Unreported Cases

INTRODUCTION

UNREPORTED CASES is a continuing feature of THE DELAWARE JOURNAL OF CORPORATE LAW. Significant unreported cases that have not been published by a reporter system will be included. The court's opinions are printed in their entirety, exactly as received.

To expedite the attorney's research, all cases are headnoted according to the NATIONAL REPORTER key number classification system.* Indices are provided for case names, statutes construed, rules of court, and key numbers and classifications for this issue.

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CASE INDEX

This Issue

Page

CAVALCADE OIL CORP. v. TEXAS AMERICAN ENERGY CORP., No. 7605 (Del. Ch. May 22, 1984). HARTNETT, *Vice-Chancellor* 417

COMFORT, INC. v. McDONALD, No. 1066(S) (Del. Ch. June 1, 1984). BROWN, *Chancellor* 420

DELAWARE STATE TROOPERS' LODGE FRATERNAL ORDER OF POLICE, LODGE #6 v. STATE, No. 7228 (Del. Ch. June 13, 1984). BROWN, *Chancellor* 425

DEPARTMENT OF TRANSPORTATION v. DELAWARE EMPLOYEES COUNCIL NO. 81, No. 833 (Del. Ch. May 4, 1984). HARTNETT, *Vice-Chancellor* 435

DMG, INC. v. AEGIS CORP., No. 7619 (Del. Ch. June 29, 1984). BROWN, *Chancellor* 437

E.I. DU PONT DE NEMOURS & CO. v. SHELL OIL CO., No. 6696 (Del. Ch. June 6, 1984). LONGOBARDI, *Vice-Chancellor* 446

GOOD v. TEXACO, INC., No. 7501 (Del. Ch. May 14, 1984). BROWN, *Chancellor* 461

HOBAN v. DARDANELLA ELECTRIC CORP., No. 7615 (Del. Ch. June 12, 1984). BROWN, *Chancellor* 470

KIRKLAND v. INTERNATIONAL COMMUNITY CORP., No. 7577 (Del. Ch. May 29, 1984). BERGER, *Vice-Chancellor* 476

LEWIS v. DAUM, No. 6733 (Del. Ch. May 24, 1984). BROWN, *Chancellor* 481

MERRILL LYNCH PIERCE FENNER & SMITH, INC. v. SUN K. SHIN, No. 7424 (Del. Ch. June 13, 1984). LONGOBARDI, *Vice-Chancellor* 487

SCHLOSSBERG v. FIRST ARTISTS PRODUCTION CO., No. 6670 (Del. Ch. May 22, 1984). LONGOBARDI, *Vice-Chancellor* 491

TECHNICON DATA SYSTEMS CORP. v. CURTIS 1000, INC., No. 7644 (Del. Ch. July 2, 1984). BERGER, *Vice-Chancellor* 499

WEINBERGER v. UOP, INC., No. 5642 (Del. Ch. April 24, 1984). BROWN, *Chancellor* 502

STATUTES CONSTRUED*

This Issue

DEL. CODE ANN., tit. 8

§ 225 476
§ 226 470
§ 226(a)(2) 470
§ 251 502
§ 262(h) 502

DEL. CODE ANN., tit. 10

§ 5703(b) 435
§ 5714 435
§ 5714(a)(3) 435

RULES OF COURT*

Del. Court of Chancery Rule 12(b)(2) 481
Del. Court of Chancery Rule 12(b)(4) 481
Del. Court of Chancery Rule 12(b)(5) 481
Del. Court of Chancery Rule 12(b)(6) 461, 481
Del. Court of Chancery Rule 23.1 ..... 461, 481
Del. Court of Chancery Rule 41(b) 481

KEY NUMBER INDEX

This Issue

ABATEMENT AND REVIVAL

4 476

ACTION

68 499
69(1) 476
69(2) 476, 499
69(4) 476

APPEAL AND ERROR

1195(1) 502

ARBITRATION

7.1 435
7.4 435
23.12 435
76(1) 435

CONSTITUTIONAL LAW

69 491

CONTRACTS

54(2) 420
116)1) 420
117(2) 420
117(3) 420
143(1) 446
143(3) 446
143.5 446
155 446

CONTRACTS ENFORCEABLE

25 437
32 437
48 437

CORPORATIONS

187 417
202 461
206(2) 481
206(4) 461, 481
211 461

(Cont'd.)

---

* Page reference is to the first page of the case in which the statute or rule is construed.

CORPORATIONS *(Cont'd.)*

211(5) 461, 481
211(6) 481
283(3) 476
310(1)..... 437, 461
310(2) 437
312(5) 481
314(2) 481
320(5) 461
553(1) 470
558..... 470
583..... 491
584..... 502
591..... 491

EQUITY

56..... 437

INJUNCTION

58..... 420
61(2) 420
134..... 417
136(1) 437
137(1) 437

INTEREST

49..... 491

LABOR RELATIONS

257..... 426
262..... 426
264..... 426

MOTIONS

39..... 487

PATENTS

211(1) 446
216..... 446

SPECIFIC PERFORMANCE

5..... 437
28(1) 426
31..... 426
128(1) 437

STATES

130..... 425

* Page reference is to the first page of the case in which the statute or rule is construed.

CAVALCADE OIL CORP. *v.* TEXAS AMERICAN ENERGY CORP.

No. 7605

Court of Chancery of the State of Delaware, New Castle

May 22, 1984

Plaintiff applied for a preliminary injunction to enjoin defendant from holding its annual stockholders meeting and from electing its directors. This request, brought eight days before the proposed meeting of May 23, 1984, was based upon plaintiff's contention that proxy materials sent by the defendant failed to disclose with complete candor all of the material facts which the stockholders needed to make an informed judgment.

The court found that the proxy statement sent by the defendant to the stockholders contained statements which, though true when made, were no longer accurate. Additionally, and more importantly, the proxy statement inadvertently stated Delaware law in a manner likely to confuse or mislead the stockholders.

The court of chancery, per Vice-Chancellor Hartnett, held that there was no basis to enjoin the meeting or the election of the directors as there was no allegation made of unfairness surrounding the election. The court also directed the defendant to make a supplementary disclosure to correct the deficiencies in its proxy statement and to give the stockholders an opportunity to revote, in the event there is an affirmative vote in favor of the proposed amendments.

1. Injunction ⟸ 134

In an action for a preliminary injunction to enjoin the holding of an annual stockholders meeting and an election of directors, there is a heavy burden placed upon a plaintiff to show cause.

2. Corporations ⟸ 187

Where proxy statement sent by corporation to its stockholders prior to the holding of its annual meeting contained statements which were no longer accurate, and where proxy statement inadvertently stated Delaware law in a way likely to confuse or mislead the stockholders, the statement failed to meet the high standard of full and complete disclosure required by Delaware law.

Edward P. Welch, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware for plaintiff.

Richard D. Allen, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendant.

HARTNETT, *Vice-Chancellor*

Plaintiff seeks a preliminary injunction to enjoin the meeting of stockholders of the Defendant scheduled for tomorrow, May 23, 1984. Plaintiff claims that the proxy materials sent by the Defendant failed to disclose with complete candor all of the material facts which the stockholders of Defendant need to make an informed judgment. For the reasons set forth, I find that there has been a disclosure (which is probably inadvertent) which might mislead the stockholders. I also find that certain events which occurred after the proxy statement was mailed have changed some of the facts set forth in the proxy statement and, therefore, in the interest of full disclosure should be made available to the stockholders. I, therefore, direct that further disclosures be made before certain charter amendments become effective. I find, however, that there is no basis for enjoining the stockholders meeting nor to enjoin the election of directors.

This action was commenced on May 15, 1984. The matter was heard today and the meeting is scheduled for tomorrow morning. This time frame unfortunately prevents a statement in depth of the facts underlining this action.

[1] There is a heavy burden upon a plaintiff when he seeks by preliminary injunction to enjoin a stockholders meeting. *Gimbel v. Signal Companies, Inc.*, Del.Ch., 316 A.2d 599 (1979); *Gropper v. North Central Texas Oil Co.*, Del.Ch., 114 A.2d 231 (1955); *Bayard v. Martin*, Del.Supr., 101 A.2d 329 (1953). After considering the record and the arguments of counsel, I am convinced that Plaintiff has not shown any basis for me to enjoin the election of directors tomorrow. In fact, at oral argument, no mention was made of any unfairness surrounding the election.

[2] Defendant, however, also seeks to restructure the corporation by amending its certificate of incorporation. The amendments are dramatic. The directors would serve staggered terms and could not be removed except for cause. And the right of stockholders to remove the directors by written consent would end.

In the proxy statement sent to the stockholders, it was stated that the proposed charter changes were unanimously recommended by the directors. This statement was true when made. Since that time, however, two directors have changed their minds and now may oppose the amendments. A third director has resigned apparently in opposition to the amendments. The Defendant was not responsible for

the resignations and, upon learning of them, made a vigorous effort to advise the stockholders of the change in circumstances. This standing alone might not cause me to grant Plaintiff any relief. Unfortunately, however, the subsequent disclosures were delayed and it is likely that the revised information will not reach the stockholders soon enough to enable them to consider the changed circumstances.

More importantly, however, is the fact that the proxy statement probably inadvertently stated the Delaware law in such a way as to be likely to confuse or even mislead the stockholders. The proxy statement said:

> The proposed amendments are not designed to deter offers for all or at least two-thirds of the outstanding shares of the Company's Common Stock, and any person owning or controlling at least two-thirds of such shares would have the power to amend or delete proposed Articles 10 and 11 at the next meeting of the stockholders.

Actually, under Delaware law, because the directors will serve staggered terms if the amendments are approved, it would probably not be possible for an owner of three-fourths of the stock of the corporation to repeal the amendments in less than two annual meetings. Therefore, it appears likely that the proposed amendments would have the effect of deterring an offer for two-thirds of the outstanding shares of the company's common stock. Although this disclosure is technical and was probably made in good faith, it fails to meet the high standard of full and complete disclosure required by Delaware law. *Lynch v. Vickers*, Del.Supr., 383 A.2d 278 (1979).

I, therefore, find the proposed amendments should not become final until after a new disclosure is made which corrects the deficiencies. Of course, if the vote tomorrow is against the amendments, the matter becomes moot and no new disclosures are required. In the event there is an affirmative vote in favor of the amendments at the tomorrow stockholders meeting however, I direct that the corporation make a supplemental disclosure to the stockholders reflecting this opinion and give the stockholders an opportunity to revote in favor of the amendments. I find no basis for changing the record date.

IT IS SO ORDERED.

COMFORT, INC. *v.* McDONALD

No. 1066(S)

Court of Chancery of the State of Delaware, New Castle

June 1, 1984

Plaintiff sought enforcement of covenant not to compete against its former salesman, now employed by a competitor. During the course of defendant salesman's employment, plaintiff had all its then employed salespeople execute a written employment contract containing a non-competition covenant. The covenant sought to prevent salespersons who voluntarily terminated their employment from working for any competitor in the Delmarva Peninsula for one year. During the term of the contract, the defendant voluntarily left plaintiff's employment and began working for a competitor.

