Martin Marietta Materials, Inc. v. Vulcan Materials Co.: Delaware Chancery Court Delays Hostile Bid Due to Breaches of Confidentiality Agreements

On May 4, 2012, the Delaware Court of Chancery temporarily enjoined Martin Marietta Materials, Inc. from pursuing a hostile bid against Vulcan Materials Co. because the court found that Martin Marietta had breached two confidentiality agreements, entered into between the parties when they were contemplating a friendly merger, by using confidential information to launch its hostile bid and formulate its terms and by disclosing confidential information in public filings and other communications with the press and investors.[1] Although neither confidentiality agreement contained a standstill provision, the court, looking to extrinsic evidence to resolve ambiguities in the text of the agreements, held that the agreements prevented Martin Marietta from using and disclosing confidential information in pursuit of its hostile bid.

Chancellor Strine's 135-page decision in this matter is worthy of note by companies that enter into confidentiality agreements, corporate attorneys who prepare them and counsel who may litigate them.

I. Factual Background

In the spring of 2010, Martin Marietta and Vulcan, the nation's two largest producers of construction aggregates used to build roads, buildings, and other infrastructure, began discussing a potential friendly merger. Martin Marietta made clear that it was "not for sale" and would only consider a consensual merger, not an acquisition by Vulcan or any other party.[2] Concerned with the prospect of an unsolicited bid by a third party, Martin Marietta and Vulcan entered into two confidentiality agreements in order to ensure the confidentiality of their merger discussions and any information exchanged in connection therewith. The parties' non-disclosure agreement ("NDA") governed the parties' exchange and treatment of non-public information ("Evaluation Material"), providing that "[e]ach party . . . shall use the other party's Evaluation Material solely for the purpose of evaluating a Transaction" and defining a "Transaction" as "a possible business combination transaction [] between" Martin Marietta and Vulcan or their subsidiaries.[3] The NDA also provided that "[s]ubject to paragraph (4)," a party may not "disclose to any other person, *other than as legally required*" that Evaluation Material has been made available, that discussions "have or are taking place concerning a Transaction or any of the terms, conditions or other facts with respect thereto" ("Transaction Information").[4] Finally, in paragraph 4, the NDA established a "Notice and Vetting Process for disclosing Evaluation Material and Transaction Information" when a party is "required" to do so pursuant to an external demand.[5]

Martin Marietta and Vulcan also entered into a common interest, joint defense and confidentiality agreement ("JDA"), which addressed information sharing regarding antitrust issues. The JDA required that "Confidential Materials" be used "solely for purposes of pursuing and completing *the* Transaction," which the JDA defined – somewhat differently from the NDA – 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."[6] The JDA, which was executed after the NDA, made clear that neither the JDA itself nor any provision contained therein

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[1] *See Martin Marietta Materials, Inc.* v. *Vulcan Materials Co.*, Civil Action No. 7102-CS (Del. Ch. May 4, 2012).

[2] *Id*. at 13-14.

[3] *Id*. at 16 (brackets and ellipses in original).

[4] *Id*. at 17-18 (brackets and emphasis in original).

[5] *Id*. at 18.

[6] *Id*. at 19 (emphasis and ellipses in original).

"shall affect or limit any other confidentiality agreements, or rights or obligations created thereunder, between [Martin Marietta and Vulcan] in connection with the Transaction."[7]

Neither the NDA nor the JDA included a standstill provision, which explicitly would have prevented the parties from making an unsolicited tender or exchange offer, and no such provision was contemplated. Neither party, however, indicated "any desire to use the Evaluation Material for a hostile purpose, and both parties engaged in communications and conduct evincing an understanding and desire that the information to be exchanged could only be used for purposes of considering a consensual, contractual business combination."[8]

Having entered into the NDA and JDA, Martin Marietta and Vulcan engaged in merger discussions for approximately one year. When the negotiations ultimately broke down and Vulcan indicated that it was no longer interested in a merger with Martin Marietta, Martin Marietta decided to proceed with a hostile bid, using Evaluation Material obtained from Vulcan to formulate its bid. The court found that "Martin Marietta made no attempt to use a so-called 'clean team' of officers and advisors who were not thoroughly steeped in Evaluation Material, likely because they could not exclude their CEO and CFO, who were key decision-makers and whose strategic calculations were profoundly influenced by the nonpublic information they got from Vulcan."[9] Martin Marietta also made no effort to shield Evaluation Material or information relating to the merger negotiations from its M&A advisors.

