

ClientAlert

Mergers & Acquisitions

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Delaware Chancery Court Finds Breach of Confidentiality Agreement and Enjoins Martin Marietta's Hostile Bid for Vulcan Materials

A recent decision of the Delaware Chancery Court shines a spotlight on the terms of confidentiality agreements and the critical importance of explicit drafting to avoid unintended consequences.

Ambiguous terms in a confidentiality agreement (and a related joint defense agreement) between Martin Marietta Materials, Inc. and Vulcan Materials Company resulted in Chancellor Leo E. Strine Jr. interpreting the agreements based on extrinsic evidence. Chancellor Strine determined that Martin Marietta had breached the agreements and enjoined Martin Marietta's hostile exchange offer and proxy contest for four months. Martin Marietta and Vulcan could have avoided months of expensive litigation and, for Martin Marietta, a devastating injunction, by carefully crafting a confidentiality agreement that clearly delineated the expectations of both parties.

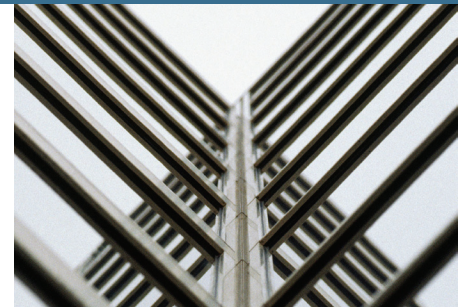
The challenge faced by Vulcan and Martin Marietta, as is often the case, may have been how to properly identify ultimate objectives at the earliest stages of discussions in advance of changed circumstances down the road. On the other hand, one or both of the parties may have deliberately chosen ambiguity in order to enhance their options.

The Delaware Supreme Court has agreed to hear Martin Marietta's expedited appeal on May 25, 2012.

Background

Vulcan had unsuccessfully been pursuing a merger with Martin Marietta for years when a senior management change in 2010 made Martin Marietta more receptive to a transaction. At the time, the relative financial positions of the companies made it likely that Vulcan would be the acquirer. The Court explained that, Martin Marietta's newly minted CEO, Ward Nye, was excited about the prospect of a merger, but also nervous about his position and the possibility that leaked discussions could put Martin Marietta in play. Consequently, Martin Marietta emphasized the importance of confidentiality, but it does not appear that the parties explicitly discussed the appropriateness of, or necessity for, a standstill which, if implemented, would have been mutual.

Initially, the confidentiality agreement was drafted by Martin Marietta's general counsel based on an earlier agreement between the parties, except that it contained several changes that the Court found only strengthened the confidentiality provisions. The agreement did not, however, contain an explicit standstill provision. The agreement did prohibit the use of confidential information for purposes other than evaluating a "business combination



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transaction between” the parties (a so-called “use” restriction). The agreement also prohibited disclosure of confidential information except as requested or required in response to a subpoena or similar legal process, subject to customary notice and vetting requirements. The agreement also seemed to permit disclosure of at least the transaction discussions to the extent “required by law”. The parties had different views as to whether disclosures “as required by law” were also subject to the notice and vetting provisions and whether disclosures of confidential information in addition to transaction discussions were permitted.

As the two companies exchanged confidential information, Nye became increasingly enthusiastic about the transaction and the synergies it offered in part, according to the Court, as a result of confidential information received from Vulcan. During the same period, Vulcan’s stock price weakened relative to Martin Marietta’s. Viewing itself as undervalued, Vulcan became less interested in a transaction and terminated discussions with Martin Marietta in June 2011. Martin Marietta, undeterred, launched a hostile exchange offer and commenced a proxy contest in December of 2011. Martin Marietta’s SEC filings and publicity campaign in support of its offer contained numerous disclosures of confidential information and information about its discussions with Vulcan. Martin Marietta sought a declaratory judgment from the Chancery Court that its actions did not violate the confidentiality agreement or related joint defense agreement.

