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Breach of Confidentiality Agreement Leads Chancery Court To Enjoin Hostile Takeover Bid: Guidance for the Future

BY GARDNER DAVIS AND JOHN WOLFEL

The takeover struggle between Martin Marietta Materials, Inc. and Vulcan Materials Company recently provided the opportunity for the Delaware Chancery Court to explore in detail the contract language customarily used in confidentiality agreements in the M&A context. Chancellor Strine's 138-page opinion in *Martin Marietta Materials, Inc. v. Vulcan Materials Company*[1] provides practical guidance for M&A professionals negotiating and interpreting confidentiality agreements.

In the lawsuit asking the Chancery Court to block Martin Marietta's hostile bid, Vulcan argued that Martin Marietta breached a nondisclosure agreement and joint defense agreement, referred to herein as the confidentiality agreements, by using nonpublic information provided by Vulcan under the confidentiality agreements, referred to as ''Evaluation Material,'' to formulate a hostile bid, which was an improper use of the information under the confidentiality agreements.

Vulcan also argued that even if Martin Marietta was free to launch a hostile bid, it could not disclose the existence of or information relating to the confidential discussions with Vulcan, frequently referred to as ''Transaction Information,'' in the M&A context, or any of the Evaluation Materials unless legally required to do so because of a subpoena or similar judicial process.

Finally, Vulcan argued that even if Martin Marietta was permitted to disclose the information required by applicable SEC rules in connection with the hostile takeover bid, Martin Marietta went far beyond what was legally required and presented a broad, selective and slanted discussion of the Evaluation Materials and

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[1] *Martin Marietta Materials, Inc. v. Vulcan Materials Company*, No. 7102-CS (Del. Ch. May 4, 2012). On May 31, the Delaware Supreme Court affirmed the Chancery Court's opinion in a brief order (*Martin Marietta Materials Inc. v. Vulcan Materials Co.*, No. 254 (Del. May 31, 2012)).

the Transaction Information as part of its public relations battle to win support for its deal.

Chancellor Strine found that Martin Marietta breached the confidentiality agreements by impermissibly using confidential Evaluation Materials provided by Vulcan to prepare a hostile takeover bid of Vulcan and related proxy contest, purposes not permitted by the agreements, and extensively disclosing Evaluation Materials and Transaction Information in its SEC filings and during various communications with investors, purposes also not permitted by the agreement.

Chancellor Strine concluded that ''it strikes me as plain that the equities favor enforcing the confidentiality agreements as written and vindicating Vulcan's reasonable expectations.''[2] Chancellor Strine enjoined Martin Marietta for a period of four months from pursuing a proxy contest, making a tender offer or otherwise taking steps to acquire control of Vulcan shares and assets. During the four-month period, Martin Marietta was also enjoined from further violations of the confidentiality agreements.

Although the opinion dignifies Martin Marietta's contorted legal arguments regarding contract interpretation with more than 80 pages of painstaking analysis, the reader is frankly left with the question – what was Martin Marietta thinking? Martin Marietta's explanation is faintly reminiscent of President Clinton's argument that ''it depends on what the meaning of the word 'is' is.'' Martin Marietta flagrantly violated its agreement not to publicly disclose confidential information provided by Vulcan or Vulcan's participation in the confidential negotiations. Martin Marietta's extensive, wrongful use of this confidential information in its public relations attack on Vulcan demonstrated very poor judgment. From an overall public policy perspective, confidentiality agreements play an important role in facilitating the M&A process. Accordingly, courts must provide a meaningful remedy for willful breaches.

Factual Background

The facts of the case tell an interesting story of the unexpected twists and turns frequently found in a large M&A deal.

Vulcan and Martin Marietta are the two largest aggregates companies in the United States. They mine and process rock for road building, concrete and other construction needs. A merger of the two companies would produce substantial cost savings from elimination of duplicate management teams and administrative functions.

Vulcan's CEO, Don James, has reached out on several occasions during the past decade to Martin Marietta's management and expressed interest in talking about a friendly merger. Each time they were approached, Martin Marietta management eventually balked, largely over the issue of who would run the surviving company. In April, 2010, Vulcan's CEO again reached out to Ward Nye, the CEO of Martin Marietta about a potential merger. Nye, who had just become the CEO of Martin Marietta, was receptive to exploring a deal but understandably nervous about losing his new job as a public company CEO. Adding to Nye's nervousness was the fact that Martin Marietta had recently been the target of an unsuccessful hostile takeover attempt.

