SIMPSON THACHER

SECURITIES LAW ALERT

MAY 2012

This month's Alert discusses a Second Circuit opinion relying on *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011) to affirm the dismissal of a securities fraud suit against CBS concerning goodwill impairments. We also address a Seventh Circuit opinion holding that defendants cannot face Section 10(b) liability for failing to correct misstatements "made" by others, and the Eleventh Circuit's reinstatement of an SEC enforcement action against Morgan Keegan & Co. in connection with auction rate securities.

In addition, we address a ruling from the Delaware Chancery Court temporarily enjoining Martin Marietta Materials' takeover attempt of Vulcan Materials based on confidentiality agreement breaches. Finally, we discuss a New York state court's dismissal of a subprime crisis-related shareholder derivative suit against Citigroup's directors and officers.

Save the Date for Our Upcoming CLE Program

On Thursday, June 21st at 4:00 PM, we will host our annual CLE panel discussion on recent decisions, emerging trends and breaking developments in securities and corporate litigation and government and internal investigations. Cocktails to follow. Please RSVP for this event by contacting Emma Rotenberg at erotenberg@stblaw.com or 212-455-3529.

The Second Circuit Relies on *Fait v. Regions Financial Corp.* to Affirm the Dismissal of a Securities Fraud Suit against CBS Concerning Goodwill Impairments

On May 10, 2012, the Second Circuit relied on its recent opinion in *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011) to affirm the dismissal of a securities fraud action against CBS Corporation and several individual defendants concerning the timing of an impairment charge to the value of CBS's goodwill. *City of Omaha v. CBS Corp.*, 2012 WL 1624022, at *2–3 (2d. Cir. May 10, 2012) (per curiam) (*CBS II*). Because there was no allegation that the defendants "did not believe in their statements of opinion regarding CBS's goodwill at the time they made them" as required under *Fait*, the Second Circuit held that the plaintiffs' "Section 10(b), Rule 10b–5, and Section 20(a) claims … were properly dismissed …." *Id.* at *3. (To read our discussion of the *Fait* decision in the September 2011 edition of the Alert, please click here.)

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Background

"On October 10, 2008, CBS announced that it was performing an interim impairment test on its existing goodwill, and that, as a result, CBS expected to incur a non-cash impairment charge during the third quarter of approximately $14 billion." *Id*. at *1. The plaintiffs subsequently brought suit alleging that the defendants "knew about the facts that led CBS to perform an interim impairment test much earlier than October 2008, so CBS should have performed the test and disclosed its results during the first or second quarter of 2008—that is, no later than June 30, 2008." *Id*. The plaintiffs claimed that the "defendants' statements about CBS's goodwill and its general financial condition during the first and second quarters of 2008 were knowingly or recklessly false." *Id*.

On March 16, 2010, the Southern District of New York dismissed the complaint in its entirety. *City of Omaha v. CBS Corp.*, 2010 WL 1029290 (S.D.N.Y. March 16, 2010) (Castel, J.) (*CBS I*). The court found that the complaint did "not adequately allege that [CBS's] failure to take an earlier impairment charge amount[ed] to securities fraud" because it contained no "coherent explanation as to what facts were known to the defendants [by the second quarter of 2008] that required them to test for impairment of goodwill …." *Id*. at *9. The plaintiffs appealed the district court's ruling.

The Second Circuit Finds That *Fait* Requires Dismissal of the Plaintiffs' Claims

On appeal, the Second Circuit affirmed the district court's ruling "for substantially the [same] reasons" set forth in the district court's opinion. *Id*. at *2. The Second Circuit explained that the district court's conclusions have since been "reinforce[d]" by *Fait*, "which had not yet been decided at the time of the district court's decisions." *Id*.

Like the *CBS II* plaintiffs, the *Fait* plaintiffs claimed that "various statements concerning goodwill were false and misleading due to [the] defendants' failure to conduct timely interim impairment testing." *CBS II*, 2012 WL 1624022, at *2; *Fait*, 655 F.3d at 108, 110. The *Fait* court "rejected [this] argument, reasoning that the 'plaintiffs' allegations regarding goodwill d[id] not involve misstatements or omissions of material fact, but rather misstatements regarding … opinion.'" *CBS II*, 2012 WL 1624022, at *2 (quoting *Fait*, 655 F.3d at 110) (alterations in the *CBS II* opinion). To plead a material misstatement or omission, the *Fait* court held that "a plaintiff must 'plausibly allege that [the] defendants did not believe [their] statements regarding goodwill at the time they made them[.]'"[1] *Id*. (quoting *Fait*, 655 F.3d at 112). Because the *Fait* plaintiffs did not allege that the defendants' statements regarding goodwill were subjectively false at the time they were made, the Second Circuit court held that the plaintiffs had "not adequately alleged actionable misstatements or omissions regarding goodwill." *Fait*, 655 F.3d at 112.