The court of chancery, per Chancellor Brown, held that the covenant was enforceable and that defendant had violated it. The court issued a temporary restraining order to prevent defendant from acting on his new employer's behalf on any jobs on which the plaintiff intended to bid. This action was intended to protect the plaintiff without totally prohibiting the defendant from working for his new employer.

1. Contracts ⇐ 117(2), 117(3)

A covenant not to compete is geographically reasonable when restricted to the area where the plaintiff actively conducts business.

Contracts ⇐ 54(2)

A promise of continued employment is sufficient consideration to support a restrictive covenant against competition.

3. Contracts ⇐ 54(2)

Where an employee has given notice of his intention to terminate his employment and, without actually terminating, then executes a written employment contract to remain with his employer, the written contract may constitute a rehiring of the employee on new terms, negating a need for any additional consideration for the restrictive covenant.

4. Injunctions ⇐ 58, 61(2)

Contracts ⇐ 117(2)

When a plaintiff demonstrates a likelihood of success on the merits

and a likelihood of irreparable injury, the court may restrain a defendant from acting in contravention of a restrictive covenant.

5. Contracts ⇐ 116(1)

In enforcing restrictive covenants, the court should seek to protect the plaintiff without unduly punishing the defendant.

William B. Chandler, Esquire, of Morris, Nichols, Arsht & Tunnell, Georgetown, Delaware, for plaintiff.

Robert C. Wolhar, Jr., Esquire, of Wolhar & Moore, P.A., Georgetown, Delaware, for defendant.

BROWN, *Chancellor*

In this action the plaintiff Comfort, Inc. seeks to enforce a contractual covenant not to compete against its former employee, the defendant, Craig McDonald. On the present record it is conceded that the defendant was formerly employed by the plaintiff, that he signed a contract of employment which contained a provision prohibiting him from competing with the plaintiff for a period of one year following a voluntary termination of his employment on his part, and that the defendant, since voluntarily resigning from his employment with the plaintiff on May 4, 1984, is now working for Sussex Electric, a direct competitor of the plaintiff, in the same capacity, namely, that of a sales representative, in which he worked for the plaintiff.

The plaintiff is located in Sussex County and is engaged in the electrical contracting business, including the installation of heating, air conditioning and plumbing. It allegedly employs over 200 people, including 10 sales representatives, and it actively does business throughout the entire Delmarva Peninsula, ranging as far north as the Wilmington area.

The defendant initially went to work for the plaintiff as a sales representative in May of 1983 under an oral arrangement. During the early fall of 1983 the defendant apparently obtained another employment opportunity and gave the plaintiff two weeks notice of his intention to terminate his employment. Thereafter, the new job opportunity of the defendant failed to materialize, and just prior to the expiration of the two-week notice period the defendant asked that his employment with the plaintiff be continued. It was, and a written contract

for a period of one year, commencing October 1, 1983 was entered into.

Shortly before this, plaintiff had become aware that several of its sales representatives were operating without the benefit of any written contract, and thus without any limitation as to their right to compete against the plaintiff in the event of their voluntary termination of their employment. The announced intention of the defendant to quit brought this to plaintiff's attention. Accordingly, the plaintiff states that it called a meeting of all of its sales representatives and tendered to them a form of employment contract which, among other things, contained a covenant not to compete in the event of the termination of their employment for any reason other than by the decision of plaintiff to do so. The noncompetition provision of the contract was allegedly explained to all of the sales representatives and the defendant, as well as the others, all agreed to the terms and executed such contracts. The noncompetition covenant in the contract signed by the defendant reads as follows:

> "In the event the employee terminates this agreement or any extensions thereto, the employee agrees, for a period of one (1) year not to work in Heating, Air Conditioning, Plumbing or Electrical in any capacity, on the Delmarva Peninsula, south of the canal."

Since it is not disputed that the defendant is now employed by a direct competitor of the plaintiff which is also situated in Sussex County, the plaintiff takes the position that the defendant is in violation of this noncompetition provision of his former contract of employment. Plaintiff asserts that as one of its sales representatives the defendant was given certain confidential information of the plaintiff dealing with the manner in which it submits bids on various contracts, including the profit margin under which it tries to work, which, if utilized on behalf of a competitor, would give the competitor an unfair advantage over the plaintiff hereafter in bidding on electrical contract work. Plaintiff contends that one purpose of the covenant not to compete was to prevent a former employee from disclosing this proprietary and confidential information to any direct competitors of the plaintiff.

Furthermore, plaintiff contends that the covenant not to compete is not unreasonable since it is limited to a period of one year and limited also to the precise geographical area in which the plaintiff conducts its business. Moreover, plaintiff says that the covenant does not prevent a former employee from engaging in work as a sales representative in the electrical field, that is to say, for example, as a represen-

tative for an electrical appliance distributor, but is only intended to prevent a former employee from working for one in direct competition with the business of the plaintiff. As to the fairness of the covenant, the plaintiff further points out that it does not apply if an employee is terminated by the plaintiff.

Finally, plaintiff contends that to the extent that the granting of a restraining order against the continuation of the defendant's present employment may impose a hardship upon him, it is one which he has brought upon himself with full knowledge of the circumstances.

Defendant does not dispute the existence of the restrictive covenant in the contract which he previously signed. However, he argues that it is too broad to be enforceable since it covers the entire Delmarva Peninsula. Moreover, the defendant relies on the decision in *Faw, Casson & Co. v. Cranston*, Del. Ch., 375 A.2d 463 (1977) for the proposition that where a new employment contract containing a covenant not to compete is presented to an employee during the course of his ongoing employment, there must be some new consideration given by the employer in addition to the continuation of his existing employment in order for the provision to be enforceable. Here, the defendant says that despite the fact that he had given notice of his intention to terminate his employment with the plaintiff in the fall of 1983, he was presented with the contract and his employment was continued before any termination actually took place. Therefore, he argues that there was no consideration given by plaintiff which would support the enforcement of the contractual provision not to compete.

The defendant also contends that so far he has only been engaged in submitting bids on government contracts for his new employer, a business area in which the plaintiff does not participate, and therefore he disputes that he is engaging in any direct competition on behalf of his new employer with the business of the plaintiff. In addition, the defendant argues that the case decisions in this State draw a distinction between noncompetition covenants enforced against a professional person as opposed to one who is merely a salesman. In the latter situation, the defendant argues that the policy of the Court has been not to enjoin the salesman from working altogether for his new employer but rather to merely enjoin the salesman from contacting any former customers serviced by him during the course of his former employment. See, *Knowles-Zeswitz Music, Inc. v. Cara*, Del. Ch., 260 A.2d 171 (1969); *Original Vincent and Joseph, Inc. v. Schiavone*, Del. Ch., 134 A.2d 843 (1957). Finally, the defendant contends that it would constitute an unjust hardship upon him to prevent him from working

altogether in the only area in which he is trained and experienced since he is currently divorced and has the sole responsibility for the care and support of five minor children.

Having thus summarized the contentions of the parties, it is my decision that the plaintiff has demonstrated its entitlement to preliminary injunctive relief.

On the present record the simple fact of the matter is that the defendant is doing just exactly that which he convenanted not to do under his former employment contract. He has voluntarily left the plaintiff's employ to work in the same capacity for a competitor of the plaintiff with full knowledge of his prior covenant no to do so. Thus, his argument as to the hardship that a restraining order would work upon him is not terribly appealing even if true.

[1] The *Faw Casson* decision on which the defendant relies specifically held that a geographical restriction to the Delmarva Peninsula south of the Chesapeake & Delaware Canal was reasonable where the business of the plaintiff was actively conducted throughout the Delmarva Peninsula. Indeed, the restrictive covenant here would seem to have been patterned after the decision in that case.

[2,3] Moreover, in the recent decision of *Research & Trading Corp. v. Powell*, Del. Ch. 468 A.2d 1301 (1983) it was held in the context of an employment contract at will that a promise of continued employment was sufficient consideration to support a restrictive covenant against competition. Also, it is certainly arguable that the written employment contract here constituted a rehiring of the defendant on new terms after he had resigned from his previous position.

[4,5] In short, I am satisfied that the plaintiff has demonstrated a likelihood that it will succeed on the merits of its claims at a final hearing and that it is likely to suffer irreparable injury unless some restraint is entered during the interim. At the same time, I am unwilling to enter an order which, in effect, would prohibit the plaintiff from continuing to work for his present employer. The need is to protect the plaintiff, and not to unduly punish the defendant.

Accordingly, a temporary restraining order will be entered enjoining the defendant from participating on behalf of his present employer, either directly or indirectly, in any bid preparations, computations or submissions for contract work on which the plaintiff also intends to submit a bid. To this end, and as a condition of the restraint granted, the plaintiff shall advise both the defendant and his present employer at least 10 days prior to the date for the submission of bids on any particular contract of its intention to bid on such contract. Any proven violation of this restraint by the defendant will constitute

a contempt of this Court's order and will not be treated lightly.

The restraining order hereby authorized will become effective upon the plaintiff giving bond in the sum of $5,000, with surety. I ask counsel for the plaintiff to prepare and submit a form of order to this effect by no later than Tuesday, June 5, 1984.

DELAWARE STATE TROOPERS' LODGE FRATERNAL ORDER OF POLICE, LODGE #6 v. STATE

No. 7228

Court of Chancery of the State of Delaware, New Castle

June 13, 1984

The Delaware State Troopers' Lodge Fraternal Order of Police brought suit seeking to obtain an order compelling the defendants to specifically perform the obligations of a collective bargaining agreement previously entered into by the plaintiff and defendant Department of Public Safety. The collective bargaining agreement contained salary schedules which called for pay increases for members of the State Police over a three year period which were not appropriated by the General Assembly and consequently not received by the members.

The court of chancery, per Chancellor Brown, granted summary judgment in favor of the defendants holding that: (1) the plaintiff failed to establish a cause of action against members of the executive branch who were not parties to the collective bargaining agreement; (2) the state agency had done all that it was required to do under the provisions of the agreement; (3) the court must limit the remedy of specific performance to the rights created by the contract; and (4) the state agency was not required to seek other funds from within its budget or elsewhere within the executive branch.

1. States ⇐ 130

Article VII, section 6 of the Delaware Constitution of 1897 has been construed judicially to impose a limitation on the collective bargaining statutes for state employees; namely that as to any agreement entered into under the public employee collective bargaining statutes, neither the state nor its agencies can be bound to the expen-

diture of funds which have not been properly appropriated by the General Assembly.

2. Labor Relations ⇐ 262

Where a state agency enters into a collective bargaining agreement with its employees, the fact that the state agency may be a part of the executive branch of the state government does not, as a matter of law, grant the plaintiff a right to relief from the governor or other members of the executive department who are not included in the terms of the agreement.