On December 12, 2011, Martin Marietta launched an unsolicited exchange offer, seeking to purchase all of Vulcan's outstanding shares, accompanied by a proxy contest, seeking to elect four new members to Vulcan's board. On the same day, Martin Marietta also filed an S-4 with the Securities and Exchange Commission ("SEC") in connection with the exchange offer, and several weeks later, filed a proxy statement in connection with the proxy contest. "Martin Marietta bypassed the Notice and Vetting Process set forth in the Confidentiality Agreements and discussed the history of its negotiations with Vulcan at length in its SEC filings in a one-sided manner that does not suggest that Martin Marietta was making an effort to present an unbiased account to Vulcan's shareholders."[10] The S-4 filed by Martin Marietta also included various details constituting Evaluation Material under the NDA and JDA. In addition, Martin Marietta detailed the history of the merger negotiations with Vulcan and disclosed Evaluation Material in numerous investor calls and presentations. Thus, according to the court, Martin Marietta selectively used the Evaluation Material and portrayed 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."[11]

On the day Martin Marietta launched its hostile bid, it filed a lawsuit, seeking a declaration that its exchange offer and proxy contest were not barred by the confidentiality agreements. Vulcan initiated a lawsuit over the same issue in federal court in Alabama and also filed counterclaims to Martin Marietta's lawsuit, "seeking a determination that Martin Marietta has breached its contractual obligations to Vulcan by improperly using and publicly disclosing information in aid of the Exchange Offer and Proxy Contest and that Martin Marietta should be temporarily enjoined from proceeding with both."[12] The parties ultimately agreed to proceed first with the Delaware case.

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[7] *Id*. (brackets in original).

[8] *Id*. at 20. In fact, the court speculated that the parties' failure to discuss a standstill was likely a result of their understanding that they were exploring a friendly deal. *Id*. at 13.

[9] *Id*. at 44.

[10] *Id*. at 49.

[11] *Id*. at 53.

[12] *Id*. at 4.

II. The Decision of the Delaware Court of Chancery

Having found, as a factual matter, that Martin Marietta used Vulcan's Evaluation Material "to decide to launch, formulate the terms of, and help convince Vulcan stockholders to accede to the Exchange Offer and Proxy Contest," Chancellor Strine of the Delaware Court of Chancery addressed Vulcan's legal claims that Martin Marietta breached the confidentiality agreements in four ways, each of which entitled Vulcan to an injunction.[13] The court agreed with Vulcan with regard to each of its arguments.

First, the court found that Martin Marietta's use of Evaluation Material in formulating its hostile exchange offer and proxy contest was not a permitted use of Evaluation Material under the confidentiality agreements. The NDA allowed "use" of Evaluation Material "*solely* for the purpose of evaluating *a Transaction*," and the JDA allowed "use" of Confidential Materials "*solely* for purposes of pursuing and completing *the Transaction*."[14] At the heart of the parties' contractual dispute was whether the unsolicited exchange offer and proxy contest qualified as "a Transaction" under the NDA or "the Transaction" under the JDA.[15] The court began by examining the text of the NDA, analyzing in depth the contract's phrase "business combination transaction between" Vulcan and Martin Marietta. While noting that "on an initial reading the contractual language seems most naturally to refer to a contractual agreement between the two companies, through their governing boards, to consummate a transaction combining the two companies' assets, in whole or in part,"[16] the court concluded that the contract's language was ambiguous and that it was unclear "whether an exchange offer that was not part of a transaction agreement that ultimately leads to a combination of assets, such as through a merger, would qualify as a business combination transaction."[17] The court similarly grappled with the use of the word "between" and could not, based on contractual language alone, reach a decision regarding whether "between" signifies a negotiated agreement or requires simply that the eventual outcome of the transaction involve a mingling of the two companies' assets.[18]

Turning to extrinsic evidence, including extensive in-court testimony and a detailed review of interim drafts of the agreements, the court highlighted the fact that when Martin Marietta and Vulcan entered into the NDA, Martin Marietta anticipated "a consensual merger of equals," not an acquisition; Martin Marietta exhibited concern about unsolicited bids from third parties as well as a hostile bid by Vulcan.[19] In addition, the court concluded that the changes that Martin Marietta's general counsel made to the confidentiality agreements illustrated Martin Marietta's intention to strengthen their protections. In light of the extrinsic evidence, the court held that "a business combination transaction between Vulcan and Martin Marietta means any step or related series of steps leading to a formal mingling of the two companies' assets that is contractually agreed upon, or

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[13] *Id*. at 54.

