Delaware Chancery Enjoins Hostile Bid Based on Confidentiality Agreement Breach

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On May 4, after a full trial, Chancellor Strine of the Delaware Court of Chancery issued a lengthy and detailed opinion in Martin Marietta Materials, Inc. v. Vulcan Materials Company, granting a four month injunction halting Martin Marietta's hostile bid against Vulcan Materials. Strine held that, in spite of the lack of an express agreement prohibiting a hostile bid—a so-called standstill agreement—Martin Marietta violated its contractual confidentiality obligations with Vulcan by going hostile when merger talks fizzled. The opinion contains a detailed analysis of language commonly used in confidentiality agreements and provides useful drafting guidance to practitioners.

Background

In December 2011, Martin Marietta made an unsolicited exchange offer for rival Vulcan Materials and commenced a proxy contest to replace the directors currently up for re-election on Vulcan's staggered board. These actions followed failed discussions regarding a possible business combination. During those discussions, the companies exchanged confidential information pursuant to a customary non-disclosure agreement (the "NDA") and, for antitrust-related information, a joint defense agreement (the "JDA"). Neither agreement contained a standstill provision expressly barring an unsolicited public takeover proposal, and the court found that at no time in the process of drafting the confidentiality agreements did the companies even discuss the inclusion of a standstill. Both agreements are expressly governed by Delaware law.

In the litigation over the confidentiality agreements that immediately ensued, Vulcan argued that Martin Marietta breached the agreements by (i) using confidential information obtained from Vulcan in formulating and planning Martin Marietta's bid and (ii) publicly disclosing, including in Martin Marietta's SEC filings made in connection with the exchange offer and proxy contest, both confidential information obtained from Vulcan and confidential "transaction information"—*e.g.*, that the parties had merger discussions and shared information. Martin Marietta claimed that it did not use confidential information in formulating the bid, that the lack of a standstill provision showed that the agreements did not preclude a hostile bid and that its disclosures to the SEC were permitted under the agreements under an express exception allowing for "legally required" disclosures.

Strine concluded that the evidence revealed that Martin Marietta did use confidential information obtained in merger discussions in forming its hostile bid. The Chancellor found several instances of material information that Martin Marietta used that could only have obtained from the merger talks—most notably, elements of the potential synergies that were expected to arise from the combination and the companies' joint antitrust analysis. Strine also found that the efforts that Martin Marietta made to cabin off information it received pursuant to the confidentiality agreements fell short and were probably impractical in any event.

Interpreting the Agreements

Vulcan argued that Martin Marietta breached the confidentiality agreements in four key ways:

- Martin Marietta could not use the confidential information—the "evaluation material"—in the aid of a hostile offer because the confidentiality agreement expressly limited the use of such information for a *business combination transaction between* the parties, which Vulcan argued meant only a consensual transaction.
- Vulcan could not publicly disclose the companies' merger discussions—the "transaction information"—because the express exception for "legally required" disclosure in the confidentiality agreements only applied to "external demands", as Strine labeled them.
- Even if Vulcan was permitted to disclose information pursuant to the "legally required" exception, Martin Marietta went well beyond what was required in its SEC filings.
- In any event, through its "push pieces", investor calls and interactions with journalists, Martin Marietta went beyond any construction of a legal requirements exception, even if such information was contained in the SEC disclosures filed by it.

Business Combination Between the Parties. With respect to Martin Marietta's claim that its use of the confidential information was permissible because a merger effected through hostile exchange constituted a "business combination transaction" that would be "between" the parties, Strine could not conclude that the phrase was unambiguous on its face, though he listed several textual arguments in favor of Vulcan's position that a hostile exchange was not "between" the parties.

Accordingly, Strine looked to extrinsic evidence of intent. He emphasized that when the NDA and JDA were negotiated, Martin Marietta was the party pushing for stronger confidentiality protections, fearing that it itself would be the subject of a hostile takeover attempt by Vulcan or a third party. Indeed, the language requiring that the transaction be "between" the parties was a change made by Martin Marietta's general counsel during drafting; without that change, the proposed draft would have covered transactions "involving" the parties, a broader standard according to Strine and, seemingly, to Martin Marietta. As market conditions changed and Martin Marietta began to consider going hostile, it itself behaved as if the NDA and JDA prohibited a bid. Notably, a draft private bear hug letter explicitly prepared by Martin Marietta stated that it was keeping its bid confidential because of the NDA. Strine also looked at industry practice with respect to confidentiality agreements, citing treatises advising generally that, in the absence of an express standstill, confidentiality agreements can create a "backdoor" standstill by narrowly defining the permitted use of information.

