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Airgas Poison Pill Upheld as the Delaware Chancery Court Endorses the "Just Not Now" Defense

The Chancery Court addressed the long-standing debate over "who ultimately decides whether a tender offer is adequate and should be accepted — the shareholders of the corporation or its board of directors."

On February 15, 2011, the Delaware Chancery Court, in a much anticipated decision in the *Airgas* hostile defense litigation, upheld Airgas, Inc.'s continued use of a poison pill to prevent Air Products and Chemicals, Inc.'s hostile tender offer to acquire control of Airgas. The decision, by Chancellor Chandler, is critically important to public companies, their shareholders and M&A practitioners because it answers the longstanding question of whether the board of a company that is the subject of a hostile tender offer can keep a poison pill in place even in the face of a premium-priced, all cash, non-coercive tender offer for all shares and even after the board has had more than enough time to explore other strategic alternatives and all relevant information has been thoroughly disseminated to the target's shareholders and the investment community. The answer to the question is "yes" if (i) the target's board acts in good faith and after reasonable investigation and reasonably believes the offer is inadequate (i.e., does not reflect the company's long-term value) but shareholders may nevertheless tender their shares in the offer and (ii) the poison pill, when combined with other takeover defenses, does not make it "realistically unattainable" for the hostile acquirer to take control of the target's board through a proxy contest. Chancellor Chandler indicated that he believed, on the facts of the case, the poison pill had outlived its proper purpose but that he felt constrained by Delaware Supreme Court precedent to rule as he did. Although the M&A community assumed the losing party in the litigation would appeal to the Delaware Supreme Court, immediately after the Chancery Court rendered its decision Air Products announced it was withdrawing its offer, thus bringing to a close this takeover (and legal) battle.

The decision was the culmination of a takeover battle that began in October 2009 when Air Product's CEO met privately with Airgas's CEO and proposed a buyout at $60 per share in an all equity deal. When Airgas rejected the offer, Air Products pursued a classic takeover path, which included (i) formally making the offer in a private letter to Airgas, (ii) going public with its offer, (iii) announcing and commencing a tender offer, (iv) launching a proxy contest for the election of a short slate of three directors to Airgas's nine-person staggered board at the company's 2010 annual meeting, (v) seeking to accelerate Airgas's 2011 annual meeting and (vi) repeatedly raising its offer, eventually making a "best and final offer" of $70 per share in cash in December 2010. Air Products succeeded in getting all three of its nominees elected to Airgas's board at the company's 2010 annual meeting but ultimately failed to accelerate Airgas's 2011 annual meeting to January of this year when the Delaware Supreme Court, in a surprising ruling, reversed the Chancery Court and held that, under Airgas's bylaws, the terms of Airgas directors must be approximately three years.

In reaching its decision, the Chancery Court applied the *Unocal/Unitrin* standard of enhanced judicial scrutiny under which, to justify takeover defenses, a target board must show that (i) it had reasonable grounds to believe 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. Although the Court expressed serious reservations about the continuing justification for a poison pill based on the facts of the case, it nevertheless found that the case fell squarely within the *Unocal/Unitrin* line of decisions. Specifically, in applying this standard to the facts before it, the Chancery Court found that:

- The Airgas board clearly demonstrated good faith and undertook a reasonable investigation of the matter because the board consisted of a majority of independent directors who relied on the advice of three reputable financial advisors, one of whom was chosen by the full board (including the three Air Products directors) and all of whom repeatedly found the Air Products offer (including its $70 per share, all cash "best and final" offer) to be inadequate;

- The Airgas board could reasonably have concluded that a threat to Airgas's corporate enterprise existed based on the substantive coercion of Air Products' offer, i.e., the fact that the offer was inadequate in the sense that it did not reflect Airgas's long term value but may nevertheless be accepted by Airgas's stockholders either because they did not understand the company's long-term value proposition or, in the case of short-term shareholders (such as merger arbitrageurs), don't care about that value. The Chancery Court's validation of substantive coercion as a threat to Airgas's corporate enterprise is noteworthy, particularly to the extent the Court expressly acknowledged that the threat may exist even where a majority of shareholders wish to tender their shares at a substantial profit. Quoting the *Unitrin* decision, the Court stated that "the directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect stockholders from offers that do not reflect the long-term value of the corporation under its present management plan;"
- The poison pill, even when combined with Airgas's staggered board and the application of Delaware's business combination statute (DGCL § 203), did not make a takeover realistically unattainable because even though the combination of these measures might preclude such a takeover "for now," a hostile suitor could eventually take control of the board if it were successful in two successive proxy contests and thereafter redeem the pill. In reaching this decision, the Chancery Court relied heavily upon the Delaware Supreme Court's recent *Selectica* decision. The Court, however, discounted the possibility that Air Products could take advantage of an Airgas shareholder's right to call a special meeting and remove the entire Airgas board without cause, finding that there was not sufficient evidence to conclude that Air Products could ever achieve the 67% super-majority vote required for removal; and
- The poison pill was a reasonable response to the threat posed to Airgas, particularly in light of the Court's findings that the offer was substantively coercive and Airgas's takeover defenses were not preclusive.

In reaching its decision, the Chancery Court also addressed whether a hostile tender offer could force a company into *Revlon* mode, in which it must seek to sell the company for the best price reasonably available. Relying on the Chancery Court's earlier decision in *TW Services*, the Court held that a target company resisting a hostile tender offer is not in *Revlon* mode and "is free to pursue its long run goals" as long as it does not take affirmative steps that otherwise put it in *Revlon* mode.

In reaching its decision, the Chancery Court relied heavily upon the following facts: (i) all three of the Air Products nominees elected to the Airgas board agreed that the Air Products offer was inadequate; (ii) that three reputable investment banks (Bank of America Merrill Lynch, Credit Suisse and Goldman Sachs) repeatedly rendered opinions to that effect (and in fact valued Airgas at ranges that included prices substantially higher than $70 per share); and (iii) the Airgas board's view of the long-term value of the company was based on a five year plan that, although bullish, was never attacked as based on unrealistic assumptions.

The Chancery Court addressed the longstanding debate over "who ultimately decides whether a tender offer is adequate and should be accepted — the shareholders of the corporation or its board of directors," and held 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." The decision further clarifies that it is the board that determines whether an offer is inadequate. Although the Chancery Court also made it clear that a target board cannot "just say never" or even "just say no" to a hostile tender offer, the critical takeaway from the decision is that if a target board "acts in good faith and in accordance with [its] fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of [its] defensive actions)," it *can* say "just not now."

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

Thomas W. Christopher
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/tchristopher
+1 212-446-4790

R. Scott Falk, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60654
http://www.kirkland.com/sfalk
+1 312-862-2340