Delaware Chancery Court Upholds Airgas Pill

On February 15, 2010, in a decision eagerly awaited by many in the corporate bar and banking community, Chancellor William Chandler upheld Airgas's poison pill defense to Air Products' US$70 tender offer.[1] The decision, while disappointing to many investors (especially risk arbs), confirms the primacy of the target's board in determining the company's fate. Conversely, for shareholders who wanted to accept the bid, the decision emphasizes the need to make sure the target does not have a staggered board, long before the company ever becomes a target.

Chancellor Chandler's decision in *Airgas* is a 153-page tour de force, reviewing Delaware law on poison pills, and anti-takeover defenses generally, over the past quarter-century since the pill first came into being. He ruled that the "enhanced scrutiny" standard set forth in *Unocal*[2] controlled, not the business judgment rule. He nevertheless found that the Airgas board had satisfied this heightened standard. He was very careful to point out that he was not upholding "just say never," but he nevertheless ruled that the board "serves as a quintessential example" of a board "acting in good faith and in accordance with their fiduciary duties (after rigorous judicial scrutiny and enhanced scrutiny of their defensive actions)."

While Chancellor Chandler went out of his way to reject any reading of a "just say no" defense as "just say never," Air Products' immediate reaction to the decision was to withdraw their US$70 offer. As a result, whether the defense might become "just say not now" or "just say not at this price," and could be overcome by judicial action, will not be tested.

Chancellor Chandler's decision was unquestionably affected by the unanimity on Airgas's board, even after Air Products had won a proxy fight to install directors it thought would be friendly to its bid. Airgas's board was staggered, so the company's shareholders had voted on only a minority of directors, and their platform had not been "accept the offer" so much as "let's make sure we consider the offer." When those newly-elected directors joined their colleagues in voting to keep the pill in place, the judicial landscape became more favorable for the target and its defenses. These new directors came onto the Airgas board at Air Products' behest, considered the offer as they promised, and found it inadequate. Chancellor Chandler was understandably reluctant to second-guess their judgment.

1 *Air Products & Chemicals, Inc.* v. *Airgas, Inc.*, C.A. No. 5249-CC (Del. Ch. Feb. 15, 2011).

2 *Unocal Corp.* v. *Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

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Under the *Unocal* standard, the court must find that there is a reasonable basis to believe a threat to corporate policy exists, and that the defensive measures taken in response are reasonable in relation to that threat and neither preclusive nor coercive. The Airgas board asserted that the threat was "short-termism," because so many of Airgas's shares were held by arbitrageurs, who simply wanted the deal to go through, and quickly. Chancellor Chandler concluded that the use of the pill to protect against that was reasonable, and the pill was not preclusive because Air Products could continue its bid and fight multiple proxy fights if it wished to do so.

The fact that the nature of a company's shareholders can change so dramatically when a bid is made, from long-term institutional holders to event-oriented risk arb hedge fund managers whose investment time horizon is much shorter, is at least an implicit concern on the part of the entire Delaware corporate law bench. In a November 2010 article in the *Business Lawyer* entitled "One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?," Vice Chancellor Leo Strine discussed this specific issue.

The resolution to this conundrum is perhaps best found in shareholders resisting takeover defenses in the first place, before a takeover fight has emerged. Staggered boards, coupled with poison pills, have proven to be a remarkably effective anti-takeover defense, as a bidder has to be prepared to win at least two consecutive proxy fights to gain a majority of the target's board who pledge to vote to redeem the pill. Corporate governance groups, like ISS, Risk Metrics, and the Council of Institutional Investors, have indicated their strong displeasure with staggered boards, and many companies have abandoned them, and even poison pills themselves, in response. While a poison pill can be re-adopted after a hostile bid is made, a staggered board likely cannot.

As a result, institutional shareholders who press for an unclassified, unstaggered board, by means of a Rule 14a-8 shareholder proposal or otherwise, are in effect saying, before "short-termism" can creep in, that even as longer-term investors, they do not want their board to adopt a "just say no" defense that is carried through to the bitter end, and that if the board adopts such a strategy when a bid is made, the shareholders want to have the right promptly to replace the entire board if they deem it necessary. By the time the bid is made, Chancellor Chandler's decision in the *Air Products* case shows it is far too late as a practical matter to be able to make such a choice.

We hope you have found this Advisory useful. If you have questions, please contact your Arnold & Porter LLP attorney or:

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