Mergers and Acquisitions Alert:

Delaware Chancery Court Enforces Confidentiality Agreement by Enjoining Hostile Bid

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Summary:

The Delaware Chancery Court recently issued an opinion finding that Martin Marietta violated two confidentiality agreements when it launched a hostile take-over bid for Vulcan Materials. While neither agreement included an express prohibition against a hostile bid—a "standstill" provision—Chancellor Strine enjoined Martin Marietta from proceeding with the bid for four months, effectively ending its proxy contest for this year. Although the holding is specific to the facts of the case, the decision has broad implications for the drafting of confidentiality agreements at the beginning of friendly transactions. In particular, practitioners ought to carefully consider the possibility of "backdoor" standstill obligations arising from confidentiality provisions and remember that confidentiality agreements can constrain the parties' strategic options should the deal go hostile.

Background:

Pursuant to merger talks that began in 2010, Vulcan and Martin Marietta executed a non-disclosure agreement covering both the information shared and the fact that the talks were taking place. The non-disclosure agreement allowed the use of information "solely for purposes of pursuing and completing" a "business combination transaction" that was "between" the parties, and it also contained a customary exception for "legally required" disclosures. The agreement did not include a standstill provision.

The merger was initially conceived as a merger of approximate equals, with Martin Marietta's management largely taking over the combined company. Martin Marietta's CEO in particular was anxious about his management team's role in the combined company and at one point offered to forego a 20% premium for Martin Marietta's stockholders for assurance that he would be the combined company's CEO. As merger talks progressed, Martin Marietta progressively found itself in a superior market position as well as confident of significant synergistic cost savings. Vulcan's management meanwhile cooled on the merger.

As talks fizzled, Martin Marietta surprised Vulcan by launching a hostile bid. In December 2011, Martin Marietta sent Vulcan a public bear hug letter and filed an S-4 detailing the terms of an exchange offer, and in January 2012, Martin Marietta filed a proxy statement in connection with Vulcan's board elections to be held in June 2012. The S-4 discussed the history of the negotiations, portraying Vulcan's CEO in an unfavorable light, as well as detailing potential cost synergies developed with the information received from Vulcan.

In determining whether Martin Marietta had breached the confidentiality agreements, Chancellor Strine engaged in a detailed examination of the language of the agreements and the intentions of the parties. Martin Marietta argued that the use and disclosure of information were permitted under the agreement because the hostile bid was pursuant to a business combination transaction between the parties; Vulcan countered that only a consensual transaction was intended. While the court found that the terms "business combination transaction" and "between" were ambiguous and did not preclude a hostile bid, the extrinsic evidence of the party's intentions indicated that hostile bids were meant to be excluded. The court paid careful attention to the negotiation of the agreement, and specifically that Martin Marietta had repeatedly sought changes to strengthen the agreement.

Martin Marietta then argued that because the disclosure of certain information was required to be included in its S-4 filing, the disclosure was permissible under the agreement's "legally required" exception. In a close reading of the non-disclosure agreement, the court found that only legally required disclosures subject to an external demand, such as a subpoena, should benefit from the exception, and found that because Martin Marietta's decision to proceed with a hostile bid was of its own volition, it should not give rise to the agreement's "legally required" exception.

The court enjoined Martin Marietta from proceeding with its hostile bid for four months, the time frame from Martin Marietta's breach until the expiration of the first agreement. This injunction will prevent Martin Marietta from engaging in a proxy contest at Vulcan's 2012 annual shareholder meeting.

Key Take-Away:

Confidentiality agreements need to be drafted with careful forethought about how the parties' positions and relationship may change over time, and about how shared information ultimately may be used. Even without an express standstill obligation, a court can preclude buyers from using confidential information to further a hostile bid if contractual language is ambiguous and the parties' intentions indicate that an information exchange is solely to further a negotiated transaction. The case is a good reminder to the M&A bar that even early-stage agreements often seen as routine can significantly impact deal strategy and outcomes.

For more information on these or related matters, please contact your Fenwick securities team or the authors.

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