

CROSS-BORDER LITIGATION SERIES

Delaware Court Supports Poison Pill Defense in *Air Products v. Air Gas*

Introduction

Late yesterday, Chancellor William B. Chandler, III of the Delaware Chancery Court simultaneously affirmed the vitality of the poison pill to ward off an unwanted hostile tender offer and confirmed that the decision-making authority to accept or reject a hostile takeover remains firmly in the province of the Board of Directors rather than the target's shareholders. This much-anticipated opinion by the Delaware Chancery Court sustained the decision by the Board of Airgas, Inc. to employ the pill to block a hostile takeover bid by its competitor, Air Products and Chemicals, although the offer had been pending for well over a year and the shareholders were well informed of the Board's negative assessment and recommendation. Over an 18-month period, the Airgas Board rejected four different all-cash, all-shares offers by Air Products on the ground that each of these offers undervalued Airgas shares. The conduct and decisions of the Board were and are consistent with existing Delaware law. As explained by Chancellor Chandler:

"...as Delaware law currently stands, the answer must be that the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors. As such, I find that the Airgas board has met its burden under Unocal to articulate a legally cognizable threat (the allegedly inadequate price of Air Products' offer, coupled with the fact that a majority of Airgas's stockholders would likely tender into that inadequate offer) and has taken defensive measures that fall within a range of reasonable responses proportionate to that threat. I thus rule in favor of defendants. Air Products' and the Shareholder Plaintiffs' requests for relief are denied, and all claims asserted against defendants are dismissed with prejudice..."

It is clear that the Chancery Court will continue to accord target boards considerable latitude to reject takeover bids that the boards view as inadequate; and it is equally clear that a hostile tender offer faces a formidable challenge when, as here, confronted with both a poison pill and a staggered board.

Immediately after the decision was released, Air Products announced that it was abandoning the offer. John E. McGlade, Air Products' chairman, stated: "It is abundantly clear that the Airgas Board is thoroughly entrenched in its position, so we have decided to withdraw our offer and move on."

The Airgas Litigation

In October 2009, Airgas became the subject of a hostile takeover attempt by its competitor, Air Products and Chemicals. Air Products made four tender offers for 100% of Airgas' stock, beginning with an offer of \$60 per share in February 2010 and concluding with \$70 per share in December 2010. Several members of Airgas's Board voted to reject each offers as undervaluing Airgas, relying in part upon the company's shareholder rights plan as a defense to the takeover. This plan, which has a 15 percent triggering threshold, effectively bars Air Products from acquiring shares above that threshold without Airgas's Board either approving the purchase or redeeming the poison pill.

Key Issues

The Airgas Decision

The "Poison Pill"

Judicial Review of Shareholder Rights Plans

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As part of its takeover attempt, Air Products mounted a proxy contest to gain control of Airgas's 10-member Board. Airgas's charter created staggered terms for directors, however, which makes it impossible to replace the entire Board at one annual meeting. Air Products succeeded in placing three directors on the Board at Airgas's September 2010 annual meeting, and then passed a bylaw amendment to move up the next annual meeting to January 2011.

But on November 23, 2010, the Delaware Supreme Court sustained Airgas's challenge to the bylaw amendment, and held that this amendment was inconsistent with the charter provision that created staggered terms for directors.

After Air Products failed in the proxy contest, it resorted to challenging the poison pill itself, arguing to the Chancery Court that it was not reasonable for Airgas's Board to use the poison pill indefinitely. Air Products contended that Airgas's Board had ample time to locate alternative suitors, and that many of Airgas's own shareholders supported the deal. In response, Airgas maintained that the pill was necessary to protect Airgas shareholders from Air Products' inadequate bids, which consistently have undervalued Airgas. Airgas believes its shares are worth at least \$78.

The Decision

Chancellor Chandler concluded "that the Airgas board, in proceeding as it has since October 2009, has not breached its fiduciary duties owed to the Airgas stockholders." Rather, the Board "has acted in good faith and in the honest belief that the Air Products offer, at \$70 per share, is inadequate."

Applying the *Unocal* test, the Chancery Court found first that it was reasonable for Airgas's Board to believe that Air Products' offer of \$70 per share posed a danger to corporate policy and effectiveness. Specifically, "based on all of the facts presented to" the Chancellor, he found "that the Airgas board acted in good faith and relied on the advice of its financial and legal advisors in coming to the conclusion that Air Products' offer is inadequate." Relying upon *Time-Warner*, the Chancellor concluded that a poison pill may be invoked as a defense to "protect ... stockholders from a 'low ball' bid."

Then, under *Unocal's* second prong, the Chancery Court concluded that Airgas's repeated invocation of the poison pill was a "proportionate response to the threat posed by Air Products' offer." *First*, "Airgas's defensive measures are certainly not coercive ... as Airgas is specifically *not* trying to cram down a management sponsored alternative, but rather, simply wants to maintain the status quo and manage the company for the long term." *Second*, the defenses were not preclusive because they did not "render the possibility of an effective proxy contest realistically unattainable." Chancellor Chandler reluctantly held that defenses are not preclusive under Delaware law irrespective of whether the defenses "delay Air Products from obtaining control of the Airgas board (even if that delay is significant) so long as obtaining control at some point in the future is realistically attainable." Even though Air Products would have "to wait another eight months to run another slate of nominees," the Chancellor "conclude[d] that Airgas's defensive measures are not preclusive" because "an Air Products' victory at the next annual meeting is very realistically attainable."

Although Chancellor Chandler expressed doubt as to whether the \$70 per share offer actually posed a "threat" to Airgas' shareholders, he found that he was "constrained by Delaware Supreme Court precedent to conclude that defendants have met their burden under *Unocal* to articulate a sufficient threat that justifies the continued maintenance of Airgas's poison pill." In other words, "Airgas's defenses have been recognized by Delaware law as reasonable responses to the threat posed by an inadequate offer—even an all-shares, all-cash offer."

Chancellor Chandler's decision is consistent with a long line of Delaware precedent validating the use of the poison pill, including *Paramount Communication v. Time Inc.*, *Unitrin v. American General Corp.*, and more recently *Yucaipa American Alliance Fund II, L.P. v. Riggio and eBay Domestic Holdings, Inc. v. Newmark*, et al.

Air Products has stated that it does not intend to appeal the decision.

This client memorandum does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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