3. Labor Relations ⇐ 264

A state agency is required to do all those things contemplated and to perform all acts within its power that are necessary to bring about the performance of its undertakings under a collective bargaining agreement with its employees.

4. Specific Performance ⇐ 28(1), 31

Parties seeking specific performance of a contract must rest their case on an agreement which is clear and definite and in which there is no need for the court to be asked to supply essential contractual elements.

5. Specific Performance ⇐ 28(1), 31

Although there may be a moral obligation on the part of the defendant agency to compensate employees for funds not appropriated under a collective bargaining agreement, the court is required to limit the remedy of specific performance to the rights created by the contract.

6. Labor Relations ⇐ 257

Where expenditure of funds under a collective bargaining agreement is expressly made dependent upon appropriation by the state General Assembly, a state agency is not obligated to seek other funds from within its budget or elsewhere within the executive branch to compensate for deficiencies which have arisen.

Richard R. Wier, Jr., Esquire, and Myron T. Steel, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware, for plaintiff.

Fred S. Silverman, State Solicitor, and Barbara MacDonald, Deputy Attorney General, Wilmington, Delaware, for defendants.

BROWN, *Chancellor*

This matter has been submitted on the briefs for decision. Both sides have moved for summary judgment, it being conceded that there is no genuine issue as to any material fact. The legal question thus presented deals with the enforceability of a provision of a collective bargaining agreement entered into between a State agency and the exclusive bargaining representative for certain State employees. Both sides have tacitly agreed that a decision prior to the end of the current fiscal year of June 30, 1984 would be helpful to the respective interests of the parties.

The plaintiffs Delaware State Troopers' Lodge Fraternal Order of Police, Lodge 6 (hereafter "the FOP") filed this action against the Department of Public Safety, the State agency in charge of the Delaware State Police, and also against Daniel Simpson, both in his capacity as Acting Secretary of the Department of Public Safety as well as in his capacity as Superintendent of the Delaware State Police. Also named as defendants are Stephen T. Golding, State Budget Office Director, Duane Olsen, Controller General, and Pierre S. DuPont, IV, Governor of Delaware. The suit is based upon a collective bargaining agreement entered into between the FOP and the Department of Public Safety on June 28, 1982 which, among other things, contained salary schedules which called for pay increases for members of the State Police at the rate of 8% for Fiscal Year 1983, 7% for Fiscal Year 1984, and 7% for Fiscal Year 1985. The relevant facts which give rise to the dispute are as follows.

I

In Fiscal Year 1983 the 8% pay increase was granted. However, due to the condition of State finances at the time, no salary increases were authorized by the General Assembly for any State employees, including the State Police, in the budget adopted for Delaware State Government for Fiscal Year 1984. This was true despite the fact that the Governor, in the budget proposed by him and submitted to the General Assembly for approval, included the 7% salary increase for the State Police as called for by the collective bargaining agreement.

At the same time the Governor, as a matter of policy, announced that because of the State's financial situation he was "freezing" the normal step and cost-of-living raises normally given to all State employees. Accordingly, for whatever reason, the State Police did not receive the 7% increase in 1984 as called for by the agreement.

In January 1984, however, the General Assembly did subsequently authorize and the Governor did sign a bill granting a 4.3% increase in salaries for all State employees, thus increasing the salaries of all State employees, including the State Police, by 4.3% for the remaining months of Fiscal 1984. While the arithmetic employed is less than clear, the parties agree that this 4.3% increase for the balance of the year means, averaged out over the entire fiscal year, that the State Police received an approximate salary increase of only 2.15% for Fiscal 1984.

In the proposed budget submitted by the Governor to the General Assembly for the forthcoming Fiscal Year 1985—which as yet has not been acted upon by the General Assembly—the Governor has apparently proposed a salary increase for the State Police at the rate of 9.7% for Fiscal 1985. Presumably, this is made up of the 7% called for by the collective bargaining agreement for Fiscal 1985 plus a percentage needed for Fiscal 1984 so as to constitute a full 4.3% increase for that fiscal year. In any event, the net result of that which has gone before and that which is currently proposed for Fiscal Year 1985 will be that the State Police will not receive the full percentage of the salary increase for which they bargained for the Fiscal Year 1984 nor will they receive the full value of the salary increases called for over the three-year term of the collective bargaining agreement.

It is admitted on behalf of the defendants that the Governor "and all subsidiary state officials of the Executive Department" intend to do nothing more for Fiscal 1985 than to propose to the General Assembly that the State Police receive the 9.7% increase in salary for the forthcoming fiscal year. The facts relied upon by the parties make no reference to the percentage of salary increase sought by the Department of Public Safety in its request to the Budget Director and the Governor for funds to be included in the Fiscal 1985 budget to be proposed to the General Assembly by the Governor, but I think it must be assumed to be a fact from that which has been presented that the request was for at least the 7% called for by the collective bargaining agreement for the third year of the contract if not the full 9.7% actually proposed.

II

The FOP feels that the foregoing circumstances leave the collective bargaining agreement dishonored by the State. However, its quarrel is not with the General Assembly for failing to fully fund the 7% increase called for by the collective bargaining agreement for 1984. Indeed it could not be since the agreement contains the following provision:

> "The parties recognize that the implementation of this Agreement is dependent upon funds being provided by the General Assembly."

[1] This contractual provisions does no more than recognize the hopefully permanent status of the law in this area. Article VIII, Section 6 of the *Delaware Constitution of 1897* directs that "[n]o money shall be drawn from the treasury but pursuant to an appropriation made by Act of the General Assembly," and this constitutional provision has been construed judicially to impose a limitation on the collective bargaining statutes for State employees, namely, that as to any agreement entered into under the public employee collective bargaining statutes neither the State nor its agencies can be bound to the expenditure of funds which have not been properly appropriated by the General Assembly. *State v. American Fed'n of State, County & Mun. Employees, Local 1726*, Del.Ch., 298 A.2d 362 (1972). See also, *Opinion of the Justices*, Del.Supr., 177 A.2d 205 (1962) which holds, among other things, that the General Assembly may not delegate to a State agency the authority to exercise the powers vested in the General Assembly by Article VIII, Section 6.

Nonetheless, the FOP feels that it has a cause of action under the agreement against those members of the Executive Department of State named as defendants herein. The FOP's position is based squarely on the decision of this Court in *State v. American Fed'n of State, County & Mun. Employees, Local 1726, supra*, (referred to hereafter as "*Local 1726*" for ease of reference) and it runs as follows.

In *Local 1726* the exclusive bargaining representative for employees for the State Division of Adult Corrections sought by counterclaim to enforce the provisions of a collective bargaining agreement entered into between it and the State Department of Health and Social Services ("the Department") which called for the Department to supply certain health insurance coverage for the employees and their families. The Department had failed to do so and, although the opinion is less than clear on the point, the Department apparently defended on the

grounds that the General Assembly had not appropriated to it the funds needed to obtain such insurance coverage. At least the basis for the decision in *Local 1726* centers around this circumstance.

In siding with the bargaining representative of the employees the Vice Chancellor summed up the situation in the following manner at 298 A.2d 367, 368:

> "It follows that although this agreement could not bind the Department to the expenditure of funds for health insurance until those funds had been properly appropriated, *it could and did bind the Department to do all of those things the agreement contemplated which were within the Department's legitimate powers.* The statute commands that the public employer 'negotiate in good faith,' 19 Del.C. § 1309, and *a good faith negotiation implies that the employer will perform those acts within its power necessary to bring about performance of its undertakings.* Therefore, the Department *may not hide behind a veil of administration inaction* drawn across the terms of an otherwise properly negotiated agreement.
>
> "It is plain that the Department has not done what it said it would do in the agreement; that is, it has not provided the agreed upon health insurance. It is equally plain that this court is without power to order the expenditure of funds for such insurance without appropriation. However, I am satisfied that the Department is in a position to provide the payment of insurance premiums, in conformity with the constitution, by the simple administrative act of including those payments as a 'priority item' in its budget.
>
> "I am aware that the decision not to include those premiums as a priority item was based upon an administrative judgment as to what items were required to be so included in order [to] meet the minimum needs of the Department, a decision based upon the exercise of discretion in 'trading off' potential priority items. But the Department signed away its discretion when it bound itself to this agreement. *It is, therefore, bound to pursue every step within its power to see that the insurance is provided.* The time for discretionary 'trade-offs' is before and during the bargaining, not after a solemn agreement has been made." (Emphasis added).

The Vice Chancellor concluded that the bargaining representative was entitled to an order compelling the Department to include the cost of obtaining the agreed upon health insurance as a priority item in its budget.

Drawing upon the literal language of the decision in *Local 1726*, the FOP argues that even though the collective bargaining agreement here could not bind the General Assembly to appropriate the monies needed to fund the full pay increase for members of the State Police called for by the agreement, it did bind the Department of Public Safety nonetheless, as well as the Governor as the head of the Executive Branch of State government, and the Budget Director, the Controller General and the Superintendent of the Delaware State Police as necessarily involved members of the Executive Branch, "to pursue every step within [their] power to see that the [pay increase] is provided." This, the FOP charges, the defendants have failed to do.

Accordingly, by this suit the FOP seeks an order compelling the Governor, the Department of Public Safety and the other named individual defendants to specifically perform the obligation of the collective bargaining agreement. In particular, the FOP asks for an order compelling the Governor and the other named defendants to include in the Fiscal 1985 budget request for the Department of Public Safety sufficient monies to fund in full the salaries called for by the collective bargaining agreement retroactive to July 1, 1983, together with interest on the salary monies heretofore unpaid. The FOP further asks that the order compel the Governor and the other named defendants "to take every step within their power, including lobbying, the submission of legislation and the submission of amendatory and supplementary appropriations . . . to ensure that all contractual salaries are funded."

In its argument in support of its motion for summary judgment the FOP further contends that the defendants Simpson, Golding and Olsen have a duty under the collective bargaining agreement to transfer funds administratively from among those remaining available to the Department of Public Safety for Fiscal 1984 for other purposes so as to fully fund the salary increase contemplated by the agreement, even to the point of reclassifying employees within the Division of State Police if it becomes necessary to do so. In short, the FOP contends that *Local 1726* requires the defendants to anything and everything possible to find or acquire within State government the money to fund in full the three-step salary increases proposed for the State Police in the collective bargaining agreement. Anything short of such an all-out effort by all of the named defendants is viewed by the FOP to be a breach of the collective bargaining agreement.

The defendants, on the other hand, take the position that the obligation of the bargaining agreement is fulfilled at such point as the Governor, during each year of the contract, submits a proposed budget to the General Assembly which includes a proposal that funds be

appropriated to fund salary increases for the State Police in the amount called for by the contract. This admittedly having been done for all three fiscal years covered by the term of the bargaining agreement, the defendants urge that summary judgment be entered in their favor dismissing the complaint on the merits.

III

I rule on this matter strictly on the basis that is has been submitted for decision by the parties. As a result, I conclude that the motion of the defendants for summary judgment must be granted and that the motion of the FOP must be denied.

