ACQUIRORS BEWARE: THE UNINTENDED STANDSTILL CONSEQUENCES OF CONFIDENTIALITY AGREEMENTS

A recent Delaware Court of Chancery decision highlights the importance of careful review and negotiation of the confidentiality agreements typically entered into at the beginning of the merger and acquisition process. In Martin Marietta Materials, Inc. v. Vulcan Materials Company (Del. Ch. 2012), Chancellor Strine placed great importance on the word “between” and read the “use” provision in a confidentiality agreement as limiting the use of confidential information to a friendly deal, thus effectively adding a standstill provision to an agreement that did not contain one. As a result, the potential acquirer was enjoined from proceeding with its acquisition for four months, effectively terminating its proxy contest for this year. The decision has been appealed.

Chancellor Strine’s opinion highlights the importance of the preliminary phases of the merger and acquisition process and the need for careful negotiation and consideration of the terms of confidentiality agreements. Given that the provisions in the confidentiality agreement at issue were relatively typical for agreements of this type and that the Court found that it could not decide certain of the issues at hand based solely on the agreement (and thus had to look to extrinsic evidence), we would expect to see certain changes in how confidentiality agreements are drafted and negotiated.

Background

In the spring of 2010, the CEOs of Martin Marietta and Vulcan began discussing a possible merger, and the companies entered into a non-disclosure agreement (the “NDA”) on May 3, 2010.1 Under the NDA, each party is required to use the other party’s “evaluation material” (generally defined as non-public information and any documents prepared by the receiving party that contain or are generated from any non-public information) solely for the purpose of evaluating a possible business combination transaction between Martin Marietta and Vulcan. This is referred to as the “use restriction.”

In addition to the use restriction, the NDA (i) prohibits disclosure of a party’s evaluation material for purposes other than the evaluation of a possible business combination transaction between Martin Marietta and Vulcan, (ii) subject to the Disclosure Restrictions set forth below, provides that a party may not disclose to any other person, other than as legally required, the fact that any evaluation material had been made available or that negotiations had taken place concerning a

---

1 The parties subsequently entered into a common interest, joint defense and confidentiality agreement (the “JDA”), effective as of May 18, 2010, to facilitate an antitrust analysis of the proposed merger. The Court’s analysis of the JDA is generally similar to the analysis of the NDA.
possible business combination transaction between Martin Marietta and Vulcan or any of the terms, conditions or other facts with respect thereto (the “Disclosure Exception”), and (iii) provides that if a party (the “Required Party”) is requested or required to provide, information in a legal proceeding, civil investigative demand or similar process, to disclose any evaluation material or any facts the disclosure of which is prohibited under clause (ii) above, the Required Party shall provide prompt notice to the other party and if the Required Party is legally required to make the disclosure, such Required Party may disclose only that portion of the other party’s evaluation material that is legally required to be disclosed (the restrictions set forth in this clause (iii) are referred to herein as the “Disclosure Restrictions”).

The NDA does not contain a standstill nor did the parties discuss including a standstill during the negotiation of the NDA. The NDA has a term of two years, is governed by Delaware law and contains a Delaware choice of forum provision.

After execution of the NDA and the JDA, the parties proceeded to exchange confidential information and to meet during 2010 and 2011 to discuss, among other things, synergies and antitrust issues. By spring 2011, Vulcan’s concentration in certain markets affected by the burst housing bubble and other factors had resulted in decreased profits and a depressed stock price, and Vulcan management thus cooled to the idea of a merger. On June 27, 2011, Vulcan’s CEO informed the CEO of Martin Marietta that Vulcan was no longer interested in a merger.

On December 12, 2011, Martin Marietta launched an unsolicited exchange offer in which it seeks to purchase all of Vulcan’s outstanding shares. Martin Marietta also launched a proxy contest seeking to elect four of the nine members of Vulcan’s classified board at Vulcan’s upcoming annual meeting, which is scheduled to occur on June 1, 2012.

