Air Products & Chemicals, Inc., v. Airgas, Inc.: Delaware Court of Chancery Upholds Longest-Lasting Litigated Poison Pill

On February 15, 2011, Chancellor William B. Chandler III of the Delaware Court of Chancery issued a decision in *Air Products & Chemicals, Inc., v. Airgas, Inc.*,[1] addressing one of the most fundamental questions debated in corporate law: between the board of directors and shareholders, whose judgment prevails when the corporation is faced with a hostile tender offer? More specifically, in the context of a hostile tender offer, who gets to decide when and if the corporation is for sale? On the facts presented, the Court sided with the board of directors, holding that a board may use its poison pill to defeat a hostile tender offer, as long as the board has articulated a legally cognizable threat posed by the offer and the board's use of the pill falls within a range of reasonable responses proportionate to the threat. The Court found that the likelihood that a majority of the target board's shareholders would tender into an offer the board deemed inadequate constituted a legally cognizable threat, and that the target board's poison pill fell within a range of reasonable responses proportionate to that threat.

I. Background and Procedural History[2]

The case originated from a private meeting in October of 2009, when the CEO of Air Products and Chemicals, Inc. ("Air Products") first conveyed his desire to the CEO of Airgas, Inc. ("Airgas") to acquire or merge with Airgas.[3] Air Products presented a $60 per share all equity deal to acquire Airgas. The Airgas board discussed Air Products' offer at its next meeting. Taking financial and legal advice into consideration, the board unanimously and quickly rejected the offer, finding the price per share to be inadequate.

Air Products persisted. It sent a letter to Airgas outlining its offer, suggesting that the amount per share was negotiable, and requesting a meeting to discuss the offer. The Airgas board responded stating that the board would consider the offer at its next meeting. The CEO of Airgas, who was also a member of the board, sought advice from Airgas' attorneys and its two financial advisors. At the meeting, the Airgas board listened to a financial analysis on Air Products' offer and management's recommendation that the board reject it. The board unanimously agreed to reject the offer again and decided not to meet with Air Products. Airgas informed Air Products of its decision.

On December 17, 2009, Air Products modified its offer to $62 per share in a cash-and-stock transaction. Air Products reiterated its interest in meeting with Airgas to negotiate the offer. The Airgas board held another meeting to discuss the modified offer. Airgas' Senior Vice President for Corporate Development presented financial analyses from Airgas' management and investment bankers, concluding that the offer undervalued Airgas. The board again unanimously rejected the offer. In early January 2010, Airgas informed Air Products of the board's decision.

On February 4, 2010, Air Products sent a public letter to the Airgas board announcing a fully financed, all-cash tender offer for all of Airgas' outstanding shares at $60 per share. Air Products indicated it would consider modifying its offer if persuaded by Airgas. The Airgas board met that week. The board's financial

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[1] *Air Prods. & Chems., Inc., v. Airgas, Inc.*, C.A. No. 5249 (Del. Ch. Feb. 15, 2011) ("Slip Op.") available at http://online.wsj.com/public/resources/documents/021511apagop.pdf.

[2] The background and procedural history is drawn from the opinion of the Court.

[3] Both Air Products and Airgas are Delaware corporations.

advisors discussed their financial analyses of the offer. Once again, the board unanimously agreed that Air Products undervalued Airgas and that the offer was inadequate. Airgas conveyed its decision to the CEO of Air Products. Airgas' main takeover defense was a shareholder rights plan, or a poison pill, with a 15% triggering threshold. It was activated and blocked Air Product's hostile takeover plan.