The *CBS II* plaintiffs, like the *Fait* plaintiffs, "place[d] considerable reliance on the Financial Accounting Standard Board's Statement of Financial Accounting Standards ("SFAS") No. 142[.]" *CBS II*, 2012 WL 1624022, at *2. "SFAS No. 142 requires interim

1. The *CBS II* court noted that although "*Fait* involved claims under Sections 11 and 12 of the Securities Act of 1933, the same reasoning applies under Sections 10(b) and 20(a) of the [Exchange] Act, as these claims all share a material misstatement or omission element." *CBS II*, 2012 WL 1624022, at *2 (internal citations omitted).

goodwill impairment testing only where 'events or changes in circumstances … indicate that it is more likely than not that the book value of a reporting unit exceeds its fair value.'" *Id*. The *CBS II* court found that the complaint did "not plausibly demonstrate that [the] defendants knew, nor even had reason to know … that it was more likely than not that interim impairment testing [in the first or second quarter of 2008] would [have] reveal[ed] that the goodwill of any specific [CBS] reporting unit was overvalued." *Id*.

Even if the complaint "did plausibly plead that [the] defendants were aware of facts that *should* have led them to begin interim impairment testing earlier," the *CBS II* court explained that "such pleading alone would not suffice to state a securities fraud claim after *Fait*." *Id*. at *3 (emphasis in original). The *CBS II* court noted that the complaint was "devoid even of conclusory allegations that [the] defendants did not believe in their statements of opinion regarding CBS's goodwill at the time they made them[,]" as required under *Fait*. *Id*.; *Fait*, 655 F.3d at 112.

In sum, the Second Circuit "conclude[d] that [the *CBS II*] plaintiffs … have at most pleaded [the] defendants' failure to comply with Generally Accepted Accounting Principles, rather than their commission of securities fraud[.]" *CBS II*, 2012 WL 1624022, at *3.

The Seventh Circuit Holds That Defendants Cannot Face Section 10(b) Liability for Failing to Correct Misstatements "Made" by Others

On April 12, 2012, the Seventh Circuit relied on *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) to hold that MGIC Investment Corp. and its managers could not be liable for alleged misstatements made by two executives of C-BASS, an entity in which MGIC held a 46% stake, during an MGIC earnings call. *Fulton Cnty. Emps. Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047 (7th Cir. 2012) (Easterbrook, C.J.). Notably, the court found that "no statute or rule create[d]" a "duty [on MGIC's part] to correct any errors [the C-BASS executives] made" in their statements on the call. *Id*. at 1051–52.

Background

MGIC insures mortgage loans. Like other public and private mortgage insurers, MGIC "incurred large losses in the financial crunch that began with the decline of the prices of securities based on packages of mortgage loans." *Id*. at 1048. When "[t]he price of MGIC's securities fell substantially[,]" plaintiffs brought multiple class actions against MGIC. *Id*. Most of the claims have since been dismissed.

"The one remaining plaintiff's sole remaining claim [was] that fraud occurred during and in connection with MGIC's quarterly earnings call on July 19, 2007." *Id*. The plaintiff contended, *inter alia*, "that some statements made [by two executives of C-BASS] during the earnings call were fraudulent." *Id*. According to the plaintiff, MGIC was "vicariously liable" for the C-BASS executives' statements under Section 20(a) of the Exchange Act because "MGIC's 46%

interest in C-BASS made it a controlled entity for which MGIC [was] responsible." *Id*. at 1051. Alternatively, the plaintiff claimed that "MGIC and the three managers named as defendants [were] directly liable under § 10(b) … and Rule 10b-5, because by inviting [the C-BASS executives] to speak [during the earnings call,] MGIC effectively 'made' their statements itself." *Id*. (internal citations omitted).

On December 8, 2010, the Eastern District of Wisconsin dismissed the complaint without leave to replead. The plaintiff appealed.

The Seventh Circuit Affirms the District Court's Order of Dismissal

With respect to the plaintiff's Section 20(a) claims, the Seventh Circuit noted that another mortgage insurer also owned a 46% stake in C-BASS. Unless the two entities agreed, "C-BASS could operate as it pleased, since its own managers held the balance of power (the last 8%)." *Id*. at 1051. The Seventh Circuit determined that "it would be inappropriate to hold MGIC liable under § 20(a) for statements made by managers of a different firm that MGIC could not control without the assent of a third party holding an equally large bloc." *Id*.

Turning to the plaintiff's Section 10(b) claims, the Seventh Circuit found that the plaintiff's "line of argument [could not] be squared with" *Janus*, "which holds that the 'maker' of a statement is the person with ultimate authority over the language." *Fulton County*, 675 F.3d at 1051; *Janus*, 131 S. Ct. at 2296. The Seventh Circuit held that the C-BASS executives, "not MGIC or its officers, had ultimate authority over their own statements" under *Janus*. *Fulton County*, 675 F.3d at 1051. The court found it significant that the plaintiff did "not contend that MGIC directed [the C-BASS executives] to say what they did" or that "as a condition of participating in MGIC's earnings call, [the C-BASS executives] promised to support the MGIC party line

(if there was one)." *Id*. Rather, the Seventh Circuit determined that the C-BASS executives "appear[ed] to have been independent agents, speaking for themselves (and of course for C-BASS, over which as CEO and COO they had day-to-day control)." *Id*.