[2] For one thing, the sole authority relied upon by the FOP is the decision in *Local 1726,* and that decision only dealt with the obligation of the contracting State agency under the terms of a collective bargaining agreement. Presumably on the theory that the Department of Public Safety is a State agency, and thus a part of the Executive Branch of State Government, the FOP has attempted to expand the decision in *Local 1726* to apply to the Governor and others in the Executive Department as well despite the fact that they are not parties to the collective bargaining agreement. In so doing it has purported to bridge a logical gap without any legal basis. There is nothing in *Local 1726* which supports or justifies such an interpretation of its content.

The FOP has offered no other authority in support of this underlying premise to its argument, namely, that where a State agency enters into a collective bargaining agreement with its employees pursuant to the statutes authorizing collective bargaining by public employees, it binds the Governor and all other members of the Executive Department to the obligation of the contract as well. That being so, the FOP has clearly failed to demonstrate that as a matter of law it has a right to relief against the defendants other than the Department of Public Safety under the terms of the collective bargaining agreement. Thus, the FOP has failed to state a cause of action against the Governor, the Budget Director and the Controller General on the evidentiary record of the case and accordingly as to these defendants summary judgment must be entered in their favor.

IV

[3] As to the Department of Public Safety and the defendant Simpson as its Acting Secretary as well as Superintendent of the Division of State Police, the latter being a governmental unit within the

Department of Public Safety, the decision in *Local 1726* clearly applies. But in my view it does not require these defendants to do all that the FOP seeks to have them compelled to do.

Local 1726 requires a State agency to do all those things contemplated and to perform all acts within its power that are "necessary" to bring about the performance of its undertakings under a collective bargaining agreement with its employees. 298 A.2d 368. In *Local 1726* the dereliction of the State agency was its failure to designate monies needed for health insurance coverage which it was committed to provide under the collective bargaining agreement as a "priority" item in the agency's budget request so as to necessarily cause that expense to be included by the Governor in the budget proposed by him to the General Assembly. It was found to be within the power of the State agency to do this so as to assure that its request for funds from the State treasury for that purpose would be considered by the General Assembly, and it was found necessary for the agency to do so since it had undertaken the obligation to attempt to obtain funds for this purpose under the agreement. It was in that context that the Vice Chancellor found that the agency had failed to take all steps within its power to see that the obligation of the contract was funded by the General Assembly.

Here, the record supports the conclusion that for each of the three years of the collective bargaining agreement the Department has caused the salary increase called for by the contract to be put before the General Assembly for its consideration in the budget proposed by the Governor. Thus, the Department of Public Safety here has done all that the State agency was ordered to do in *Local 1726*.

[4,5] Thirdly, the action here is one to specifically enforce the obligations of a party to a collective bargaining agreement. This necessarily requires a look at the contract itself. The agreement here does not contain language by which the employees are to be guaranteed a total increase in salary over a period of three years. Rather, the agreement provides that the "regular salaries of all Employees shall be in accordance with the schedules set forth in Exhibit 'A,' 'B' and 'C' attached hereto, and made part of this Agreement." The attached schedules set forth salary figures by rank and grade for State Police officers for each of the fiscal years beginning on July 1 of 1983, 1984 and 1985 respectively. These schedules presumably work out to percentage increases of 8%, 7% and 7% over each of the three years.

In view of the fact that the parties expressly recognize in the agreement "that the implementation of this Agreement is dependent upon funds being provided by the General Assembly" it seems clear that

the obligation imposed upon the Department of Public Safety by the agreement is to attempt in good faith to seek funding from the General Assembly in order that the salary schedules proposed for Fiscal Years 1983, 1984 and 1985 are put into effect for each of those years. There is nothing in the language of the contract that I see which imposes an obligation on the Department of Public Safety to seek to make up in a subsequent year a deficiency in the salary schedule for a preceding year brought about the failure of the General Assembly to fully fund the salary schedule as requested.

It is settled law in this Court that a party seeking specific performance must rest his case on an agreement which is clear and definite and in which there is no need for the Court to be asked to supply essential contractual elements. *M.F. v. F.*, Del.Ch., 172 A.2d 274 (1961); *Simms v. Schwartz*, Del.Ch., 134 A.99 (1926). To enforce the agreement here so as to require the Department of Public Safety to seek in its 1985 budget request funds to make up the deficiency in the 1984 salary increases authorized by the General Assembly would be to add a term to the collective bargaining agreement which does not clearly appear from its language, nor by necessary implication therefrom. Arguably, there may have been a moral obligation on the part of the defendant agency to make such an effort, but the Court is required to limit the remedy of specific performance to the rights created by the contract.

Finally, as to the argument of the FOP that the Department of Public Safety is contractually obligated to seek to use other funds from within its budget, or to seek other funds elsewhere within the Executive Branch so as to make up the Fiscal 1984 deficiency, it would seem that its own case authority stands against it. In *Local 1726*, as previously cited herein, it was held that the collective bargaining agreement "could not bind the Department to the expenditure of funds for health insurance until those funds had been properly appropriated." 298 A.2d 368. Applying that holding to this case, the collective bargaining agreement here cannot be held to bind the Department of Public Safety to an expenditure of funds for salary increases unless funds have been properly appropriated for that purpose by the General Assembly.

Accordingly, deciding the present motions strictly on the basis on which they were presented, I find that summary judgment must also be entered in favor of the defendants Simpson and the Department of Public Safety.

An appropriate form of order may be submitted.

DEPARTMENT OF TRANSPORTATION *v.* DELAWARE EMPLOYEES COUNCIL NO. 81

No. 833

Court of Chancery of the State of Delaware, Kent

May 4, 1984

Plaintiff Delaware Department of Transportation sought to stay an arbitration proceeding initiated by a labor union pursuant to the union's labor contract with the department. The court of chancery, per Vice-Chancellor Hartnett, denied the application holding that the plaintiff must first address the issue of whether the controversy is subject to arbitration to the arbitrator and not to the courts. If it is found that the claims of the defendant are not within the scope of the arbitration agreement, then the plaintiff may proceed in court to vacate any award made.

1. Arbitration ⇐ 23.12

The only grounds for enjoining an arbitration are: (1) a valid arbitration agreement was not made; (2) the arbitration agreement has not been complied with; or (3) the arbitration is barred by a lapse of time. DEL. CODE ANN. tit. 10, § 5703(b) (1953).

2. Arbitration ⇐ 7.1

The question of the scope of an arbitration agreement is first addressed to the arbitrator.

3. Arbitration ⇐ 76(1)

An arbitration award may be vacated where the arbitrators exceeded their powers or so imperfectly executed them that a final and definite award upon the subject matter was not made. DEL. CODE ANN. tit. 10, § 5714(a)(3) (1953).

4. Arbitration ⇐ 7.4

Where one is unsuccessful in arguing to the arbitrator that the claims of the opposing party are not within the scope of the arbitration agreement, then one may proceed in court to seek to vacate any award made.

5. Arbitration ⇐ 7.4

Questions of whether a particular controversy is subject to

arbitration should first be addressed to the arbitrator and not to the courts.

Mark A. McNulty, Esquire, Deputy Attorney General, Department of Transportation, Dover, Delaware, for plaintiff.

Thomas L. Little, Esquire, of Wilmington, Delaware, for defendant.

HARTNETT, *Vice Chancellor*

Plaintiff seeks to stay an arbitration proceeding which is scheduled to be held on May 10, 1984. The defendant, a labor union, sought arbitration pursuant to a clause in its labor contract with the plaintiff. The controversy arises because the Governor on February 11, 1983, issued proclamation declaring a snow emergency and providing that certain state employees could be excused from work early. The complainants were not excused because they were needed to help in the removal of the snow and now seek, through a grievance procedure which provides for arbitration, additional money or compensatory leave for the time they were required to remain at work. Plaintiff seeks to enjoin the arbitration because it claims that the issue presented is not within the scope of the arbitration agreement. It claims that the question of additional compensation for the employees is precluded by certain Rules of the State Merit System. The plaintiff's application to enjoin the arbitration must be denied.

10 *Del. C.* § 5703(b) sets for the only grounds for the enjoining of an arbitration. These are: (1) that a valid arbitration agreement was not made; (2) that the arbitration agreement has not been complied with; or (3) that arbitration is barred by a lapse of time. *State v. James Julian, Inc.*, Del. Ch., C.A. No. 748-K, Hartnett, V.C. (March 8, 1983). None of these three grounds relate to the question of whether the claim is arbitrable. As I stated in my opinion in *James Julian, Inc. v. Raytheon Service Co.*, Del. Ch., 424 A.2d 665 (1980), the question of the scope of an arbitration agreement is first addressed to the arbitrator.

10 *Del. C.* § 5714 provides for the vacating of an arbitration award. 10 *Del. C.* § 5714(a)(3) provides that an award may be vacated where "the arbitrator exceeded their powers, or so imperfectly executed them that a final and definite award upon the subject matter was not made."

It is therefore clear that if the plaintiff is unsuccessful in arguing to the arbitrator that the claims of the defendant are not within the

scope of the arbitration agreement, then it may proceed, pursuant to 10 *Del. C.* § 5714(a)(3), to seek to vacate any award made.

The purpose of arbitration is to avoid lawsuits and to give the parties a forum for the resolution of their disputes without the necessity and expense of a proceeding in a court. Questions of whether a particular controversy is subject to arbitration therefore should first be addressed to the arbitrator and not to the courts.

The plaintiff's application to enjoin arbitration is therefore denied.

IT IS SO ORDERED.

DMG, INC. *v.* AEGIS CORP.

No. 7619

Delaware Court of Chancery of the State of Delaware, New Castle

June 29, 1984

Action by plaintiff, DMG, Inc., seeking enforcement of contractual rights claimed under an April 23, 1984, agreement and plan of merger with defendant Aegis Corporation. Plaintiff moved for a preliminary injunction to prevent defendant from altering bylaws, articles of incorporation, assets, indebtedness, or the business structure of Wellcraft Marine Corporation, a wholly-owned subsidiary of Aegis.

Plaintiff alleged its right to enforcement of the written option granted it by Aegis to acquire, for a period of one year, a fifty-one percent interest in Wellcraft. Plaintiff based its claim on the fulfillment of the condition that a third party acquire a forty percent or greater interest in Aegis prior to completion of the DMG-Aegis merger.

The court of chancery, per Chancellor Brown, held that the motion for a preliminary injunction must be denied. Because the court found plaintiff's consideration in the underlying contractual agreement lacking, it held that plaintiff had failed to demonstrate the likelihood of success on the merits necessary for the relief sought.

1. Injunction ⇐ 136(1)

Application for preliminary injunction is evaluated in light of the given context in which the application has arisen.

2. Contracts Enforceable ⇐ 25, 32, 48

Valid consideration is lacking for enforcement of alleged contractual rights when party seeking enforcement neither paid nor promised to pay anything.

3. Injunction ⇐ 137(1)

A preliminary injunction will not issue unless a plaintiff has established a reasonable probability of ultimate success on final hearing.

