to keep in mind when planning a transaction are discussed below.

1. Developing an Antitrust Strategy

Potential antitrust issues will inform the parties' strategy in connection with several threshold negotiation issues including due diligence, deal timing and contract negotiations. As a consequence, it is essential to scope out whether the proposed transaction raises potential antitrust concerns at the earliest stages of the transaction planning process. Some preliminary questions to ask include:

- Do the parties compete with one another?
- Do either or both of the companies have significant market shares in these overlap areas?
- Will the transaction result in the consolidation of the market to only a few competitors?
- Do the parties believe that customers will have competitive concerns about the proposed combination?
- Does one party supply the other, and if so, is the buyer acquiring a key input that might foreclose its competitors from access to a step in the supply chain?

Besides discussions with business personnel, strategic plans prepared in the ordinary course of business may provide an unfiltered view of the competitive landscape and whether the business considers the other party as a competitor and to what extent.

Recognizing up front whether a transaction may raise antitrust issues and forming an antitrust strategy to address those issues can impact how the parties engage with one another throughout deal negotiations and pre-closing integration planning, as discussed further below. An antitrust strategy can also facilitate the parties' ability to manage the regulatory review process more effectively by proactively addressing the anticipated concerns of their customers and, ultimately, the antitrust agencies. Being proactive in approaching antitrust concerns allows parties to budget their time and money accordingly and avoid surprises along the way.

2. Document Control

Careless document creation can make an easy deal hard by raising questions where there otherwise would not be any. Conversely, careful wording can make a hard deal easier to defend. Whether or not the parties anticipate significant antitrust issues, careful document creation is a best business practice that can mitigate against undue costs and delays in the course of an antitrust review.

Documents prepared by the parties and their advisors that evaluate the deal are the most important information in the regulators' initial review, and can make or break the antitrust review of a deal. When creating transaction-related documents, parties should be careful to avoid antitrust "buzz words," such as: market leader; dominant position; high entry barriers; rationalize pricing or competition; achieve pricing power; avoid a price war; foreclose competition; or increase costs for rivals. This obviously applies to all press releases, talking points, frequently asked questions and Securities and Exchange Commission (SEC) filings, but also to all internal presentations, documents and communications – including "private" e-mail correspondence.

The recently revised joint Horizontal Merger Guidelines by the Department of Justice (DOJ) and Federal Trade Commission (FTC) emphasize the evidentiary importance of parties' ordinary course documents, such as business and strategic plans. Consequently, regardless of whether a company is currently contemplating a transaction, it should exercise care in how it discusses and documents competition and pricing decisions in internal documents because these documents will carry greater probative weight in an antitrust review than the deal-related documents prepared with the antitrust agencies as the anticipated audience. Further, in the event the deal evaluation documents were not carefully created, ordinary-course documents that contradict the puffery in the deal-related documents will be helpful in defending the merits of the transaction.

3. Informed Contract Negotiation

Understanding the potential antitrust regulatory obligations and concerns that a transaction may raise allow the parties to enter into better informed deal negotiations. From a procedural standpoint, parties need to consider their merger notification obligations for purposes of determining various conditions to closing. Considering both procedural and substantive issues, parties need to ensure that they build in enough time to allow for resolution of any anticipated merger reviews and negotiate how closely they will cooperate with one another to complete those reviews. With respect to substantive antitrust concerns, the parties need to consider how much antitrust risk they are willing to accept. For example, the seller may feel strongly about a "hell or high water" clause or a break-up fee, whereas the buyer may not be willing to accept so much antitrust risk. The parties cannot make informed decisions about termination provisions or other contingency planning without first exploring the relevant antitrust issues.

4. Merger Notification Assessment

While parties need to analyze whether they are subject to merger notification regulations in various jurisdictions around the world, applying the U.S. merger notification regulations under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) can be complicated and yield unexpected results. Generally, acquisitions of voting securities, assets or a controlling interest in a non-corporate entity (such as an LLC or partnership) valued above $263.8 million (adjusted annually for the change in gross national product), or above $66.0 million, but below $263.8 million if the parties also meet certain net sales/total assets thresholds, are reportable where no exemptions apply.