The plaintiff "propose[d] to get around *Janus* … by asserting that MGIC had a duty to correct any errors [the C-BASS executives] made." *Id*. Rejecting this contention, the Seventh Circuit found that "no statute or rule creates such a duty—if there were one, *Janus* … itself would have come out the other way." *Id*. at 1051–52. In *Janus*, the plaintiff unsuccessfully sought to hold Janus Capital Management ("JCM") liable for statements that appeared in the prospectuses of *Janus* Investment Fund; JCM allegedly played a significant role in preparing the prospectuses. *Janus*, 131 S. Ct. at 2296. The Supreme Court held that JCM could not face Section 10(b) liability because Janus Investment Fund "determined the prospectus[es'] contents[,]" not JCM. *Fulton County*, 675 F.3d at 1051; *Janus*, 131 S. Ct. at 2304.

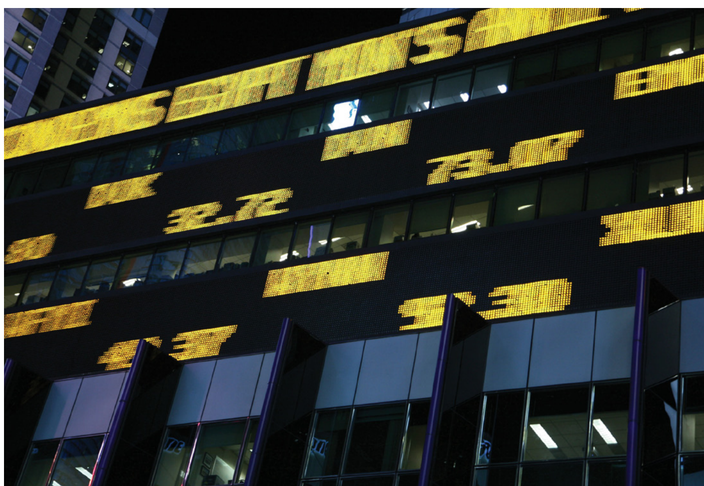
The Seventh Circuit noted that JCM "could have issued a press release denouncing or correcting the prospectus[es] but didn't." *Fulton County*, 675 F.3d at 1052. Similarly, MGIC "could have added its own footnotes or corrections to what [the C-BASS executives] said, but it [was] [still] no more liable than was [JCM] for keeping silent when someone else spoke." *Id*.

The Eleventh Circuit Reinstates an SEC Enforcement Action against Morgan Keegan Concerning Auction Rate Securities

On May 2, 2012, the Eleventh Circuit reinstated an SEC enforcement action against Morgan Keegan & Co. alleging that the company's brokers had "misrepresented" auction rate securities ("ARS") "as cash alternatives and omitted mention that ARS carried liquidity risk." *SEC v. Morgan Keegan & Co.*, 2012 WL 1520895, at *8 (11th Cir. May 2, 2012) (per curiam). The Eleventh Circuit found that the Northern District of Georgia had "erred in granting summary judgment for Morgan Keegan based on the 'materiality' element of the securities violations charged …." *Id.* at *17.

Background

On July 21, 2009, the SEC brought suit against Morgan Keegan under Sections 15(c)(1) and 17(a) of the Securities Act, and Section 10(b) of the Exchange Act. The SEC contended that "in late 2007 continuing through the collapse of the ARS market in February 2008, Morgan Keegan's brokers misrepresented ARS liquidity risk in an attempt to increase sales." *Id.* at



*7. Specifically, the SEC "cite[d] the testimony of four customers who stated that Morgan Keegan brokers [had] misled them regarding the risk associated with ARS." *Id.* "The customers averred that the brokers did not disclose the possibility of an auction failure[,]" and that "some Morgan Keegan brokers [even] claimed that ARS investments carried no risk at all." *Id.* The SEC alleged that "these four customers never saw" Morgan Keegan's written disclosures regarding the liquidity risk of ARS and "their brokers never told them where these documents could be found." *Id.*

"Following discovery, Morgan Keegan moved for summary judgment on all counts on the ground that the undisputed facts failed to show a 'material' misrepresentation or omission …." *Id.* at *8. The district court found that "'the oral statements of four brokers out of hundreds would not lead a rational jury to believe that Morgan Keegan, as a whole, misrepresented the risks of ARS investments to its customers.'" *Id.* (citation omitted). Accordingly, the district court granted Morgan Keegan's motion for summary judgment. The SEC appealed.

