DELAWARE COURT OF CHANCERY UPHOLDS AIRGAS POISON PILL, ENDING TAKEOVER BATTLE

February 17, 2011

To Our Clients and Friends:

In a long-awaited decision, the Delaware Court of Chancery on Tuesday upheld the Airgas board's steadfast refusal to disarm its poison pill in the face of long-time suitor Air Products' widely supported hostile offer. In *Air Products and Chemicals, Inc. v. Airgas, Inc.*,[1] the court was asked to address the so-called "just say 'no'" defense in its purest form—to decide whether a target company subject to an all-cash, fully financed tender offer with a non-coercive structure could keep in place its poison pill and thus prevent fully informed shareholders from deciding for themselves whether to sell their shares in the offer. Upholding the pill reluctantly but firmly under Delaware Supreme Court precedent, Chancellor Chandler found the Airgas board to be a "quintessential example" of a board acting in good faith in accordance with its fiduciary duties.

Shortly after the decision was handed down, Air Products withdrew its $5.9 billion hostile offer, ending a 16-month saga.

BACKGROUND

Air Products made its first private overture to Airgas in September 2009. On February 11, 2010, faced with strong resistance from the Airgas board, Air Products launched its $60 per share tender offer for Airgas, conditioned, among other things, on the redemption of Airgas' poison pill. The Airgas board, after reviewing management's detailed five-year strategic plan and receiving inadequacy opinions from its two investment banks, recommended against the offer, stating that it grossly undervalued Airgas.

Air Products thereafter commenced a proxy contest to replace the three members of Airgas' nine-director staggered board who were up for election at the 2010 annual meeting and to amend Airgas' bylaws to require that its next annual meeting be held in four months, at which time Air Products would seek to replace three more directors. By the time of the 2010 annual meeting on September 15, Air Products had raised its bid to $63.50 and then to $65.50, both prices the Airgas board rejected as inadequate.

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1 C.A. 5249-CC (Del. Ch. Feb. 15, 2011).

Air Products' nominees were elected to the Airgas board and the by-law amendment was approved, although later invalidated by a decision of the Delaware Supreme Court.[2] The newly elected directors promptly took a "fresh look" at Airgas' strategic plan, retained their own independent counsel and persuaded Airgas to hire a third investment bank. Presumably to Air Products' surprise and discomfiture, its nominees were favorably impressed with Airgas management's strategic plan and found the underlying assumptions to be reasonable. Although Air Products ultimately raised its bid to a "best and final" $70, the Airgas board—including the Air Products nominees—rejected it as inadequate, holding firmly to the view that Airgas was worth at least $78 per share in a sale transaction.

The court was thus faced with a novel set of circumstances. Over a period of 16 months, Air Products had raised its bid by $10 per share and had won its proxy contest to elect three directors to the Airgas board. Vast amounts of information regarding Air Products' bid and Airgas' strategic plan and reasons for rejecting the bid were in the public domain, and shareholders had ample time to analyze the arguments on both sides. Many shareholders clamored for Airgas to negotiate with Air Products. Still, Airgas would not dismantle its defenses and let the shareholders decide. Under these circumstances, can a target continue to "just say 'no'" by refusing to dismantle its poison pill?

ANALYSIS

The court applied the familiar two-pronged *Unocal* analysis: did the Airgas board show that it had reasonable grounds for believing that the Air Products offer represented a threat to corporate policy and effectiveness? And, if so, was Airgas' response not coercive or preclusive and within a range of reasonableness?

The threat that Airgas perceived is a variation of what is known as "substantive coercion": Airgas shareholders might accept Air Products' inadequate offer and cede control of the company because a large number of those shareholders were short-term speculators who would sell for a quick profit, regardless of the intrinsic adequacy of the price. Although Chancellor Chandler "ha[d] a hard time believing that inadequate price alone . . . in the context of a non-discriminatory, all-cash, all-shares, fully financed offer poses any 'threat'," he concluded that "under existing Delaware law, it apparently does." To address the legitimacy of this threat, the court first had to consider whether the Air Products offer was indeed inadequate.

Not only had three investment banks delivered inadequacy opinions, but the three Air Products nominees to the Airgas board agreed that the offer was inadequate. The quality of

[2] *Airgas, Inc. v. Air Products and Chemicals, Inc., 8 A.3d 1182 (Del. 2010).*

Airgas' strategic plan was critical to the determination by the directors and their advisors that the offer was inadequate. By all accounts, it was a detailed plan that had been developed in the ordinary course of Airgas' business, well before the Air Products offer materialized, and was not "tweaked" in response to the offer. Moreover, the Airgas board understood the plan well—the Air Products nominees were favorably impressed not only by the plan and its assumptions, which they found to be conservative, but also by how knowledgeable the board was. While assumptions could always be challenged, it appeared that the plan was realistic and thoughtful, and that it supported values well in excess of those offered by Air Products. The court therefore concluded that the Airgas board had acted reasonably and in good faith in determining that the Air Products offer was inadequate.

Turning to the appropriateness of Airgas' response to the Air Products threat, the court cited the Delaware Supreme Court's recent pronouncement in *Versata Enterprises v. Selectica*[3] that "the combination of a classified board and a Rights Plan do[es] not constitute a preclusive defense." The court noted for these purposes that Air Products had already won one proxy contest and, although it would have to wait another seven or eight months, it could realistically win a second. Without dwelling on the hollow nature of the first victory given the views of the first three would-be insurgent board members, the court concluded that Airgas' defenses were not preclusive and were reasonable under the circumstances.

POISON PILLS AND "JUST SAY 'NO'" IN DELAWARE

The Airgas decision underscores the continued vitality and effectiveness of poison pills under Delaware law. Last year, the Delaware Supreme Court upheld an "NOL" poison pill with a 4.99% trigger,[4] and the Court of Chancery upheld the use of a poison pill by Barnes & Noble in the face of the rapid accumulation of shares by investor Ron Burkle.[5] More fundamentally, the decision upholds the allocation to directors, and not to stockholders, of authority to manage the corporation, including in the realm of takeover defense.

But Delaware corporations cannot always "just say 'no'" in the face of hostile offers. As the Delaware Supreme Court recently reiterated, "the adoption of a Rights Plan is not absolute."[6]

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3 Versata Enters. Inc. v. Selectica, Inc., 5 A.3d 586, 604 (Del 2010).

4 Versata. See also our memo "Delaware Supreme Court Upholds Validity of NOL Rights Plan," dated October 5, 2010.

5 Yucaipa Am. Alliance Fund II, LP v. Riggio, 1 A. 3rd 310 (Del. Ch. 2010).

6 Versata, 5 A.3d at 607.

And, "[t]he Board does not now have unfettered discretion in refusing to redeem the rights."[7] The *Unocal* analysis is searching, and the defendants will not always prevail, as Craigslist found out when it unsuccessfully tried to use a poison pill to protect the potential loss of its unique corporate culture indefinitely.[8] In the *Airgas* case, the court found strong support for the Airgas board's position in the comprehensive, realistic pre-existing strategic plan that the Airgas board used to value the company, in the strongly held views of Air Products' own nominees that the Air Products offer was inadequate, and in the thorough, good-faith efforts the board made at every step to evaluate the offer and the company's long-term stand-alone alternative.

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7 Moran v. Household Int'l Inc., 500 A.2d 1346, 1354 (Del. 1985).

8 eBay Domestic Holdings, Inc. v. Newmark, 2010 WL 3516473 (Del. Ch. Sept. 9, 2010).