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RECONSIDERING NDAs IN LIGHT OF MARTIN MARIETTA MATERIALS, INC. v. VULCAN MATERIALS CO.

On May 4, 2012, the Delaware Court of Chancery held that MartinMarietta Materials had violated a pair of confidentiality agreements with Vulcan Materials and issued a 4-month temporary injunction suspending MartinMarietta’s hostile exchange offer for Vulcan and related proxy contest. Martin Marietta, Inc. v. Vulcan Materials Company, CA No. 7102-CD (May 4, 2012). Martin Marietta has appealed the Court’s decision to the Delaware Supreme Court. The case - which was decided by the Court as a pure contract case (and not as a fiduciary duty case) - has important implications for drafting transactional non-disclosure agreements. In this Alert, we first discuss the Court’s decision and then provide some key takeaways.

Background

Martin Marietta and Vulcan had been flirting with a friendly combination for over ten years and in the spring of 2010, the two companies began seriously discussing a merger of equals with Vulcan as the buyer. Soon thereafter, the parties entered into a non-disclosure agreement (NDA) which provided that protected information was to be used "solely for the purposes of evaluating a Transaction" and defined "a Transaction" as "a possible business combination transaction between Martin Marietta and Vulcan or one of their respective subsidiaries." Shortly after executing the NDA, the parties entered into a related joint defense and confidentiality agreement (JDA), which covered the joint analysis of antitrust implications and the related joint analysis of synergies that would result from a merger. The JDA provided that protected information was to be used "solely for the purposes of pursuing and completing the Transaction" and defined "the Transaction" as "a potential transaction being discussed by Vulcan and Martin Marietta . . . involving the acquisition of all or certain of their assets or stock." We refer to the NDA and JDA together as the Confidentiality Agreements.

Throughout 2010 and the first half of 2011, the parties exchanged confidential information, discussed various aspects of the merger and conducted an analysis of anticipated synergies that would result from the merger. However, by the summer of 2011 Vulcan’s stock had declined significantly relative to Martin Marietta’s stock and Vulcan called off the merger negotiations. Not wanting to give up the pursuit, Martin Marietta seized the advantage of its relatively more valuable currency (its own stock) and launched a hostile exchange offer and proxy contest for Vulcan in December 2011. In the disclosure filings filed with the SEC, Martin Marietta discussed the history of the merger negotiations with Vulcan as well as a number of details which were the result of the joint synergies analysis conducted by the parties. Following the SEC filings, Martin Marietta made further disclosures of this information in various press releases, conference calls and communications with journalists.
Vulcan claimed that Martin Marietta's use of confidential information in formulating its hostile bid and the related SEC filings and following disclosures were a breach of Martin Marietta's obligations under the Confidentiality Agreements and requested the Court to enjoin the hostile bid.

Analysis

Did Martin Marietta use confidential information to support its hostile bid and was such use a breach of its obligations under the Confidentiality Agreements?

The Court Found that Martin Marietta Used Confidential Information to Support its Hostile Bid. Despite Martin Marietta's insistence to the contrary, the Court found that Martin Marietta had clearly used and relied on confidential information in deciding to launch its hostile bid. The Court noted that the confidential information (particularly the joint synergies analysis) provided Martin Marietta with insight into the potential value of a combination and that further acts and statements made by Martin Marietta executives and advisors confirmed that confidential information most likely played a role in the decision to go hostile.

The Court Found that Martin Marietta Breached its Obligations under the NDA. Martin Marietta argued that, even if it had used confidential information in formulating its hostile bid, such use was permissible because the NDA allowed confidential information to be used "solely for the purpose of evaluating a Transaction" and that the definition of "Transaction" (a "business combination transaction between Martin Marietta and Vulcan") included a hostile exchange offer. Following a lengthy analysis by the Court of the precise meaning of the words "business combination" and "between" (an analysis that involved dictionary citations, including whether "between" referred to reciprocal actions or spatial relationships), the Court determined that the language was ambiguous and turned to extrinsic evidence as a guide to whether the parties intended to permit the use of confidential information in a hostile transaction:

First, the Court noted that at the time the Confidentiality Agreements were negotiated, Martin Marietta's CEO was concerned with preventing an unsolicited sale of the company. Accordingly, the Court concluded that he would not have agreed to share confidential information if Vulcan would be permitted to use the confidential information it received in furtherance of an unsolicited bid for Martin Marietta.