On February 11, 2010, Air Products commenced its $60 per share, all-cash tender offer for all of Airgas' outstanding shares of common stock and backed by committed financing.[4] Air Products also declared it would run a proxy contest to nominate three directors to be elected to Airgas' board at Airgas' next annual meeting.[5]

Airgas' board convened a special meeting to discuss Air Products' tender offer. The board's financial advisors presented detailed financial analyses and again advised the board that the tender offer was inadequate. In its Schedule 14D-9 filed with the SEC, Airgas urged its shareholders to reject Air Products' offer because it undervalued Airgas. Airgas submitted an explanation of why the tender offer was inadequate and asserted that Air Products' offer was "extremely opportunistic . . . in light of the depressed value of the Airgas Common shares prior to the announcement of the Offer."[6]

On March 13, 2010, Air Products nominated three independent directors for the three seats on Airgas' board that were up for election at the next annual meeting. Additionally, Air Products declared it would propose the following three bylaws to be approved by Airgas' shareholders: (1) amend Airgas' bylaws to require Airgas to hold its 2011 annual meeting and all subsequent annual shareholder meetings in the month of January; (2) amend Airgas' bylaws to limit the Airgas board's ability to reseat directors not elected by Airgas shareholders at the annual meeting (excluding the CEO); and (3) repeal all bylaw amendments adopted by the Airgas board after April 7, 2010.[7] About a month later, Airgas' board voluntarily amended its bylaws to grant the board the discretion to set the date for its annual meeting. The board's purpose in doing so was to push back the meeting to have more time to educate its shareholders and "demonstrate performance of the company" before the next meeting.[8]

On July 8, 2010, Air Products raised its offer to $63.50 per share and repeated its desire to negotiate with Airgas. Airgas' board held two special meetings to consider the revised offer. The board's financial advisors presented analyses, concluding that the newest offer still undervalued Airgas. The CEO of Airgas sent a public letter to the CEO of Air Products rejecting the offer and refusing to discuss the offer because $63.50 was "not a sensible starting point for any discussions or negotiations."[9] Airgas filed an amendment to its Schedule 14D-9, explaining that it rejected Air Products' latest offer because it was inadequate. It explained that the $63.50 a share

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[4] The tender offer had several conditions, including: (1) a majority of the total outstanding shares tendering into that offer; (2) the Airgas board redeeming its rights plan or the rights otherwise having been deemed inapplicable to the offer; (3) the Airgas board approving the deal under Delaware General Corporation Law § 203 or § 203 otherwise having been deemed inapplicable to the offer; (4) the Airgas board approving the deal under Article VI of Airgas's charter or Article VI otherwise being inapplicable to the offer; (5) certain regulatory approvals having been met; and (6) the Airgas board not taking certain action (i.e., entering into a third-party agreement or transaction) that would have the effect of impairing Air Products' ability to acquire Airgas. Slip Op. at 33.

[5] Airgas' board of directors was comprised of nine members separated into three equal classes, and one class of three directors was up for election each year. All of the directors, other than the CEO, were independent.

[6] *Id.* at 35.

[7] *Id*. at 38.

[8] *Id.* at 40.

[9] *Id.* at 41.

offer did not comport with Airgas' future expectations. Airgas urged its shareholders not to tender their shares. Airgas then filed its proxy statement for the September annual meeting and advised its shareholder to vote against Air Products' nominees and the proposed bylaw amendments. Soon after, Air Products filed its definitive proxy statement. It urged shareholders to vote for its nominees and bylaw proposals to enable Air Products' acquisition of Airgas.

On September 6, 2010, Air Products increased its offer to $65.50 per share. The next day, the Airgas board met to discuss the increased offer. Once again, the board's financial advisors concluded that Air Products' offer was inadequate and the board unanimously rejected the offer. Airgas filed another amendment to its Schedule 14D-9 urging shareholders to reject the offer.

On September 10, 2010, the CEO of Airgas, Airgas' financial advisors, and other Airgas representatives met with twenty-five to thirty Airgas shareholders. The shareholders wanted the board to meet with Air Products to discuss the offer. The board indicated that if Air Products raised its offer to $70-a-share, it would meet with Air Products to discuss a transaction. Air Products learned of Airgas' focus on $70-a-share, and Air Products' attorney asked Airgas to commit to agreeing to a deal at $70-a-share if Air Products offered such amount. Airgas would not make this commitment.

Airgas' annual meeting took place on September 15, 2010. Air Products succeeded in getting its three nominees elected to Airgas' board. Additionally, Air Products' bylaw proposals were adopted by Airgas' shareholders. Soon after, Airgas increased its board to ten members, and the CEO, who was not re-elected, was reappointed to the board.

