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The Rise of 'Nanny Corporations'

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The term "nanny state" often critically refers to policies where government is perceived as being excessive in its desire to protect or control particular aspects of society while simultaneously undermining personal responsibility. For example, the San Francisco Board of Supervisors recently voted to ban McDonald's and other fast-food restaurants from providing free toys with Happy Meals and similar food items because those meals contain an unacceptable level of calories, fat and sodium. Excessive state action is used to protect people from the consequences of their actions by restricting options.

Has Delaware precedent on poison pills and other takeover defenses produced a so-called "nanny corporation" in which shareholders are prevented from deciding whether they want to tender their shares in a so-called "best and final" all-cash tender offer, even though the shareholders have all the information required to make an informed choice? The recent decision by Chancellor William Chandler in the Air Products-Airgas fight suggests yes.

The facts of the Air Products-Airgas battle are well known. Air Products had been pursuing Airgas for over a year and had purportedly made its best and final offer to acquire Airgas at $70 per share. Believing that $70 per share was inadequate and that the true value of the company was $78 per share, the Airgas board continued to maintain its takeover defenses (including a poison pill and staggered board), denying its shareholders the ability to determine for themselves whether to tender their shares and accept the offer. Air Products and certain shareholders of Airgas sued Airgas asking the court to order Airgas to redeem the poison pill and remove its other defenses.

Chancellor Chandler upheld Airgas's use of the poison pill and other takeover defenses.

However, throughout the opinion, his tone of skepticism and cynicism regarding the precedent he is bound to follow is readily apparent. At the beginning, he states, "[t]rial judges are not free to ignore or rewrite appellate court decisions. I am constrained by Delaware Supreme Court precedent to conclude that the defendants have met their burden under *Unocal* to articulate a sufficient threat that justified the continued maintenance of Airgas's poison pill." In what essentially amounts to a dissenting opinion within his own "majority" opinion, Chancellor Chandler advocated his "personal" view that the Airgas poison pill served its legitimate purpose. He cited the fact that Air Products' best and final offer of $70 per share had been on the table for over two months and Air Products' pursuit of Airgas had been ongoing for over 16 months, which had given the Airgas board more than a year to inform its shareholders about what it believed to be the intrinsic value of Airgas, the value of Airgas in a sale transaction, the nature of Air Products' purported opportunistic timing and the inadequacy of its offer. The poison pill also helped Airgas force Air Products to raise its bid by $10 per share from its first publicly announced offer. Perhaps most importantly, Airgas's shareholder base was sophisticated and well-formed.

Unfortunately for Air Products and Airgas's shareholders, Chancellor Chandler's adherence to binding Delaware precedent as he understood it prevented him from substituting his business judgment for that of the Airgas board, effectively denying shareholders the ability to decide what they believed to be in their best interest.

Poison pills have significant benefits for shareholders by deterring coercive takeover tactics while preserving a board's bargaining power and flexibility to deal with a third-party acquirer. When used properly, poison pills can maximize shareholder value by preventing the acquisition of control or a position of substantial influence without offering to pay shareholders a fair control premium. Poison pills also provide a board adequate time to gather and bestow information on its shareholders, as well as to explore strategic alternatives.

After it adopts a poison pill, the board must use the pill even-handedly in conducting an auction (if that is what ensues), and the board should not use the pill as a "just say no" weapon to thwart offers that are otherwise in the best interests of shareholders. Furthermore, the purpose of the poison pill should never be simply to preclude shareholders from choosing an alternative that the board finds less valuable or beneficial (or perhaps even more harmful) to shareholders, especially where shareholders can make an informed judgment about accepting the offer. When the poison pill's rationale transforms to preventing shareholders from mistakenly tendering into an inadequately priced offer, the pill has become an instrument of the so-called "nanny corporation." And the options available to shareholders have been restricted in order to protect them from the consequences of their own informed decision.

In determining whether the Airgas board should redeem the poison pill, Chancellor Chandler appropriately applied the *Unocal* standard, under which the board of directors must demonstrate that it had reasonable grounds for believing a danger to corporate policy and effectiveness (i.e., a legally

cognizable threat) existed and that action taken in response to that threat is reasonable in relation to the threat posed.

Although Chancellor Chandler was skeptical that a justifiable threat existed, he reluctantly stated that Delaware precedent required him to find that the Airgas board had indeed met the *Unocal* standard. According to his opinion, the only real threat discussed by the Airgas board was the inadequate price of Air Products' offer coupled with the fact that a majority of the Airgas stock was then held by merger arbitrageurs who would be willing to tender into the $70-per-share offer to maximize their short-term profit at the potential expense of the remaining minority shareholders. The recognition that this constituted a threat worthy of the continued maintenance of a poison pill is faulty for at least three reasons. First, as Chancellor Leo E. Strine Jr. said in *Chesapeake v. Shore*: "If stockholders are presumed competent to buy stock in the first place, why are they not presumed competent to decide when to sell in a tender offer after an adequate time for deliberation had been afforded them?" Second, the merger arbitrageurs bought their shares from long-term shareholders who viewed the increased market price generated by the Air Products offer as an advantageous time to sell and did not view a market price less than $70 per share as a gross misrepresentation of the company's value. Third, a circumstance where educated shareholders may mistakenly (at least in the view of the board) accept an underpriced offer because the shareholders ignored or disbelieved the board's view on the company's value should not be classified at a threat level that permits devices to be maintained that have the effect of preventing shareholders from exercising their will.

With respect to the second prong of the *Unocal* standard, a takeover defense is not preclusive or coercive as long as it falls within the range of reasonableness. Air Products and the shareholder plaintiffs argued that the combination of the staggered board and the poison pill were preclusive because they rendered the possibility of an effective proxy contest

realistically unattainable. Inauspiciously, only four months before, in *Versata Enterprises Inc. v. Selectica Inc.*, the Delaware Supreme Court held that the combination of a classified board and a poison pill was not a preclusive defense because an acquirer could wage a proxy contest and obtain control of a board over a two-year period. Once again, citing that he was bound by precedent, Chancellor Chandler grudgingly ruled in favor of Airgas, stating that it was realistically attainable that Air Products could obtain control at some point in the future and that the board's actions do not forever preclude Air Products from acquiring Airgas or from getting around the defensive measures. This standpoint is great in theory but, unfortunately, ignores the economic reality and conditions faced by a hostile acquirer during its pursuit of a target, which include a depressed stock price and the high costs (both in time and resources) of maintaining its bid for another year. As a result, is it really practical to believe than an acquirer will "stick around" for at least two years? Do we want to encourage the use of limited time and resources for such a purpose, especially when the shareholder base has the information necessary to make an educated assessment?

Chancellor Chandler closes by stating that pills do not and cannot have a set expiration date. He is absolutely correct. Otherwise, poison pills would lose their potency and become an illusory defense with the mere passage of time. However, the poison pill should not be a tool that is wielded to prevent shareholders from making their own well-informed decision even if the shareholders reject management's good faith determination that the hostile offer is inadequate. When the rationale for maintaining the poison pill is to protect shareholders from their own ignorance and mistakes, we become even closer to the creation of the "nanny corporation" in which even the most informed and sophisticated shareholders are denied the ability to determine what is in their best interests.