WSGR ALERT

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DELAWARE CHANCERY COURT UPHOLDS AIRGAS BOARD'S REFUSAL TO REDEEM POISON PILL

In a landmark ruling this week, the Delaware Court of Chancery forcefully affirmed the right of a board of directors to maintain a "shareholder rights plan"—more commonly referred to as a "poison pill"—in response to an all-cash tender offer so long as the board determines, in good faith and in accordance with its fiduciary duties, that the offer is inadequate. In *Air Products and Chemicals, Inc. v. Airgas, Inc.*, No. 5249-CC (Del. Ch. Feb. 15, 2011), Chancellor William B. Chandler III explained that under existing Delaware Supreme Court precedent, a corporate board, while subject to "rigorous judicial fact-finding and enhanced scrutiny" of its use of the pill, can maintain the pill to prevent shareholders from accepting a tender offer that the board believes does not adequately value the company, even if that offer is not "structurally coercive." The *Air Products* decision reaffirms the scope of a corporate board's managerial authority in responding to tender offers it views as contrary to the best interests of the corporation's shareholders.

Background

Air Products first expressed its interest in acquiring Airgas in a private meeting between the two companies' CEOs. Offers of $60 and $62 per share were made and rejected, with Airgas's CEO indicating that the Airgas board was not interested in pursuing negotiations in the price range suggested by Air Products' offers.

Air Products responded by taking its offer public. Its first public offer was for $60 per share, and was conditioned upon, among other things, a majority of outstanding shares tendering into the offer, and the Airgas board redeeming the company's poison pill. The Airgas board received opinions from two different financial advisors stating that the offer was inadequate, and the board publicly and repeatedly told shareholders that Air Products' offer grossly undervalued the company. Air Products, meanwhile, nominated a slate of three new directors for the staggered Airgas board. Air Products promised that the nominees would be "independent" and able to "consider without any bias [the Air Products] Offer." Air Products also proposed amending Airgas's bylaws to require the company to hold all subsequent annual shareholder meetings in the month of January. The amendment would have had the effect of permitting Air Products to secure the election of a second slate of Airgas directors more quickly.

The two companies continued to argue publicly over the merits of Air Products' offer, which was raised first to $63.50 and then to $65.50. At the annual Airgas shareholder meeting, the shareholders elected Air Products' slate and approved Air Products' proposed bylaw amendment. (The Delaware Supreme Court subsequently invalidated the bylaw amendment. For a WSGR Alert regarding that important decision, please visit http://www.wsgr.com/WSGR/Display.aspx?SectionName=publications/pdfsearch/wsgralert_shortens_directors.htm.) The new directors, however, ultimately reached the same conclusion as the incumbents: that Air Products' offer was inadequate, and that the poison pill should be kept in place. A third financial advisor, hired at the behest of the new directors, further supported this decision. Air Products brought suit, and after a bench trial on the matter—but before the court issued its ruling—raised its offer to $70 per share, which Air Products represented was its "best and final" offer. The Airgas board claimed that the offer was still inadequate, sticking to its position that, while it was not categorically opposed to a sale, the value of Airgas in a sale was, according to its analyses, "at least $78 per share."

The Chancery Court's Decision

The Chancery Court ruled in favor of the Airgas board and dismissed all claims against the Airgas board with prejudice. The court began its analysis by finding that where a poison pill is being maintained as a defensive measure and a board is faced with a request to redeem the pill, the well-established two-part "intermediate standard" of review set forth in *Unocal Corp. v. Mesa Petroleum Co.* applies, instead of the more lenient "business judgment rule." Under the first *Unocal* prong, the target board must show that it had "reasonable grounds for believing danger to corporate policy and effectiveness existed." Under the second prong, the target board must show that its response was "reasonable in relation to the threat posed."

Chancellor Chandler found that the Airgas board had met both prongs of the *Unocal* test. With respect to the first prong, he found that the Airgas board had undertaken a good faith and reasonable investigation concerning the adequacy of Air Products' offer. This investigation included securing reports from three different outside independent financial advisors, as well as advice from two different law firms, one of which was retained by the Air Products nominees. The court further found that the board itself was comprised of

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a majority of outside, independent directors (including the three Air Products nominees), which, under *Unocal*, "materially enhanced" proof of the board's good faith and reasonable investigation.

The court next addressed the issue of whether a tender offer that is not "structurally coercive"—defined as one that does not punish non-tendering shareholders with less favorable treatment than tendering shareholders—can present a cognizable "threat" to the company. The court recognized the argument that the law should not find a cognizable threat in such circumstances; the Airgas shareholders were admittedly a "sophisticated group" that had an "extraordinary amount of information available to them with which to make an informed decision about Air Products' offer." Nevertheless, the court felt "bound" by Delaware Supreme Court precedent teaching that a tender offer that is not "structurally coercive" can still be "substantively coercive," and therefore pose a legally cognizable threat to which the board is entitled to respond. The court concluded that the Airgas board faced just such a threat, in light of the danger that the arbitrageurs who held a majority of Airgas's stock would tender their shares notwithstanding the long-term value of the company.

Turning to the second *Unocal* prong, the court began by acknowledging that a defensive measure will not be upheld if it is "preclusive." Although the court found that the Airgas board's refusal to redeem the pill "in fact precluded" Air Products' tender offer, it nevertheless felt "constrained" to conclude that the defensive measure still was not "preclusive" under Delaware Supreme Court precedent, because Air Products could have nominated, and the shareholders could have elected, a second slate of directors at the next annual Airgas shareholder meeting. Chancellor Chandler also concluded that the Airgas board's response to the offer was within the "range of reasonableness," as evidenced, again, by the good faith and reasonableness of the board's investigation, and the fact that Air Products' own nominees believed that Air Products' $70 offer was inadequate.

Implications

The *Air Products* ruling is significant in many respects. First, because it is not being appealed, Chancellor Chandler's thoughtful and comprehensive opinion will represent Delaware law for the foreseeable future. If and when a question of the use and/or validity of a shareholder rights plan under Delaware law is litigated again, Chancellor Chandler's discussion of existing precedent makes his opinion very persuasive authority for other courts.

The decision also is important because it clarifies that existing Delaware Supreme Court precedent "allow[s] a board acting in good faith (and with a reasonable basis for believing that a tender offer is inadequate) to remit the bidder to the election process as its only recourse." More fundamentally, the decision makes clear the board's primacy over the question as to whether or not a company should be sold. Thus, the decision endorses, in the words of the court, "Delaware's long-understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions)."

For more information on the *Air Products* case or any related matter, please contact a member of Wilson Sonsini Goodrich & Rosati's securities litigation practice.

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