[14] *Id*. at 57 (citing NDA and JDA, respectively) (emphasis in original).

[15] *Id*. at 57-58.

[16] *Id*. at 60.

[17] *Id*. at 72.

[18] Notably, in its analysis of the word "between," the court cited approvingly the 2009 decision of the Ontario Superior Court of Justice in *Certicom Corp*. v. *Research in Motion Ltd*, which blocked an unsolicited takeover bid of one party for the other based on the word "between," holding that "[b]ased on the ordinary and usual meaning and dictionary definition of the word 'between' and the manner in which the word is used in the [confidentiality agreements], a takeover bid would in my view only amount to a business combination *between* the parties if Certicom consented to, or endorsed, the transaction and in that manner participated with RIM in RIM's bid." *Id*. at 75-76 (quoting 94 O.R. 3d 511 (Can. Ont. Sup. Ct. J.)) (brackets and emphasis in original).

[19] *Id*. at 82.

consented to, by the sitting boards of both companies at the outset of those steps being taken."[20] Thus, the court found that Martin Marietta's exchange offer and proxy contest did not qualify as "a Transaction" under the NDA, as neither was a "business combination transaction between" the two companies. The court, therefore, held that "Martin Marietta breached the limitations on use of Evaluation Material under the NDA."[21]

Second, in addition to finding that Martin Marietta breached the confidentiality agreements by using confidential material in deciding to launch its hostile bid, the court held that Martin Marietta was barred by the NDA from disclosing Evaluation Material or Transaction Information publicly in its S-4 filing. Vulcan argued that Martin Marietta was not permitted to disclose this confidential material publicly, because "the exception in the Confidentiality Agreements permitting 'legally required' disclosures only applied when a party received an External Demand" (per paragraph 4 of the NDA), and "Martin Marietta's decision to engage in a hostile Exchange Offer and voluntarily impose upon itself a requirement to disclose certain information that it had itself demanded be kept confidential did not fall within this contractual definition of 'legally required.'"[22] Martin Marietta, on the other hand, asserted that once it decided to launch its exchange offer, it was "legally required," pursuant to SEC rules, to disclose the fact of the negotiations and the substance of Vulcan's Evaluation Material. The court again began its analysis with an examination of the relevant language of the NDA and again found that it could plausibly support the position of either party. Turning to extrinsic evidence to resolve the contract's ambiguity, the court focused on the drafting history of the NDA, especially changes made by Martin Marietta's general counsel that tightened paragraph 3 (the paragraph prohibiting disclosure of Evaluation Material or Transaction Information other than as legally required), most notably by adding the words "[s]ubject to paragraph (4)" (which is the paragraph outlining the "Notice and Vetting Process for disclosing Evaluation Material and Transaction Information" when required pursuant to an external demand).[23] The court also emphasized again the importance that Martin Marietta placed on "maximum confidentiality" prior to engaging in merger discussions, in an effort to "protect against interloper risk."[24] All the revisions to the NDA made by Martin Marietta's general counsel were designed to reflect the concern that "the parties' nonpublic information, and, critically, the fact that the parties were even in negotiations, be kept strictly confidential."[25] Thus, the extrinsic evidence led the court to conclude that "the circumstances under which a party is permitted to make 'Required Disclosure[s]' under ¶ 4" (*i.e.* upon request "in legal proceedings, subpoena, civil investigative demand or other similar process") "are the only circumstances under which a party is allowed to make 'legally required' disclosures under ¶ 3."[26] The court, therefore, held that Martin Marietta breached the NDA by including the parties' negotiating history in its S-4 filing, which was not filed in response to an external demand.[27]

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[20] *Id*. at 88.

[21] *Id*. at 89. The court also discussed, albeit more briefly, the meaning of "the Transaction" in the JDA, concluding, "without resorting to extrinsic evidence that the JDA was breached by Martin Marietta's use of Confidential Materials in preparing the antitrust analysis related to its hostile bid," since neither the exchange offer nor the proxy contest was "the" transaction "being discussed" at the time the JDA was negotiated. *Id*.

