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Expert Analysis

Martin Marietta v. Vulcan: Delaware Courts Penalize Unsportsmanlike Conduct

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The Delaware Chancery Court's recent decision in *Martin Marietta Materials Inc. v. Vulcan Materials Co.*, 2012 WL 1605146 (Del. Ch. May 4, 2012), is usually discussed in terms of Delaware principles of contract interpretation and the technical aspects of drafting nondisclosure agreements, or NDAs. Chancellor Leo Strine's 80 pages of painstaking legal analysis support this view, but it misses the forest for the trees.

A JUDICIAL TIME-OUT

At its core, *Martin Marietta v. Vulcan* is about the Chancery Court punishing a bad actor for inappropriate and outrageous conduct during a takeover contest. Martin Marietta was essentially penalized for unsportsmanlike conduct.

Vulcan and Martin Marietta are the two largest aggregates companies in the United States. They mine and process rock used in construction and road building. Both companies were badly hurt by the recession, but Vulcan suffered more because of extensive operations in Florida and California where construction was particularly hard hit.

The case arises from Martin Marietta's December 2011 hostile takeover bid for Vulcan. However, the factual basis for the lawsuit relates back to spring 2010, when the two companies began private talks to explore a friendly merger of equals. At the outset of those friendly discussions, the companies entered into an NDA and an antitrust joint defense agreement, or JDA. Vulcan initiated the dialogue and provided nonpublic information regarding the level of potential synergies from combining the two companies. Vulcan's antitrust advisers also shared analysis regarding the extent of divestiture necessary in order for the Department of Justice to permit the combination. Although the opinion discusses the significance of this information at length, as a practical matter it does not seem that material.

NO DEAL-BREAKER

The information provided by Vulcan certainly would not make or break a deal. The confidentiality agreements between Martin Marietta and Vulcan followed the customary, three-tiered M&A nondisclosure structure, with one paragraph providing

for nondisclosure of the parties' evaluation materials (nonpublic information disclosed during the discussions), another providing for nondisclosure of transaction information (the existence of the discussions and everything said during those discussions), 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. The agreements also limited the parties' use of evaluation materials "'*solely*' for the purpose of evaluating a potential transaction," which Chancellor Strine interpreted to mean only a friendly deal.

As important as the language of the confidentiality agreements, at least from the perspective of the case representing a penalty against Martin Marietta for unsportsmanlike conduct, Martin Marietta's CEO, Ward Nye, "emphasized the need for confidentiality" throughout the discussions.

Chancellor Strine noted "both CEOs' evident desire for confidentiality, and the shared premise that they were seeking to explore whether a friendly, consensual merger agreement could be reached."

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"The record is replete with evidence of CEO Nye's expressed desire to make sure that nothing Martin Marietta shared with Vulcan, including the very fact of discussing a merger, could be revealed publicly because they might facilitate an unsolicited bid by an interloper," Chancellor Strine added.

Nye's notes prepared for his preliminary conversation with Vulcan's investment banker state, "As a threshold matter, it's obviously critical that for anything to happen, all our communications, and all of yours with [Vulcan's CEO], be kept confidential – we need to trust each other at this." Nye insisted that "absolute confidentiality, even as to the fact of their discussions, was maintained."

THINK, 'SETTLEMENT DISCUSSIONS'

The M&A process depends on a basic level of personal honesty and integrity. When two CEOs agree to keep their private conversations confidential, they are expected to keep their word.

Lawyers, and therefore Chancellor Strine, are familiar with the concept of settlement discussions. In order to resolve a dispute, the two sides frequently agree to keep their settlement conversations confidential so that they can communicate candidly without fear that their statements will subsequently be used against them. Everyone familiar with the process agrees that this approach facilitates the parties reaching a deal. Moreover, it is unethical for a lawyer to use privileged settlement discussions as the basis for an argument to the court.

Notwithstanding Nye's promise of confidentiality, in order to win support for its hostile bid, Martin Marietta publicly discussed the substance of Vulcan's statements during the confidential negotiations in a one-sided manner in both its SEC filing and in numerous investor calls and presentations. Nye admitted at trial that Martin Marietta's detailed, argumentative disclosure of the confidential discussions was "a tactical decision influenced by its flacks." For example, Martin Marietta's SEC filings unfairly portray Vulcan's CEO, Don James, as "an obstinate CEO blocking a deal because he wants to stay in power." Chancellor Strine noted

that "Martin Marietta did not disclose Nye's willingness to trade a 20 percent premium to the Martin Marietta shareholders for the CEO position at the combined company." Martin Marietta also did not mention "Nye's reluctance to talk seriously about a merger for a period spanning over nearly a decade, which was at least in part driven by a desire to keep their managerial positions."

THROWING THE FLAG

Chancellor Strine found that Martin Marietta, following the advice of its public relations advisers, clearly used information protected by the confidentiality agreement 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."

It appears Chancellor Strine found Martin Marietta's unethical behavior to constitute unsportsmanlike conduct, and he threw the penalty flag. "It strikes me as plain that the equities favor enforcing the confidentiality agreements as written and vindicating Vulcan's reasonable expectations," the judge said. "Rewarding a breaching party like Martin Marietta would encourage other parties to end-run contractual pre-disclosure procedures ... and underscore the unreliability of confidentiality agreements as a risk-reducing device that enables parties to more readily consider voluntary, value-maximizing M&A transactions."

Other commentators point out that the opinion contains detailed analysis of the language of the NDA and the parties' intent in order to determine whether a hostile takeover constitutes a "transaction" and whether Martin Marietta violated the confidentiality agreements by using the "evaluation materials" provided by Vulcan in order to develop and launch its hostile bid.

Martin Marietta's lawyers probably could have won the lawsuit if the only issue was the extent to which Martin Marietta used Vulcan's evaluation material to develop its hostile bid.

However, Martin Marietta's fate was sealed before Chancellor Strine reached this stage of the decision. The detailed legal analysis of the contract was icing on the cake.

CONCLUSIONS

Chancellor Strine's factual finding that Martin Marietta wrongfully used Vulcan's evaluation materials to prepare its hostile bid in violation of the confidentiality agreements made the decision more difficult to attack on appeal. But the factual finding that Martin Marietta based its analysis of the deal on Vulcan's cost-saving information and antitrust analysis is contrary to most M&A professionals' practical experience. This information may have played a small part in the background analysis, but it is more likely that Nye and the Martin Marietta management team smelled blood in the water with a competitor's stock selling at a depressed price, and they seized the opportunity to launch a surprise attack. Given Chancellor Stine's finding that Nye previously was willing to forgo a 20 percent premium for Martin Marietta shareholders if he could be CEO of the combined merger-of-equals enterprise, this deal appears to be more about ego and testosterone than precise financial analysis. Martin Marietta didn't need Vulcan's help to recognize the potential cost savings from combining two very similar businesses, and Vulcan's lawyer could independently get a grip on the antitrust divestiture risk.

Martin Marietta's lawyers probably could have won the lawsuit if the only issue was the extent to which Martin Marietta used Vulcan's evaluation material to develop its hostile bid. But Martin Marietta's twisted and misleading use of Vulcan's statements during friendly, "confidential" merger discussions in an effort to win the public relations battle and unfairly put Vulcan on the defensive constituted unsportsmanlike conduct, at least by the generally accepted rules of M&A, and Chancellor Strine penalized Martin Marietta with a four-month injunction, thereby giving Vulcan an opportunity to regroup and develop its own defensive strategy.

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