4. Corporations ⇐ 310(2)

The business judgment rule is customarily invoked as a defense measure by directors who are being sued for an alleged impropriety.

5. Corporations ⇐ 310(1)

Absent authority for the proposition, the business judgment rule cannot be utilized by a plaintiff to gain specific performance from the successor board of directors of a corporation for actions undertaken by the former board.

6. Specific Performance ⇐ 5, 128(1)

Where there is no evidence that plaintiff bargained for anything of unique value for plaintiff, plaintiff is not entitled to specific performance, but rather would be limited to the remedy of damages for breach of contract.

7. Equity ⇐ 56

A court of equity looks to the substance of a transaction, not to its form, in determining how the parties intended the provisions of an agreement to control the rights granted under it.

8. Injunction ⇐ 136(1)

A preliminary injunction will not issue where plaintiff has failed to demonstrate convincingly that it is likely to succeed on the merits of its position upon final hearing.

Richard L. Sutton, Esquire, and William H. Suddell, Jr., Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, and Asa Rountree, Esquire, Standish F. Medina, Jr., Esquire, and Bart Schwartz, Esquire, of Debevoise & Plimpton, New York, for plaintiff.

R. Franklin Balotti, Esquire, and Samuel A. Nolen, Esquire, of Richards, Layton & Finger, Wilmington, Delaware, and Dennis J. Block, Esquire, Joseph S. Allerhand, Esquire, and Jonathan M. Hoff, Esquire, of Weil, Gotshal & Manges, New York, for defendant.

BROWN, *Chancellor.*

By this action the plaintiff, DMG, Inc., a Florida corporation ("DMG"), seeks to enforce certain contractual rights claimed by it under an agreement and plan of merger entered into with the defendant Aegis Corporation ("Aegis") on April 23, 1984. As a part of the overall relief sought, DMG has moved initially for a preliminary injunction to prevent Aegis from altering the bylaws, articles of incorporation, assets, indebtedness or the business structure of Wellcraft Marine Corp. ("Wellcraft"), a wholly-owned subsidiary of Aegis, and to prevent Aegis from effecting any other change in Wellcraft which would not be in the ordinary course of Wellcraft's business pending the outcome of this litigation.

This prayer of DMG for preliminary injunctive relief centers around a written option given by Aegis to DMG which, by its terms, granted DMG the right for a period of one year to acquire 51% of Wellcraft upon the happening of a certain event, namely, the acquisition by a third party of 40% or more of Aegis's stock prior to the consummation of the agreed-upon merger between DMG and Aegis. That event has occurred. On or about May 15, 1984, a third party, Minstar, Inc. ("Minstar"), acquired some 77% of the outstanding stock of Aegis by means of a public tender offer. Minstar has since replaced the former board of directors of Aegis which entered into the merger agreement with DMG with a new board composed of its own nominees. Since the agreement between DMG and Aegis requires that the merger be approved by a majority of the shareholders of Aegis, and since Minstar has since obtained a majority position in Aegis prior to the proposed merger being voted upon, it seems highly unlikely that the proposed merger will ever be approved.

Viewed realistically, it would seem that the Wellcraft option as well as certain other features of the merger transaction proposed between DMG and Aegis, through its then board of directors, came into being as a result of defensive strategy designed to discourage Minstar's attempt to take over Aegis. Minstar had commenced its tender offer for any and all shares of Aegis on April 6, 1984, more than two weeks before the Wellcraft option and merger agreement between DMG and Aegis

were executed. Part of Minstar's business is the manufacture and sale of fiberglass and aluminum boats. Wellcraft is in a similar boating business and apparently enjoys considerable success. Thus, it is not unreasonable to assume that one of Minstar's primary considerations in seeking to gain control of Aegis was a desire to thereby acquire control of the operations of Wellcraft, its wholly-owned subsidiary. Similarly, it is not unreasonable to assume that by granting an option to DMG to acquire 51% stock interest in Wellcraft in the event that Minstar obtained 40% interest in Aegis through the tender offer, Aegis was attempting at the time to create a roadblock to the Minstar effort. It is in this context that the present application of DMG must be considered.

At the time that the merger agreement and option were executed, Minstar's tender offer price stood at $5.25 per share. Under the merger agreement DMG proposed to acquire all Aegis shares at $5.75 per share. The merger agreement further provided that Aegis would pay all legal expenses of DMG connected with the merger up to $1.25 million, even in the event that the merger did not go through. The merger agreement also provided that in the event that a third party acquired more than 40% of Aegis's stock prior to the expiration of the contractual time period in which the merger could be completed, then Aegis would pay DMG a fee (or penalty as Minstar's interests would have it) of $1.5 million. A second option agreement granted by Aegis gave DMG the right to purchase some 1.4 million authorized but unissued shares of Aegis in the event that a third party acquired 40% or more of Aegis prior to the closing on the merger. Initially at least, there was also a side agreement by which the management of Aegis was guaranteed certain financial considerations by DMG upon the completion of the merger.

Following the announcement of the merger agreement, Minstar increased its tender offer price to $6.00 per share. DMG responded by announcing that it did not intend to offer anything more, or, as reported by the Wall Street Journal, when Minstar increased its offer to $6.00 per share DMG "walked away."

Thereafter, Minstar completed its tender offer, acquired its present 77% interest in Aegis and installed its new board of directors to control the affairs of Aegis. Shortly thereupon, Aegis, as sole shareholder of Wellcraft, caused the certificate of incorporation and the bylaws of Wellcraft to be amended so as to provide for a classified board of directors and for cumulative voting for directors, and so as to add also a requirement for a two-thirds vote of all outstanding shares

for any action by Wellcraft that requires shareholder approval. The obvious effect of this action is to render useless the 51% stock interest in Wellcraft granted to DMG under the option insofar as the power to immediately use that 51% interest to control Wellcraft is concerned. On information and belief DMG also fears that Aegis, as now controlled by Minstar, harbors the further intention to sell or dispose of the assets of Wellcraft or to commingle them with Minstar's boating interests to the extent that it may feel it necessary in order to further thwart any rights claimed by DMG under the Wellcraft option. Accordingly, DMG seeks a preliminary injunction to prevent any such actions by Aegis until such time as DMG's rights under the Wellcraft option, as well as under other terms of the merger agreement, can be resolved through this litigation.

The application of DMG presents a disturbing issue given the context in which the application has arisen. I must concede that I have had great difficulty in attempting to resolve the matter, as the time interval between the application and the decision will attest. However, I am convinced at this point that the motion for the preliminary injunction must be denied.

The issue is disturbing for several reasons. For one thing, as Aegis now points out, DMG is attempting to enforce the Wellcraft option, as well as certain other alleged contractual rights, for which it paid absolutely nothing. In the face of the Minstar tender offer Aegis sought a protective suitor. Enter DMG. But, in return for its agreement to merge with Aegis at a higher price per share to Aegis's shareholders than was then being offered by Minstar, DMG insisted upon certain things from Aegis. One was the requirement that all of its counsel fees and expenses in connection with the merger up to $1.25 million be paid by Aegis. Another was the requirement that Aegis pay it a fee of $1.5 million in the event that a third party acquired a 40% interest in Aegis prior to the completion of the merger. A third was the right to purchase 1.4 million shares of Aegis at an established price in the event that a third party acquired such a 40% interest. Finally, there was the requirement that DMG be permitted to purchase a 51% interest in Wellcraft at a fixed price of $16 million in the event that a third party acquired a 40% interest in Aegis prior to the consummation of the merger.

For all of these purported contractual entitlements, DMG did no more than obligate itself to obtain the financial commitments necessary to enable it to merge with Aegis at a price of $5.75 per share to be paid to the shareholders of Aegis. It neither paid nor promised to pay

anything to Aegis itself for the additional rights it received in return. In particular, it paid nothing to Aegis as such for the two options, including the Wellcraft option.

Moreover, DMG necessarily insisted upon and obtained these contractual concessions from Aegis with full knowledge of Minstar's competing effort to acquire Aegis. In this regard, it must be noted that all of the above considerations insisted upon and obtained by DMG were geared to losing in its thereby established contest with Minstar to acquire Aegis. Thus, it was bargaining from the outset on the basis that its offer to merge, although accepted by Aegis, would possibly be topped by another, and it is relying on this promise to merge under the frailities of these known conditions as constituting sufficient legal consideration to support also the additional contract rights claimed by it, including the option to acquire a 51% interest in Wellcraft. I must confess that I have some doubt as to whether or not a valid consideration for the Wellcraft option actually exists.

At the same time there is no doubt that a document purporting to create the Wellcraft option does actually exist and that it was authorized by the board of directors of Aegis which was then in control of the corporation. At this preliminary injunction stage, this is a factor to be reckoned with, particularly in light of DMG's burden to demonstrate a likelihood of success on the merits. And this leads to a second problem area.

Because of the success of the Minstar tender offer, Aegis has a new board. Thus, while Aegis, the corporation, granted the Wellcraft option, and while relief is now being sought against Aegis to protect the rights allegedly granted by the option, Aegis is not now the same corporation that granted the option. This is because Aegis now has a new and controlling shareholder—namely, Minstar, the party who I think it fair to say the Wellcraft option was designed to discourage—and a new board of directors which predictably views the legal effect of option differently than did its predecessor board.

This situation creates confusion because it has prompted DMG to rely on the business judgment rule as a reason to support its preliminary injunction application. Aegis has argued that the Wellcraft option constitutes a waste of corporate assets and a breach of fiduciary duty by the previous management of Aegis motivated by a design to perpetuate itself in office. For this reason, Aegis argues that the option should not be protected by a preliminary injunction.

DMG counters by arguing that in a tender offer situation defensive maneuvers by a target company, including a sale of assets or subsidiaries to a third party, are not open to attack on the basis of a

breach of fiduciary duty or a waste of assets when they are undertaken based upon the informed business judgment of the board of directors acting in what it believes to be the best interests of the shareholders. *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.) (applying Delaware law), *cert. denied*, 454 U.S. 1092 (1981); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982) (applying Delaware law); *GM Sub Corp. v. Liggett Group, Inc.*, Del. Ch., C.A. No. 6155, Brown, V.C. (Apr. 24, 1980). Thus, DMG argues that the previous board of directors of Aegis has the protection of the business judgment rule available to it with regard to its grant of the Wellcraft option, and that the burden here is on Aegis with its management as now constituted to overcome the presumption of validity accorded to the act of its prior board. It argues that Aegis has not met this burden.

This, of course, means that DMG, as the plaintiff is attempting to claim the benefit of the business judgment rule available by law to the board of directors with which it dealt in an effort to establish its right to preliminary injunctive relief against a corporation now directed by a successor board. I must confess that this strikes me as a novel approach. Our case decisions indicate that in general concept the business judgment rule is customarily invoked as a defensive measure by directors who are being sued for an alleged impropriety.