The size-of-transaction is measured according to what a party will hold "as a result of" (that is, following) the transaction. Thus, for example, acquiring one more share of stock (whether on the open market or through some other channel) where a shareholder already holds stock of an issuer, and the aggregate value of the stock to be held as a result of the transaction is in excess of the reporting thresholds may require an HSR notification. Other examples of reportable transaction that might not be intuitive include: conversion of non-voting stock, options or warrants; transactions where the seller receives stock as consideration; and secondary acquisitions, *i.e.*, the indirect acquisition of minority interests held by a target.

Parties need to be sensitive to these types of situations, and plan ahead to avoid a situation where they have unwittingly acquired equity interests or assets without first observing the waiting period under the HSR Act, which can result in civil penalties of up to $16,000 per day.

Finally, parties need to be sensitive to a growing number of foreign filing requirements whenever a transaction has an international component. Notification thresholds are surprisingly low in many jurisdictions, and substantial lead time is required for the preparation of non-U.S. notifications. Disparate waiting periods across jurisdictions will effect transaction timing. As a consequence, parties should undertake a review of potential obligations early in the transaction planning process to avoid delays and added expense.

5. Avoiding Gun Jumping

So-called "gun-jumping" can occur in two contexts. First, there is procedural gun-jumping, whereby one party takes beneficial ownership of voting securities, assets or non-corporate interests without first observing the statutory waiting period under the HSR Act. Such activity may result in civil penalties of up to $16,000 per day that the parties are not in compliance with the HSR Act. This prohibition applies regardless of whether or not the parties compete with one another. Parties can avoid this risk by continuing to operate as separate independent entities and not consummating the transaction prior to the expiration or termination of the HSR waiting period.

Second, there is substantive gun-jumping, whereby *competitors* that are planning a transaction begin to act in concert prior to the closing of the transaction, giving rise to claims of unlawful collusion under Section 1 of the Sherman Act. The DOJ and FTC understand that the parties need to exchange certain information through due diligence and integration planning, and need to preserve the value of what the buyer has agreed to acquire through restrictive covenants on the seller prior to closing. However, the agencies become suspicious when the information exchanged is competitively sensitive or not appropriately quarantined, or the buyer's restrictions on the seller's independent operation prior to close goes beyond trying to merely preserve the value of the business.

To reduce the risk of gun-jumping, parties should avoid the following:

- Do not exchange competitively sensitive information without prior consultation with antitrust counsel.
- If the exchange of competitively sensitive information is necessary to evaluate whether to proceed with the transaction, or to close the transaction,
    - Consider implementing "clean teams" to handle the information, and keep it from personnel who could act on it in the course of their day-to-day job functions,
    - Consider outsourcing pre-closing integration planning functions,
    - Use historical or aggregated information, and
    - Limit the data to that which is relevant and necessary to the process of negotiating and consummating the transaction.
- Do not include covenants in the transaction agreement that effectively allow the buyer to take beneficial ownership or exercise pre-closing control of the target.
- The parties may undertake integration planning prior to closing, but should not implement those plans until after closing. Parties should undertake these activities pursuant to integration planning guidelines developed in consultation with antitrust counsel.

Conclusion

Parties should be sensitive to antitrust issues – both procedural and substantive – at the earliest stages of the planning process in any proposed transaction. These issues will impact due diligence, contract negotiations, deal timing and integration planning. Prudence and careful planning will avoid surprises—and resulting expense and delay. Moreover, failure to involve antitrust counsel early on in the process may jeopardize the parties' ability to obtain antitrust clearance for their deal and, worst case, it may give rise to additional antitrust risks separate and apart from the underlying transaction itself.

EU State Aid Issues in M&A Due Diligence: Where Subsidies Turn Into Liabilities

by Martina Maier and Philipp Werner

State aid law is a concept that is unique to the European Union. State aid took center stage during the recent financial crisis, since EU Member States effectively needed approval from the EU before granting rescue packages or other loans designed to assist ailing banks and companies.

