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Air Products & Chemicals, Inc. v. Airgas, Inc.

Just Say Wait

By Paul S. Ware

On Feb. 15, 2011, Chancellor William B. Chandler III of the Delaware Court of Chancery issued his ruling in the epic takeover battle between Air Products & Chemicals, Inc. and Airgas, Inc. The case posed the fundamental question regarding the allocation of power between directors and stockholders in a hostile tender offer: Who gets to decide when and if the corporation is for sale? More specifically, as framed by Chancellor Chandler, when faced with a structurally non-coercive, all-cash, fully-financed tender offer directed to the stockholders of the corporation, may a board of directors, acting in good faith and with a reasonable basis for its decision, keep a poison pill in place so as to prevent stockholders from making their own decision about whether they want to tender their shares, even if the stockholders are fully informed as to the board's views on the inadequacy of the offer? On the facts before it, the court concluded that the Airgas board could maintain its poison pill, effectively denying stockholders the right to vote on the Air Products offer, because the Airgas board had met its *Unocal* burden (*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)) to articulate a legally cognizable threat posed by the offer, and the retention of the pill by the board fell within a range of reasonableness proportionate to the threat. In its analysis, the court found that the likelihood that a majority of Airgas stockholders would tender into an offer the board judged inadequate constituted a legally cognizable threat, and that the retention of the pill in the face of the threat was a proportionately reasonable response. The setting of corporate goals and the timeframe for achieving those goals remain squarely the responsibility of the board and may not be delegated to stockholders. Until further pronouncement by the Supreme Court of Delaware, the power to defeat an inadequate hostile tender offer lies with the board of directors and its judgment to maintain its poison pill.

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Background

Air Products began pursuing a possible transaction with Airgas in the fall of 2009. Before going public with its offer, Air Products initially proposed to Airgas management in October 2009 an all-stock transaction at $60 per share, which was subsequently increased in December 2009 to an offer of $62 per share in a combination of stock and cash. Each of these proposals was considered, analyzed and rejected by the board of Airgas.

In February 2010, Air Products commenced a public tender offer to acquire all outstanding shares of Airgas at $60 per share, an offer that it increased three times over the next 12 months to its "best and final" offer of $70 per share. The offers were conditioned on the redemption of the poison pill by the Airgas board. The latter rejected each of the Air Products offers as "clearly inadequate," consistently maintained that Airgas was worth at least $78 per share, and declined to redeem the pill.

In addition to other takeover defenses, Airgas had in place a staggered board. As part of its takeover efforts, Air Products nominated a slate of three directors for election at the 2010 Airgas annual meeting, and proposed several bylaws for adoption, including one that would accelerate the Airgas annual meeting with the effect that the staggered board could be changed more quickly. At the September 2010 annual meeting, all three Air Products nominees were elected to the Airgas board.

On Dec. 21, 2010, the Airgas board, including the newly elected Air Products nominees, met to consider the "best and final" offer from Air Products. The three Air Products nominees had retained their own independent counsel and a new third independent financial adviser (in addition to the two independent financial advisers previously retained by Airgas) had been engaged to advise the full Airgas board. All three financial advisers concluded that the best and final offer from Air Products was inadequate. As a result, the board, including all three of the Air Products nominees, unanimously rejected the Air Products offer.

The Decision

Chancellor Chandler noted that it is well-settled in Delaware that a board's decision to maintain a poison pill is evaluated under the *Unocal*-enhanced scrutiny standard. This standard required the Airgas board to demonstrate both that it had reasonable grounds for believing a danger to corporate policy and effectiveness existed, and that the response to the threat was reasonable in relation to the threat posed. In evaluating the first prong of *Unocal*, the Chancellor noted that the Airgas board had to show not only the reasonableness of its investigation and process, but also the reasonableness of the results that it reached.

Applying *Unocal*, the court noted that the Airgas board was comprised of a majority of outside directors, that it had received three separate opinions from outside independent financial advisers that the Air Products offer was "clearly inadequate," that the Airgas board, including the three Air Products nominees, agreed

unanimously that the Air Products offer was clearly inadequate, and that Airgas had an existing five-year strategic plan that was not implemented or "tweaked" because of the Air Product overtures. Accordingly, the court concluded that the Airgas board had made a good-faith determination that the Air Products offer was inadequate, that there was sufficient evidence that Airgas stockholders might tender into the inadequate offer, and, therefore, the Air Products offer posed a legally cognizable threat.