Correspondingly, Aegis is cast in the role of denying that the business judgment rule applies to action taken by its own board of directors. The parties have got things turned around. The offense is attempting to score with a defensive maneuver while the defense has dug in with a basic play taken from the playbook of the offense. It is little wonder that this portion of the game is difficult to follow.

However, while the cases relied upon by DMG are good as far as they go, none of them stand for the proposition that the business judgment rule can be utilized by a plaintiff in the manner attempted here for the purpose of establishing a right to a preliminary injunction against internal corporate action. The absence of any such authority at this stage of the proceedings is persuasive against the argument.

There is also a third factor. DMG's prayer for injunctive relief with regard to the Wellcraft option is based necessarily on a claimed right to specific performance. The right to specific performance is based in turn on the premise that the Wellcraft option entitles DMG to something unique. The claimed uniqueness derives from the contention that the option gives DMG the right to acquire control of Wellcraft at any time during the one-year option period at the stated option price. Compare, *Equitable Trust Co. v. Gallagher*, Del. Supr., 102 A.2d 538 (1954).

The option itself, however, does not speak to control even though the 51% figure indicates that control was probably within the contemplation of the parties. Rather, it gives DMG the right to purchase 51% of the stock of Wellcraft upon the happening of the stated event. Since the option was obtained in the face of an ongoing tender offer by Minstar for control of the parent, Aegis, it necessarily had to be within the realm of foreseeability at the time that the option was given by Aegis to DMG that Minstar might do precisely what it has done here, namely, increase its tender offer price so as to prevail over DMG's merger proposal, acquire a controlling interest in Aegis, and thereafter bring about a change in the charter and bylaws of Wellcraft before the option was exercised by DMG so as to require something more than a 51% stock ownership interest to guarantee immediate control of Wellcraft's board of directors. The fact that DMG chose not to compete further with Minstar and to offer nothing more than the $5.75 per share price set forth in the merger agreement is a further indication to me that it was prepared to concede at the outset that Minstar was likely to be successful in obtaining a controlling interest in Aegis.

Since the Wellcraft option must be viewed realistically in the setting in which it was obtained, I am not entirely convinced that DMG is entitled to rely on the premise that the Wellcraft option guaranteed it the right at any time during a period of one year to purchase control of Wellcraft. In fact, the option document itself contains no language which would purport to restrict Aegis from altering the charter or bylaws of Wellcraft during the period of the option.

If the option cannot be said to carry with it necessarily the right to acquire control of Wellcraft, then it is at least arguable that it carries with it nothing of unique value to DMG and that consequently DMG has no right to specific performance as opposed to a recovery of damages for a breach of the option obligation by Aegis. This leads to the final factor that requires discussion here.

DMG points to a provision of the merger agreement between it and Aegis which does, in fact, require Aegis to hold all of its assets and subsidiaries intact pending the consummation of the proposed merger. This provision specifically forbids the amendment of either the certificate of incorporation or the bylaws of a subsidiary of Aegis during the time period prior to the consummation of the merger.

The merger agreement sets October 31, 1984 as the outside date within which the proposed merger can be completed. The merger agreement, of course, is with Aegis. Thus DMG argues that even though Minstar has since obtained a controlling interest in Aegis, thus making it all but certain that the proposed merger agreement with DMG

will never receive the requisite shareholder approval, the merger agreement itself nonetheless remains a live contract at least through October 31, 1984 and under its terms Aegis may not alter the charter or bylaws of Wellcraft or dispose of or commingle its assets. DMG argues that it is entitled to have this provision of the merger agreement enforced which, if done, would serve to put Wellcraft back in a position in which DMG could meaningfully exercise its option and acquire a 51% controlling interest in Wellcraft prior to the expiration of the merger agreement.

I cannot accept this argument either. The provision in the merger agreement on which DMG relies was obviously intended to assure DMG that it would get, upon the completion of the merger, that for which it bargained in the merger agreement. DMG is now forced to concede the obvious, namely, that the merger will never take place due to the inability to obtain shareholder approval by Aegis. At the same time it wants the clinically dead merger agreement enforced so as to protect its rights in a separate option which, by its terms, only came into being because the shareholder vote needed to approve the merger agreement became unobtainable.

A court of equity looks to the substance of a transaction, not to its form. While technically the merger agreement may still be performable according to its terms, the reality of the situation appears to be that it is over and done with. It is no doubt true that the merger agreement and the Wellcraft option were both a part of the proposed merger package between DMG and Aegis. But in practical effect, the latter was intended to come to life only when the former died. As so structured I cannot conclude that DMG had made a sufficient showing at this stage that the provision of the merger agreement relied upon was intended to control the rights granted to it under the option.

As noted previously, I have had considerable difficulty in resolving this matter. Admittedly, DMG's position has been drafted with care so as to give it the maximum advantage of legal technicality. It may be that on a more expansive record I might be forced to view one or more of the factors discussed herein differently. However, taking them all together at this juncture on the record and arguments on which the positions of the parties were presented, I am persuaded that DMG has failed to demonstrate convincingly that it is likely to succeed upon the merits of its position with regard to the Wellcraft option upon a final hearing.

Accordingly, the motion for DMG for a preliminary injunction is denied. IT IS SO ORDERED.

E.I. DU PONT DE NEMOURS & CO. v. SHELL OIL CO.

No. 6696

Court of Chancery of the State of Delaware, New Castle

June 6, 1984

Plaintiff E.I. du Pont de Nemours and Company, Inc. (Du Pont) sought a declaratory judgment against defendant Shell Oil Co. Plaintiff had granted a license to defendant for the sale and manufacture of a patented chemical. Subsequently, defendant entered into an agreement with a third party whereby that party would make the licensed chemical for defendant and then buy it from defendant.

Plaintiff claimed that this agreement between defendant and the third party was a sublicense in violation of the licensing agreement between plaintiff and defendant.

Defendant claimed that the third party agreement was in compliance with the terms of defendant's agreement with plaintiff. Moreover, the agreement between plaintiff and defendant did not specifically address the permissibility of manufacture by and resale to the same third party.

The court of chancery, per Vice-Chancellor Longobardi, held that the agreement between defendant and the third party was not in violation of the agreement between plaintiff and defendant. Furthermore, the court reasoned that the parties legally obtained the right to compete against each other and the court would not intervene to upset the natural order of the marketplace by rewriting the agreement.

1. Contracts ⇐ 143.5
   Patents ⇐ 211(1)

In interpreting an agreement, it is not enough to look at the end result; rather there must be an examination of the relevant documents and surrounding circumstances and a determination of things like custody, control, and title before the issue can be resolved.

2. Contracts ⇐ 155
   Patents 211(1)

Where there is to be any construction of an agreement, it must be construed against the drafter.

3. Contracts ⇐ 143(3)
   Patents 216

Where parties bargained for and obtained the right to openly and aggressively compete against each other, the court will intervene to upset the natural order of the marketplace by rewriting the agreement.

4. Contracts ⟸ 143(1)

If competent parties, uninfluenced by improper forces, bind themselves by an agreement which they later realize is improvident, they may blame themselves alone, and they may not importune the courts for relief.

Richard L. Sutton, Esquire, and Jack B. Blumenfeld, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

E. Norman Veasey, Esquire, and Allen M. Terrell, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendant.

LONGOBARDI, *Vice-Chancellor*

In 1968, the Plaintiff, E.I. du Pont de Nemours and Company ("DuPont") granted to the Defendant, Shell Oil Company ("Shell") a license ("License Agreement") to manufacture and sell a chemical called methomyl. In 1981, Shell entered into two agreements with Union Carbide Agricultural Products Corporation, Inc. ("Carbide") which provided for Carbide to make methomyl and allowed Carbide to buy it from Shell. DuPont, by this lawsuit, seeks a declaratory judgment that the License Agreement does not authorize the Shell/Carbide Agreements. Shell contends that those Agreements are authorized by the License Agreement.

This is the Court's decision after a trial on the merits.[1]

The License Agreement that is the subject matter of this litigation arose out of negotiations between DuPont and Shell and other Shell affiliated overseas companies.[2] The chief negotiators for DuPont were Edward Kane, then General Manager of DuPont's Industrial and Biochemical Department, and Albert Griggs, a Manager of Contracts, who negotiated the License Agreement. Norbert Reinert, an

1. This is a bifurcated trial of limited issues. Depending on the outcome of this trial, there could be a subsequent trial on other issues.

2. Shell has certain business ties with overseas companies which use the Shell name. The overseas companies principally involved are Shell Internationale Research Maatschappij, N.V. and Shell International Chemical Company, herein collectively referred to as "SIRM."

attorney, counseled them. The chief negotiator for Shell was Alan Batchelder. The chief negotiator for SIRM was Maurice Hazlewood.

In the 1960s, DuPont and SIRM each had developed a chemical called methomyl and had filed patent applications in various jurisdictions of the world. By 1967, it was apparent that Shell would obtain the dominant patent position for methomyl in most of the commercially important countries other than the United States. DuPont's interest in exploiting the Australian market prompted an inquiry looking to some type of agreement between it and Shell and SIRM. At a meeting in New York between DuPont, Shell and SIRM in October of 1967, the parties reached an agreement in principle on two license agreements. One was between DuPont and SIRM and the other between DuPont and Shell. A letter from Griggs to Batchelder dated November 10, 1967, provided as follows:

1. Shell and DuPont would exchange licenses under patents of all countries, the license to Shell in the United States to become effective January 1, 1974.

2. Each party will pay a royalty of 5% of the net selling price of products sold under the license.

3. DuPont and Shell would exchange information on toxicity of the [methomyl] by stages as each stage of the work is completed.

Later, at a meeting in November of 1967, the commencement date of Shell's United States license was changed from 1974 to 1973. Although the details were to be subsequently finalized, DuPont was given the immediate right to proceed with market development as though the contracts were in effect. Apparently, it was DuPont's urgent and immediate desires that prompted a very hurried resolution of the matter.

In any event, DuPont then bargained for the right to draft the cross-licenses and Shell agreed. Their first draft provided: "a nonexclusive license, without the right to sublicense, to become effective January 1, 1973, to make, have made, use and sell METHOMYL . . . under the DU PONT PATENT RIGHTS." After some further negotiations, two separate license agreements were executed in 1968. One between DuPont and Shell covering the United States (the subject matter of the present lawsuit) and one between DuPont and SIRM covering the rest of the world. The final version of the License Agreement for the United States granted to Shell: ". . . a nonexclusive license, without the right to sublicense, to make, have made, use and sell for use and resale METHOMYL . . . under the DU PONT PATENT RIGHTS." The difference between this final version and

the earlier draft was the insertion of the words "for use and resale."

With regard to the words "to make, have made", it is generally conceded by the parties that DuPont's negotiators did intend to allow Shell the right to have methomyl made for it by other parties. No one ever discussed whether anyone could make methomyl for Shell and then buy it from Shell. It just did not occur to them, or at least it was not discussed between the negotiators. At trial, Batchelder, referring to Shell's rights to make, have made, use or sell methomyl, said they were intended to be expansive and unrestricted rights. Reinert testified that they intended that Shell have an unrestricted right to make, have made, use and sell methomyl.

