

M&A Hotline

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DELAWARE SUPREME COURT OPINES ON CONFIDENTIALITY OBLIGATIONS IN A FRIENDLY TURNED HOSTILE BID

The Delaware Supreme Court ("SC") has issued on July 10, 2012, a formal opinion explaining its decision dated May 31, 2012 (the "**Order**") to temporarily prevent Martin Marietta Materials, Inc. ("**Martin Marietta**") from pursuing a hostile takeover bid against Vulcan Materials Co. ("**Vulcan**"). The Order upholds the decision of the Delaware Court of Chancery ("**Chancery Court**") on the matter and has garnered the attention of the corporate houses considering M&A transactions and the legal practitioners, alike. While the Order reminds and reinforces the significance of confidentiality agreements in M&A deals, the novelty of the Order is that it highlights the possibility of confidentiality agreements taking the shades of 'standstill agreements' in certain case.

FACTUAL BACKGROUND

In 2010, Vulcan and Martin Marietta¹, the largest and second largest producers, respectively, of construction aggregates in the US commenced mutual discussions for a potential friendly merger. Since, neither Party was willing to be acquired by the other, the discussions were limited to a negotiated merger between the Parties. Akin to other M&A negotiations, the Parties entered into a non-disclosure agreement dated May 3, 2010 (the "**NDA**") to ensure the confidentiality of their merger discussions and any information exchanged in connection therewith. Further, for the purposes of analyzing the antitrust implications of the proposed merger, the Parties also entered into a common interest, joint defense and confidentiality agreement dated May 18, 2010 (the "**JDA**").²

The NDA categorically prohibited a Party from using the other Party's confidential information other than for evaluating a Transaction and defined the term "Transaction" as "a possible business combination transaction between" Martin Marietta and Vulcan or their subsidiaries. As always, the NDA provided an exception to the above mentioned stipulation, enabling a Party to disclose the confidential information of the other Party if such disclosure is mandated by the law. However, any disclosure of confidential information on account of a legal requirement had to be in compliance with the "notice and vetting process for disclosing the confidential information" prescribed under the NDA.

Similarly, the JDA obligated each of the Parties to use the confidential information of the other Party, solely for the purposes of pursuing and completing the Transaction; which term was defined 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". The JDA expressly clarified that neither the JDA nor its provisions shall affect or limit any other confidentiality agreements between the Parties, or rights or obligations created there under, in connection with the Transaction.

It is interesting to note that the Parties had not executed a standstill agreement nor did the NDA or the JDA include a standstill provision, explicitly prohibiting a Party from making an unsolicited tender or exchange offer to acquire the other Party during the prescribed time period.

Subsequently, the merger negotiations between the Parties failed and on December 12, 2011, Martin Marietta launched an unsolicited exchange offer, seeking to purchase all of Vulcan's outstanding shares, accompanied by a proxy contest, seeking to elect four new members to Vulcan's board. Martin Marietta disclosed the details of the exchange offer and proxy contest with the Securities and Exchange Commission ("**SEC**"). Without adhering to the notice and vetting process prescribed under the NDA, Martin Marietta disclosed the details of its negotiations with Vulcan and the confidential information of Vulcan shared during the negotiations in its SEC filings. Separately, Martin Marietta presented the details of the merger negotiations with Vulcan and the confidential information of Vulcan in numerous investor calls and presentations that it conducted in connection with the exchange offer.

DECISION OF THE CHANCERY COURT

Relying on extrinsic evidence available, the Chancery Court had interpreted the provisions of the NDA and the JDA to conclude that Martin Marietta had breached the terms of the NDA and the JDA, which entitled Vulcan to an injunction.

First, the Chancery Court concluded that the use of Vulcan's confidential information by Martin Marietta including the details of merger negotiations in connection with the exchange offer and proxy contest violated the terms of the NDA and the JDA. To arrive at this conclusion, the Chancery Court had to understand whether a hostile bid by Martin Marietta would qualify as a "Transaction" under the NDA and the JDA. If that was the case, then Martin Marietta would not be in breach of the NDA and the JDA in using the confidential information for the purposes of the exchange offer and the proxy contest. Analysing the various drafts of the NDA exchanged between the Parties and the discussions between the Parties, the Chancery Court concluded that the intention of the Parties and especially Martin Marietta was to share confidential information solely for the purpose of a consensual merger and not a

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unilateral hostile bid. Against that backdrop, the Court opined that the terms "business combination transaction" and "between" used in the definition of the term "Transaction" should mean only a consensual, negotiated merger between the boards of Martin Marietta and not an unsolicited hostile bid by Martin Marietta that bypasses the Vulcan board.

Second, the Chancery Court clarified that the exception provided under the NDA to disclose confidential information of other Party if required by the Law would apply only if there is an external demand by law or the agencies of the state and not in a case where an intentional action of a Party would trigger such a requirement under law. Here too, the Court relied on extrinsic evidence to interpret the exception under the NDA. Accordingly, the Court concluded that the disclosures made by Martin Marietta with SEC in connection with the hostile bid was not on account of an external demand by law but was triggered only because Martin Marietta elected to make the hostile bid. Further, the disclosures made with the SEC were not in adherence with the "notice and vetting process" prescribed under the NDA which amounts to a violation of the NDA.

Third, the Court held that even if Martin Marietta were legally required to make disclosures with SEC, it had clearly exceeded the extent of disclosures required for that purpose. Instead of making the requisite disclosure, Martin Marietta was extravagant in the quantum of Vulcan's confidential information shared with the public through the disclosures made under the filings made with SEC.