Also on December 12, 2011, Martin Marietta brought suit in Delaware seeking to obtain a declaration that nothing in the NDA or the JDA bars the exchange offer and the proxy contest. Vulcan counterclaimed, seeking a determination that Martin Marietta had breached its contractual obligations to Vulcan by improperly using and publicly disclosing information in connection with the exchange offer and the proxy contest and that Martin Marietta should be temporarily enjoined from proceeding with both.

The Opinion

In a 138-page opinion, the Court found that Martin Marietta had breached the NDA and enjoined Martin Marietta for a period of four months from pursuing a proxy contest, making an exchange offer or otherwise taking actions to acquire control of Vulcan.

First, the Court held that Martin Marietta was not free to use evaluation material in connection with the exchange offer and the proxy contest, because the NDA limited Martin Marietta to using such information only for a business combination transaction between Vulcan and Martin Marietta in the sense of one that was the product of a voluntary contractual decision between the governing boards of the companies. In making this finding, the Court determined that each of Vulcan’s and Martin Marietta’s interpretation of the phrase “business combination transaction
between” Vulcan and Martin Marietta was reasonable; thus the Court used extrinsic evidence, such as the parties’ negotiating history and objective manifestations of their intent, to resolve the dispute. In addition, the Court noted a similar 2009 decision by the Ontario Superior Court permanently enjoining RIM’s hostile bid for Certicom. After weighing such evidence, the Court determined that Martin Marietta, at the time that it entered into the NDA, understood that a business combination transaction between the parties would be a transaction signed up by the sitting boards of Martin Marietta and Vulcan.

Second, the Court held 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 publicly disclose evaluation material or the fact of the companies’ merger discussions because it had not received requests for information in a legal proceeding, civil investigative demand or similar process, or otherwise complied with the Disclosure Restrictions, but instead disclosed this information pursuant to SEC rules to which it was subject by virtue of launching the exchange offer and proxy contest, and without compliance with the Disclosure Restrictions. Martin Marietta argued that the disclosures were legally required, fell under the Disclosure Exception and were not subject to the Disclosure Restrictions, while Vulcan argued that the Disclosure Exception did not apply and that in any event compliance with the Disclosure Restrictions was required. In making its determination, the Court found that each of Vulcan’s and Martin Marietta’s interpretation of the relevant contractual provisions was reasonable; thus the Court used extrinsic evidence such as the drafting history of the NDA and the expressed expectations of the CEOs to resolve the ambiguity in favor of Vulcan.

The Court also held that Martin Marietta breached the NDA by virtue of the broad and selective disclosures used in its S-4 and the disclosures it made in its proxy statement and investor and media communications. The Court held that the NDA put the burden on the disclosing party to show that each and every disclosure was legally required.

By virtue of these breaches, the Court granted Vulcan an injunction against Martin Marietta’s hostile bid for a period of four months, which injunction will preclude Martin Marietta from running its slate of directors for election at Vulcan’s 2012 annual meeting. The four-month period was the period requested by Vulcan, although the Court noted that a longer injunction may have been justified.

**Conclusion**

This decision highlights the importance of the preliminary phases of the merger and acquisition process and the need for careful negotiation and consideration of the terms of confidentiality agreements.

---

2 Martin Marietta argued that the exchange offer and proxy contest are each transactions that qualify as a “business combination” in certain legal contexts and they are related transactions designed to give Martin Marietta the power to ultimately cause a merger of the two companies, and that if “between the parties” meant “negotiated between the parties,” it would effectively create a standstill, which the parties could have done but chose not to do.
If you have any questions regarding this memorandum, please contact Maurice M. Lefkort (212-728-8239, mlefkort@willkie.com), Robert B. Stebbins (212-728-8736, rstebbins@willkie.com), Adam Turteltaub (212-728-8129, aturteltaub@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

May 15, 2012

Copyright © 2012 by Willkie Farr & Gallagher LLP.

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or an invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in or any reliance upon this information. Under New York’s Code of Professional Responsibility, this material may constitute attorney advertising. Prior results do not guarantee a similar outcome.