After the annual meeting, Airgas filed a lawsuit against Air Products in the Delaware Court of Chancery to render the bylaw moving the annual meeting to January invalid. Air Products and the Airgas shareholders ("Shareholder Plaintiffs")[10] requested that the Court order Airgas to redeem its poison pill, which was thwarting Air Products' tender offer, and permit Airgas' shareholders to decide whether to tender into Air Products' $70-a-share offer.

The case was tried over five days, from October 4 to 8, 2010. The evidence at trial convinced the court that Airgas' shareholders had as much information as they needed to make an educated determination of whether to accept Air Products' offer. Additionally, it was clear that Air Products was willing to offer more than $65.50-a-share, but if Airgas redeemed its poison pill, Air Products would attempt to close the transaction at $65.50-a-share. Both parties submitted briefs and presented oral arguments on October 8, 2010. The Court upheld the validity of the bylaw moving the annual meeting to January, and Airgas appealed.

On October 26, 2010, the Chairman of Airgas sent a letter to the CEO of Air Products, stating that Airgas' board, including the three board members nominated by Air Products, believed that $65.50 per share "is grossly inadequate."[11] Nonetheless, Airgas' board indicated its readiness to negotiate with Air Products, but only if Air Products was willing to offer a price reflecting what Airgas believed to be an accurate valuation of its stock: about $70-a-share. The CEO of Air Products responded positively to Airgas' request. However, Airgas' board announced, in another letter to Air Products, that the board unanimously agreed "the value of Airgas in a sale is at least $78 per share."[12] Air Products was unwilling to increase its offer to that level. The two companies still met

[10] The Shareholder Plaintiffs owned 15,159 shares of Airgas common stock and claimed to represent all other similarly situated shareholders.

[11] Slip Op. at 53.

[12] *Id.* at 55. The three Air Products' nominees later clarified that the board's statement regarding its belief that Airgas was

to discuss transaction possibilities, but the meeting turned out to be futile. The purported eight-dollar increase in Airgas' value put a damper on any hopes of a mutual agreement between the two companies.

On November 23, 2010, the Delaware Supreme Court reversed the Court of Chancery's opinion, holding the bylaw was invalid and that Airgas' annual meetings must take place about one year apart.[13] The Court of Chancery still had to rule on certain issues, particularly whether Airgas must redeem its poison pill. On December 2, 2010, in light of the Supreme Court's recent ruling, Chancellor Chandler sent the parties a letter asking for answers to several unresolved issues that would be handled in post-trial briefing.[14] Specifically, he asked whether the parties believed the Supreme Court's ruling affected the remaining issues.[15]

On December 10, 2010, the Airgas board agreed to retain a third independent financial advisor to evaluate Air Products' offer to solidify its position that it was exercising sound judgment and impartiality.

The parties' supplemental post-trial briefs were due to the Court on December 10, 2010. At the eleventh-hour, Air Products increased its offer to its "best and final" offer at $70-a-share.[16] Airgas' board met again, on December 21, 2010, to discuss Air Products "best and final" offer.[17] Airgas' management presented the company's five-year plan --which the Shareholder Plaintiffs characterized as "optimistic"-- to the board and each of its three financial advisors separately presented its financial analysis, all concluding that $70-a-share was an inadequate price. The Airgas board, including the Air Products' nominees, unanimously rejected Air Products' offer. One of the board members clarified that they were "not opposed to a sale of Airgas – but they are opposed to $70 because it is an inadequate bid."[18] Airgas promptly filed another amendment to its Schedule 14D-9, again explaining that Air Products' latest offer was inadequate and urging Airgas' shareholders not to tender their shares.[19] The board stressed that it believed Airgas' value to be at least $78 per share.

The Court held a supplemental evidentiary hearing and the parties presented closing arguments. The Court noted that evidence showed that Airgas' shareholders were sophisticated and had enough information to decide for themselves what to do about Air Products' offer.

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worth $78-a-share was not meant to guarantee that Airgas would accept an offer at this price, or that an offer at this price guaranteed that Airgas was willing to negotiate with Air Products. *Id.* at 61-62.