Finally, the court concluded that disclosures made by Martin Marietta to the press and investors clearly violated the NDA and the JDA. The Court was of the opinion that Martin Marietta was not permitted to open the floodgates of Vulcan's confidential information to the world at large simply because they had made some disclosures with the SEC. The Court rejected the argument of Martin Marietta that once information is disseminated through SEC disclosures it is no longer confidential information and can be further shared with public.

Upon finding Martin Marietta in breach of the NDA and the JDA, the court granted an injunction against Martin Marietta's hostile bid for a period of four months, based on the date Martin Marietta launched the exchange offer (December 12, 2011) and the expiration date of the NDA (May 3, 2012).³

DECISION OF THE SC

Without further reviewing the facts of the matter, the SC upheld the decision of the Chancery Court to hold that the only Transaction contemplated under the NDA and JDA was a consensual merger and not a hostile bid. Further, the SC interpreted the language of NDA to hold that disclosure by Martin Marietta to SEC was not pursuant to an external legal demand as mandated under the NDA and constituted a breach of the NDA. Also, the SC upheld the decision of the Chancery Court on non-compliance with notice and vetting process prescribed under the NDA and disclosure to the press and the investors. Additionally, Martin Marietta had claimed before the SC that the Chancery Court has stealthily converted the NDA and the JDA into a "standstill agreement" that was not contemplated or agreed between the Parties.

The SC rejected this claim of Martin Marietta and opined that this argument is factually incorrect, irrelevant and made to distract from a proper analysis of the genuine contractual issues. The court acknowledged that standstill agreements and confidentiality agreements are qualitatively different. The court stated that it is undisputed that the NDA and JDA are confidentiality agreements rather than standstill agreements, as they did not prohibit Martin Marietta from making a hostile bid for Vulcan; they did, however, preclude Martin Marietta from using and disclosing Vulcan's confidential information except as expressly permitted by the NDA and the JDA.

RELEVANCE OF THE ORDER IN THE INDIAN CONTEXT

Typically, parties involved in M&A/ private equity ("PE") investment negotiations impose standstill obligations on all the relevant parties for certain pre-determined period during which time such parties cannot initiate/ undertake similar transactions or negotiations with other parties. The objective is twofold; maintaining status quo of the parties during the negotiation stage and preventing a party from using the particulars and information of one negotiation in another. The standstill obligations are generally customized to suit the commercial requirements of the parties. In India where transactions are generally promoter driven, the standstill agreements are critical for the investors to ensure that the promoters do not consider simultaneous transactions with multiple investors or acquirers. On the other hand, for the promoters, it is important to prevent the investors/ acquirers from concluding the transaction with other shareholders to the exclusion of the promoters on the basis of the information shared by the promoters. The Order highlights that even in the absence of an express standstill agreement/clauses, the restriction on use or disclosure of confidential information may create a de facto standstill obligation between the parties if the information protected under confidentiality will need to be used/ disclosed by the party considering another transaction with other parties or an unsolicited bid to acquire another party. To that extent, a confidentiality restriction may also have the effect of a standstill restriction if a proposed hostile bid, is made on the basis of confidential information or warrants disclosure of confidential information.

This is particularly relevant in case of transactions involving listed securities as dealing in the securities of public listed companies when in possession of confidential price sensitive information could have insider trading implications. Typically, in PIPE deals, a PE investor conducts diligence on the target company and during the course of such diligence, the PE investor may become aware of certain price sensitive information relating to the target company. To avert breach of insider trading laws, disclosure of confidential price sensitive information in the possession of the bidder/ acquirer / PE investor may be required but when such disclosure is contractually prohibited, the bidder / PE investor may not be able to make a hostile bid. Further, even in the context of unlisted companies, non-disclosure agreements could prevent the acquirer from acquiring a competing company engaged in similar business as the target company, if the target company is able to demonstrate that the confidential information of the target company was used by the acquirer to acquire competing company to the detriment of the target company. In such a situation, the Indian courts could interpret confidentiality clauses as akin to standstill clauses thereby restricting the acquirer from acquiring a competing company.

Please note that the restriction on the use of confidential information may not prevent a hostile bid if the bidder can sufficiently demonstrate that its team that had access to the confidential information of the target is different from the team making the hostile bid and the bidder had duly instituted 'chinese walls' to ensure this.

Another important point that the Order elucidates is the need to appropriately draft the terms of the non-disclosure to

capture and reflect the intention of the parties. The Chancery Court has expressly mentioned in its order that the language used in the NDA and the JDA was ambiguous and therefore, the court has to rely on extrinsic evidence to arrive at the decision. This can be avoided if the terms of the confidentiality agreements are carefully worded without any room for ambiguity.

Further, the Order clarifies that the exception to confidentiality pursuant to legal requirement would apply only in case of an external legal demand. Accordingly, disclosures warranted under the applicable Indian securities laws including takeover laws and insider trading laws would not be exempt from confidentiality restriction so long as such disclosures were triggered by an intentional act or action of the party bound by confidentiality.

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You can direct your queries or comments to the authors

¹Vulcan and Martin Marietta are hereinafter collectively referred to as the Parties and individually as a Party.
²The JDA and the NDA are hereinafter collectively referred to as the Confidentiality Agreements.
³The minimum period under the NDA during which Vulcan's confidential information could not be used against Vulcan.

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