Chancellor Chandler then turned to the second prong of *Unocal* and concluded that the decision of the Airgas board not to redeem the pill was a reasonable response to the Air Products threat. The court examined whether the Airgas defensive measures were preclusive or coercive, noting that a defensive measure is coercive if it is aimed at "cramming down" on stockholders a management-sponsored alternative. In this case, Airgas was specifically not trying to cram down a management-sponsored alternative, but rather sought to maintain the status quo and manage the company for the long term. Turning to the issue of preclusiveness, the court stated that a response is preclusive if it makes gaining control "realistically unattainable." The Chancellor noted that while the Airgas defensive measures certainly worked to delay a successful proxy contest for control of the Airgas board, they did not prevent Air Products from obtaining control. The court pointed out that Air Products had previously run a successful slate of new directors. Citing the recent Delaware Supreme Court decision in *Versata Enterprises, Inc. v. Selectica, Inc.*, ___ A.3d ___, No. 193, 2010 (Del. Oct. 4, 2010) Chancellor Chandler noted that under current Delaware law the combination of a staggered board and a rights plan was not a preclusive defense, and, accordingly, he was constrained by current precedent to conclude that Airgas's defensive measures were not preclusive. As Chancellor Chandler noted, a board cannot say "never," but under current Delaware precedent, for companies with a pill plus a staggered board, it may be permissible for a board to "just say wait"… for a very long time.

Takeaways and Observations

Conduct an independent process with expert advisers: Chancellor Chandler praised the Airgas board as a "quintessential example" of process and conduct, highlighting that: 1) the Airgas board had a majority of independent directors; 2) the Airgas board relied on the advice of three expert and experienced investment bankers; 3) all three Air Products nominees agreed the final offer was inadequate; and 4) the Airgas strategic plan was based on realistic assumptions.

Have an articulated strategic business plan: Have a real and reasonable business plan that your board understands. Don't put your strategic plan on the shelf. Review it regularly with your board. Challenge the plan and your board's command of it. Airgas had a detailed five-year strategic business plan that was based on reasonable and realistic assumptions. Its board members were intimately familiar with the plan, its assumptions and the prospects of the company. The strategic business plan was not implemented or even "tweaked" because of Air Products, but rather had been formulated in the ordinary course of corporate governance and management by the board as an appropriate, reasonable and realistic plan for Airgas and its long-term prospects and benefit.

Demonstrate improving financial results: Easier said than done, but if a board wants to maintain the status quo, it needs to be able to show its plan is working. Because of the length of the proxy contest and tender offer, Airgas had a full 12 months of operations in which to demonstrate its improving financial results. Airgas showed consistently improving financial results during each passing quarter, results that were objectively verifiable and evidence of the reasonableness of the board's defensive measures and the validity of its strategic plan.

Revise charters and bylaws to clarify director terms and annual meeting dates: Corporate charters and bylaws should be reviewed and revised to provide unambiguous provisions regarding the length of directors' terms and the time between annual meetings. Be consistent in scheduling annual meetings and be clear and precise in proxy statements and filings in describing the length of directors' terms.

Insurgents should advocate "stockholder choice" as well as a "fresh look": The court noted that the Air Products nominees campaigned on the basis of a "fresh look" rather than "let stockholders decide." The court did not answer, however, whether adopting a single plank based on letting stockholders decide would be consistent with the overall fiduciary duties of directors. The decision does suggest that an insurgent should campaign in its fight materials, not just on a "fresh look," but also on evaluating the reasonableness of the analysis and basis for management's position regarding the intrinsic value of the target company, as well as a comparison of the likelihood of achieving such value and results. This would include an evaluation and weighing of the competing proposals by the board; specifically, the certainty and finality of a best and final all cash offer at $70 weighed against the subjective achievability of a $78 intrinsic value.

Insurgents should argue that a tie goes to the stockholders: Chancellor Chandler asserted that the Airgas board cleared the *Unocal* burden "with greater ease" when the Air Products offer was at $65.50 rather than $70. The implication being that it was more difficult for the Airgas board to conclude that a final and firm all cash offer at $70 was "clearly inadequate" compared to an inherently uncertain subjectively determined $78 intrinsic value. Insurgents should emphasize the uncertainty and subjectivity of the board's calculation of a higher intrinsic value, to make the analysis focus on the rough equivalency of a final and best offer of $70 compared with the subjective achievability of an intrinsic value of $78 per share. Essentially, make the case that a $70 bird in the hand is equivalent to a $78 bird in the bush. And in the case of such an equivalency or "tie," stockholders should be allowed to make their own decisions.

Conclusion

Shareholder rights plans are alive and well in Delaware. The combination of a poison pill with a staggered board is a valid and potent takeover defense. The *Airgas* decision confirms the previous 25 years of Delaware case law upholding the use and maintenance of poison pills by independent boards acting in good faith, after reasonable investigation and in reliance on independent financial and legal advisers, in response to legitimate threats posed by hostile bidders.

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