New Guidance on Confidentiality Agreements

A recent opinion regarding the enforcement of certain provisions commonly found in confidentiality agreements in the context of a hostile takeover provides important guidance on the drafting process of such agreements. In *Martin Marietta Materials, Inc. v. Vulcan Materials Company*, C.A. 7102-CS (Del. Ch. 2012), the Delaware Court of Chancery (Chancellor Strine) found that the use of information received by Martin Marietta Materials, Inc. ("Martin Marietta") under a confidentiality agreement in pursuit of a hostile bid to acquire Vulcan Materials Company ("Vulcan") violated that confidentiality agreement. The companies are the two largest construction materials suppliers in the United States. After a long history of discussions about a potential merger, Martin Marietta and Vulcan entered into a nondisclosure agreement (the "NDA"), and a common interest, joint defense and confidentiality agreement (the "JDA," together with the NDA, collectively, the "Confidentiality Agreements") in the spring of 2010. The Confidentiality Agreements did not contain an explicit standstill provision, but there was a restriction that the confidential information be used "solely for the purpose of evaluating" a "possible business combination transaction between [Martin Marietta] and [Vulcan] or one of their respective subsidiaries." The history of the negotiations between Martin Marietta and Vulcan demonstrated that Martin Marietta was at least as concerned as Vulcan regarding the potential misuse of confidential information, including the possibility that the disclosure of confidential information such as the existence of negotiations might put Martin Marietta "in play."

Negotiations between Martin Marietta and Vulcan broke down, and on December 12, 2011, Martin Marietta launched an unsolicited exchange offer in which it sought to purchase all of Vulcan's outstanding shares. Martin Marietta also launched a simultaneous proxy contest, seeking to elect four new members to Vulcan's classified board at its annual meeting on June 1, 2012. In connection with both the exchange offer and proxy contest, Martin Marietta was required to file certain statements with the U.S. Securities and Exchange Commission ("SEC"), which filings contained confidential information received by Martin Marietta under the terms of the Confidentiality Agreements. Martin Marietta brought a suit to obtain a declaration that nothing in the Confidentiality Agreements barred the exchange offer or proxy contest. Vulcan responded with counterclaims seeking a determination that Martin Marietta breached its contractual obligations to Vulcan by improperly using and publicly disclosing information in aid of the exchange offer and proxy contest and that it should be temporarily enjoined from proceeding with both.

Chancellor Strine ruled in favor of Vulcan, and on May 4, 2012 enjoined Martin Marietta from pursuing the exchange offer or proxy contest for a period of four months. First, the Court held that Martin Marietta breached the Confidentiality Agreements by using the confidential information in pursuit of a hostile bid, and not solely for "a possible business combination *transaction between* [Martin] and [Vulcan]," as defined in the NDA and as similarly defined in the JDA. Importantly, Chancellor Strine noted that the eventual exchange offer was predicated on synergy numbers that were derived from, and could clearly be traced to, evaluation material provided by Vulcan. Second, the Court held that Martin Marietta breached the NDA when it disclosed confidential information to the SEC because such disclosure was not legally required as described in the NDA. The NDA provided that confidential information may be disclosed if legally required "by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process." Martin Marietta's self-imposed disclosure to the SEC was not the type of legally required disclosure permitted by the NDA. Lastly, the Court held that Martin Marietta breached the NDA by not providing Vulcan with prompt notice of its disclosure to the SEC and by not limiting its disclosure to the minimum amount necessary to satisfy such legal requirement as provided under the NDA.

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Shortly after the opinion was issued, Martin Marietta filed an appeal and a motion to be permitted to continue its hostile bid during the pendency of the appeal. The Court denied the motion to continue thereby affirming the four month injunction, which was selected because it matched the time period between Martin Marietta's launch of the exchange offer (December 12, 2012) and the date of expiration of the NDA (May 3, 2012). Now Martin Marietta will not be able to run its slate of four directors at the June 1, 2012 annual meeting of Vulcan shareholders, and because only two Vulcan directors stand for election in 2013, the ruling eliminates Martin Marietta's chances of taking control of Vulcan's 10 member board until 2014. Martin Marietta continues to appeal the Court's original ruling.

