May 7, 2012

Delaware Court Temporarily Blocks Martin Marietta's Hostile Bid to Acquire Rival Vulcan

Court Specifically Enforces Two Confidentiality Agreements

In a much-anticipated opinion, Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery has enjoined Martin Marietta Materials from pursuing an unsolicited exchange offer to acquire industry rival Vulcan Materials and a related proxy contest for four months. As discussed below, the decision underscores the Court's willingness to specifically enforce contracts and to issue broad equitable remedies, provides guidance on drafting confidentiality agreements, and sounds a cautionary note to companies considering a hostile bid of the consequences of receiving confidential information from a potential target under a confidentiality agreement, irrespective of whether it includes a standstill restriction.

In the spring of 2010, Martin Marietta and Vulcan engaged in confidential merger discussions. In connection with these discussions, the companies entered into two confidentiality agreements. While neither agreement contained a standstill provision, the agreements provided that the parties were only permitted to use confidential material for the purpose of considering a "business combination transaction" that was "between" the parties or for the purpose of pursuing and completing the transaction that was "being discussed" by the parties. In addition, as is customary, the agreements prohibited disclosure of confidential material and the fact that merger discussions had taken place, subject to certain exceptions for "legally required" disclosures and compliance with a "notice and vetting" process to the disclosing party if any disclosures were required.

The negotiations did not lead to an agreed transaction and, in December 2011, Martin Marietta launched a hostile exchange offer for Vulcan and a proxy contest. The parties commenced litigation against one another in several jurisdictions relating to these matters. In Delaware, Vulcan alleged that the confidentiality agreements prohibited the use of confidential information for any purpose other than a *negotiated* business combination, that Martin Marietta used confidential Vulcan information to formulate its exchange offer and proxy contest, and that Martin Marietta disclosed such information in breach of the confidentiality agreements in several respects. The Court held an expedited trial and had multiple rounds of post-trial briefing.

Chancellor Strine viewed the question of "use" — *i.e.*, whether Martin Marietta used confidential Vulcan information to formulate and commence its exchange offer and proxy contest — as a central factual question. Chancellor Strine concluded that the record confirmed that Martin Marietta had used confidential Vulcan information in formulating its bid, particularly with respect to synergy estimates and antitrust analysis. Having resolved this threshold factual question, the Court then turned to the disputed legal issues concerning the proper interpretation of the confidentiality agreements. Chancellor Strine concluded, among other things, that:

- *The Non-Disclosure Agreement Prohibited the Use of Confidential Information for a Hostile Bid.* Chancellor Strine devoted a substantial portion of his opinion to the interpretation of the language prohibiting the use of confidential information other than for the purpose of considering a "business combination transaction between" the parties. Chancellor Strine noted that the most natural reading of that language was to prohibit the use of such information except in furtherance of a negotiated business combination (particularly as compared to broader language, sometimes used in confidentiality agreements and included in an early draft of the Martin Marietta/Vulcan agreement, limiting the use of confidential material to transactions "involving" the parties). Chancellor Strine, however, found that this language was susceptible to more than one reasonable interpretation and thus considered extrinsic evidence. The Court concluded that "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." The Court's conclusion was heavily influenced by evidence that, during negotiations, Martin Marietta had been the party more insistent that the existence and substance of the merger negotiations be kept confidential and that the CEO of Martin Marietta had no interest at the time in any transaction other than a negotiated merger. Against that backdrop, the Court ruled that Martin Marietta had breached the "use" restrictions by using confidential Vulcan information to formulate its hostile bid.

- *The Confidentiality Agreements Did Not Permit Martin Marietta to Trigger a "Legally Required" Disclosure Unilaterally or to Ignore the "Notice and Vetting Process."* Martin Marietta had argued that it was required, in its SEC filings relating to the exchange offer and proxy contest, to disclose certain confidential Vulcan information and the fact of the prior negotiations with Vulcan. Chancellor Strine concluded that the language in the agreements concerning "legally required" disclosure was susceptible to multiple, reasonable interpretations and thus again considered extrinsic evidence. The Court concluded that the safe harbor for "legally required" disclosures was not triggered by a unilateral decision by either company to go hostile. Moreover, the Court found that Martin Marietta simply "blew through" the "notice and vetting" requirements of the confidentiality agreements.
- *Even Were the Exceptions to Apply, Martin Marietta's Disclosures Greatly Exceeded What Would Have Been Legally Required*. Notably, Chancellor Strine concluded that, both in its SEC filings and its non-SEC disclosures (*e.g.*, press releases, investor presentations, investor communications), Martin Marietta went far beyond anything strictly required by the SEC and did so in a one-sided effort to advocate its proposals to Vulcan's shareholders.

Legal commentators and practitioners had speculated that, even were the Court to conclude that Martin Marietta had breached the agreements, the Court might struggle to tailor an appropriate remedy. Citing "Delaware's pro-contractarian public policy," Chancellor Strine honored the provisions in the confidentiality agreements expressly providing for specific performance in the event of breach. Chancellor Strine enjoined Martin Marietta from pursuing its efforts to acquire control of Vulcan for four months, which the Court measured based on the length of time between the commencement of Martin Marietta's hostile offer in December 2011 and the expiration of one of the confidentiality agreements on May 3, 2012. Chancellor Strine opined that this remedy was reasonable "[b]ecause the victim of the breach has sought a temporally reasonable injunction tailored to the minimum period of time that the breaching party was precluded by the confidentiality agreements from misusing the information it had received or making disclosures that were not legally required in the sense defined in the confidentiality agreements."