As 1973 approached, Shell prepared to enter into competition with DuPont in the United States market. Initially, they sought to buy methomyl from DuPont and thereby formulate their product, Nudrin.

DuPont refused to sell them methomyl. Without a source of methomyl, Shell was forced to produce methomyl at a facility which they were leasing from the United States at the Rocky Mountain Arsenal near Denver, Colorado (the "Denver Plant"). Methomyl production commenced in 1973 and then Shell contracted with others to formulate the final product, Nudrin. By 1978, Shell had captured about 25% of the United States' market and, by 1982, it was very close to the 50% mark. These are at least some of the signs which, one can assume, alarmed DuPont. After conceding a 5 year lead time to DuPont, Shell had become an aggressive and serious commercial contender.

In the meanwhile, Carbide had developed a product called Larvin which uses methomyl as an intermediate in its formulation. In April of 1978, it turned to Shell to buy its methomyl needs but the Denver Plant could not produce sufficient quantities. Carbide, not understanding the import of the License Agreement, asked Shell for a sublicence [sic] to produce methomyl. Shell explained that it did not have the right to sublicense Carbide but proposed that Carbide manufacture methomyl for Shell for a fee, a toll conversion agreement, and then Shell would sell methomyl to Carbide, a purchase and sale agreement.

The parties met again on several occasions and then, in May, 1979, Carbide proposed that it buy Shell's technology and then sell methomyl to Shell. (Shell's process technology for manufacturing methomyl had been patented by Shell and is separate from the DuPont patents which are the subject of the 1978 License Agreement.) At the same time, Carbide was negotiating with DuPont for a license to produce methomyl. DuPont refused to license Carbide but offered to sell methomyl to Carbide "for a price." At this stage, Shell and DuPont

were aware of Carbide's needs for large quantities of methomyl. Carbide finally agreed to Shell's proposal and entered into a Toll Conversion Agreement and a separate Purchase and Sale Agreement. They were signed in late January, 1981. The agreements basically provided that Carbide would construct a plant that could produce 18 million pounds of methomyl annually and then Carbide would buy back from Shell its needs for Larvin. The agreements resolved production problems for Shell and requirement problems for Carbide. A fair and representative summary of the Shell/Carbide Agreements acceptable to the Court for reference purposess as follows:[3]

> The Shell/Carbide Toll Conversion Agreement includes, in summary, the following basic terms:
>
> Recitals: Shell has a right to "have made." Shell has decided not to continue to operate at Denver and has decided to have its methomyl requirements made by a third party (Carbide).
>
> Article 1: Definitions.
>
> Article 2: Carbide to exert best efforts to complete by December 31, 1983 project facility of 18 million pounds of methomyl per year. Design to be Carbide's responsibility. Process technology to be furnished by Shell.
>
> Article 3: Shell to provide Carbide with estimates, order and shipping schedules for Shell's total requirements. Shell is to provide EPA labels per Shell's registration.
>
> Article 4: Toll conversion fee schedule declines with increase in volume in 1 million pound increments from 1 to 18 million pounds. Provision for containers.
>
> Article 5: Quantities to be Shell's total requirements for itself, an all customers including Carbide, subject to specified minimums and the maximum of plant capacity.
>
> Article 6: Shell to furnish most of the raw materials. If Carbide can obtain materials at lower prices, Shell will authorize Carbide to purchase on Shell's behalf.
>
> Article 7: Carbide required to maintain certain standards on quantity of material usage.
>
> Article 8: Carbide warrants to conform to quality specifications and to conduct tests per Appendix A. Shell has right to inspect. Carbide's limitations on warranties.
>
> Article 9: Title to all raw materials furnished to Carbide

3. The summary is taken from Defendant's Post-trial Brief, p. 34.

and title to all methomyl produced for Shell shall remain in Shell at all times. Risk of loss on Carbide until delivery.

Article 10: Shell to provide process technology and technical assistance for $1,000,000 fee.

Article 11: Confidentiality.

Article 12: Shell warrants it has right to "have made" under DuPont's '834 product patent. Shell to defend infringement actions brought against Carbide.

Article 13: Shell to defend action against Carbide for Shell's negligence, etc.

Article 14: Carbide to defend action against Shell for Carbide's negligence, etc.

Article 15: Termination December 31, 1988 or upon breach, etc. In the event Carbide's Board has not authorized budget for plant prior thereto, Carbide may terminate by September 30, 1981.

Articles 16-22: Accounting, records, auditing; Force Majeure; Notices; Independent Contractor; Liens; Taxes; and Miscellaneous provisions, including requirement for Carbide to comply with EEOC requirements.

The basic provisions of the Shell/Carbide Purchase and Sale Agreement are the following:

Recitals: Carbide's requirements to increase, Shell's desire to supply Carbide.

Article 1: Definitions include Shell's EPA Registration Information.

Article 2: Term to December 31, 1988 unless sooner terminated.

Article 3: Shell to sell Carbide's requirements for use in making [Larvin] or for export sales [to non-patent countries]. Quantities are minimums and maximums. Carbide not required to purchase minimums until it obtains EPA registration for Larvin. Shell not obligated to sell unless Carbide performs obligation to make under Toll Conversion Agreement. Parties agree to negotiate in good faith on further quantities or other uses.

Article 4: Notification of requirements, orders, deliveries.

Article 5: Price to Carbide decreases with increased volume stated in one million pound increments.

Article 6: Deliveries to be made at Carbide's plant in containers furnished by Carbide.

Article 7: Risk of loss passes to Carbide on delivery and

placement into Carbide's containers.

Article 8: Shell warrants that product meets specifications but makes no other warranties.

Article 9: Termination sooner than 12/31/88 upon breach or termination of the Toll Conversion Agreement.

Article 10: Accounting, Records, Audits.

Article 11: Force majeure.

Article 12: Shell to cooperate with Carbide with regard to Shell's EPA registration data only for the purpose of Carbide's obtaining EPA authorization for sale of Larvin and its formulations.

Articles 13-15: Notices, taxes, miscellaneous provisions.

The agreements were the result of careful research and scrutiny by the legal departments of both Shell and Carbide and even by outside counsel. The importance of the project was emphasized by Carbide's chief executive officer who requested his people to be exceptionally thorough. Even though they were satisfied that the agreements were lawful exercises of Shell's rights under the License Agreement, both Shell and Carbide anticipated a lawsuit by DuPont. The expectation was not entirely unwarranted. After all, DuPont, with a five year lead time on covering the United States' market, had lost to Shell an important purchaser of methomyl. One can fully appreciate, therefore, the meticulous care that the parties extended in drafting the documents to reflect a lawful and authorized exercise of Shell's "have made" and "sell" rights. Viewed in this context, the exchanges between lawyers for the parties are valuable because they reflect an intent to draft documents that could not be mistaken for a sublicense and thereby be in violation of the License Agreement. Rather than be critical of this endeavor, the Court finds it refreshingly competent lawyering. After all, lawyers do this every day in an effort to protect certain interests of their clients. Compare, for instance, the detail in many large construction project contracts where the various contractors and subcontractors attempt to establish or deny employer and employee relationships. It is, in the final analysis, the ultimate rights and responsibilities as detailed in the agreements that provide the basis for deciding the legal issues. And so it was in this case. Shell and Carbide both wanted to avoid any pitfall that could be used to establish their relationship as licensor and sublicensee.

Naturally, DuPont objects to these Shell/Carbide Agreements. DuPont contends they are interdependent and coterminous, negotiated and executed simultaneously, with performance fully coordinated and

interdependent. As an example, DuPont points out that the minimum quantities of methomyl which Carbide must toll convert are the identical amounts which Carbide must purchase. DuPont contends that the agreements are a sham and that the end result of all of the legal maneuvering is that Carbide is getting exactly what it could not get from DuPont, a license to produce all of its needs for methomyl.

On the other hand, Shell contends that what Carbide received under the Shell/Carbide agreements is entirely different from the license that DuPont and Carbide had been negotiating. Look, for instance, at the grant clause of Carbide's version of its proposal for a license from DuPont:

> II. *License Rights*
>
> 2.11. DuPont does hereby grant to [Carbide] a royalty free, non-exclusive license and right under the DUPONT Methomyl Patents to manufacture methomyl in the United States for use as an intermediate in the manufacture of [Larvin]. . . .

The grant clause of DuPont's version reads as follows:

> 2. *Grant*
>
> 2.1. DuPont grants to [Carbide] a nonexclusive license with no right to sublicense under the DuPont Methomyl Patents to manufacture Methomyl in the U.S. for use as an intermediate for the manufacture of [Larvin] and to make, use and sell [Larvin].

Shell argues further that what Carbide and DuPont were negotiating for was a license to Carbide by which Carbide obtained legitimate exploitable rights, whereas under the Shell/Carbide Agreements, Carbide received no such rights. In addition, Shell hotly contests DuPont's characterization of the agreements as interdependent and coterminous. It contends that the agreements require Carbide to toll convert methomyl even if Carbide decided not to buy methomyl from Shell.

A review of the documents reveals that Carbide is "patently" acting as an independent contractor hired by Shell to make Shell's requirements for methomyl. Shell holds title to the raw materials throughout the manufacturing process and to the methomyl as it is produced. Under the agreement, Carbide must build one plant, make up to 18 million pounds of methomyl per year according to Shell's

specifications using Shell's technology. Under the Purchase and Sale Agreement, Carbide must purchase the maximum amount of methomyl from Shell necessary to satisfy its needs for the production of Larvin. As Carbide's volume of purchases increases, its cost decreases. When Carbide needs methomyl, it places an order for it with Shell and then Shell orders it produced from Carbide. Delivery for toll conversion purposes occurs at the time the material is produced and loaded into barrels. For purchase purposes, Carbide takes it delivery off the assembly line at which point it is obligated to pay under the Purchase and Sale Agreement. The remainder is delivered to Shell.

DuPont contends that the agreements cannot be viewed individually, that they must be viewed collectively to understand the net result of their existence.

The "net result" method of review indicates, according to DuPont, that Carbide really has a license. In effect, it contends, Shell has granted Carbide everything Carbide ever wanted in its licensing proposals with DuPont. For instance, Carbide wanted a license to manufacture methomyl for its use as in intermediate in the formulation of Larvin. Now, Carbide is getting all the methomyl it needs through the Shell/Carbide Agreements. This "net result" analysis, it contends, is supported by *Southwire Co. v. U.S. Intern. Trade Comm'n*, 629 F.2d 1332 (C.C.P.A. 1980), and *Carey v. United States*, 326 F.2d 975 (Ct.Cl. 1964).