The Eleventh Circuit Holds That Courts May Consider Alleged Misstatements by Individual Brokers When Evaluating Materiality in an SEC Enforcement Action

The Eleventh Circuit first addressed the "threshold question of whether, in an SEC enforcement action, a misstatement or omission by an individual broker to an individual investor may be included in the [materiality] analysis of the 'total mix' of information available to the hypothetical reasonable investor." *Id.* at *12. "For several reasons," the court "conclude[d] that … brokers' alleged misstatements [can be] included in the materiality inquiry in an SEC enforcement action." *Id.*

First, the Eleventh Circuit determined that

"Morgan Keegan [could not] show that its [brokers'] oral misstatements were immaterial merely by showing that those statements were not made publicly." *Id.* The court explained that "the Supreme Court's materiality standard analyzes the 'total mix' of information available to a hypothetical reasonable investor, not just to the public at large." *Id.*

Second, the Eleventh Circuit held that "a rule excluding all individual broker-investor communications from the materiality inquiry [would be] underinclusive[.]" *Id.* at *13. "[T]he hypothetical reasonable investor looking for a short-term, liquid investment is likely to consider his broker's statements about the relative merit (and lack of risk) of certain investments in deciding among different investment options." *Id.*

Finally, the Eleventh Circuit found "no statutory or precedential support for Morgan Keegan's argument that some threshold number of investors must be misled before finding its brokers' misrepresentations 'material' in an SEC enforcement action." *Id.* "The SEC is not required to prove an institution-wide effort by brokers to mislead customers in order to bring or to prevail in an SEC enforcement action." *Id.* "Simply put, a numerical threshold for materiality runs counter to the securities acts' broad grant of authority to the SEC" to "seek relief for *any* violation of the securities laws, no matter how small or inconsequential." *Id.* at *12-13 (emphasis in original).

The Eleventh Circuit Finds That Morgan Keegan's Written Disclosures Did Not Render its Brokers' Alleged Oral Misstatements Immaterial

The Eleventh Circuit next considered whether "Morgan Keegan's written disclosures … rendered its brokers' oral misrepresentations immaterial as a matter of law." *Id.* at *14. The court explained that the question of "whether written disclosures should trump oral misrepresentations is highly fact-specific and … not amenable to bright-line rules." *Id.* at *15.

Here, "[t]he oral misrepresentations … were made directly to customer-investors who aver they never received or knew about the written disclosures at the time of their purchases." *Id.* at *16. While "Morgan Keegan produced adequate written disclosures" regarding the risks of ARS, there was no evidence that "Morgan Keegan directly gave customers

these written disclosures before or after customers purchased ARS" during the relevant time period. *Id.* "The only written documents that were directly given to ARS purchasers were … trade confirmations" that said "absolutely nothing about liquidity risk." *Id.* The trade confirmations did "refer customers to [Morgan Keegan's] website for 'information regarding the auction procedures,' but the trade confirmations list[ed] only the Morgan Keegan home page" rather than the ARS-specific section of Morgan Keegan's site. *Id.*

The Eleventh Circuit determined that "even if a brokerage company's written disclosures might render its individual brokers' oral misstatements immaterial in some cases, Morgan Keegan's manner of distribution of its written disclosures in this particular case was insufficient to warrant summary judgment for Morgan Keegan." *Id.* at *14.

The Delaware Chancery Court Temporarily Enjoins Martin Marietta Materials' Takeover Attempt of Vulcan Materials Because of Confidentiality Agreement Breaches

On May 4, 2012, after a four-day hearing, the Delaware Chancery Court issued a four-month long injunction of Martin Marietta Materials, Inc.'s $5.5 billion unsolicited attempt to acquire Vulcan Materials, Co. on the grounds that Martin Marietta had breached confidentiality agreements with Vulcan by using and disclosing nonpublic information exchanged during earlier merger discussions in connection with what became a hostile bid and proxy contest. *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 1605146 (Del. Ch. May 4, 2012) (Strine, C.). "Although the [governing] confidentiality agreements did not include an express standstill," the Chancery Court found that "they did bar either party from … [u]sing the broad class of 'evaluation material' defined by the confidentiality agreements" for any purpose other than "the consideration of a contractually negotiated business combination transaction between the parties[.]" *Id.* at *1.

Background

"In the spring of 2010, the CEOs of Martin Marietta and Vulcan began discussing a potential merger." *Id.* at *2. On May 3, 2010, the companies entered into a non-disclosure agreement (the "NDA") "[i]n the interest of keeping their discussions confidential[.]" *Id.* The companies later entered into a "common interest, joint defense and confidentiality agreement" (the "JDA") to "facilitate an analysis of the antitrust implications of a merger[.]" *Id.* The NDA and JDA (together, the "Confidentiality Agreements") "broadly define materials subject to protection" (collectively, the "Evaluation Material"). "At no time in the process of drafting either the NDA or the JDA did Martin Marietta or Vulcan discuss the inclusion of a standstill provision, which explicitly would have prevented them from making an unsolicited tender or exchange offer." *Id.* at *9. The Confidentiality Agreements provide that money damages would not be sufficient remedy for any breach and that the non-breaching party would be entitled to equitable relief, including an injunction and specific performance.