Martin Marietta and Vulcan were both concerned about becoming the target of a hostile takeover because their shares were trading at historical bargains as a result of the recession gripping the housing and construction industries.

During their first meeting, Nye emphasized the need for confidentiality. Chancellor Strine found that ''[a]lthough neither James nor Nye discussed the need for a standstill preventing Martin Marietta or Vulcan from proceeding against the other without consent, both agreed upon the need for a confidentiality agreement to cloak any merger discussions between the companies and any information exchanged.''[3] According to Chancellor Strine, ''the failure to discuss a standstill most likely flowed from both CEO's evident desire for confidentiality and a shared premise that they were seeking to explore whether a friendly, consensual merger agreement could be reached.''[4]

According to Chancellor Strine, ''[t]he record is replete with evidence of Nye's express desire to make sure that nothing that Martin Marietta shared with Vulcan, including the very fact of discussing a merger, could be revealed publicly, because it might facilitate an unsolicited bid by an interloper. Nye also made clear that Martin Marietta was not interested in being purchased by anyone, including by Vulcan, and that the discussion had to be for the purpose of a consensual deal only.''[5]

Martin Marietta's general counsel prepared the first draft of a nondisclosure agreement, commonly referred to in the M&A world as an ''NDA,'' based on a confidentiality agreement that Martin Marietta and Vulcan previously had used in an asset swap transaction. In a run-of-the-mill swap of operating assets between two large companies, a so-called ''standstill'' provision, which explicitly prevents the parties from making a hostile takeover offer or launching a proxy fight, would not be necessary or appropriate. But this appears to be the classic case of the lawyers starting with the wrong form of document. Given both parties' concerns about a hostile takeover, a mutual standstill provision should have been top-of-mind when drafting the NDA.

Every one of the Martin Marietta's general counsel's proposed changes had the effect of making the NDA stronger in the sense of broadening the information subject to its restrictions and limiting the possible uses and disclosures of the covered information.

The NDA provides that ''[e]ach party . . . shall use the other party's Evaluation Material solely for the purpose of evaluating a Transaction.'' A ''Transaction'' is defined as ''a possible business combination transaction . . . *between* [Martin Marietta] and [Vulcan] or one of their respective subsidiaries.''[6]

In addition to restricting either party's use of the other party's Evaluation Material ''for the purpose of evaluating a Transaction,'' the NDA prohibited disclosure of a party's Evaluation Material ''for purposes other than the evaluation of a Transaction.''[7] The NDA also provided that a party may not ''disclose to any

[2] *Id.* at 136.

[3] *Id.* at 12-13.
[4] *Id.* at 13.
[5] *Id.* at 13.
[6] *Id.* at 16.
[7] *Id.* at 17.

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other person, other than as legally required, the fact that any Evaluation Material has been made available hereunder, the discussions or negotiations have or are taking place concerning a Transaction or any of the terms, conditions or other facts with respect thereto.''[8]

The NDA also contained a notice and objection process for disclosing Evaluation Material and transaction information that would otherwise be confidential in circumstances when a party is ''required'' to do so in the sense that the party has received an external demand such as a subpoena.

In the M&A arena, as Chancellor Strine notes, confidentiality agreements customarily set up a three-tiered non-disclosure structure similar to that of the NDA at issue here, with one paragraph providing for nondisclosure of the parties' evaluation material, a second paragraph providing for nondisclosure of transaction information, and a third establishing a notice and objection regime in favor of the nondisclosing party when the disclosing party seeks to disclose confidential information because of some sort of legal requirement.[9] Therefore, many of the Chancery Court's observations about the Martin Marietta-Vulcan NDA are applicable to M&A transactions generally.

At no time in the process of the drafting of the NDA did the parties discuss the inclusion of a standstill provision, which explicitly would have prevented them from making a hostile takeover bid. ''But, at the same time, at no time did either party indicate any desire to use Evaluation Material for a hostile purpose, and both parties engaged in communications and conduct evincing the intent that the confidential information being shared could only be used for purposes of considering a consensual, contractual business combination and that neither party had the contractual right to reveal even the existence of the confidentiality agreement itself or the fact of the parties' discussions, much less their substance.''[10]

Martin Marietta and Vulcan management met several times to discuss the potential benefits of a merger. Vulcan shared specific information about headcount, revenue and profit centers that was not publicly available. Vulcan also provided nonpublic information about its migration to a new enterprise software platform that would be less expensive and improve performance. Vulcan's new software could handle the combined entity and would permit Martin Marietta to avoid an expensive upgrade for its own enterprise software.

