To Our Clients & Friends

Delaware Decision Highlights Pitfalls & Opportunities of Seemingly Routine Preliminary Agreements in M&A

When Confidentiality Agreements Become De Facto Standstills

A new decision by Chancellor Leo Strine of the Delaware Court of Chancery points up the need for heightened care in the drafting and review of even seemingly routine preliminary agreements and documents in the merger and acquisition process.

In an opinion issued last Friday (May 4, 2012), concerning the takeover contest between Martin Marietta Materials, Inc. and Vulcan Materials Company, the court delayed a takeover bid by four months and effectively killed a proxy contest based on a finding that Martin Marietta (the bidder) had breached a routine confidentiality agreement. The NDA did not have a "standstill" clause, but it did prohibit – as NDA's typically do – the use of "Evaluation Material" (e.g., confidential due diligence material) for any purpose other than the consideration of a "Transaction" between the parties, and it prohibited – as NDA's also typically do – disclosure of the fact that the parties had held discussions concerning a possible transaction. In arriving at its decision, the court painstakingly parsed single words of the NDA as well as presentation books, board minutes and other internal documents to determine that Martin Marietta had breached the NDA by launching a tender offer for Vulcan and a proxy contest against Vulcan's board after Vulcan decided against pursuing a transaction – even though the NDA did not contain a "standstill". The court also held that Martin Marietta could not create its own "out" from the NDA by initiating a hostile tender offer and proxy contest that would create disclosure obligations under SEC tender offer and proxy rules. The consequence: a transaction pursued for a decade is now at risk.

The decision is notable also for the importance it attaches to single words and slight wording differences. To cite just one example, the court read great significance into one word – "between" – and the use of "between" instead of "involving" in the definition of the "Transaction" covered by the NDA. To the court, "a possible transaction . . . ***involving*** [the bidder] and [the target]" would have been more likely to include unsolicited as well as friendly transactions, while "a possible transaction ***between***" the parties suggested that the parties intended material disclosed under the NDA to be used only in a friendly transaction pursuant to a mutual merger or acquisition agreement.

The court also emphasized negotiating history and internal documents and communications indicating that the parties were interested only in a friendly deal, that they were sensitive to (and want to avoid) unsolicited bids, and that the NDA was part of their intended protection against hostile bids. Companies should not, however, count on gaining advantage from undisclosed internal "spin." Indeed, the internal record cited by the court was used *against* the party that created the record, as a check on later inconsistent positions and arguments.

Also notable was the way the court treated documents prepared (or influenced) by the bidder's legal and financial advisers. By way of example, the court in one place parsed language in the Bidder's board minutes – protective language that was almost certainly reviewed (if not drafted or suggested) by lawyers – and used the "unusualness" of the language to turn an intended shield into an unintended self-wounding spear. Elsewhere, the court cited language in "discussion materials" prepared by the bidder's financial adviser as tantamount to an admission against interest. In each instance, the language was carefully and thoughtfully drafted, but the court aggressively drew adverse inferences. If there is any lesson in this, it may be that clearly sensitive issues need even more sensitive handling than has commonly been assumed in the past, and that the content and wording of presentation books, "discussion materials" and minutes need to be vetted even more closely or rethought altogether.

Although the target company prevailed in the case, it is clear that if the parties ***did*** actually want a standstill or standstill-like protections from the outset, their NDA was not ideally crafted to achieving that objective: a two-, four-, six- or eight-page NDA should not require a 138-page judicial opinion to interpret or enforce. So the other lesson in Chancellor Strine's decision may be this: if you want a standstill, draft one and include it in the agreement, and if you don't want a standstill, be more direct and explicit about that, too.

Because NDA's are commonly negotiated early in the M&A process, before companies have engaged M&A counsel or financial advisers, the most critical lesson for companies in the court's decision may well be the importance of reaching out to M&A advisers sooner and earlier than in the past, to ensure that business goals are met and are not inadvertently thwarted by something included in – or omitted from – a seemingly routine preliminary document like an NDA.

For further information and thoughts on the development reported in this Memorandum, please contact any of the senior lawyers of CapKey Advisors named below.

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