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Delaware Chancery Court Upholds Poison Pill in Airgas Case

In *Air Products and Chemicals, Inc. v. Airgas, Inc.*, C.A. No. 5249-CC (Del. Ch. Feb 15, 2011), Chancellor William Chandler III of the Delaware Court of Chancery upheld Airgas's board of directors continued use of a poison pill to prevent a hostile takeover by Air Products. In its decision, the court held that the Airgas board could refuse to redeem the poison pill in the face of Air Product's non-discriminatory, all-cash, all-shares, fully financed offer that it deemed inadequate, even though the board had adequate time to explore other alternatives and stockholders had been given all relevant information necessary to make an informed investment decision. The decision upholds a long line of Delaware cases affirming the use of poison pills by target boards and shortly after the decision was issued Air Products withdrew its \$70 per share hostile takeover offer.

Background

Air Products first approached Airgas privately in October 2009, proposing an all-stock acquisition transaction. In February 2010, after several Air Products proposals were rejected by Airgas's board, Air Products launched a \$60 per share fully financed, all-cash, all-shares tender offer. Airgas's board recommended against the offer citing a five-year strategic plan prepared by the company's management in November 2009 and inadequacy opinions from its two financial advisors that stated that Air Products's bid undervalued the company.

Air Products subsequently initiated a proxy contest to elect its slate of three directors to replace the three members of Airgas's nine-director staggered board whose terms expired at the 2010 annual meeting held on September 15, 2010. In addition, Air Products initiated a stockholder proposal to amend Airgas's bylaws to require that all future annual meetings be held in January (which, if successful, would have resulted in the 2011 annual meeting occurring four months after the 2010 annual meeting). Air Products's slate of directors was elected to the board but the proposed bylaw amendment, though approved by Airgas's stockholders, was invalidated by the Delaware Supreme Court.

Prior to the 2010 annual meeting, Air Products twice raised its bid (up to \$65.50 per share) and was rebuffed each time by the Airgas board. Following the election of Air Products's slate of directors to the Airgas board, Air Products raised its bid to a best and final offer of \$70 per share, which the Airgas board (including the three independent directors nominated by Air Products) unanimously rejected. The Airgas board maintained that the value of Airgas was at least \$78 per share, a valuation which was based on its management's strategic plan and the opinion of a third investment bank engaged by the board to evaluate Air Products's revised bid. Air Products asked the court to order Airgas to redeem its poison pill and thereby permit Airgas's stockholders to decide whether or not to accept Air Products's offer.

Analysis

In reaching its decision, the court applied the two-pronged *Unocal* standard of enhanced judicial review to evaluate the actions taken by the Airgas board, which requires that a target board show that it had reasonable grounds for believing a danger to the corporate enterprise existed and that any board action taken in response to that threat was reasonable in relation to the threat posed.

The court noted that the first prong of the *Unocal* test is satisfied in part by demonstrating good faith and reasonable investigation, and that proof of good faith and reasonable investigation is enhanced by approval of a board comprised of a majority of outside independent directors that has sought and relied upon advice of legal and financial advisors. In this case, the Airgas board was comprised of a majority of independent directors who relied on three separate independent financial advisors to evaluate Air Products's bid. Each of the financial advisors, the third of which was approved by the directors nominated by Air Products, found Air Products's bid to be inadequate.

The first prong of the *Unocal* test further requires a target board to identify a threat to the corporate enterprise. While Chancellor Chandler found it difficult to understand how, as a general matter, an inadequate all cash, all shares tender offer with a back-end commitment at the same price could be a "threat," the court found that, based on Delaware Supreme Court precedent, the inadequate \$70 per share price offered by Air Products, coupled with the fact that a majority of Airgas's stock was held by merger arbitrageurs who might be willing to tender their shares for such an inadequate price, was a form of substantive coercion that constituted a legitimate threat to the company. Under Delaware corporate law, directors have the prerogative to determine that the market undervalues its stock and to protect its stockholders from offers that do not reflect the long-term value of the corporation under its present management plan. Consequently, with certain limited exceptions (such as where *Revlon* duties would apply), a board of directors is not required to maximize stockholder value in the short term, even in the context of a takeover.

Under the second prong of the *Unocal* test, the court found that the continued use of the poison pill was not coercive or preclusive and was reasonable in relation to the threat posed by Air Products's inadequate offer. The court noted that maintenance of the poison pill permitted the company, which had consistently achieved improved financial results quarter over quarter, to be run with a long-term view. Importantly, the poison pill was not a cramming down of a management-sponsored alternative and did not forever preclude Air Products from obtaining control of the company, which it could accomplish by waging a proxy contest for control of the Airgas board (which it had successfully done in part) or by increasing its price to a level that adequately valued the company. Furthermore, the court noted that directors alone are entitled to determine the time frame for achievement of corporate goals. In this case, Airgas's board had reasonably adopted the strategies and timeline outlined in its management's strategic plan and it was not obligated to abandon its deliberately conceived strategy for a short-term stockholder profit even in the face of a tender offer at a per share price that a majority of Airgas stockholders likely would have accepted. As such, the court found that maintenance of the poison pill was within a range of reasonable responses that the board could have adopted and a course of action that has been clearly recognized under Delaware law.

Conclusion

While noting that the protracted nature of the takeover battle had granted the Airgas board sufficient time to fully inform its stockholders about its view of the company and the inadequacy of Air Products's offer, Chancellor Chandler was nonetheless constrained by a long line of Delaware Supreme Court precedent upholding the use of poison pills and reaffirming the primacy of the board in determining matters of corporate control. And, while Airgas's maintenance of its poison pill was upheld in this instance and its board found not to have breached their fiduciary duties, the court's ruling was undoubtedly influenced by the factual circumstances surrounding this takeover attempt, including the fact that the three directors nominated by Air Products, and a third financial advisor selected with their approval, found the Air Products offer inadequate. Although Chancellor Chandler noted that "the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors," board action will nonetheless be scrutinized closely in matters of corporate control.

In closing, the court made clear that it was not endorsing a "just say never" policy with its decision. Rather, it was endorsing Delaware's long understood respect for reasonably exercised managerial discretion so long as boards are found to be acting in good faith in accordance with their fiduciary duties after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions.

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