Second, the Court noted that the behavior of Martin Marietta executives and its advisors in the months leading up to the hostile bid evinced a belief that it was not permitted to use the confidential information for the purposes of formulating and selling its hostile bid. The General Counsel of Martin Marietta told executives and outside advisors not to use any confidential information and requested that all of the on-site confidential information be held in her office. The Court further found the minutes of the Board which noted that the decision to consider a hostile bid was based on "publicly available information" were a conspicuous attempt to show that confidential information had not been used.

Finally, the Court looked to the "interpretive gloss" provided by the JDA, which the parties agreed related to the same course of commercial activity and should be read together and harmonized with the NDA. The Court found that the JDA clearly defined "the Transaction" as the friendly merger being discussed between the parties.
Based on the extrinsic evidence, the Court found it clear that the parties intended the language "business combination transaction between Martin Marietta and Vulcan" to refer only to a transaction that was consented to by the sitting boards of both companies. Because a hostile exchange offer was not intended to be included in the language, the court found that Martin Marietta breached its obligations under the NDA when it used confidential information to formulate and sell its hostile bid.

Was Martin Marietta entitled to launch its hostile bid, impose on itself certain legal disclosure obligations and then use those obligations to circumvent the Confidentiality Agreements?

Legally Required Disclosure. The NDA prohibited the parties from disclosing confidential information or from disclosing the fact that merger discussions had taken place unless such disclosure was "legally required." Martin Marietta argued that disclosure through its SEC filings relating to the hostile bid qualified as "legally required." After determining that even the words "legally required" were ambiguous, the Court again embarked on a lengthy analysis of the parties' intent (again noting Martin Marietta's concern with confidentiality at the outset of negotiations) and concluded that the term "legally required" was only intended to include disclosure that was in response to an external demand (such as a subpoena). Therefore, Martin Marietta's optional course of action (the hostile bid), which imposed SEC disclosure obligations, did not qualify as "legally required" disclosure. Accordingly, the Court found that the disclosures made in the hostile bid SEC filings constituted a breach of Martin Marietta's obligations under the NDA.

Outcome

As the Confidentiality Agreements included provisions for injunctive relief, the Court enjoined the hostile bid. While the Court based its decision as to breach on a detailed analysis of the words of the contract and the intent of the parties, the decision to enjoin was grounded in part on public policy concerns. Martin Marietta argued that enjoining the hostile bid would chill M&A activity, harming stockholders and lowering share values, and that a loss for Martin Marietta in this litigation would turn every confidentiality agreement into a standoff. The Court disagreed, noting that in order for companies to exchange information and explore potential transactions, the parties need to have faith that confidential information would indeed be protected. On this point, the Court commented that "failing to enforce confidentiality agreements in the M&A context will reduce, not increase, value-enhancing combinations . . . [and] the [o]verall cost to investors if the law does not enforce confidentiality agreements might turn out to be quite large in terms of transactions that are not done."

Key Takeaways

The Court's decision serves as a wakeup call to practitioners that confidentiality agreements negotiated in the early stages of a deal can have significant consequences down the road. The language of the Confidentiality Agreements at issue was not particularly novel or unusual and was drafted by experienced practitioners. Nevertheless, the Court found the language of the Confidentiality Agreements ambiguous and found it necessary to resort to extrinsic evidence to determine the intent of the parties. The decision suggests revising certain standard language to avoid ambiguity, as well as various other takeaways.

Defining the "Transaction"

Confidentiality agreements typically open with a statement of the purpose for which confidential information is being exchanged and often, as in Martin Marietta v. Vulcan, with reference to a "Transaction," as defined. Chancellor Strine's decision is a reminder to pay greater attention to this.
definition, since it is this definition that drives the use restriction on the confidential information. Specifically, the definition should be explicit in its limitation to a consensually negotiated transaction.