Vulcan argued that the terms of the confidentiality and joint defense agreements made clear that Martin Marietta could only use confidential information for the purpose of considering a friendly transaction. Vulcan argued that even if Martin Marietta was free to launch a hostile bid, it could not reveal publicly its prior discussions with Vulcan or any of the confidential information that was exchanged unless the legal requirement for it to do so came from an external demand such as a subpoena and subject to the notice and vetting provisions. Martin Marietta argued that Vulcan was attempting to read a standstill into the confidentiality agreement which did not otherwise exist and that it could use the confidential information for any “business combination transaction” including an unsolicited approach. Martin Marietta further asserted that it could disclose the prior discussions and the confidential information so long as it was legally required to do so, even if the legal requirement arose as a result of discretionary action by Martin Marietta to subject itself to SEC disclosure requirements by launching the exchange offer and proxy contest.

Rulings

Chancellor Strine analyzed the permitted uses of the confidential information. Determining that the confidentiality agreement was ambiguous, the Court ruled, based on an extensive review of extrinsic evidence, that the parties intended that they could only use confidential information in connection with their consideration of a friendly, negotiated transaction. Martin Marietta’s use of the confidential information in connection with its hostile exchange offer and proxy contest, therefore, violated the confidentiality agreement.

The Court also determined based, in part, on extrinsic evidence relating to Martin Marietta’s “obsessive” concern with confidentiality, that Martin Marietta was not entitled to an exception to its confidentiality obligations for disclosures required by law, as the obligation to make such disclosures only arose as a result of Martin Marietta’s unilateral decision to commence a hostile bid for Vulcan.

With respect to the injunctive relief requested by Vulcan, the Court highlighted the express agreement in the confidentiality agreement that “money damages would not be a sufficient remedy for any breach...by either party” and “that the non-breaching party shall be entitled to equitable relief”. In granting the injunction, the Court stated that such a statement between the parties is sufficient to demonstrate the irreparable harm necessary for an injunction.

Takeaways

Although the decision does not break any new legal ground, it does provide important judicial confirmation regarding commonly used provisions in confidentiality agreements.

- A “use” restriction, particularly when paired with a restrictive nondisclosure provision, may function as an implicit “standstill” whether or not the agreement contains an explicit standstill provision. This may not be intended. Acquirers, therefore, must focus on the practical impact of use and nondisclosure provisions, particularly if the confidentiality agreement purports to terminate explicit standstill provisions earlier than the use and nondisclosure provisions. Acquirers must carefully consider the wisdom of agreeing to “use” restrictions when the paramount purpose of confidentiality agreements, as the name suggests, is confidentiality. As a practical matter, in an unsolicited transaction it may be impossible to harmonize the disclosure requirements of the tender offer and proxy rules with the use and nondisclosure restrictions of a typical confidentiality agreement. Consequently, an acquirer that does not want to be bound by a standstill may prefer to avoid entering into a confidentiality agreement in the first instance. This generally will be unacceptable to a target.

- If the parties agree that confidential information is to be used only in a contractually negotiated transaction approved by the target's incumbent board of directors, the confidentiality agreement should expressly so state. This should be easy to do.
- Notwithstanding the above, in light of the great difficulties and risks faced by Vulcan in this litigation, public targets are well-advised to include explicit standstill provisions in almost all confidentiality agreements.
- Public targets should be cautious in agreeing to carve-outs to confidentiality obligations which permit disclosures that are simply "legally required". This could allow an acquiring party to unilaterally take discretionary actions vitiating the confidentiality protections a target thought it had. Chancellor Strine's decision reduces this risk, at least in contracts governed by Delaware law.
- Delaware courts will specifically enforce confidentiality agreements and may enjoin an unsolicited overture, at least temporarily, upon a breach. Chancellor Strine accepted, without challenge, the parties' recitation in the confidentiality agreement that money damages would be an insufficient remedy and that the parties had agreed to the availability of specific performance. It is important for confidentiality agreements (and other agreements) to explicitly state that the parties "shall" be entitled to specific performance, not just that they "may" be entitled to specific performance.

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