SIMPSON THACHER

MEMORANDUM

Delaware Chancery Court Delays Martin Marietta's Takeover Attempt of Vulcan Materials Due to Confidentiality Agreement Breaches

May 15, 2012

On May 4, 2012, the Delaware Chancery Court enjoined Martin Marietta from pursuing its $5.5 billion unsolicited attempt to acquire Vulcan Materials for four months, based on its use and disclosure of nonpublic information received during discussions the parties held about the possibility of a negotiated merger.[1] Although the confidentiality agreement between the parties did not contain an explicit standstill provision,[2] the Court concluded that, based on the specific wording of the agreement as well as the parties' negotiations and other extrinsic evidence, the companies intended to bar disclosure of the existence of their negotiations and to limit the use of shared information to a mutually consensual negotiated transaction.

On the questions of whether Martin Marietta's hostile bid would cause irreparable harm to Vulcan and whether the harm of an injunction would outweigh its benefits, the Court relied on a provision in the confidentiality agreement in which the parties agreed to injunctive relief for breaches, as well as a public policy argument favoring enforcement of confidentiality agreements in order to facilitate and encourage business combination discussions. The Court noted, however, that it viewed the litigation as a purely contractual case and did not address the issue of whether the Vulcan board's fiduciary duties might prevent it from seeking to enforce the confidentiality agreement in the context of a premium bid.

BACKGROUND

After a number of attempts by Vulcan to engage Martin Marietta in merger discussions, in 2010 the companies agreed to discuss a prospective deal. In advance of the discussions, the parties negotiated and entered into the confidentiality agreement that is at issue in *Vulcan*. As is typically the case, the agreement contained provisions regarding what the confidential information could be used for and in what circumstances public disclosure would be permitted. The agreement, however, did not contain (and, according to the opinion, the parties did not discuss) a standstill provision that prohibited either party from initiating an unsolicited offer.

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1 *Martin Marietta Materials, Inc. v. Vulcan Materials Company, C.A. No. 7102-CS (Del. Ch. May 4, 2012).*

2 There were two separate confidentiality agreements between the parties: the principal, M&A-related agreement and a joint defense agreement that the parties entered into in connection with their antitrust discussions. The joint defense agreement was not central to the Court's holding, and for the sake of simplicity, this memorandum simply refers to the principal agreement.

Discussions regarding the potential deal fizzled over time as Vulcan's interest waned, and in June 2011 Vulcan informed Martin Marietta that it was no longer interested in pursuing a transaction at that time. Martin Marietta, however, had become increasingly interested in the combination and decided to proceed unilaterally by taking an offer directly to Vulcan's shareholders. On December 12, 2011, Martin Marietta launched an exchange offer, offering 0.5 share of Martin Marietta stock for each Vulcan share, which represented an approximately 18% premium based on the market prices of the two companies during the 30-day period preceding the launch. Concurrently with the exchange offer, Martin Marietta initiated a proxy contest seeking to install its own slate of directors in the four seats on Vulcan's board that were up for election at Vulcan's 2012 annual meeting. The Delaware litigation then ensued about whether Martin Marietta breached its confidentiality agreement with Vulcan in formulating and moving forward with its exchange offer and proxy contest.

COURT FINDS THAT MARTIN MARIETTA BREACHED THE CONFIDENTIALITY AGREEMENT IN MULTIPLE RESPECTS

The Court found that Martin Marietta violated its confidentiality agreement with Vulcan in a number of respects, including (i) impermissibly using confidential information it received from Vulcan in formulating its hostile bid to acquire Vulcan and (ii) publicly disclosing information that it was not permitted to disclose. To arrive at these determinations, Chancellor Strine analyzed various provisions of the confidentiality agreement in detail:

- *"Use" Restriction*. The confidentiality agreement's provisions addressing how shared information may be used by the parties obligated each to use such information "solely for the purpose of evaluating a Transaction," with the term Transaction defined as "a possible business combination transaction between [Martin Marietta] and [Vulcan] or one of their respective subsidiaries." The Court, considering extrinsic evidence as discussed below, concluded that this provision meant that the information shared between the parties could only be used for the purpose of considering a friendly, negotiated deal (noting among other things that the language could have been crafted more broadly so as not to imply that a "Transaction" had to be consensual). The Court also concluded that Martin Marietta had in fact relied significantly on confidential information in formulating its takeover bid.

- *Exceptions to Nondisclosure Rule*. Chancellor Strine also analyzed in great detail the exceptions to the general prohibitions on publicly disclosing confidential information shared between the parties and information regarding the fact that the parties were holding discussions (which the Court referred to as "transaction information"). After again determining that the agreement was ambiguous and therefore required an examination of extrinsic evidence, the Court made the following findings:

    - The exception that allowed for disclosure of transaction information when "legally required" did not permit Martin Marietta to unilaterally create a legal disclosure requirement by launching a hostile offer (thereby triggering various SEC disclosure rules). In the context of the confidentiality agreement at issue, the

"legally required" exception was interpreted to refer to some form of discovery obligation or affirmative legal process such as a subpoena.

- Both confidential information and transaction information were subject to what the Court referred to as the "Notice and Vetting Process" in the confidentiality agreement, which are the procedural rules for responding to an information disclosure requirement (generally, providing notice to the other party of the intended disclosure and giving the other party the opportunity to seek a protective order or other remedy to limit disclosure). There was no dispute that Martin Marietta disclosed information without following the Notice and Vetting Process, but Martin Marietta contended that only the confidential information shared between the parties, and not the transaction information, was meant to be subject to such procedures. Although such a bifurcation is not unusual in confidentiality agreements generally, the Court concluded that the confidentiality agreement in this instance did not draw such a distinction.