[13] *Airgas, Inc. v. Air Prods. & Chems., Inc.*, 8 A.3d 1182 (Del. 2010).

[14] Dec. 2, 2010 Letter Order 1-2.

[15] *Id.*

[16] *Id.* at 66. Airgas argued that the trial was moot once Air Products raised its offer to $70-a-share, because the case turns on Air Products' previous $65.50-a-share offer and Airgas' board's actions in response to that offer. *Id.* at 6. The Court rejected Airgas' argument. *Id.* Airgas additionally requested the Court to force Air Products to submit its internal, financial analyses demonstrating how it concluded that $70-a-share was its "best and final" offer. *Id.* at 67. The Court denied Airgas' request, holding that Air Products is not obligated to explain how it settled on its offer. *Id.* The Court considered Air Products' offer as its "best and final" offer, based on Air Products' representations to the Court, the public, and the SEC. *Id.*

[17] *Id.* at 71.

[18] *Id.* at 73.

[19] It is important to note that every time Airgas provided information in its 14D-9, it provided painstakingly detailed information and attached the opinions from its financial advisors. *Id.* at 74.

II. Court of Chancery's Decision

It is well settled under Delaware law that when a company uses its poison pill to defend against a hostile takeover, and the board is asked to redeem the pill, the *Unocal* standard of review applies.[20] *Unocal* calls for enhanced judicial scrutiny. To justify the use of defensive tactics, a board must demonstrate that: (1) it had reasonable grounds for believing a danger to corporate policy and effectiveness existed (*i.e.*, the board must articulate a legally cognizable threat) and (2) any board action taken in response to that threat is reasonable in relation to the threat posed. To satisfy the first prong, the board must articulate a legitimate threat to corporate policy and effectiveness, and demonstrate the reasonableness of the board's conclusion and of the investigation and process leading to that conclusion. To satisfy the second prong, the Court must substantively review the board's actions and determine whether the board's defensive tactics were proportional to the threat posed. This second prong is necessary because of "the omnipresent specter that directors could use a rights plan improperly, even when acting subjectively in good faith."[21]

Under the first prong, Airgas was obligated to prove that it had "grounds for concluding that a threat to the corporate enterprise existed."[22] Airgas argued that Air Products' offer posed several threats to the company.[23] The Court pointed out that Airgas' board only discussed the inadequacy of the price of the offer as a threat to the company at the board meetings. The Court found that the only threat to Airgas was the inadequate price, coupled with the fact that a majority of Airgas' stock was held by merger arbitrageurs who would likely tender into Air Products' offer.[24] As to the inadequacy of Air Products' offer, Airgas' witness admitted that when presenting expectations for the company, management was optimistic. When evaluating how Airgas' board determined that Air Products' offer was a threat, the Court focused on the fact that Airgas' board is comprised of a majority of outside, independent directors. Additionally, the board relied on legal advisors and three outside, independent financial advisors in determining that Air Products' offer was inadequate. Absent any evidence that the board did not act in good faith in relying on optimistic projections for the company, and considering the fact that "reasonable minds can differ as the view of future value" of Airgas, the Court accepted the board's conclusion that the price was inadequate.[25]

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[20] See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). Airgas argued that the business judgment rule, not the *Unocal* standard, should apply here. Slip Op. at 79. Airgas' argument was that: the *Unocal* standard only applies when there is an "omnipresent specter that a board may be acting primarily in its own interests," and since Air Products' nominees, who are independent directors, agreed with the incumbent board after hearing the investment bankers' financial analyses, the "theoretical specter of disloyalty does not exist" here. *Id*. at 80. The Court dismissed Airgas' argument as an "incorrect statement of the law." *Id.* *Unocal* enhanced scrutiny applies because of the omnipresent specter that board members are acting in their own interests to secure their own power and jobs. *Id.* at 81-82. There is no doubt under Delaware law that the *Unocal* standard applies to a board's defensive actions in the context of a hostile takeover. *Id.* at 82.