After one of these meetings, Martin Marietta's CFO wrote her CEO a memo outlining specific confidential information provided by Vulcan that convinced her that her prior cost savings estimates were too conservative. This information was subsequently provided to the Martin Marietta board.

At the same time, antitrust counsel for Martin Marietta and Vulcan met to review the antitrust problems of the proposed transaction and the likelihood of obtaining DOJ consent. At the outset of these discussions, the two companies executed a Common Interest, Joint Defense and Confidentiality Agreement or ''JDA'' to protect their analysis of potential antitrust issues from the Department of Justice. In her comments to the initial draft of the JDA, Martin Marietta's general counsel changed the language in the definition of ''Transaction'' from ''transaction contemplated by Vulcan and Martin Marietta'' to ''potential transaction being discussed by Vulcan and Martin Marietta.''[11] This change again evidences Martin Marietta's desire to tighten the parties' confidentiality agreements. Moreover, the JDA repeatedly refers to ''*the* Transaction,'' suggesting, at least in Chancellor Strine's mind, that there was only one transaction under discussion at the time.[12]

At the antitrust lawyers' meeting, the parties shared information that was not publicly available to evaluate the likelihood of divestitures for each quarry and mine. The lawyers also shared their legal analysis of the relative likelihood of divestitures in each geographic area where Vulcan and Martin Marietta overlapped.

After these preliminary discussions, evolving market conditions and a deterioration in Vulcan's stock price and the resulting increase in the relative value of Martin Marietta shares to Vulcan shares led Vulcan's management and board to conclude that a merger was not in its best interest at the present time. However, the same conditions that made the deal less attractive to Vulcan made the merger even more attractive to Martin Marietta.

In June, 2011, Martin Marietta began to consider alternatives to a friendly deal. Chancellor Strine determined that Martin Marietta's decision that a hostile deal was economically viable was made on the basis of confidential Evaluation Material provided by Vulcan. The evidence included examples of Martin Marietta's investment bankers and senior management relying on cost saving projections developed on the basis of detailed nonpublic information provided by Vulcan and on the antitrust analysis provided by Vulcan's lawyers.

On December 12, 2011, Martin Marietta launched an unsolicited exchange offer seeking to acquire all of Vulcan's outstanding shares. Martin Marietta offered 0.5 of a Martin Marietta share for each Vulcan share, which represented an 18% premium over the average closing share price of Martin Marietta and Vulcan shares during the prior 30-day period. To put pressure on the Vulcan board, Martin Marietta also launched a proxy contest, seeking to elect its own slate of nominees to Vulcan's classified board at Vulcan's upcoming annual meeting, which was scheduled to occur on June 1, 2012.

Martin Marietta filed with the SEC an S-4 in connection with the exchange offer and a proxy statement in connection with the proxy contest. Martin Marietta ignored the notice and objection process set forth in the confidentiality agreements and discussed at length the history of its negotiations with Vulcan in the SEC filings in a one-sided manner that suggested, at least to Chancellor Strine, that Martin Marietta was not making an effort to present an unbiased account to Vulcan shareholders. The S-4 included substantial detailed information that constituted Evaluation Materials provided by Vulcan under the confidentiality agreements, including the anticipated synergies from the merger and the fact that the legal teams did not identify any significant impediments to a business combination transaction at their antitrust meetings.

At trial, Martin Marietta's CEO admitted that these disclosures were ''a tactical decision'' crafted by the public relations advisors. For example, ''the S-4 por-

[8] *Id.* at 17-18.
[9] *Id.* at 110.
[10] *Id.* at 20.

[11] *Id.* at 86.
[12] *Id.* at 87.

trays Vulcan's CEO 'as an obstinate CEO blocking a deal because he wants to stay in power.' "[13]

Martin Marietta subsequently disclosed Evaluation Material provided by Vulcan and transaction information in investor calls and presentations in an effort to win support for its deal. These communications included a detailed history of the "discussions [and] negotiations that [have] taken place concerning the transaction," along with references to the "opinions," "analyses" and the "nonpublic information" of Vulcan as to issues like required antitrust divestitures and synergies.[14]

Chancellor Strine concluded that Martin Marietta "clearly used Evaluation Material in pursuit of its hostile bid . . . by selectively using that Material and portraying it in a way designed to cast Vulcan's management and board in a bad light, to make Martin Marietta's own offer look attractive, and to put pressure on Vulcan's board to accept a deal on Martin Marietta's terms."[15]