[22] *Id*. at 54-55.

[23] *Id*. at 102-03 (brackets in original). It did not escape the court's attention that, in the early stages of the discussions, the primary concerns over confidentiality were voiced by Martin Marietta and that, in the course of the negotiations, the "tightening" changes were requested by Martin Marietta, the party now seeking a looser interpretation. *Id*. at 102-05.

[24] *Id*. at 105.

[25] *Id*. at 107.

[26] *Id*. at 108, 93 (brackets in original).

[27] The court similarly held that Martin Marietta breached the NDA's Notice and Vetting provision that required Martin Marietta to give Vulcan prompt notice prior to making its disclosure, as well as the JDA's similar provision requiring the disclosing party to obtain the consent of all parties and their counsel prior to disclosing confidential information. *Id*. at 115-16, 119.

Third, the court held that even if Martin Marietta were legally required, for purposes of paragraph 3 of the NDA, to disclose certain information per SEC rules, "Martin Marietta has not come close to justifying the level of broad and selective disclosure of Transaction Information and Evaluation Material that it chose to give in its S-4, let alone the disclosures that it made in its proxy statement and in its communications with investors and the press."[28] According to the court, Martin Marietta could have satisfied SEC requirements with a more simple recitation of the facts in its S-4 – that the parties entered into merger discussions, signed confidentiality agreements, and ultimately did not come to an agreement and terminated their negotiations – rather than including a wealth of information (including subjective impressions) that would help Martin Marietta prevail in its hostile bid for Vulcan. The court found that "Martin Marietta disclosed far more than was legally required, in a plain attempt to cast Vulcan in a bad light through a debatable and selective disclosure of Transaction Information and Evaluation Material."[29]

Finally, the court held that Martin Marietta's disclosures to the press and investors violated the confidentiality agreements because, even if the disclosures in its S-4 filing were "legally required" under the confidentiality agreements, nothing in those agreements suggested that once Martin Marietta made such a disclosure, "the floodgates could open and all of Vulcan's confidential information could come pouring out."[30] These disclosures, used by Martin Marietta to sell its hostile bid, thus constituted yet another breach of the confidentiality agreements.

Upon finding Martin Marietta in breach of the confidentiality agreements, the court granted an injunction against Martin Marietta's hostile bid for a period of four months, which it found, based on the date Martin Marietta launched the exchange offer (December 12, 2011) and the expiration date of the NDA (May 3, 2012), was "the *minimum* period of repose during which [Vulcan's] Evaluation Material and the Transaction Information could not be used against" Vulcan.[31] Though recognizing that the injunction would cause Martin Marietta delay, the court noted that such delay was the result of Martin Marietta's own actions and reasoned that "[r]ewarding a breaching party like Martin Marietta would encourage other parties to end-run contractual pre-disclosure procedures like the Notice and Vetting Process in ¶ 4 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."[32] Significantly, the injunction has the effect of blocking Martin Marietta's bid until after Vulcan's annual stockholders meeting, scheduled for June 1, 2012.

III. Significance of the Decision

Although the decision of the Delaware Chancery Court was based on extrinsic evidence rather than on contract language alone, the decision illustrates that even where a confidentiality agreement does not contain an express standstill provision, a contractual provision restricting disclosures of confidential information only when required pursuant to a "discovery obligation or affirmative legal process may have the effect of creating a backdoor standstill restriction if what is subject to that restricted definition is" information that would need to be disclosed in the event one of the parties decided to pursue an unsolicited offer for the other.[33] The awaited

[28] *Id*. at 120.

[29] *Id*. at 126.

[30] *Id*. at 127.

[31] *Id*. at 137 (emphasis added).

[32] *Id*.

[33] *Id*. at 114-15.

decision of the Delaware Supreme Court, which has agreed to expedite Martin Marietta's appeal of the Delaware Chancery Court's decision, will further inform practitioners drafting confidentiality agreements in the M&A context.

In the meantime, Chancellor Strine's decision stands as an important reminder of the care to be taken in preparing and negotiating confidentiality agreements (particularly for companies that are accustomed to relying on a standard form) and the extent to which courts may in certain circumstances look to the drafting history and other extrinsic evidence in interpreting them.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Yafit Cohn at 212.701.3089 or ycohn@cahill.com.