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Confidentiality Agreements and Standstill Provisions; the Delaware Chancery Court Broadly Construes Confidentiality Agreements and Enjoins a Hostile Bid Despite the Absence of Standstill Provisions Relating to Stock Transactions

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In a significant recent decision, *Martin Marietta Materials, Inc. v. Vulcan Materials Company*[1], the Delaware Chancery Court reiterated the preference of Delaware courts to enforce confidentiality agreements and to construe them broadly as a matter of public policy. Specifically, the court granted equitable relief to Vulcan Materials Company (Vulcan), enjoining a hostile exchange offer by Martin Marietta Materials, Inc. (Martin) for a period of four months. The relief granted is the type of relief that would reasonably be expected if an appropriately drafted standstill provision had been included in the relevant confidentiality agreements, notwithstanding that those agreements did not include any standstill provisions that expressly prohibited a hostile exchange offer or a hostile proxy solicitation. Standstill provisions that prohibit the recipient of confidential information from engaging in certain activities, including, but not limited to, launching a proxy contest, purchasing shares or engaging in change of control transaction are often included in the confidentiality agreements utilized by public reporting companies. In reaching its decision the court did not limit its analysis to the four corners of the relevant agreements, but rather relied heavily on extrinsic evidence relating to the intent and expectations of the parties in construing the agreements.

Background

For approximately two years Martin and Vulcan engaged in discussions about a potential merger. To ensure that their discussions would be kept confidential the parties entered into two different confidentiality agreements. On May 3, 2010, the companies executed a non-disclosure agreement (the NDA) and a few weeks later they executed a joint defense and confidentiality agreement (the JDA and the NDA are hereafter referred to as the confidentiality agreements). Neither of the confidentiality agreements contained a standstill provision. The NDA governed the exchange of "evaluation material," defined as nonpublic information furnished by the disclosing party and any documents, materials or analysis generated from such nonpublic information. The parties agreed that they would only use evaluation material for the purpose of evaluating a "transaction," defined as a possible business combination transaction between the two parties. The NDA prohibited the disclosure of the negotiations or discussions underlying the transaction unless such disclosure was legally required. However, even where a disclosure was legally required the NDA mandated certain notice and related vetting procedures, which allowed the other party an opportunity to comment on the breadth of any disclosure. The JDA contained an even narrower definition of "transaction," i.e., one that was "being discussed" by the parties.

No consensual business combination was ever concluded by Martin and Vulcan. On December 12, 2011, Martin launched an unsolicited hostile exchange offer to purchase all of Vulcan's outstanding shares. Martin also launched a hostile proxy solicitation seeking to elect four new members to Vulcan's classified board at Vulcan's upcoming annual meeting. In connection with its proxy statement, Martin filed a registration statement on Form S-4 (the registration statement) with the SEC which contained a very detailed history of the party's negotiations and a summary of other

1 *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, C.A. 7102-CS (Del. Ch. May 4, 2012)

information that Martin obtained during the negotiations. On the same day that Martin launched its hostile bid, it brought suit in the Chancery Court seeking a judicial declaration that nothing in the confidentiality agreements barred the hostile bid or the proxy contest. Vulcan counterclaimed seeking a determination that Martin had breached the confidentiality agreements by improperly disclosing confidential information and an injunction against Martin acquiring Vulcan shares.

The Court's Opinion

On May 4, 2012, the Chancery Court held that Martin violated both the NDA and the JDA and issued an injunction preventing Martin from taking any action to acquire Vulcan for four months.

