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WSGR ALERT

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DELAWARE COURT OF CHANCERY BLOCKS HOSTILE TAKEOVER EFFORTS DUE TO BREACHES OF CONFIDENTIALITY AGREEMENTS

Earlier this month, the Delaware Court of Chancery issued its much-anticipated post-trial decision in the dispute between "the top two rock stars in the aggregates industry," Martin Marietta Materials and Vulcan Materials. In his 138-page opinion, Chancellor Leo E. Strine, Jr., held that Martin Marietta violated both use and disclosure restrictions in two confidentiality agreements signed by the parties during friendly merger discussions in 2010 when, in late 2011, Martin Marietta launched a hostile $5.5 billion bid to take over Vulcan. As a result, the Chancellor enjoined Martin Marietta from persisting in its tender offer for Vulcan stock and its proxy contest for seats on Vulcan's board for a period of four months. The Chancellor's decision is especially noteworthy in light of the fact that neither confidentiality agreement contained an explicit standstill provision, which would have expressly prohibited one party from seeking to acquire another party in an unsolicited manner. Indeed, the decision sends a stark warning that customary, early-stage confidentiality agreements—even those that do not contain explicit standstill provisions—can preclude parties from pursuing unsolicited takeovers.

Background

In the spring of 2010, the CEOs of Martin Marietta and Vulcan began discussing the possibility of a negotiated merger transaction. Although the parties never discussed a standstill agreement, Martin Marietta's CEO did stress in negotiations that his company was "not for sale" and "made clear that Martin Marietta was not interested in being purchased by anyone, including by Vulcan, and that the discussion had to be for the purpose of a consensual deal only." To facilitate the negotiations and in light of these concerns, the parties entered into two confidentiality agreements.

Both agreements limited the ways information could be used: the parties agreed that they could use information exchanged under the agreements solely for the purposes of evaluating and pursuing a transaction. One agreement defined "transaction" as "a possible business combination transaction. . . between [Martin Marietta] and [Vulcan] or one of their respective subsidiaries," and the other defined it 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." Both agreements also required the parties to keep the information exchanged—and the very existence of the negotiations—confidential unless disclosure was legally required.

Throughout 2010, the parties exchanged sensitive business information (particularly with respect to synergy estimates and antitrust risk) and met and conferred with one another and their respective counsel. Over the course of these exchanges, however, market dynamics changed. When discussions began, Vulcan was the more natural acquirer, but by the spring of 2011, Vulcan's stock was depressed relative to Martin Marietta's, thus making Vulcan appear to be an attractive target. This shift contributed to Vulcan's management's loss of interest in the prospect of a potential transaction, but, the court found, "[w]hen the original suitor cooled its ardor, the once-reluctant dance date became more enamored." Thus, even before Vulcan formally called off talks in June 2011, Martin Marietta had begun plotting a hostile takeover plan.

On December 12, 2011, Martin Marietta sent a bear hug letter to Vulcan, launched a tender offer, and commenced a proxy contest to replace members of Vulcan's board. The public disclosures the company made gave a "one-sided," blow-by-blow recitation of the earlier merger negotiations. Litigation followed in multiple jurisdictions, with the case in Delaware putting the confidentiality agreements on trial. Vulcan accused Martin Marietta of breaching both agreements by misusing and improperly disclosing the information exchanged.

The Court of Chancery's Decision

Following a full trial on the merits, the Court of Chancery made two key factual findings. First, the court found that "Martin Marietta has clearly used Evaluation Material in pursuit of its hostile bid." Second, the court found that Martin Marietta had disclosed confidential material and the existence of the earlier negotiations. The legal analysis centered on whether this use and disclosure violated the confidentiality agreements. Chancellor Strine held that Martin Marietta breached both agreements in both ways.

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With respect to the use of the material, the court first conducted a nuanced parsing of the contractual language and then concluded that the language of the nondisclosure agreement was susceptible to more than one reasonable interpretation. After considering the extrinsic evidence (and, in particular, the negotiating history between the parties), the court determined that the agreement contained an implied requirement that any "transaction" must be "contractually agreed upon, or consented to by the sitting boards of both companies at the outset of those steps being taken," even though they did not expressly prohibit either party from launching a hostile bid. In reaching this conclusion, the court was moved particularly by Martin Marietta's concerns at the outset. "On the evidence," the Chancellor wrote, "I am persuaded that [Martin Marietta] would never have agreed to exchange confidential information if [it] thought that one of the parties to the NDA was free to launch an unsolicited exchange or tender offer or a proxy contest under the terms of the Agreement." Consequently, the Chancellor concluded that Martin Marietta had breached the confidentiality agreements by using the information it received from Vulcan in furtherance of its hostile bid.

With respect to the disclosures, the Chancellor once again carefully scrutinized the contractual language and, after concluding that the relevant language was susceptible to multiple, reasonable interpretations, looked to the record surrounding the negotiation of the confidentiality agreements. The court held that it was not plausible that Martin Marietta would have agreed to a provision permitting "legally required" disclosure where either party could trigger an arguable "legal requirement" by unilaterally launching a hostile bid. Moreover, even if Martin Marietta had been permitted to make disclosures of confidential information, the court held that the disclosures it actually made went too far.

Having found numerous breaches, the court turned its attention to remedies. Many practitioners and academics reflecting on this dispute had predicted that the court might find a breach but be unwilling to enter an injunction. They were wrong. The Chancellor warned that "[u]nless both parties to a contract have their reasonable expectations respected by the courts, then contracts will not serve their intended purpose. Ultimately, disrespecting contracts seems to threaten far more harm to investors in a capitalist economy than it does good." As a result, the court ordered the relief requested by Vulcan: a four-month injunction barring Martin Marietta from persisting with its proxy fight and exchange offer. Because Vulcan's annual meeting is set for June, this order likely will have the effect of deterring a bid for a full year.

Implications

By shutting down Martin Marietta's hostile attack on Vulcan, the Delaware Court of Chancery once again flexed its considerable remedial muscle and demonstrated Delaware's strong commitment to the strict enforcement of contracts. The decision should serve as a warning to any company entering into negotiations that it should involve counsel at an early stage to review carefully all terms of proposed confidentiality agreements, as provisions respecting the use and disclosure of material obtained in those negotiations can have broad and lasting effects even though they may not expressly prohibit such actions as launching an unsolicited takeover offer. In particular, this decision is a cautionary reminder that potential acquirers may foreclose their ability to pursue a hostile bid by entering into a customary confidentiality agreement with the target company.

Furthermore, although this decision required Martin Marietta to halt its hostile exchange offer and proxy solicitation temporarily, potential sellers should not take this decision to mean that every confidentiality agreement restricting the use and disclosure of information exchanged between the parties in furtherance of a transaction will, as a matter of law, contain an implicit standstill provision, since the decision was highly dependent on the specific facts of this case. Both potential acquirers and sellers should consult with counsel in drafting and negotiating confidentiality agreements in order to safeguard against unintended consequences.

For more information about this case or any other related matter, please contact a member of Wilson Sonsini Goodrich & Rosati's mergers and acquisitions practice.

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