



JONES DAY  
**COMMENTARY**

## DELAWARE CHANCERY COURT UPHOLDS POISON PILL IN TAKEOVER BATTLE FOR AIRGAS

On February 15, 2011, the Delaware Chancery Court released a highly anticipated decision relating to the protracted battle for control of Airgas Inc. The decision, authored by Chancellor William Chandler, reconfirmed the board-centric model of Delaware law by:

- upholding Airgas' use of a rights plan to protect its shareholders from a tender offer that its board deemed to be inadequate; and
- holding that, under current Delaware law, the power to defeat an inadequate tender offer ultimately lies with the target company's board of directors, not a particular category of shareholders or the shareholders generally.

Air Products and Chemicals, Inc. first privately expressed an interest in acquiring its rival Airgas in October 2009, but the Airgas board rejected its overtures. In February 2010, Air Products launched a fully financed, all-cash offer to acquire all outstanding shares of Airgas for \$60 per share. The offer was

conditioned, among other things, on the Airgas board redeeming the rights issued under the rights plan or otherwise making them inapplicable to the offer. The Airgas board recommended against the offer, noting that the timing of the offer was extremely opportunistic in light of the depressed value of Airgas' shares.

In March 2010, Air Products launched a proxy contest, and its slate of three independent director nominees was elected to Airgas' staggered board at its September 2010 annual meeting. After increasing its offer several times, Air Products made what it called its "best and final" offer of \$70 in cash per Airgas share in December 2010. Airgas' board unanimously rejected that offer as inadequate and refused to eliminate Airgas' rights plan in the face of the offer. Importantly, the three Air Products nominees, who were proposed as independent director nominees willing to take a fresh look rather than nominees committed to Air Products' views, and a third financial advisor, hired in response to the request by the Air Products nominees for independent financial advice, concurred in this conclusion.

Air Products' lawsuit claimed that the Airgas board's maintenance of the rights plan was unreasonable and wrongfully barred Airgas' shareholders from considering Air Products' offer. After a trial held in October 2010, extensive post-trial briefing, and a supplemental evidentiary hearing held in January 2011, the court concluded that the Airgas directors had not breached their fiduciary duties and had acted in good faith and in the honest belief that the Air Products offer of \$70 per share was inadequate.

The court applied the *Unocal* standard of review, the first prong of which required the Airgas board to demonstrate that it reasonably believed that a legally cognizable threat existed. The court found that the Airgas board acted in good faith and relied on the advice of its financial and legal advisors in concluding that the Air Products offer was inadequate. Further, the court noted that the Delaware Supreme Court has recognized "substantive coercion"—the risk that a target's shareholders may accept an inadequate offer because of ignorance or mistaken belief regarding the board's assessment of the long-term value of the target's stock—as a legally cognizable threat under *Unocal*. In this regard, the court found that there was sufficient evidence that a majority of Airgas shareholders "might be willing to tender their shares regardless of whether the price is adequate or not—thereby ceding control of Airgas to Air Products. This is a clear 'risk' ... because it would essentially thrust Airgas into *Revlon* mode," thereby obligating the Airgas board to maximize short-term value for its shareholders.

The second prong of the *Unocal* analysis required the Airgas board to demonstrate that its defensive response (here, its maintenance of a rights plan in combination with its classified board) was a proportionate response to the perceived threat. To do so, the Airgas board must demonstrate that the defensive response is neither coercive nor preclusive, and that it is within a "range of reasonableness." The court found that the Airgas measures were intended only to preserve the status quo and thus were not coercive in nature. Further, although the classified board structure prevented

Air Products from obtaining control of the Airgas board in the short term, obtaining control over the board—and the fate of the rights plan—was still realistically attainable in the future, and thus the defenses were not preclusive. Further, the court noted that the Delaware Supreme Court has held that a board may properly employ a poison pill as a proportionate defensive response to protect its shareholders from an inadequate bid, and expressly held in the recent case of *Versata Enterprises, Inc. v. Selectica, Inc.* that the combination of a classified board and a rights plan does not constitute a preclusive defense.

While the *Airgas* decision is not surprising, unique aspects of the case may well limit its practical relevance in future takeover defenses. Most importantly, Airgas had a classified board. The number of companies with classified boards has been, of course, rapidly declining, and the ISS-led investor community can be expected to return to classified board structures as a key focus after *Airgas*. Moreover, Air Products' nominees were independent and eventually concurred with the Airgas board. Air Products' proxy contest may well have had its intended effect had its proposed nominees committed to the redemption of Airgas' pill.

The court cautioned, however, that its opinion does not endorse the position that a board can "just say no" or "just say never" to a hostile tender offer:

A board cannot "just say no" to a tender offer. Under Delaware law, it must first pass through two prongs of exacting judicial scrutiny by a judge who will evaluate the actions taken by, and the motives of, the board. Only a board of directors found to be acting in good faith, after reasonable investigation and reliance on the advice of outside advisors, which articulates and convinces the Court that a hostile tender offer poses a legitimate threat to the corporate enterprise, may address that perceived threat by blocking the tender offer and forcing the bidder to elect a board majority that supports its bid.

Although the *Airgas* opinion is clearly a win for Airgas—the Air Products tender offer expired without renewal on the day the decision was released—Chancellor Chandler indicated that he would have ruled differently if not constrained by the current state of Delaware law. Chancellor Chandler was not convinced that inadequate price was a cognizable threat in the case of a nondiscriminatory, all-cash, all-shares, fully financed tender offer, noting that the record indicated that Airgas’ shareholders were sophisticated, well-informed, and had available to them all of the information they would need to make an informed decision. Chancellor Chandler stated that, in his view, the Airgas poison pill had served its legitimate purpose, noting that the combination of the rights plan and the staggered board had given Airgas a full year to inform its shareholders about its assessment of Airgas’ long-term value and to educate its shareholders on the inadequacy of Air Products’ offer. It remains to be seen whether the views of Chancellor Chandler and other Chancery Court jurists who have expressed doubt regarding structural coercion, and who have suggested that a rights plan may have served its purpose after providing adequate time for considering strategic alternatives and informing shareholders, will ultimately gain traction with the Delaware Supreme Court. At least for the time being, Delaware law remains highly deferential to the use of rights plans to protect shareholders from perceived threats.

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