When the companies first embarked on merger discussions, "it was Vulcan who was pursuing Martin Marietta" and "Vulcan was seen as the natural acquirer that would pay a premium." *Id.* at *15. But "[b]y spring 2011, Vulcan's concentration in markets affected by the burst housing bubble and other factors … had resulted in decreased profits and a depressed stock price." *Id.* at *16. "As a result, the value of a share of Vulcan stock in comparison to a share of Martin Marietta stock had declined in a way that persisted over time." *Id.* "This made the threat that Martin Marietta would be seen as the low-priced industry target ripe for hostile taking less substantial, and it gave Martin Marietta more power in its dealings with its suitor, Vulcan." *Id.* "Martin Marietta began contemplating being the dominant partner itself by using its own now relatively more valuable currency—its own stock—to buy Vulcan at a premium." *Id.*

On June 27, 2011, Vulcan's CEO informed Martin Marietta's CEO that "Vulcan was no longer interested in a merger[.]" *Id.* at *18. On December 12, 2011, Martin

Marietta launched an unsolicited exchange offer to purchase all of Vulcan's outstanding shares (the "Exchange Offer"). "To create a Vulcan board more receptive of its offer, Martin Marietta also launched a proxy contest, seeking to elect four new members to Vulcan's classified board at Vulcan's upcoming annual meeting, which is scheduled to occur on June 1, 2012 (the 'Proxy Contest')." *Id*. at *2. Martin Marietta "discussed the history of its negotiations with Vulcan at length in its SEC filings" in connection with the Exchange Offer. *Id*. at *22. In addition, Martin Marietta "disclosed Evaluation Material and other material shielded by the Confidentiality Agreements in numerous investor calls and presentations." *Id*. at *23.

"On the same day that it launched its hostile bid, Martin Marietta brought … suit to obtain a declaration that nothing in the [C]onfidentiality [A]greements bars the Exchange Offer and Proxy Contest." *Id*. at *3. Vulcan counterclaimed, "contend[ing] that Martin Marietta [had] flagrantly breached the Confidentiality Agreements by using Evaluation Material to formulate a hostile bid, which was not a proper use under the Confidentiality Agreements." *Id*. at *3. Vulcan further argued that "even if Martin Marietta was free to use the Evaluation Material to consider whether to launch a hostile offer … it was not permitted to disclose that information or the fact of the companies' merger discussions … publicly." *Id*. at *24. Vulcan sought a determination "that Martin Marietta should be temporarily enjoined from proceeding with both" the Exchange Offer and the Proxy Contest. *Id*. at *2.

The Court Finds That Martin Marietta Used Evaluation Material in Connection with the Exchange Offer and Proxy Contest

The Chancery Court first considered the threshold factual issue of "whether 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[.]" *Id*. at *23. Martin Marietta refused to disclose "the reasons for key business decisions [relating to the Exchange Offer and Proxy Contest] because those decisions were apparently driven by legal advice[.]" *Id*. at *18. Despite the "scarce" record, the court found that "Martin Marietta did use Evaluation Material in forming its hostile bid." *Id*. at *19. The court also "conclude[d] that Martin Marietta and Vulcan's joint antitrust analysis from 2010 was used by Martin Marietta in forming its hostile bid a year later." *Id*. at *20. The court found it particularly significant 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." *Id*.

The Court Finds That Martin Marietta's Use of the Evaluation Material Breached the Confidentiality Agreements

The court then turned to the question of whether Martin Marietta's use of the Evaluation Material for purposes of the Exchange Offer and Proxy Contest violated the Confidentiality Agreements. The NDA provides that Martin Marietta may "'use' Evaluation Material '*solely* for the purpose of evaluating *a Transaction*.'" *Id*. at *25 (emphasis in opinion). The NDA defines the phrase "a Transaction" as "a possible business combination transaction between [Martin Marietta] and [Vulcan] or one of their respective subsidiaries." *Id*. Similarly, the JDA provides that Martin Marietta may use materials subject to the JDA "'*solely* for purposes of pursuing and completing *the* Transaction.'" *Id*. (emphasis in opinion). The JDA defines the phrase "the 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.'" *Id*. (emphasis in original).

Vulcan argued that both definitions "exclude the Exchange Offer and Proxy Contest because: (i) neither is a 'business combination transaction' that is 'between' Martin Marietta and Vulcan for purposes of the NDA in the sense that the sitting board of Vulcan has not contracted to consummate the transaction; and (ii) the only transaction 'being discussed' by the parties was a consensual, contractual merger of equals …." *Id*. at *26.

