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Expert Analysis

Delaware Chancery Court's Vulcan Ruling Puts Teeth in Non-Disclosure Agreements

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A recent Delaware Chancery Court case serves as a reminder to parties negotiating non-disclosure agreements and their legal counsel about the importance of non-disclosure agreements to the M&A process and how non-disclosure agreements may prohibit a party receiving confidential information from engaging in a hostile transaction even if an explicit standstill provision is not included.

In *Martin Marietta Materials Inc. v. Vulcan Materials Co.*, No. 7102, 2012 WL 1605146 (Del. Ch. May 4, 2012), Vulcan argued that Martin Marietta's hostile exchange offer and related proxy contest should be enjoined because Martin Marietta used and disclosed Vulcan's confidential information in connection with a hostile transaction rather than a "friendly" business combination as required by the terms of the non-disclosure agreement between the parties.

Martin Marietta, however, contended that its exchange offer and proxy contest should not be enjoined because it did not use confidential information to formulate the offer and the non-disclosure agreement did not contain a "standstill" provision expressly prohibiting Martin Marietta from making a public offer to Vulcan shareholders or commencing a proxy contest.

The Chancery Court held May 4 that Martin Marietta violated the terms of the non-disclosure agreements by using confidential information in forming its $5 billion hostile exchange offer and proxy contest and by disclosing confidential information, including the fact that the parties were having discussions. As a result of such violations, the court ruled in favor of Vulcan by granting a four-month injunction against Martin Marietta's hostile exchange offer and proxy contest (effectively precluding Martin Marietta from conducting a proxy contest in 2012 given that Vulcan's annual

shareholder meeting is currently scheduled for June 1). Martin Marietta issued a press release May 7 announcing its intention to appeal the Chancery Court's ruling.

BACKGROUND

Over the past nine years, senior executives of Martin Marietta and Vulcan Materials had preliminary discussions with respect to a potential business combination on several occasions. In May 2010 the companies entered into a non-disclosure agreement in anticipation of more detailed discussions between the companies and their respective representatives regarding a potential business combination.

A few weeks later, in order to facilitate an analysis of the potential antitrust implications of a business combination, the companies entered into a separate common interest, joint defense and confidentiality agreement. Most notably, both agreements:

Companies disclosing confidential information should carefully consider the definition of "transaction" and the manner in which the term is negotiated.

- Limited each party's use of the confidential information "solely for the purpose of evaluating a transaction."
- Defined "transaction," in the case of the non-disclosure agreement, as a possible business combination transaction "between" the parties and in the case of the joint defense agreement, 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.
- Required the companies to refrain from disclosing confidential information except where disclosure would be required by law.
- Did not include a "standstill" provision (which would have expressly prohibited either company from making a public offer to the other company's shareholders, commencing a proxy contest or acquiring the other company's shares).

After entering into the NDA and the JDA, the companies exchanged certain information about their businesses and operations, including the markets in which they operate, as well as certain legal analyses regarding a potential transaction. In mid-2011 the parties' discussions broke down as the companies were unable to agree on, among other things, the combined company management team, valuation and potential synergies.

Martin Marietta commenced an unsolicited exchange offer Dec. 12 to acquire all of the outstanding shares of Vulcan for 0.50 of a share of Martin Marietta common stock for each share of Vulcan (which represented a premium of approximately 18 percent to the 30-day average price of Vulcan's common stock). In connection with the exchange offer, Martin Marietta disclosed in its public filings with the Securities and Exchange Commission, among other things:

- The history of the negotiations between the companies.
- That there were no significant antitrust impediments to a deal.
- The amount of the anticipated annual cost synergies.
- Vulcan's unwillingness to consider significant actions to create more meaningful cost savings.

In connection with the offer, Martin Marietta also notified Vulcan of its intent to nominate independent directors to Vulcan's board at Vulcan's 2012 annual shareholder meeting, which was scheduled for June 1. Martin Marietta filed an action in the Delaware Chancery Court, seeking declaratory and injunctive relief that the NDA and the JDA did not prohibit the unsolicited exchange offer or proxy contest.

Vulcan counterclaimed seeking an order requiring Martin Marietta to withdraw its hostile exchange offer, the proxy contest and all public filings containing confidential information disclosed in breach of the non-disclosure agreements.