**Use**
Chancellor Strine’s opinion demonstrates that use restrictions in confidentiality agreements have teeth and will be enforced. Nonetheless, the Chancellor had to contend with the argument of Martin Marietta - which the Chancellor found contrived - that in fact the information it received from Vulcan was of no consequence to its decision to commence its hostile bid. The party desiring protection for the confidential information may wish to consider adding a presumption to its form, shifting to the receiving party the burden of proof on the issue of use. On the other hand, the decision indicates that in proper circumstances, the receiving party might succeed in demonstrating that it did not in fact utilize the confidential information in violation of the parties’ agreement, notwithstanding contrary appearances.

**Standstill**
There would have been no *Martin Marietta v. Vulcan* case had the parties included standard standstill provisions in the Confidentiality Agreement. Even where parties are in discussion for a merger of equals and hostile overtures are furthest from their minds, there is no reason not to include reciprocal standstill provisions. See, e.g., New York City Bar Association Model Form of Reciprocal Confidentiality Agreement (May 23, 2011), [http://www2.nycbar.org/pdf/report/uploads/20072130-ReciprocalConfidentialityAgreement.pdf](http://www2.nycbar.org/pdf/report/uploads/20072130-ReciprocalConfidentialityAgreement.pdf).

**Compelled Disclosure**
The legally compelled disclosure exception to confidentiality is standard fare for NDAs, and the negotiation over these provisions is narrowly confined, usually over the extent to which reliance on advice of counsel is required. Martin Marietta’s argument that a party could bootstrap its way to compelled disclosure by voluntarily injecting itself into a circumstance of SEC mandated reporting would have been rejected by most practitioners. After *Martin Marietta v. Vulcan*, this argument should no longer be left to the vagary of judicial inferences. Henceforth, NDAs should explicitly negate the ability of a party to bootstrap its way to compelled disclosure.

**Injunctive Relief**
This case also serves as a reminder of the importance of providing for injunctive relief in confidentiality agreements, as the aggrieved party will rarely be able to prove actual damages from a breach. While provisions for injunctive relief are standard in confidentiality agreements, the Martin Marietta v. Vulcan decision is a reminder of their importance. These provisions should state that the aggrieved party is "entitled to specific performance," as opposed to providing that the party "may seek specific performance," and should expressly dispense with any requirement for posting a bond.

**Term**
A typical confidentiality agreement has a fixed term - most often between one and two years - that runs from the date that the agreement is executed. This makes sense where all the confidential information is furnished towards the beginning of the term. However, where information is to be furnished continuously throughout the term, or where, as in *Martin Marietta v. Vulcan*, there is a breach during the term, the fixed term may fail to provide the intended protection. Parties may therefore wish to consider a term that is keyed to the time of delivery where information is to be provided over time. Also, where there is a breach during the term, the agreement may provide for its automatic extension for a reasonable additional period, something Chancellor Strine did in *Martin Marietta v. Vulcan* in the exercise of the equitable powers of the Chancery Court.
Choice of Forum
Vulcan is a New Jersey corporation, while Martin Marietta, is a North Carolina corporation. The parties chose to govern their confidentiality agreement by Delaware law with jurisdiction in the Delaware courts, a choice that appears to have worked well for Vulcan. Indeed choice of law and forum may be outcome determinative. This suggests the advisability of considered attention to these boilerplate provisions, with Delaware - at least for now - appearing to be a jurisdiction of choice for a party on the delivering end of sensitive information.

Fiduciary Duties
Chancellor Strine emphasized that he was not reaching the issue of whether the Vulcan board had a fiduciary duty to waive provisions of the confidentiality agreement to allow the hostile bid of Martin Marietta to proceed. As a New Jersey corporation, the fiduciary duties of the Vulcan board were governed by New Jersey law, and the Chancellor limited himself to interpreting the terms of the parties’ confidentiality agreement, which was governed by Delaware law. Nonetheless, parties should be aware that the Delaware courts have ruled, or intimated, that in appropriate circumstances, the board of a Delaware corporation may have a duty to waive the provisions of a standstill agreement to facilitate a transaction in the best interests of shareholders. The same may apply to the use restrictions of confidentiality agreements.

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