Martin Marietta countered that "the Exchange Offer and Proxy Contest are business combination transactions 'between' Martin Marietta and Vulcan in the sense that an ultimate combination of the businesses will be 'between' the two companies." *Id*. Moreover, "even if the JDA provides a narrower definition of 'Transaction' than the NDA does," Martin Marietta asserted that "the NDA definition would prevail because the JDA … provid[es] that the terms of the JDA shall not 'affect or limit' the NDA." *Id*.

The Chancery Court "determined that both Vulcan and Martin Marietta's interpretations of the phrase 'business combination between' Vulcan and Martin Marietta [were] reasonable." *Id*. at *36. Accordingly, the court "turn[ed] to extrinsic evidence to resolve the dispute." *Id*.

First, the court "consider[ed] the parties' negotiating history and the objective manifestations of their intent when entering into the NDA." *Id*. The court found that Martin Marietta's CEO "would never have agreed to exchange confidential information if he 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 [a]greement." *Id*. Moreover, the court noted that all changes made by Martin Marietta's General Counsel to the NDA's definition of the term "Transaction" "had the effect of strengthening the protections afforded by [the NDA] rather than weakening them." *Id*. at *37.

Second, the court found that "Martin Marietta's own conduct in the months leading up to the launch of its hostile bid … reveal[ed] an understanding of the use restrictions imposed by the Confidentiality Agreements that [was] at odds with the one it advance[d] here." *Id*. "When Martin Marietta decided to go hostile, it and its advisors took actions that evinced a belief that, under the terms of the Confidentiality Agreements, Martin Marietta should not be using Vulcan's Evaluation Material for purposes of formulating, deciding upon, and selling its hostile bid, and at all relevant times Martin Marietta behaved as if it were trying to conceal its use of Vulcan's Evaluation Material." *Id*.

Finally, the court determined that "the definition of 'the Transaction' in the JDA provides a gloss on what Vulcan and Martin Marietta meant by the words 'business combination between' when they entered into the NDA and supports a finding in Vulcan's favor." *Id*. at *38 (internal citation omitted). "The fact that the parties refer to '*the* Transaction' throughout the JDA … makes clear that there was only one transaction under discussion at the time." *Id*. at *38. "There is no question that the one Transaction being discussed by the parties when they entered into the JDA was a negotiated one." *Id*.

The Chancery Court concluded that "as clarified by the extrinsic evidence, 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 consented to, by the

sitting boards of both companies at the outset of those steps being taken." *Id*. at *39. Under this definition, the court held that neither the Exchange Offer nor the Proxy Contest qualifies as a "'business combination transaction' that is 'between' Vulcan and Martin Marietta" within the meaning of the NDA. *Id*.

The court held that "Martin Marietta [had] breached the limitations on use of Evaluation Material under the NDA" and that "the JDA was separately breached[.]" *Id*.

The Court Finds That Martin Marietta's Disclosure of the Evaluation Material Breached the Confidentiality Agreements

After a review of the extrinsic evidence, the Chancery Court determined that the NDA precluded either party from disclosing Evaluation Material or the fact that the parties had engaged in merger discussions ("Transaction Information") unless that party was "legally required to disclose" because:

> (i) it had received "oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process"; and (ii) its legal counsel had, after giving the other party notice and the chance for it to comment on the extent of disclosure required, limited disclosure to the minimum necessary to satisfy the requirements of law [the "Notice and Vetting Process"][.]

Id. at *1 (footnote omitted).

The court found that this exception did not permit Martin Marietta to unilaterally create a legal disclosure requirement by launching a hostile offer and thus triggering various SEC disclosure rules. "[E]ven if Martin Marietta's disclosures were somehow [legally] required[,]" the court held that "Martin Marietta [had] breached the NDA by failing to adhere to the Notice and Vetting Process that it would have been required to follow in advance of making any such disclosure." *Id*. at *50. Moreover, the court found that "Martin Marietta ha[d] 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." *Id*. at *52.

The court determined that "Martin Marietta [had] also breached its obligation [under the JDA] to not disclose .... opinions exchanged between the parties that related to the antitrust risk of a Vulcan-Martin Marietta merger." *Id*. "These antitrust-related opinions protected by the JDA were subject to notice and procedural requirements similar to the Notice and Vetting Process set forth in ... the NDA." *Id*. Because "Martin Marietta did not first obtain Vulcan's consent" prior to disclosing these materials, the court held that "the terms of the JDA were breached." *Id*.