[21] Slip Op. at 79 (citations omitted).

[22] *Id.* at 104 (citing *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 599 (Del. 2010)).

[23] Airgas argued that that Air Products' offer was coercive, opportunistically timed, and put the shareholders in a "prisoner's dilemma." Slip Op. at 104-105.

[24] Merger arbitrageurs, who purchased Airgas' stock when Air Products announced its interest in acquiring Airgas and when it was trading at a much lower price, "have short-term interests" and would likely tender into Air Products' inadequate offer because they would still gain a significant return on their investment. Slip Op. at 106, 113-114. Merger arbitrageurs' interests threaten the minority shareholders. *Id.* at 105. The Court noted that the threat caused by merger arbitrageurs is only legitimate if the offer is truly inadequate. *Id.* at 114. The Court also found that, in a battle between both parties' experts, there was sufficient evidence that a majority of the shareholders would tender their shares into Air Products' purportedly inadequate offer. *Id.* at 118.

[25] *Id*. at 26.

The Delaware Supreme Court held in *Unitrin*[26] that "the directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect its shareholders from offers that do not reflect the long-term value of the corporation under its present management plan."[27] In the context of a hostile takeover, a board does not have a duty to maximize its shareholders' value in the short term.[28] The Supreme Court "endorse[d the] conclusion that it is not a breach of faith for directors to determine that the present stock market price of shares is not representative of true value or that there may indeed be several market values for any corporation's stock."[29] Further, a board that in good faith views a hostile offer as inadequate may use a poison pill as a proportionate response to shield its shareholders from a substandard bid. Therefore, Airgas' board appropriately employed its poison pill to protect the company's long-term goals.

Prong two of *Unocal* requires that the board's defensive tactics are not preclusive or coercive, and if neither, must fall within a "range of reasonableness."[30] The Court determined that Airgas' poison pill was not coercive because the Airgas board was not trying to force an alternative plan on the shareholders, but simply trying to preserve the status quo.

The Court had difficulty determining whether Airgas' poison pill was preclusive, or in other words, made Air Products' ability to acquire control of Airgas' board "realistically unattainable."[31] Although the presence of a classified board makes it much more difficult for a company to acquire control of the target board, the Delaware Supreme Court has held that a poison pill employed by a classified board does not in and of itself make the defensive tactic realistically unattainable or preclusive.[32] While a classified board would no doubt delay a hostile acquirer from obtaining control of the board, it would not outright prevent this from happening. The Court heard two conflicting expert opinions from proxy experts on whether obtaining control of Airgas' board by Air Products was "realistically attainable" with the poison pill in place. Both experts conceded that it is extremely difficult to predict how an election would turn out, and the Court deemed both expert opinions to be "unhelpful and unconvincing."[33] Forced to make a decision, the Court credited Airgas' expert with making the dispositive argument that Air Products could win the requisite number of votes -- to call a special meeting and to remove the entire board without cause -- if its offer was "sufficiently appealing."[34] Or, Air Products could obtain control of the board by attaining a simple majority of the voting shareholders at the next annual meeting.[35] Therefore, the poison pill did not make Air Products' chances of taking control of Airgas' board realistically unattainable or preclusive.

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[26] *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

[27] Slip Op. at 119 (citing *Unitrin*, 651 A.2d at 1376).

[28] Airgas was not in *Revlon* mode, which would trigger a duty on behalf of the board to maximize shareholder value. *Id.* at 119. The *Revlon* case is beyond the scope of this case and will not be discussed.

[29] *Id.* at 119-120 (citing *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 n.12 (Del. 1990)).

[30] *Unitrin, Inc.*, 651 A.2d at 1388 (citing *Paramount Commc'ns, Inc.*, at 45-46).

[31] Slip Op. at 122.

[32] *Versata Enters., Inc.*, 5 A.3d at 604.

[33] Slip Op. at 130.

[34] *Id.* at 135.