Drafting Guidance

The ruling makes clear that Delaware courts will strictly construe the contractual language contained in confidentiality agreements, and will use their powers to enforce equitable remedies in the case of breach. The Court's analysis provides important guidance for drafting and negotiating confidentiality agreements.

- **Permitted Uses and Disclosures:**
  - *Sell Side:* The seller should ensure that the buyer can only use the confidential information "solely" for the purpose of evaluating the transaction contemplated by the confidentiality agreement.
  - *Buy Side:* The buyer should ensure that it may use the confidential information for at least the purposes of negotiating, evaluating and, if applicable, consummating the transaction. Generally, the buyer should seek the most expansive description of permitted uses and disclosures that the seller is willing to accept. The buyer should also reject any restriction on using information for a purpose "detrimental" to the seller.
- **Definition of Transaction:**
  - *Sell Side:* The term "Transaction" should be defined narrowly, as a mutually-agreeable transaction negotiated between the parties, in order to preclude hostile behavior even in the absence of a standstill provision. Additionally, refer to the transaction as "the Transaction." The use of the word "the" makes it clear which transaction is contemplated by the confidentiality agreement.
  - *Buy Side:* The term "Transaction" should be defined broadly, as a potential transaction "involving" the parties, in order to contemplate multiple forms of a potential transaction and to leave open the possibility that an offer directly to shareholders could qualify. Additionally, refer to the transaction as "a Transaction," which leaves open the possibility that the parties are contemplating multiple forms of a transaction.
- **Definition of "Legally Required":** The NDA provided that "[i]n the event that a party . . . [is] requested or required (by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process) to disclose any of the other party's [confidential information] or any of the facts, the disclosure of which is prohibited under [this NDA] . . . the party requested or required to make the disclosure shall provide the other party with prompt notice of any such request or requirement."

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- *Sell Side:* The "legally required" disclosure exception in a confidentiality agreement should be limited to disclosure in circumstances where a party receives an external demand for information such as from a subpoena, interrogatory, civil investigative demand or similar process, and not where a party voluntarily self-imposes a legal requirement such as through a registration statement or through disclosures in a proxy contest. Also, the seller should ensure that merger discussions and other transaction information are subject to the same disclosure requirements and limitations as confidential information in the agreement.

- *Buy Side:* The buyer should ensure that any qualification or definition of the term "legally required disclosures" includes self-imposed disclosures (*i.e.*, proxy contests, tender offers, registration statements, etc.). More generally, the buyer should ensure that the exception broadly covers any disclosure required by "law, regulation or legal process."

- **Mandatory Notice and Opportunity:**

  - *Sell Side:* Include a provision requiring prompt written notice and opportunity to object when the receiving party is making a disclosure as required by law, including self-imposed legal requirements. Also, require that merger discussions and other transaction information be subject to the same notice requirements as other confidential information.

  - *Buy Side:* Limit the notice provision to require notice only when it is legally permitted or reasonably practicable, and request a carveout from the notice requirement for routine regulatory disclosures.

- **Standstills:**

  - While the case granted an injunction without an explicit standstill in this case, public companies (or those contemplating an IPO) concerned about the possibility of hostile takeovers should not rely on similar results, but should consider insisting on explicit standstills.

- **Injunctive Relief:** The Court reiterated that under Delaware law, parties may contractually stipulate requisite elements of a compulsory remedy. In this case, the parties stipulated that irreparable harm would exist in the absence of an injunction by stating that "money damages would not be a sufficient remedy for any breach . . . by either party" and that "the non-breaching party shall be entitled to equitable relief, including injunction and specific performance, as remedy for any such breach."

  - *Sell Side:* The confidentiality agreement should provide that money damages would not be a sufficient remedy and that the seller shall be entitled to equitable relief.

  - *Buy Side:* A buyer may want to make any statement regarding equitable relief permissive rather than mandatory (*i.e.*, change "would not" to "may not" and "shall be" to "may").

While the above practice tips contemplate that there will always be an obvious "sell side" and "buy side" party, it is worth noting that in the case of strategic mergers between similarly sized companies, it is sometimes not clear which side a particular party is on. Martin Marietta, for example, was considered to be the target when the parties started discussions, but because of changed circumstances, became the potential acquiror. The Court noted that when Martin Marietta was negotiating the Confidentiality Agreements, it was

the side that was trying to tighten the restrictions on use of the information – a stance that was used against it at trial.

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