In response to concerns expressed by Martin Marietta that a decision to enjoin its offer would have widespread consequences in the M&A markets because it effectively would read a standstill into an agreement that did not include one, Chancellor Strine stated:

> The best way to address Martin Marietta's legitimate concerns is not for courts to fail to enforce confidentiality agreements as written. It is for the parties who enter into them to be clear about their terms, and for a party unwilling to honor a contractual promise not to make it in the first place. An examination of all the evidence here convinces me that Martin Marietta is not being held to any promise it did not make. Rather, it is being held to exactly the bargain it successfully sought to impose on Vulcan as a condition to sharing information and having merger talks.

There are several important implications of this decision for practitioners to keep in mind and for the M&A market more generally, namely:

- While the Court's decision was driven largely by the specific facts and circumstances of the case before it, the decision serves as a salient reminder that companies that wish to retain the flexibility to go hostile must carefully consider whether to enter into a confidentiality agreement or the terms thereof (even without a standstill).
- In theory, parties might be able draft "use" restrictions in a way that would enable a segregated team within a company and its advisors to receive and consider confidential information in furtherance of a negotiated deal while a separate team, insulated from such information, could work on a hostile transaction. However, as a practical matter, the critical importance of involving senior management (particularly C-level executives) and boards of directors in the consideration of both a negotiated transaction and a hostile offer likely would render such provisions unworkable.
- Even were a company able to draft and navigate acceptable limitations on the "use" of confidential information, we are skeptical that a company would be able to both satisfy the prohibitions on the "disclosure" of such information *and* actively and aggressively pursue an unsolicited bid. In its opinion, the Court noted that the confidentiality agreements operated to put the burden on the disclosing party to show that "each and every disclosure of [confidential material] was legally required," which Martin Marietta did not and could not do. Accordingly, while a company theoretically may be able to launch a hostile bid and disclose only what was strictly required, it may prove difficult (if not impossible) to make the company's case to shareholders and the investment community forcefully in an SEC-cleared tender offer or proxy statement without disclosing sensitive and confidential information in violation of a confidentiality agreement. These concerns are particularly acute in the case of a stock-for-stock offer, where disclosure and discussion of synergy estimates may be central to the success or failure of a bid. However, these worries remain even in a cash offer, where a bidder may have received a target's management projections, as the SEC has historically viewed such projections as material information that must be disclosed in summary form in a bidder's SEC filings.
- In one sense, as the Court suggests, the challenges posed by a pre-existing confidentiality agreement for a party considering a hostile bid may be fixed by ensuring that one only enters into a properly worded contract in the first place. For example, many confidentiality agreements involving public companies include a standstill that expires, in most cases, before the expiration of the confidentiality undertaking. Thus, as a purely contractual matter, there will be an opportunity in the negotiation of a confidentiality agreement to make it clear that, when the standstill expires, the party receiving confidential information is free to proceed with a hostile bid. But of course the Court's decision makes clear that the agreement also must include an exception from *both* the "use" *and* the "disclosure" restrictions for the sunset of the standstill to be truly effective. While a rational argument can be made that the two terminations should go hand in hand, it remains to be seen whether potential targets will be comfortable with such an "escape hatch." On the one hand, it is nothing more than the logical extension of the notion that the standstill period will end. On the other hand, we expect that many targets will be troubled that the would-be bidder might not only use, but disclose, sensitive information. In any case, there is a real question as to whether the market will evolve in this direction.

  If the effort to "fix" the issues raised in the *Vulcan* litigation as a drafting matter gains no traction, public companies that are considering entering into merger discussions but wish to leave open the option of going hostile may be more reluctant to enter into confidentiality agreements than they once were. In addition, there is little doubt that, for existing confidentiality agreements similar to those in the *Vulcan* matter, a party may be more reluctant to make a hostile offer in light of this decision.

- In *Vulcan*, the Court was not presented with the interesting question of how to address a challenge to a hostile bid launched *after* the expiration of a standstill but *before* the expiration of the "use" and "disclosure" restrictions. Provided that the language is clearly drafted and that it is likewise clear (unlike in the *Vulcan* matter) that the parties intended to allow a hostile bid, we would expect the focus to be on the proper scope of the "use" and "disclosure" restrictions. For the reasons noted above, however, the "disclosure" restrictions may prove the more difficult to navigate.

Martin Marietta announced this morning that it intends to appeal the Court's decision and to seek a stay of the Court's ruling pending the outcome of the appeal. Absent a near-term and sweeping reversal from the Delaware Supreme Court, Martin Marietta's efforts to acquire Vulcan will be blocked until after Vulcan's annual meeting, which is currently scheduled to occur on June 1, 2012.

Click here for a copy of *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, C.A. No. 7102-CS (Del. Ch. May 4, 2012).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

John D. Amorosi	212 450 4010	john.amorosi@davispolk.com
George R. Bason, Jr.	212 450 4340	george.bason@davispolk.com
David L. Caplan	212 450 4156	david.caplan@davispolk.com
Paul R. Kingsley	212 450 4277	paul.kingsley@davispolk.com
Scott B. Luftglass	212 450 4155	scott.luftglass@davispolk.com
Sabrina L. Ursaner	212 450 4185	sabrina.ursaner@davispolk.com