[35] The Court noted that Air Products announced it would not wait eight months until Airgas' next board meeting to try to gain control of the board. Slip Op. at 136-137. This was Air Product's decision, and it did not render Air Products' chances of acquiring control of Airgas' board realistically unattainable. *Id.*

Since the poison pill was not coercive or preclusive, the Court then analyzed whether Airgas' board's defensive tactics in response to the threat of Air Products' offer were within a "range of reasonableness."[36] Airgas' board simply tried to maintain the status quo and prioritized Airgas' future over short-term shareholder gain, which is permitted under Delaware law.[37] In doing so, it made a good faith decision, in reliance on legal and financial advisors and with primarily independent outside directors, that this was the best option for Airgas. The poison pill does not preclude Airgas from ever being acquired; it merely made it more difficult to be acquired at a price the board believed was inadequate. The Court found that Airgas' defensive tactics fell within the range of reasonableness.

The Court held that Airgas' board acted "in good faith and in the honest belief that the Air Products offer, at $70 per share, is inadequate" and did not breach its fiduciary duties owed to Airgas' shareholders.[38] Airgas met its burden under *Unocal* by (1) proving that Air Products' offer constitutes a legally cognizable threat and (2) showing that the poison pill is a reasonable response to the threat posed by Air Products' offer. The Court denied Air Products' and the Shareholder Plaintiffs' requests for relief and dismissed all claims asserted against Airgas with prejudice.

In applying Delaware law, Chancellor Chandler expressed some reservations. For example, he stated that he has "a hard time believing that inadequate price alone . . . in the context of a non-discriminatory, all-cash, all-shares, fully financed offer poses any 'threat'" to Airgas, but "under existing Delaware law, it apparently does."[39] He doubted that there is any "threat" because the shareholders are sophisticated and well informed, and have had over a year to make an informed decision on whether to accept Air Products' offer. He even cited a case that expresses doubt that an inadequate all-cash, all-shares tender offer -- similar to the offer in this case -- can be considered a threat.[40] Nevertheless, he acknowledged that the Delaware Supreme Court "has recognized inadequate price as a valid threat to corporate policy and effectiveness."[41]

Chancellor Chandler also admitted that he was "constrained by Delaware Supreme Court precedent" in concluding that Airgas satisfied the *Unocal* standard.[42] He interjected his personal view that, in spite of the Court's holding, he believed that "Airgas's poison pill has served its legitimate purpose."[43]

Chancellor Chandler discussed the origin and development of the poison pill technique.[44] He noted that boards do not have unlimited discretion in refusing to redeem the poison pill, but the limits on a poison pill have not yet been defined. Practitioners and academics have debated the merits, limitations, and evolution of the poison pill at length. The question of whether a board can "just say no" to redeeming a poison pill has dominated the discourse.[45] Chancellor Chandler pointed out that Airgas continued to "just say no." He acknowledged that

[36] *Id.* at 139.

[37] *Paramount v. Time*, 1989 WL 79880, at *19 (Del. Ch. July 14, 1989).

[38] Slip Op. at 7.

[39] *Id*. at 7.

[40] *See Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 278, 289 (Del. Ch. 1989).

[41] *Id.* at 9.

[42] *Id*. at 7.

[43] *Id.* at 8.

[44] The poison pill was first upheld, by the Delaware Supreme Court, in *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1354 (Del. 1985).

[45] Slip Op. at 148.

poison pills have a great potential to be abused and can effectively render a company takeover proof. Chancellor Chandler emphasized that his decision does not endorse "just say never"[46] but rather that Delaware law gives great deference to the good faith determinations of a well informed board acting in accordance with its fiduciary duties, such as Airgas' board.

III. Significance of the Decision

Air Products and Chemicals, Inc. v. Airgas, Inc. did not rule on any novel issues of law. It illustrated the effectiveness of the poison pill and the scope of a board's ability to perpetuate the pill. The decision declined to shift the power to decide whether to accept a hostile tender offer from a corporation's board of directors to its shareholders.

Air Products apparently has no plans to appeal the case. Shortly after the Court's ruling, the CEO of Air Products announced that the company was withdrawing its $5.9 billion takeover bid for Airgas.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; Melissa A. Raggi at 212.701.3765 or mraggi@cahill.com.

[46] *Id.* at 152.