In a nutshell, EU State aid rules prohibit governments and other public bodies from granting subsidies – or any other advantages – to companies without prior approval from the European Commission. (This concept is similar to the more familiar standstill obligation and approval requirements of merger control). If a government grants a subsidy or other advantage to a company *without* prior approval, the European Commission will order the Member State to recover the so-called "illegal aid" from the company that benefited from it.

Once the European Commission orders the repayment of State aid that was improperly given to a company, the beneficiary has limited defenses available to it to avoid repayment. For example, a company usually may not claim that it legitimately believed that the aid was legally granted because every company is presumed to be aware of the State aid rules and is expected to verify the prior approval by the Commission. The only defense available is "total impossibility" – but even this defense is of limited assistance because courts only acknowledge total impossibility in insolvency cases.

This has important implications for companies seeking to acquire shares or assets of a company located in Europe – especially in the wake of the financial crisis during which many aid packages were given by national governments. First, there is a risk that the conditions for the granting of aid are no longer fulfilled if the beneficiary is acquired by another company (*e.g.*, where the amount of aid depends on the size of the group. Second, the main risk is that an acquiring company finds *itself* liable for the repayment of aid if the target has benefited from illegal aid, which the European Commission later orders to be repaid. Therefore, companies seeking to acquire a target in Europe must very carefully assess whether the target has received illegal aid in the past. This is not easy because the concept of "State aid" in the European Union covers far more than subsidies. In general, any economic advantage granted by a public authority in the European Union to an undertaking and any exemption granted by a public authority from costs, taxes and other charges that an undertaking would usually have to bear, can constitute State aid. This means that loans and guarantees from a government (or other public body) can constitute State aid, if the beneficiary does not pay a market premium or does not provide a market collateral. Tax advantages such as lower tax rates, tax deferrals or tax exemptions for companies, industry sectors or regions may likewise be considered State aid. Above-market compensation for services provided for the State, or below-market prices paid for the acquisition of public companies, can also contain State aid.

This raises the question: How does an acquiring company assess the risk that it could later become liable for State aid improperly conferred on a target? The answer lies in the due diligence process. Companies need to look for warning signs of State aid, such as direct subsidies, loans from public bodies, State guarantees, tax measures and generally deals with public bodies. Companies, and their advisers, that identify such red flags need to verify whether these measures were properly notified to the European Commission, whether they have been approved by the European Commission and whether the aid was conferred in compliance with the approval decision. The European Commission's website has a useful search tool for cases that companies may consult. However, acquiring companies will have to engage in a deeper analysis in more complex cases where it is not obvious that an apparent "advantage" actually constitutes State aid (*e.g.*, if the target previously acquired a public company, or has provided services to the State). Where it is not clear whether a measure constitutes State aid, the acquiring firm may either resort to an expert opinion or adjust the purchase price according to the risk assessment.

The risk assessment will depend on whether the acquiring firm wants to acquire shares or assets. In share deals, independently of the price paid by the acquirer for the shares, the aid will be deemed to remain with the target that received the aid in the first place. The acquirer should therefore be aware of the risk of State aid recovery and adjust the price according to the risk assessment. For asset deals, as a general principle, as long as the acquirer pays a market price, he may not be held liable for the repayment of aid received by the target as the aid is deemed to remain with the seller. The devil is in the detail of proving that a market price has been paid. Moreover, if an asset deal only leaves an "empty shell" and the deal can be seen as circumventing the recovery order, the acquirer may still be held liable for the repayment of the aid. Whether the transaction can be seen as a circumvention of State aid rules is usually very difficult to determine.

Thus, while it is possible to mitigate the risks of State aid in acquisitions, it is extremely important that companies and their lawyers identify any red flags in the legal due diligence, correctly assess the risk and adjust the price tag accordingly so that subsidies do not turn into liabilities.