In filings with the court, Vulcan argued, among other things, that:

- The NDA and the JDA permit the use of confidential information only for the purpose of considering a business combination transaction "between" the parties, that is, a friendly transaction. Vulcan argued that the word "between" necessitates reciprocal action on the part of both Vulcan and Martin Marietta, a requirement that is not met by Martin Marietta's hostile exchange offer made to Vulcan's shareholders without the prior consent of the Vulcan board and a proxy contest that contemplates replacing Vulcan chosen director nominees with Martin Marietta chosen director nominees.
- The NDA and the JDA expressly barred disclosure by Martin Marietta of Vulcan's confidential information unless disclosure was required by law, the disclosing party had given the other party prior notice and a chance to seek an injunction, and disclosure is limited only to what is legally required. Vulcan argued that this precluded Martin Marietta from revealing publicly that the parties had engaged in merger discussions or revealing any of Vulcan's confidential information unless Martin Marietta was legally required in response to oral questions, interrogatories, requests for information or documents in legal proceedings, subpoenas, civil investigative demands or other similar process. Vulcan further argued that even if Martin Marietta were permitted to use the confidential information for purposes of a hostile bid and even if it were required to disclose such information under applicable SEC rules, Martin Marietta nonetheless failed to adhere to the notice requirements it was required to have followed in advance of any disclosure (*i.e.,* requiring Martin Marietta to give prompt notice of any such request or requirement so that the other party may seek a protective order or other appropriate remedy) and disclosed more than what was legally required (*i.e.*, disclosing confidential information in press releases, investor conference calls, communications with journalists, etc.).
- Although the NDA and JDA did not contain a typical "standstill" provision, the context of the agreements and their drafting history established that use of Vulcan's confidential information for hostile purposes was never contemplated by the parties.

In filings in the Chancery Court, Martin Marietta argued, among other things, that:

- Martin Marietta was entitled to use Vulcan's confidential information to evaluate a possible business combination between the companies, regardless of whether such combination is effected through a negotiated transaction or unsolicited offer. Martin Marietta argued that a business combination transaction "between" the companies should not be read as requiring reciprocal action on the part of both

Acquirers and parties receiving confidential information might tailor the definition to include business transactions "negotiated or otherwise," thereby including offers made directly to shareholders.

companies (*i.e.*, a friendly transaction), but rather that the need for a transaction to be "between" is satisfied so long as the ultimate transaction results in a combination of the assets of the companies. Furthermore, Martin Marietta also argued that if "between" did mean "negotiated" (or friendly), it would effectively create a standstill, which the parties did not include in the NDA and JDA.

- The general prohibition on disclosing Vulcan's confidential information does not apply because federal securities laws required disclosure of Vulcan's confidential information in connection with Martin Marietta's public exchange and its proxy contest. Martin Marietta explained that its disclosures in press releases, investor conference calls, communications with journalists, etc., were not prohibited, because such disclosures were subsequent to its required SEC filing disclosures.
- Vulcan should not be awarded the benefit of a standstill agreement for which it never bargained.

If parties want to ensure the protection a standstill affords, they need to include one in the agreement.

THE DECISION

The Chancery Court enjoined Martin Marietta's hostile exchange offer and proxy contest for four months, saying Martin Marietta used confidential information in connection with its decision to launch its hostile exchange offer and proxy contest in violation of the NDA and the JDA.

In his ruling, Chancellor Leo Strine acknowledged that it was not entirely clear whether a "business combination transaction between Vulcan and Martin Marietta" included a hostile exchange offer and proxy contest and conceded, in particular, that each company's reading of the word "between" as it is used in the NDA's definition of "transaction" is plausible. As a result, the judge relied on extrinsic evidence in concluding that Martin Marietta and Vulcan both clearly understood that at the time of entering into the NDA the confidential information provided would be used solely for the purpose of entering into a negotiated, friendly transaction.

In reaching this conclusion, the Chancery Court noted the negotiating history and that the intent of Vulcan and Martin Marietta at the time of entering into the NDA was to structure a negotiated merger of equals, not an acquisition. Furthermore, certain changes made to the NDA during negotiations (*i.e.*, adding the words "business combination" in front of "transaction" and replacing the word "involving" with "between") suggested a requirement of reciprocal action between the parties as opposed to a hostile action of one party.

