SIMPSON THACHER MEMORANDUM

Delaware Chancery Court Reaffirms Poison Pill and "Just Say No" Defense in Airgas Takeover Battle

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On February 15, 2011, the Delaware Court of Chancery ruling in *Air Products & Chemicals, Inc. v. Airgas, Inc.* confirmed that directors of a target company can refuse to redeem the company's poison pill in the face of an inadequate hostile offer to its stockholders, even if a majority of the stockholders would likely tender into the offer and even if the board has had adequate time to explore alternatives and fully explain its views to the stockholders. The decision directly addressed the so-called "just say no" defense, and promptly following the issuance of the Court's opinion Air Products announced that it was withdrawing its offer.

Air Products initially sought to acquire Airgas through discussions with management in late 2009 in an all-stock transaction at $60 per share. The Airgas board rejected the proposal, and in February 2010, Air Products commenced an all-cash, all-shares, fully financed offer for Airgas at the same $60 per share level. The Airgas board, relying principally on its belief in management's long-term business plan, repeatedly rejected the offer as inadequate despite several increases in the offer price during the course of the contest. At the 2010 Airgas annual meeting, three independent nominees proposed by Air Products were elected to serve on the Airgas board. By the time of the Chancery Court's decision, Air Products had increased its unsolicited offer to a "best and final" price of $70 per share in cash, but each of the Airgas directors, including those nominated by Air Products, continued to steadfastly maintain that the offer was inadequate and that the value of Airgas was at least $78 per share. Air Products asked the Court, among other things, to order Airgas to redeem its poison pill so that the company's stockholders could decide whether to accept the Air Products offer.

Viewing the case fundamentally as a decision on whether a board's fiduciary duties, in the context of a hostile takeover, require it to abandon its long-term plans and instead permit stockholders to decide the target's fate, Chancellor Chandler concluded that "as Delaware law currently stands, the answer must be that the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors." Using a standard *Unocal* analysis, he found that the Airgas board acted in good faith and had demonstrated that it had conducted a reasonable investigation. The facts that the Airgas board was composed of a majority of outside directors, including three independent directors nominated by Air Products, and that the board had relied on "not one, not two, but three outside independent financial advisors," were specifically highlighted in the opinion. In addition, the credibility of Airgas' business plan, which had been carefully reviewed by the board and which, as Chancellor Chandler noted, was not "tweaked" or "fudged" on an ad hoc basis during the takeover contest, was a major factor in the Court's

deference to the Airgas board's business judgment not to sell the company.[1] Although he noted that he had a "hard time believing that inadequate price alone … in the context of a non-discriminatory, all-cash, all-shares, fully financed offer posed any 'threat' – particularly given the wealth of information available to Airgas' stockholders," Chancellor Chandler ruled that under existing Delaware law, the Airgas board had met its burden to identify a legally cognizable threat to corporate policy and effectiveness: namely, the inadequate offer price, combined with the fact that a majority of the Airgas stockholders (nearly half of which were merger arbitrageurs) might be willing to tender, whether or not the price was adequate. The Court also noted that while many of Airgas' stockholders clearly wanted to tender their shares for short-term gain, under Delaware law the board has sole authority, when acting deliberatively and in an informed manner, to decide the time frame for realizing corporate goals and strategies. Under the second prong of the *Unocal* analysis, the Court found that the Airgas board's continued maintenance of the poison pill was not a coercive attempt to compel stockholders to accept a "management-sponsored alternative" and did not preclude Air Products from waging a successful proxy contest for control of the Airgas board. Rounding out the analysis, the Court concluded that responding to the threat by maintaining the poison pill was within a range of reasonable responses, noting that the use of defensive measures to prevent a change of control from occurring at an inadequate price is a "course of action [that] has been clearly recognized under Delaware law," and that the Airgas board's actions "do not forever preclude Air Products … from acquiring Airgas or from getting around Airgas' defensive measures if the price is right."

The *Airgas* decision highlights the challenges under current Delaware law of successfully winning a hostile takeover battle for a target company with a staggered board and related takeover defenses. The decision also highlights the critical importance of a bidder's strategy when forming a slate of directors for a proxy contest and determining the platform on which to run its slate. The fact that the Air Products nominees "changed teams," thereby making the Airgas board unanimous in its view that the Air Products bid was inadequate, provided important support for the reasonableness of the Airgas board's decision to keep saying "no." As Chancellor Chandler noted early in his decision, "this decision does not turn so much on who won the battle of the [financial] experts as it does on the special circumstances surrounding the conduct of the Air Products nominees to the Airgas board." Hostile bidders in future takeover battles will need to weigh the possibly greater electability of a slate running on a "fresh look" platform against the possibly greater certainty associated with a "kill the pill" platform (recognizing that even if the new directors dissent from the incumbent board's conclusions, a court could still uphold the decision of the majority to retain the poison pill under a *Unocal* analysis).

The *Airgas* decision stands as the most important pill reaffirmation case in a number of years and should provide added comfort to a target board that a decision to refuse an inadequate bid is a valid course of action. Boards should remain mindful, however, that the Airgas board was

[1] Chancellor Chandler observed several times in his opinion that Airgas maintained a detailed strategic plan that was reviewed and updated on a fairly regular cycle. As has been the case in prior Delaware decisions, the presence of a thoughtfully developed and documented pre-existing business strategy unquestionably proves helpful in the context of "just say no" litigation.

helped by a good set of facts—*e.g.*, there was a credible long-term business plan; the board, including the hostile bidder's own nominees, was unanimous in its belief in the long-term value of the plan; and the bidder's best and final offer was meaningfully below the acquisition value implied by the plan—which may not be present in future contests. Moreover, the *Airgas* opinion is yet another example of the importance of good process for all board actions. In the context of "just saying no" the Court repeatedly emphasized that the board must be found to be acting in good faith after a reasonable investigation in order for its defensive actions to have a chance of withstanding "rigorous judicial fact-finding and enhanced scrutiny of their defensive actions."

The *Airgas* opinion is certain to reinvigorate the on-going debate regarding the primacy of the board of directors versus the stockholders and the wisdom of allowing a target board to decide whether its stockholders may accept a takeover bid, regardless of how fully informed the stockholders are and how non-coercive the bid is. For the time being, however, Delaware law continues to provide that "the power to defeat an inadequate hostile tender offer ultimately lies with the board of directors."

You can download a copy of the full *Airgas* opinion by clicking here.

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