Air Products Ruling Will Set Takeover Benchmark

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Defining moments in corporate law are pretty infrequent. Less often still do they resonate beyond an elite cabal of dealmakers and legal wonks.

But this week promises one such juncture as a Delaware court assesses the latest legal battle in the year-long hostile takeover attempt by Air Products of its industrial gases rival Airgas.

"We're heading into the biggest M&A case in 20 years," says one lawyer. "No matter which way this goes, it will define the law."

Air Products, having declared its latest pitch "best and final", is asking the court to strike down its quarry's poison pill, designed to protect against a takeover.

The pill can be activated once anyone acquires 15 per cent of the company and acts to dilute the stake of the would-be acquirer by offering shares to other shareholders at a discount.

William Chandler, the Court of Chancery judge expected to step down shortly, has a rare opportunity to order the removal of a pill when the case gets under way on Tuesday.

If the pill stands, the case could solidify the notion that power resides with boards in business-friendly Delaware. Striking down the pill would indicate that such devices are temporary, designed to allow boards to make their case and seek competing offers. Ultimately, however, shareholders should decide.

That outcome would edge Delaware – and by extension the US – closer to the UK, Australia and Canada, where pills are either frowned upon or strictly limited.

Such defining cases are rare. The last with this profile ended in 2004 within days of a hearing, when PeopleSoft agreed to a $10bn takeover by Oracle after 15 months of wrangling.

People familiar with Airgas's thinking argue that the fact that even Air Products' own three board nominees have dismissed its $70-a-share offer shows that their defences remain justified. Moreover, they add, Airgas shareholders can call a special meeting to throw out the board.

Only six of 85 Fortune 500 companies that staggered elections for their boards – which only allows a specified number of directors to be replaced at one time – have a similar provision.

Jim Morphy, senior M&A partner at Sullivan & Cromwell, is sceptical that the courts will knock out the pill. "The Delaware Supreme Court in 1989 rejected the idea that boards have any obligation to abandon their long-term business plan in the face of an inadequate offer," he says. "It will no doubt be an interesting day in court but I believe ultimately the pill will be sustained."

The fact remains, however, that no would-be buyer has successfully navigated both a pill and a staggered board, suggesting to some that the combination oversteps the mark in legitimate defences.

In December, the state's Supreme Court found that Airgas could not be forced to hold its next annual meeting early. Air Products' proposal, supported by shareholders, was designed to circumnavigate Airgas's staggered board.

Either way, the pill ruling will come at an interesting time for Delaware.

"Delaware wants to continue to be the pre-eminent jurisdiction on corporate law issues," says Prof Guhan Subramanian, a corporate governance expert at Harvard Law School. "If it strays too far in the balance between boards and shareholders, there is potential for the federal government to step in and take over certain aspects of corporate law."

With financial regulation on areas traditionally left to the states, Washington could act.

At issue is whether the US will remain an anomaly in favouring a director-centric model of corporate governance over so-called shareholder democracy.

Prof Subramanian sees merit in a change. "For the past 25 years, the US has been an outlier in the global arena," he says. "There is a strong theory, supported by empirical evidence, that some vulnerability to a hostile takeover has an important disciplinary effect on corporate America."