Interestingly, Strine noted that Martin Marietta's counsel, who drafted the "between the parties" language, must have been aware of the Ontario case of *RIM v. Certicom*, a widely-publicized case recently decided at the time of the drafting of the NDA. In *Certicom*, the Ontario court enjoined a hostile offer, based on a finding that it was made in breach of a confidentiality agreement without a standstill, focusing, similarly, on the notion that a hostile bid could not constitute a business combination "*between*" the parties.

Legal Requirements Exception. Chancellor Strine rejected Martin Marietta's contention that its SEC disclosures were allowable under exceptions permitting disclosure when "legally required". First, Strine conducted a textual analysis of the exceptions in question to find that the definition of a legal requirement was narrowed by its express terms to an externally driven legal requirement such as a subpoena or CID—an "external demand" as Strine called it. As such, Strine rejected Martin Marietta's argument that the disclosures were legally required, characterizing the purported legal requirements as being triggered solely by an entirely voluntary solicitation by Martin Marietta. Strine also noted that Martin Marietta continued to disclose information outside of the SEC context, and he could find no basis to hold that initial disclosure to the SEC created any right to "open the floodgates" and make these further disclosures, even where they were disclosures already made in Martin Marietta's SEC filings.

Extent of Disclosure. Finally, Strine noted that the disclosures made in the SEC filings went far beyond those required by law (as is customary in hostile bids), including by disclosing cherry-picked facts designed to make Martin Marietta's bid look more attractive and Vulcan look worse. Strine also held that the evidence showed that Martin Marietta failed to comply with the procedural obligations tied to the legal requirements provisions, which would have required notice and vetting by Vulcan prior to disclosures being made.

The Injunction

In fashioning a remedy, Chancellor Strine noted that the parties expressly agreed in the NDA and JDA that money damages would not be a sufficient remedy for breach and that the non-breaching party should be entitled to an injunction. Strine cited Delaware law's strongly pro-contractarian public policy, generally respecting parties' bargained-for agreements to injunctive relief in contracts. While Strine admitted some difficulty in determining whether an injunction would do more harm than good, he concluded that the value of upholding confidentiality obligations in the M&A context, for the sake of protecting future arrangements inducing the sharing of sensitive information and the benefits that flow therefrom by facilitating transactions, outweighed any perceived harm.

Having decided on an injunction, Strine turned to the issue of its length. Because there had been four months remaining on the confidentiality obligations under the NDA at the time of the December bid, Strine issued an injunction of four months—the "temporally reasonable" period sought by Vulcan, tailored to the amount of time Martin Marietta should have been precluded from making its hostile bid. The JDA, which was also breached, had no expiration date. Notably, the four-month injunction period carries past the scheduled date of the board election with respect to which Martin Marietta was waging its proxy contest. Further, the injunction was issued the day after the expiration of the NDA, which some observers speculated would be used as an excuse for the court to avoid issuing an injunction.

Conclusion

The opinion left open one important question that many would have liked answered. Strine expressly declined to address what he noted to be an "interesting…[and] colorable argument"—that a backdoor standstill obligation might be imposed in a confidentiality agreement that contained a "legal requirements" exception not narrowly limited to responses to "external demands". Under that argument, a broader legal requirements disclosure exception in a confidentiality agreement could be unavailable when triggered by the bidder's voluntary action, such as a hostile tender offer requiring SEC disclosure. In a footnote, Strine cited Vulcan's pre-trial brief, where it cited Corbin on Contracts, for the contractual doctrine that "a legal prohibition preventing performance is not a defense if the situation leading to the prohibition is attributable to the acts of the party asserting the defense."

In dealing with confidentiality agreements, practitioners are often faced with many of the interpretive questions addressed in *Martin Marietta*, which appears to be the first significant Delaware case to tackle them in a detailed fashion. In Strine's review of the relevant treatises and model agreements, he found a lack of consistency and precision, underscoring the need for careful drafting in preparing an essential document that can sometimes be overlooked as mere boilerplate. Strine ended his opinion with an admonishment to any future Martin Mariettas: "transactional lawyers are advised that restricting the scope of legally required disclosures to those that arise in the context of some sort of discovery obligation or affirmative legal process may have the effect of creating a backdoor standstill restriction." Sometimes, boilerplate matters.