

Delaware Supreme Court Rejects Attempt to Reduce Directors Term on Staggered Board to 28 Months

In *Airgas, Inc. v. Air Products and Chemicals, Inc.*, No. 649, 2010 (Del. Nov. 23, 2010), the Delaware Supreme Court, reversing the Chancery Court, held that a bylaw amendment moving up Airgas's annual meeting by eight months was inconsistent with the company's charter provision creating staggered terms for directors and permitted an improper removal of directors without cause.

Background

Airgas has been the subject of a hostile takeover attempt by its competitor, Air Products, since October 2009. Air Products made its first tender offer for 100 percent of the Airgas shares at \$60 per share on February 11, 2010. Between February and Airgas's September 15, 2010 annual meeting, Air Products raised its bid twice, eventually to \$65.50 per share. Each bid was rejected by the board of Airgas as undervaluing the company. As part of its takeover attempt, Air Products launched a proxy contest to gain control of Airgas's staggered board by nominating three candidates for election at the 2010 annual meeting and proposing amendments to Airgas's bylaws. Each of Air Products' director nominees was elected by the Airgas stockholders at the 2010 meeting.

One of the proposed bylaw amendments provided: "The annual meeting of stockholders to be held in 2011 (the '2011 Annual Meeting') shall be held on January 18, 2011 at 10:00 a.m., and each subsequent annual meeting of stockholders

shall be held in January." The practical effect of this amendment would have been to accelerate Airgas's 2011 annual meeting so that it occurred only four months after the 2010 meeting, providing Air Products with the opportunity to gain control of Airgas' board without waiting the standard twelve months between annual meetings. Essentially, Air Products would circumvent the staggered board mechanism.

The holders of 45.8 percent of the shares entitled to vote at the 2010 meeting (51.9 percent of all shares actually voted) voted in favor of Air Products' proposed bylaw. Airgas challenged the passage of the proposal, arguing that it was inconsistent with the bylaw regarding the staggered board and therefore could only be enacted if approved by the holders of 67 percent of the shares entitled to vote at the annual meeting, not by a simple majority. Airgas further argued that the bylaw was invalid because it conflicted with the company's charter provision establishing a staggered board.

There is nearly identical language regarding the staggered board in both the Airgas bylaws and the Airgas charter. Each document provides that the corporation's directors will "be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election."

Airgas argued that this language should be interpreted to mean that directors are elected to approximately three year terms. It contended

that moving the annual meeting such that directors who were elected in August 2008 would have terms ending in January 2011 would impermissibly shorten the directors' terms without the supermajority approval that the charter required for any bylaw that was inconsistent with the staggered board provisions or that caused directors to be removed without cause.

Air Products countered that neither the bylaws nor the charter specified a particular term length for directors, and therefore moving the annual meeting to January was not inconsistent with the existing bylaws and would not conflict with the charter.

In October, the Delaware Chancery Court agreed with Air Products that the bylaw amendment did not conflict with Airgas's charter. The Chancery Court applied rules of construction to construe the ambiguous terms in the bylaws and charter—"annual" and "year." Based on established precedent that the common or ordinary meaning of ambiguous language controls and that, if charter or bylaw provisions are unclear, any doubt should be resolved in favor of stockholders' electoral rights, the court held that the terms require only that the stockholder meeting occur once per year.

Delaware Supreme Court Opinion

The Delaware Supreme Court reversed the Chancery Court's decision. Like the Chancery Court, the Supreme Court found the charter provisions to be ambiguous and looked to general rules of construction to construe the provisions. The Supreme Court noted that ambiguous words and phrases are to be given their commonly accepted meanings unless the context otherwise requires or unless legal phrases having special meaning are used. The Supreme Court explained that, where extrinsic evidence resolves the ambiguity, the court must give effect to the intended meaning of the parties as revealed by the circumstances surrounding its creation.

The extrinsic evidence examined by the Supreme Court included Delaware case law, charters and bylaws of other companies with staggered boards, and model forms and commentary. The court began by noting that Delaware courts, and a U.S. District Court applying Delaware law, had previously interpreted similar charter language to establish staggered boards with classes of directors who serve three year terms. The Supreme Court also noted that many Delaware corporations with similar charter language "expressly represent in their proxy statements that their staggered-board directors serve three year terms." The court further pointed to various legal commentary that confirmed the understanding that language like that in the Airgas charter and bylaws is intended to provide that each class in a staggered board is elected for three year terms.

The court also focused heavily on the fact that Air Products' position would reduce the directors' terms from 36 to 28 months. It noted that Air Products' bylaw "has the effect of prematurely removing Airgas's directors who would otherwise serve an additional eight months on Airgas's board."

Takeaways from *Airgas*

- Despite the decreased use of staggered boards in recent years, the Delaware Supreme Court has made clear that it will not permit tactics that interfere with the commonly understood effects of staggered boards when the legitimacy of those tactics is questionable. The court may have been concerned about allowing the outcome of a takeover fight to turn on a bylaw of debatable validity that had only been approved by the holders of 45.8 percent of the shares entitled to vote.
- Although it is clear that an annual meeting cannot be moved so that it is only four months after the prior annual meeting, the Delaware Supreme Court did not draw a bright line as to what constitutes "annual." It is not certain how

much an annual meeting could be moved up without conflicting with a charter provision or Delaware law.

- Even with the benefit of the Supreme Court’s decision, companies that are revising or adopting new charter or bylaw provisions would be wise to carefully review the language to ensure clarity. As the Chancery Court noted, simple language that stated that the annual meeting be held “as closely as practicable in the same month of each year” would have avoided the need for a court battle over the meaning of “annual.”

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