The Court Rejects Martin Marietta's Policy-Based Arguments and Grants a Temporary Injunction

Martin Marietta contended that granting the injunctive relief Vulcan requested would have the effect of "turn[ing] every confidentiality agreement into a standstill" and could result in "a chill on M&A activity." *Id*. at *56. The Chancery Court found no basis for Martin Marietta's suggestion that "courts should not enforce confidentiality agreements as they do other contracts on the ground that to do so is necessary to protect stockholders." *Id*. at *57. On the contrary, the court found that adopting such an approach "might well disadvantage investors in a material way." *Id*. "If managers of corporations come to understand that

confidentiality agreements will not be enforced as written, that will likely diminish their willingness to explore M&A transactions." *Id.* at *59. "The overall cost to investors if the law does not enforce confidentiality agreements might turn out to be quite large in terms of transactions that are not done." *Id.*

The Chancery Court explained that "[t]he best way to address Martin Marietta's legitimate concerns is not for courts to fail to enforce confidentiality agreements as written." *Id.* at *57. Instead, "[i]t is for the parties who enter into them to be clear about their terms, and for a party unwilling to honor a contractual promise to not make it in the first place." *Id.*

Here, the court found that "[a]n examination of all the evidence" established that "Martin Marietta [was] not being held to any promise it did not make." *Id.* "Rather, it [was] being held to exactly the bargain it successfully sought to impose on Vulcan as a condition to sharing information and having merger talks." *Id.* "In view of these realities," the court determined that "the equities favor enforcing the Confidentiality Agreements as written and vindicating Vulcan's reasonable expectations." *Id.* at *59. The court issued a four month-long injunction precluding Martin Marietta from "prosecuting a proxy context, making an exchange or tender offer, or otherwise taking steps to acquire control of Vulcan shares or assets." *Id.* at *60. The injunction "preclude[s] Martin Marietta from running its slate of directors for election at Vulcan's June 1, 2012 annual meeting." *Id.* at *59.

The Delaware Supreme Court Grants an Expedited Appeal

On May 14, 2012, Martin Marietta appealed the Chancery Court's order. On May 16, 2012, the Delaware Supreme Court set arguments in the appeal for May 25, 2012—a week prior to Vulcan's annual shareholder meeting. The Delaware Supreme Court has since moved the date of arguments to May 31, 2012, the eve of Vulcan's meeting.

A New York State Court Dismisses a Subprime Crisis-Related Shareholder Derivative Suit against Citigroup's Directors and Officers

On May 15, 2012, a New York state court dismissed a derivative suit brought by shareholders of Citigroup, Inc. "in the wake of the … subprime mortgage-related asset debacle" resulting in a multi-billion dollar write-down of Citigroup's subprime-related assets for the fourth quarter of 2007. *Lerner v. Prince*, 2012 WL 1758136, at *1 (N.Y. Sup. Ct. May 15, 2012) (Fried, J.). The court found that the business judgment rule protected the Citigroup Board's decision to refuse the plaintiff's demand. As to the plaintiff's claims arising out of the Board's investigation of the demand, the court held that the plaintiff had neither made a proper demand nor adequately alleged demand futility. The court denied the plaintiff's request to replead.

Background

On December 7, 2007, the plaintiff "made a formal demand asking that the Board sue certain current and former directors, officers, and employees for alleged breaches of fiduciary duty related to Citigroup's sub-prime-related exposures." *Id.* at *1. The plaintiff "pointed to, among other things, Citigroup's contingent liabilities and off-balance sheet transactions, its losses from trading in [collateralized debt obligations], [and] its management's [alleged] manipulations of reported earnings, assets, and net worth." *Id.* at *2.

On February 28, 2008, the Board "formed a Demand Committee to investigate, review, and analyze the allegations in the Demand[.]" *Id.* at *3. The Board named Franklin A. Thomas as its sole member, and retained the Delaware law firm of Potter Anderson & Corroon LLP "to assist in the investigation and evaluation of the Demand[.]" *Id.* In April 2009, following Thomas's

retirement, the Board appointed Michael O'Neill to serve on the Demand Committee.

On July 15, 2009, the plaintiff brought a shareholder derivative suit in New York state court claiming that "his Demand had been constructively and wrongfully refused by the Board." *Id.* However, it was not until May 27, 2010 that the Demand Committee informed the Board of its findings that "Citigroup was unlikely to prevail if it pursued the claims in the Demand, that the litigation was not in the best interests of Citigroup or its shareholders, and that the Demand should be refused[.]" *Id.* "The Board then voted unanimously to reject the Demand[.]" *Id.*

On June 22, 2010, the plaintiff filed an amended complaint alleging, *inter alia*, new claims against Thomas and O'Neill for "causing Citigroup to expend millions of dollars in an allegedly sham investigation" of the plaintiff's Demand. *Id.*

"By letter dated June 25, 2010," the Board informed the plaintiff that it had "adopted the recommendation of the Demand Committee" and therefore "rejected [the] plaintiff's Demand in its entirety[.]" *Id.* "The seven-page letter recounted the Demand Committee and Potter Anderson's actions in investigating [the] plaintiff's Demand, including reviewing over 17 million pages of internal Citigroup documents, conducting interviews of current and former officers, directors and employees of the company, obtaining expert advice regarding certain of the products at issue, and meeting frequently with Potter Anderson to evaluate, analyze and discuss the Demand Committee's recommendation to the Board[.]" *Id.*

The defendants subsequently moved to dismiss the plaintiff's complaint on the grounds that "the Board's refusal of the claims raised in [the] plaintiff's Demand [was] protected by the business judgment rule." *Id.* at *4.