Chancellor Strine said Martin Marietta disclosed confidential information and the fact that the parties had had discussions regarding a potential transaction in violation of the NDA and the JDA. The court did not accept Martin Marietta's argument that since the federal securities laws required disclosure of confidential information, it did not violate the NDA and the JDA because, the court explained, the decision to commence an exchange offer and proxy contest was voluntary on the part of Martin Marietta and the NDA and the JDA only made permissible the disclosure of confidential information if such disclosure was in response to an external legal demand.

The Chancery Court further noted that even if Martin Marietta had been permitted to disclose confidential information because it was "legally required" to, Martin Marietta failed to vet such disclosures with Vulcan in advance as required by the terms of the agreements and disclosed significantly more than what was legally required under

the federal securities laws. The court noted that rather than disclosing what was "legally required," Martin Marietta viewed the SEC filings as an opportunity to work with its public relations advisers to help sell the deal to Vulcan stockholders.

Chancellor Strine also noted that Martin Marietta had the burden of proving that each and every disclosure of confidential information was legally required (not only in respect to the subject of the disclosure, but also the level of specificity of disclosure) and that Martin Marietta had not satisfied this burden. In addition, the court found that Martin Marietta's disclosure of confidential information through press releases, investor conference calls, and communications with journalists was in no way legally required and the fact that Martin Marietta had disclosed such confidential information in its SEC filings did not give it a license to launch a public relations campaign and continue to disclose such information.

PRACTICE NOTES

Although the Chancery Court's opinion turned, in large part, on the specific facts and circumstances, including the background of the negotiations between Vulcan and Martin Marietta, Chancellor Strine's opinion does provide some guidance for how we should think about non-disclosure agreements.

Although Vulcan may have been successful in this case, relying on the "indirect protection" argument (i.e., that the other terms of the agreement achieve the same result as a standstill) is uncertain.

Scope of 'transaction'

Companies disclosing confidential information should carefully consider the definition of "transaction" and the manner in which the term is negotiated (*e.g.*, was the term broadened or narrowed during negotiations, what did the parties contemplate during the negotiations, etc.). Given the Chancery Court's discussion, parties might define "transaction" to include a "negotiated" or "mutually agreeable" business combination between the parties or specify that the use of the information will not be "in any way detrimental" to the disclosing party, and specifically exclude offers made directly to shareholders.

Acquirers and parties receiving confidential information might tailor the definition to include business transactions "negotiated or otherwise," thereby including offers made directly to shareholders.

Disclosure of confidential information

Parties negotiating non-disclosure agreements might consider limiting the parties' ability to rely on the "except as required by law" exemption by specifically limiting such exemption to those disclosures required by discovery obligation or judicial process (*i.e.*, having received oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process).

When the party receiving confidential information believes there is a possibility of a transaction turning hostile, the party receiving confidential information should consider including an express provision permitting disclosures of confidential information under securities laws or stock exchange rules (including in connection with a public offer).

Furthermore, the party receiving confidential information should be careful not to make disclosures in press releases, conference calls, communications with the press

if such disclosures are prohibited under the non-disclosure agreement (regardless of whether such confidential information was previously disclosed in SEC filings in accordance with the terms of a non-disclosure agreement).

Standstill

If parties want to ensure the protection a standstill affords, they need to include one in the agreement. Although Vulcan may have been successful in this case, relying on the "indirect protection" argument (*i.e.*, that the other terms of the agreement achieve the same result as a standstill) is uncertain.

(Pictured left to right) **Michael Aiello** is chairman of the over 600-lawyer corporate department of **Weil Gotshal & Manges** and co-head of the firm's New York private equity and mergers and acquisitions department. He is also a member of the firm's management committee. **Sachin Kohli** is an associate in the corporate department of Weil's New York office. He represents public and private companies, as well as private equity funds, in connection with acquisitions and divestitures, and also provides counsel on general corporate matters and corporate governance issues. **Frank Martire** and **Allison Donovan** are associates in the corporate department of Weil's New York office.