The court based its holding on several key factors, the first was the meaning of the term transaction in the confidentiality agreements. The court questioned whether the word "between" in the phrase "a business transaction *between* the two parties" included the unsolicited exchange offer made by Martin. The court found this phrase to be ambiguous and looked to extrinsic evidence, including discussion between the parties and prior drafts of the confidentiality agreements. While Vulcan argued that the exchange offer was not a transaction *between* the parties because it was not a voluntary transaction consented to by the respective boards of the parties, Martin argued that the exchange offer met this requirement because it would result in a combination of the two businesses. The court explained that the extrinsic evidence demonstrated that Martin never would have agreed to exchange information if it thought that the information would be exposed to a hostile offer.[2] Therefore, the court held that the definition of transaction in the NDA did not include a hostile bid, but instead was limited to "any step or related series of steps leading to a formal mingling of the companies' assets that is contractually agreed upon, or consented to, by the sitting boards of both companies at the outset of those steps being taken."

Next, the court analyzed whether the "legally required" exception of the NDA permitted Martin to use confidential material in the registration statement filed to effect its hostile exchange offer and in the proxy statement sent to shareholders. The court concluded that the disclosures in the registration statement and the proxy statement did not fall within this exception because the legal requirement mandating disclosure (the filing requirements of federal securities laws) were triggered by Martin's discretionary action. The court explained that the legally required exception was meant to include only specific external demands like subpoenas, interrogatories or other third-party processes, not requirements brought on by the party's own actions. The court also concluded that even if Martin's disclosures in its registration statement and proxy statement were legally required, Martin's disclosures exceeded the disclosure requirements of the federal securities laws. The court agreed with Vulcan's position that Martin should have made minimal, "flat and simple" disclosures and should have deferred from disclosing more information until and unless prompted by the SEC.

Finally, the court explained that even if it had found that Martin's disclosures in connection with the exchange offer and proxy statement were "legally required," Martin breached the NDA by failing to follow the notice and vetting procedures dictated therein. The notice and vetting procedures of the NDA, the court explained, were applicable to any external demand and therefore Martin breached the NDA by failing to comply with these procedures.

Significance of the Case

While this decision does not establish new law, it reinforces several principles under Delaware law and is significant to all public companies. The decision is significant to public companies in the following respects:

- Delaware courts will imply standstill provisions into confidentiality agreements under appropriate circumstances.
- If no explicit standstill provision is used, the parties should expressly define the term transaction and specify

2 The court based this conclusion on (i) discussions between the parties showing that it was a priority to Martin's CEO that Martin not be subject to a hostile bid, (ii) the behavior of Martin after its decision to pursue a hostile offer including, gathering and protecting all of the nonpublic material collected during its negotiations and (iii) the editing by Martin's lawyers changing the phrase "a transaction involving the parties" to the more restrictive phrase seen in the current draft of the NDA.

the permissible and impermissible uses and disclosures of confidential information to avoid a court reading a standstill provision into the agreement.

- Any attempt to retain the option of a hostile transaction by way of narrowly defining evaluation material so as to limit its scope to nonpublic information furnished by the disclosing party and to exclude the information derived from such information likely will be carefully scrutinized by the Chancery Court, and will be analyzed in the context of relevant extrinsic evidence regarding the intent of the parties.
- In circumstances in which a contra party refuses to include standstill provisions in a confidentiality agreement a party wishing not to have any of the evaluation material utilized against it in a hostile transaction should take care to document its intent and expectations in separate written communication that no such material be utilized against it in a hostile transaction.
- Parties must be explicit in confidentiality agreements with respect to the type of disclosures (all disclosures or only legally required disclosures) to which the notice and vetting requirements apply.
- To avoid a claim by the disclosing party that the recipient party used the confidential information to compete with the disclosing party, the recipient party should adopt internal procedures for handling the confidential information, including using "clean teams" to review the confidential information.
- While the holding of this case is by its terms limited to Delaware law, the decisions of the Delaware Chancery Court are given great weight by the courts of many other jurisdictions, and therefore this decision must be considered by all entities that enter into confidentiality agreements, whether or not Delaware law applies.

To discuss any questions you may have regarding the issues discussed in this alert, or how they may apply to your particular circumstances, please contact Michael D. Handler at 206.808.7839 or mhandler@cozen.com.