The Business Judgment Rule Protects the Citigroup Board's Refusal of the Plaintiff's Demand

The court explained that "'when a board refuses a demand, the only issues to be examined are the good faith and reasonableness of [the board's] investigation.'"[2] *Id.* at *5 (internal citation omitted). "[T]he board decision is entitled to the presumption of the business judgment rule, and the burden is on the shareholder to allege facts with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule[.]" *Id.* "In determining whether the board's decision [was] informed, the standard is gross negligence[.]" *Id.*

"Here," the court determined that the complaint "fails to allege particularized facts that create a reasonable doubt about the reasonableness and good faith of the Board in investigating [the] plaintiff's Demand." *Id.* The court found no basis for the plaintiff's "conclusory" allegation that "the Demand Committee was a 'sham in its inception.'" *Id.* at *6. First, the court explained that "the fact that the committee had [just] one member [was] insufficient to raise a reasonable doubt" as to the Demand Committee's ability to "undertake a good faith investigation." *Id.* Moreover, "the fact that Thomas was near retirement [did] not warrant the conclusion that he was unable to conduct a reasonable investigation, or that he was somehow beholden to the alleged officers and directors named in the complaint." *Id.* As to the plaintiff's allegations

2. Because Citigroup is a Delaware corporation, the court applied Delaware law in reviewing the plaintiff's claims.

regarding the other responsibilities of Thomas and O'Neill, the court explained that "[o]utside corporate directors often serve in various capacities and have multiple responsibilities, and that, in itself, does not constitute evidence that they could not conduct a proper investigation." *Id.*

With respect to the plaintiff's allegations of director liability, the court emphasized that "[t]he 'mere threat of personal liability for approving a questioned transaction, standing alone is insufficient to challenge either the independence or disinterestedness of directors'; instead, it must rise to the level of a 'substantial likelihood of director liability.'" *Id.* (quoting *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1980)). Here, the plaintiff alleged that Thomas "'was highly unlikely to recommend' that Citigroup take any action against the wrongdoers" because of his "'personal culpability'" in the case. *Id.* However, there were no "specific allegations that Thomas was even involved in the alleged machinations which are the subject of the complaint." *Id.* The plaintiff also claimed that O'Neill was "'predisposed to causing [Citigroup] to fail to take any action,' and that he had a 'long-held bias against shareholders' because he was part of a settlement of another unrelated shareholder derivative action." *Id.* Again, the court found that "[t]hese allegations lack specificity and fail to state the basis for such conclusions." *Id.*

As to the plaintiff's claim that "Potter Anderson was 'conflicted counsel,'" the court found that the plaintiff "fail[ed] to explain or provide any supporting facts for the alleged conflict." *Id.* There was "no allegation that Potter Anderson represented any of the alleged wrongdoers." *Id.* Moreover, the court determined that "the allegation that [Potter Anderson] had previously been retained to represent a subsidiary of Citigroup in an entirely unrelated matter [was] insufficient to support a viable conflict of interest argument." *Id.*

Because the plaintiff "failed to plead any particularized facts to raise a reasonable doubt that the Board here acted in an informed manner, independently, and in good faith[,]" the court held that "[t]he business judgment rule shields the Board from further inquiry." *Id.* The plaintiff thus "lack[ed] standing to pursue the derivative claims arising out of the Demand and asserted in his Amended Complaint." *Id.*

The Plaintiff's Claims Concerning the Demand Committee's Investigation Are Dismissed

The court also dismissed the plaintiff's remaining claims against Thomas and O'Neill for breach of fiduciary duty, aiding and abetting such breach, and waste in connection with the Demand Committee's investigation. The court found that these claims did "not arise from the same set of circumstances as set forth in the Demand." *Id.* at *7. "The references to excessive spending and waste in the Demand have absolutely nothing to do with the investigation, which had not begun until months after." *Id.*

The plaintiff contended that a letter sent from plaintiff's counsel to Potter Anderson in September 2009 satisfied the demand requirement with respect to these additional claims. The letter "allege[d] that Thomas and O'Neill ha[d] conflicts[,]" "challenge[d] the legitimacy of the Demand Committee's investigation," and "generally describe[d] harm to the corporation[.]" *Id.* Because the letter did not "specifically request the Board to embark upon a particular course of remedial corporate action[,]" the court held that it "fail[ed] to satisfy the legal requirements for a demand." *Id.*

Alternatively, the plaintiff argued that "demand with regard to these new claims would [have been] futile." *Id.* at *8. The court found that the plaintiff did not specifically plead demand futility or "support his assertion of demand futility." *Id.* The court explained that "[a]llegations of waste do not automatically excuse the requirement to make a demand." *Id.*

The court dismissed the plaintiff's complaint in its entirety, without leave to replead.

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