Legal Arguments

In the Chancery Court lawsuit, Vulcan argued that Martin Marietta breached the confidentiality agreements in several ways and that any one of these breaches entitled Vulcan to an injunction remedying the breach. Vulcan's primary argument was that Martin Marietta was not free to use Evaluation Materials in aid of a hostile attempt to acquire control of Vulcan, because the confidentiality agreements limited Martin Marietta to using such information only for a business combination transaction between Vulcan and Martin Marietta in the sense of a consensual deal approved by the boards of both companies. Under the confidentiality agreements, Martin Marietta was obligated to "use" Evaluation Materials "solely for the purpose of evaluating a Transaction." The NDA defines a "Transaction" as "a possible business combination transaction *between* [Martin Marietta] and [Vulcan] or one or their respective subsidiaries." In slight contrast, the joint defense agreement defines "Transaction" as "a potential transaction *being discussed* by Vulcan and Martin Marietta . . . involving the combination or acquisition of all or certain of their assets or stock."[16]

In interpreting the issue, Chancellor Strine recognized "that the Court must give words their common meaning 'within the setting in which they are employed.' "[17] Chancellor Strine noted that the Model confidentiality agreement published by the ABA instructs transactional lawyers that the term "business combination" is appropriate when the parties wish to maintain a level of generality as to the "form or the structure that an M&A transaction may take."[18] According to Chancellor Strine, "other M&A treatises and model agreements use the term "business combination" in a similarly flexible fashion."[19]

"The term 'transaction' could also be used because it signifies that the goal of the parties was to use information to see whether they could reach agreement on a particular kind of a contractual transaction, one involving a business combination. That is, the use of the term transaction can be sensibly read to signal that there would be an agreement on the how of the combination."[20]

A proxy contest is hard to fit within the definition of a "business combination transaction." "Rather, a proxy contest is the antithesis of a component part of a voluntary contract to combine businesses."[21]

Chancellor Strine was influenced by the word "between" to narrow the set of potential business combinations. " 'Between,' in the context of the NDA, can be read to necessitate reciprocal action on the part of both Vulcan and Martin Marietta, a requirement that is not met by an exchange offer made to Vulcan shareholders without the prior consent of the Vulcan board and is not met by a proxy fight that has as its goal the circumvention of the current Vulcan board's consent."[22]

The ABA's Model confidentiality agreement defines a "Transaction" as "a possible negotiated transaction."[23] The Model does not include "between" in this definition. According to Chancellor Strine, "this omission is important because it suggests that 'between' and 'negotiated' are equivalent terms. In other words, use of 'between' as a qualifier is unnecessary in the model definition of 'Transaction' because the word 'negotiated' is already used, and if the parties include 'negotiated' they do not need to use the alternative 'between.' "[24]

Chancellor Strine also considered the parties' negotiating history and the objective manifestations of their intent in interpreting the language of the confidentiality agreements. Martin Marietta "would never have agreed to exchange confidential information if [it] thought that one of the parties to the NDA was free to launch an unsolicited exchange or tender offer or a proxy contest under the terms of the Agreement."[25]

Moreover, the JDA defines the "Transaction" as "a potential transaction being discussed by Vulcan and Martin Marietta."[26] The only transaction that was "being discussed" at the time the parties entered into the JDA was a negotiated merger.[27]

In light of all the extrinsic evidence, Chancellor Strine found that "Martin Marietta, at the time that it entered into the confidentiality agreements, demanded and understood that any business combination transaction that was between the parties would be a transaction signed up by the sitting boards of Martin Marietta and Vulcan."[28] "The last thing that Martin Marietta would have wanted to allow would be a gunpoint trans-

[13] *Id.* at 50.
[14] *Id.* at 52-53.
[15] *Id.* at 53.
[16] *Id.* at 57-58.
[17] *Id.* at 65, citing *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 394 (Del. Ch. 2008).
[18] *Id.* at 68. *See* ABA *Model confidentiality agreement* 345 (2011).
[19] *Id.* at 68-69.
[20] *Id.* at 71.
[21] *Id.* at 73.
[22] *Id.* at 75.
[23] *Id.* at 76. *See* ABA *Model confidentiality agreement* 345 (2011).
[24] *Id.* at 76.
[25] *Id.* at 82.
[26] *Id.* at 86.
[27] *Id.* at 86-87.
[28] *Id.* at 87.