- Even if the confidentiality agreement had permitted disclosure triggered by Martin Marietta's hostile bid, and resulting SEC filings, Martin Marietta went well beyond the minimum disclosure required by law (including what the Court viewed as a slanted history of the parties' negotiations influenced by public relation objectives).

As noted above, the Court examined an extensive amount and variety of extrinsic evidence (including the negotiating history and course of conduct between the parties, as well as treatise and other third-party materials regarding confidentiality agreements) in order to resolve what it viewed as ambiguities within the four corners of the confidentiality agreement. What appeared particularly important to the Court was its finding that during the confidentiality agreement negotiations Martin Marietta itself was concerned about the possibility of Vulcan acting unilaterally. The Court details, for example, a number of changes that Martin Marietta negotiated in an effort to *tighten* the confidentiality agreement, and at one point in the opinion notes that "[i]n light of all the extrinsic evidence, it is clear that Martin Marietta, at the time that it entered into the Confidentiality Agreement[], 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. The last thing that Martin Marietta would have wanted to allow would be a gunpoint transaction entered into after an unsolicited exchange offer and proxy contest."

THE INJUNCTIVE RELIEF

Having determined that the confidentiality agreement was breached, the Court enjoined Martin Marietta for a period of four months from prosecuting any proxy contest, making any exchange or tender offer of otherwise taking steps to acquire control of Vulcan. The four month period was suggested by Vulcan, which reasoned that the confidentiality agreement was set to expire in early May 2012 and Martin Marietta launched its exchange offer approximately four months in advance of this expiration date. The principal effect of the injunction is to prevent Martin

Marietta from running its slate of directors for election at Vulcan's upcoming annual shareholders meeting, which is currently scheduled for June 1, 2012.

The Court articulated a number of reasons for concluding that the injunction was an appropriate remedy in this case. Chancellor Strine observed that the parties had agreed in the confidentiality agreement that a non-breaching party should be entitled to injunctive relief and noted that the difficulty in measuring the loss Vulcan suffered "is a reason why the parties' voluntary agreement that any breach would give rise to injunctive relief should be respected and honored, not gutted by a judge, particularly of a state whose public policy is pro-contractarian." And although Chancellor Strine noted Marin Marietta's argument that enjoining its premium offer for four months may do more harm than good, he focused on the overall social cost of not enforcing contracts rather than the specific financial harm that Vulcan or its shareholders might suffer (stating, for example, that "[t]he 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"), as well as the evidence suggesting that Martin Marietta had itself negotiated for tight confidentiality restrictions because of concerns about the harm it would suffer from an unwanted takeover bid from Vulcan.

CONCLUDING THOUGHTS AND TAKEAWAYS

In addition to serving as another reminder of the importance of careful drafting, *Vulcan* also highlights other issues in the context of entering into, or evaluating rights and obligations under, confidentiality agreements.

- Particular consideration needs to be given to whether the terms of a confidentiality agreement create an implied standstill provision, either by limiting the use of confidential information or by necessitating that all disclosure of confidential information and transaction information be subject to an external legal demand and the procedures typically associated with notice and vetting provisions. Although the result in *Vulcan* in this regard appears heavily driven by the underlying facts and circumstances, as well as some ambiguously drafted terms, parties negotiating a confidentiality agreement without standstill provisions must carefully assess the implications of the information restrictions and the extent to which there is a mutual understanding of the parties that either of them could terminate discussions and proceed with a hostile bid at any time.

- The Court's relatively brief discussion regarding the "harm" created by Martin Marietta's breaches raises an unresolved question as to what set of circumstances may persuade a court that on a balancing of the equities the harm associated with precluding shareholders from considering a premium bid outweighs the harm associated with ignoring a contractual breach of a standstill provision. Martin Marietta's contention in *Vulcan* that an injunction deprives (at least temporarily) the target's own shareholders of the chance to decide for themselves whether the unsolicited offer is attractive is a proposition that been made in a number of situations in which a party violated a standstill. In fact, a previous incarnation of Martin Marietta was involved in such a situation in 1994 when it entered into an agreement to acquire Grumman in an all-cash

transaction. Northrop, which had a signed standstill agreement with Grumman as a result of earlier talks between the two companies, launched a competing all-cash bid for $5 more per share ($60 per share versus Martin Marietta's $55 per share). When Grumman did its best to orchestrate an auction between the two bidders, Martin Marietta demanded that Grumman enforce the standstill against Northrop. Grumman observed in publicly filed correspondence to Martin Marietta that in order to enforce the standstill it would need to show "how Grumman would be damaged." Ultimately Grumman terminated its agreement with Martin Marietta and merged with Northrop.

Notably, however, in the Northrop/Grumman/Martin Marietta battle, as well as in other similar situations, the standstill violation took place in the context of an all cash topping bid when the target company was already in play. Such a situation stands in contrast to the facts in *Vulcan*—among other things, Vulcan had not committed to sell itself for cash, thereby putting itself in *Revlon* mode, and instead actively sought to avoid being put in play. In addition, as noted at the outset of this memorandum, in the view of the Court "[*Vulcan*] is a purely contractual case, and cannot be confused with cases where a board has faced a claim that its fiduciary duties require it to waive contractual rights so as to further the best interests of the company's stockholders." Put simply, the facts, circumstances and procedural history underlying a dispute matter, and the outcome in *Vulcan* in no small part appears to be a product of this principle.

POSTSCRIPT

Shortly after the *Vulcan* decision, Martin Marietta announced that it will pursue an appeal of the decision. On May 14, 2012, the Court of Chancery denied Martin Marietta's motion for a stay of entry of the injunction pending appeal.

You can download a copy of the full *Vulcan* opinion by clicking here.

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