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action entered into after an unsolicited exchange offer or proxy contest.''[29]

Therefore, Martin Marietta's use of the Evaluation Materials in deciding upon, formulating and publicizing its exchange offer and proxy contest breached the limitations on use of Evaluation Materials in the confidentiality agreements because these hostile activities did not fall within the definition of ''Transaction.''[30]

Chancellor Strine also found that the hostile bidder could not circumvent the ''no disclosure'' provisions under the theory that it was legally required as part of the SEC filings. This exception to nondisclosure only applied where the party was legally required to disclosure because it had received a subpoena or similar legally compelled requests for production of documents in a legal proceeding. Moreover, the hostile bidder violated its obligation by making disclosure in the SEC filings without giving the other party notice and a chance for it to comment to the extent the disclosure required limiting disclosure to the minimum necessary to satisfy the requirements of law.

Finally, Chancellor Strine held that the bidder violated the confidentiality agreement by using the evaluation materials and the fact of the confidential takeover negotiations during its press releases, investor conference calls and other efforts to garner investor support for its hostile bid. Therefore, the Chancery Court granted the target's request for a temporary injunction with the effect of putting off the breaching party's proxy contest and exchange offer for a period of four months.

On appeal, the Delaware Supreme Court affirmed Chancellor Strine's four-month injunction barring Martin Marietta from pursuing its hostile takeover or proxy contest and requiring that Martin Marietta comply with the confidentiality agreements.

Lessons Learned

Chancellor Strine's 138-page opinion offers several useful lessons for M&A professionals when drafting confidentiality agreements:

1. Expressly provide for specific performance and injunctive relief in case of breach.

Chancellor Strine found that ''consistent with Delaware's pro-contractarian public policy, the parties' agreement that the victim of any breach of the confidentiality agreements should be entitled to specific performance and injunctive relief should be respected.''[31] Therefore, all confidentiality agreements should explicitly provide for specific performance and injunctive relief.

2. Existence of irreparable harm.

The parties should agree contractually on the existence of irreparable harm in the event of a party's breach. Chancellor Strine noted that the Chancery Court has held that such a stipulation is typically sufficient to demonstrate irreparable harm.[32]

3. Delaware choice of law and venue provision.

The parties had a dispute regarding the proper court for resolution of disputes. Vulcan, headquartered in Birmingham, sought the benefit of the hometown state court. However, the Delaware Chancery Court's level of sophistication with M&A law generally and the well-established state of the Delaware case law after this decision make it desirable to expressly provide for the contract to be governed by Delaware law and, if the transaction is large enough to justify the additional expense, for disputes to be decided by the Delaware courts.

4. Standstill provision.

The confidentiality agreement should contain an express standstill which prohibits either party from launching a hostile bid if there is any risk of such a development.

5. Disclosure exception for SEC filings and stock exchange regulations.

The confidentiality agreements should expressly state that the parties may disclose information, as reasonably required in the opinion of their counsel, in the SEC filings and to comply with stock exchange requirements.

6. Limit 'transaction' to friendly deal.

The definition of ''permitted use'' / ''proposed transaction'' should specify that evaluation material is only to be used in connection with a consensual transaction approved in advance by the boards of both companies.

7. Use 'clean team' if circumstances change.

In the event that a party decides to subsequently pursue a hostile strategy, the acquiror should use a so-called ''clean team'' of officers and advisors who are not tainted by the evaluation material to develop and evaluate the takeover bid.[33] In this case, Martin Marietta used the same investment bankers and antitrust advisors that had worked with Vulcan and had reviewed the confidential Evaluation Materials.

8. Destroy or segregate Evaluation Material if circumstances change.

The potential acquiror should destroy or segregate all Evaluation Materials received under a confidentiality agreement if circumstances change and it decides to pursue a hostile strategy.

9. Clarify that 'notice and objection' procedure applies to all disclosures.

The ''notice and objection'' procedures in favor of the nondisclosing party when the disclosing party seeks to disclose confidential information should expressly apply to all disclosure of Evaluation Material and all disclosure of Transaction Information regardless of whether provided pursuant to subpoena or in connection with SEC filings or stock exchange requirements.

[29] *Id.* at 87.
[30] *Id.* at 89.
[31] *Id.* at 1.
[32] *Id.* at 132-133.
[33] *See Certicom Corp. v. Research in Motion Ltd* (2009), 94 O.R. 3d 511 (Can. Ont. Sup. Ct. J.).