In *Carey*, the United States became a successor to a license which permitted sublicensing for a process to manufacture titanium. Under the license, the licensor ("Kroll") was entitled to a 100% royalty from the United States but only a 50% royalty if the sale of titanium was made by United States' sublicensees. After the war, the United States realized the value of titanium in the manufacture of aircraft and sublicensed private manufacturers for its production. Under the agreements, the Government could purchase 100% of the produced titanium at a certain price. Failure of the Government to exercise the option provided the producer the right to sell the titanium on the open market but any surplus had to be bought by the Government. Kroll contended the contracts were not sublicenses but amounted to production by the United States and Kroll, therefore, was entitled to a 100% royalty. Kroll's theory was that the only buyers of titanium were defense contractors who then sold aircraft to the Government. Consequently, Kroll contended the sales of titanium were really for the benefit of the United States. Based on these facts, the court concluded that the sale of titanium to defense contractors was really for the benefit of the sublicensees, the producers, and therefore, the 50%

royalty was due Kroll. For all that titanium sold by the producers to the Government, Kroll was entitled to a 100% royalty. The relevance of this case to Plaintiff's position appears somewhat strained because it was not the "net result" that determined whether production was for the Government or on behalf of the producers-sublicensees. The court looked at the sales objectively and then made the determination of whether the sales were made on behalf of the United States or on behalf of the producer-sublicensees based on the actual contracts between the United States and its sublicensees and their buyers.

Similarly, the *Southwire* case is not of much help to DuPont. The only real value of the case is the out of context quotation from *Carey*, otherwise, the decision stands for the proposition that a licensor can have a product made for it and to sell it and use it as its own. Its manufacturer cannot be considered a licensee so long as the manufacturer acquires no "rights" to the product it produces.

[1] The difficulty with this aspect of DuPont's argument is that for the most part, it is dependent on some bootstrapping to sustain the viability of the argument. For instance, DuPont contends that all of the authorities are in agreement that the Court should look to the substance and not the form of the Shell/Carbide Agreements and, if it did, it would find that "Carbide is making methomyl for its own use, [and consequently] the Arrangement is a sublicense." Plaintiff's Opening Post-Trial Brief, p. 55. What is substance and what is form is not so easy to discern. Merely saying that Carbide is making methomyl for itself does not describe in a legal sense what rights Carbide has when it produces the methomyl. Admittedly, the net result is that Carbide is getting all the methomyl it desires. But it cannot sell it in the Untied States. It cannot have others make it for Carbide. These are the relevant indicia, among others, needed to legally determine whether Carbide is a licensee. In short, there must be an examination of the relevant documents and surrounding circumstances, a determination of things like custody, control and title before the issue can be resolved. It is not enough to look at the end result. *Cf. Philadelphia Storage Battery Co. v. Radio Corporation*, Del.Ch., 194 A. 414 (1937), *reh'gs denied*, 2 A.2d 80 (1938), *aff'd*, Del.Supr., 6 A.2d 329 (1939). A perusal of the circumstances surrounding these factors alone, that is, custody, control and title, establishes in this Court's mind that Carbide is not getting a sublicense. See, *e.g., Southwire Co. v. U.S. Intern. Trade Comm'n, supra*, at 1338, ("Bell did not authorize Krupp to make the equipment or sell it to anyone other than Bell, and thus did not grant a sublicense to Krupp."); *Westinghouse Electric & Mfg. Co. v. Tri-City Radio E. Supply Co.*, 23 F.2d 628, 635 (8th Cir. 1927),

("The practical result of this arrangement was that Trego . . . manufactured the apparetus [sic] and, *in its own name* [emphasis added], sold the same paying . . . a stipulated royalty for the privilege. This was nothing more nor less than a sublicensing. . . .")

Another factor of significance raised by DuPont is that Shell is getting a "royalty" from Carbide and doing absolutely nothing for it but keeping books and records on production by Carbide. But this was a bargained right that Shell obtained from DuPont. Why shouldn't it be able to sell the product for a profit? The parties anticipated full and unfettered competition in the United States' market and the size of Shell's profit should be of no concern to DuPont. Interestingly, however, the issue has turned into a double edged sword. An economic analysis of the situation demonstrates that what Shell is getting from Carbide is not what one would normally expect from a license agreement. Royalties are normally in the 5% range while the margin of profit on the sales to Carbide are bringing Shell six times that amount. Typically, these are the profit ranges one would expect from the outright sale of a product and, in this case, is in fact historically similar to profits generated by Shell for sales from its Denver operation. If one were to consider this a factor in determining whether the License Agreement's prohibition against sublicensing has been violated, one would certainly consider it favorably towards Shell.

DuPont contends that although the License Agreement is silent on the issue, Shell's right to "have made and sell" are restricted rights which prevent Shell from selling methomyl to the individual who may toll convert for Shell. Taking the rights independently, DuPont agrees that Shell has the unrestricted right to have methomyl made for it and that Shell also has the unrestricted right to sell methomyl in the United States. A restriction becomes operable, according to DuPont, when the toll converter becomes the very same person who buys the product. Now, that is not obvious when one reads the License Agreement. As a matter of fact, the License Agreement contains no language which could be construed as restricting Shell's right to sell methomyl or to have it made.

In pursuit of this theory, DuPont has devoted a great deal of its effort to show that what Carbide was bargaining for through a license from DuPont, Carbide is now getting through the Toll Conversion and Purchase and Sale Agreement from Shell. The theory, I suppose, is that if they are getting methomyl, then it must be through a license. Such sophistic reasoning is not persuasive and this is especially so when one compares what DuPont and Carbide were bargaining for as a license and what Carbide now has with Shell. Listed below is a com-

pilation of indicia relative to both situations that have some relevance to the comparison.[4]

Obligations, Responsibilities and Rights of Carbide	Contained in Shell/Carbide Agreements	Contained in the Proposal for the DuPont/Carbide License
1. Carbide obligated to build methomyl plant	Yes [5]T/C Art. 2	No
2. Carbide required to build methomyl plant of specified size	Yes T/C Art. 1(R)	No
3. Carbide required to make methomyl by specified process	Yes T/C Art. 1(c)	No
4. Carbide required to buy methomyl under certain circumstances	Yes [6]P/S Sec. 3.01	No
5. Carbide required to operate its methomyl facility in an efficient matter	Yes T/C Art. 7	No
6. Carbide required to make methomyl and cannot have it made by others	Yes T/C Art. 2	No
7. Carbide required to build and operate plant even if EPA does not register Carbide's produce for cotton and soybean use	Yes T/C Art. 5 P/A Sec. 3.02	No
8. Carbide must produce methomyl in 41 gallon drums	Yes T/C Appendix F	No
9. Carbide relieved of responsibility of obtaining labels under F.I.F.R.A.[7]	Yes T/C Art. 3.04	No

4. The chart as proposed in Defendant's Brief, p. 114.
5. T/C refers to the Toll Conversion Agreement.
6. P/S refers to the Purchase and Sale Agreement.
7. Under the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. § 136 *et. seq.*, a label for all pesticides is required. As the entity required to obtain the label for methomyl, Shell would be responsible to the Federal Environmental Protection Agency if the methomyl produced did not comply with the F.I.F.R.A. label.

Obligations, Responsibilities and Rights of Carbide	Contained in Shell/Carbide Agreements	Contained in the Proposal for the DuPont/Carbide License
10. Carbide relieved of liability to EPA for violation of methomyl quality control under F.I.F.R.A.	Yes T/C Art. 3.04	No
11. Carbide obligated to pay $500,000 in the event that its Board does not provide for the construction of a methomyl facility by a definite date	Yes T/C Art. 5.03	No
12. Carbide required to meet specified United States Equal Employment Opportunity Commission requirements	Yes T/C Art. 22.01	No
13. Carbide relieved of the risk of governmental taxes	Yes T/C Art. 2.1	No
14. Carbide relieved of the responsibility for providing raw materials for the manufacture of methomyl	Yes T/C Art. 6	No
15. Carbide relieved of responsibility for personal injuries relating to raw materials furnished for manufacture of methomyl	Yes T/C Art. 8.04	No
16. Carbide may terminate if the other party to the agreement becomes bankrupt or insolvent	Yes T/C Art. 15.02	No
17. Carbide may inspect books of the other party	Yes T/C Art. 16	No
18. Carbide must permit inspection of its books and records	No	Yes

Obligations, Responsibilities and Rights of Carbide	Contained in Shell/Carbide Agreements	Contained in the Proposal for the DuPont/Carbide License
19. Carbide is permitted to rely upon methomyl registration information for the purpose of obtaining registrations from EPA	No	Yes

Moreover, under the Shell/Carbide Agreements, Carbide's obligations, responsibilities and rights are unaffected by the possible future events shown on the next chart. In contrast to those same eventualities are the effects under the proposed DuPont/Carbide license.

Effect on Obligations, Responsibilities and Rights of Carbide if:	Shell/Carbide Agreements	Proposals for the DuPont/Carbide License
(a) The Dupont methomyl patent is determined to have been obtained by fraud	No effect	Royalties may be terminated and past royalties recovered.
(b) Dupont uses methomyl patent in violation of antitrust law	No effect	Royalties may be terminated and past royalties recovered.
(c) DuPont engages in misuse of methomyl patent precluding infringement relief	No effect	Royalty payments or other license obligations may be ignored until misuse purged
(d) Carbide discovers a good patent reference which invalidates DuPont methomyl patent	No effect	Carbide can challenge patent validity and at least terminate royalty payments as of date of litigation.
(e) Dupont methomyl patents declared invalid in third party litigation	No effect	Carbide can challenge validity on same basis and at least terminate royalty payments as of date of litigation.

Under the license which was proposed by DuPont, Carbide has substantial and independent rights. Under the Shell arrangement, Carbide is a purchaser of methomyl for the production of its Larvin and it has no right to sell or have methomyl made for it in the United States. It has no independent right to exploit its possession of methomyl except through the production of Larvin. It would appear that if the decision were to be based on an analysis of what had been negotiated as a license from DuPont compared to what Carbide is entitled to do as a toll converter and purchaser from Shell, the issue of "sublicense" would be resolved against DuPont.

[2-4] This points up, however, the distracting nature of dealing with the issues in this case. The amorphous arguments and framing of issues is a tribute to the genius of counsel. Upon reflection, however, the issue becomes somewhat basic. What was intended by the parties and is that intention reflected in their agreement? On that basis, one must concede that the parties intended that Shell should have the unrestricted right to have methomyl made. Shell also had the unrestricted right to sell methomyl and this includes whether it was made for Shell or whether it made the methomyl itself. To decide that Shell's right to sell is restricted because its purchaser had some unsuccessful negotiations with DuPont appears preposterous and inappropriate. The nagging notion that keeps recurring is that DuPont, because it lost the competition for Carbide's business, now wants to rewrite the License Agreement. That time has long since passed. DuPont now is disappointed in the unexpected consequences of its deliberate and knowing selection of words for inclusion in the License Agreement. The Court will not rewrite the License Agreement. *In Re Celotex Co.*, 17 F. Supp. 254 (D.Del. 1936); *Danby v. Ostopathic Hospital Ass'n of Delaware*, Del. Ch., 101 A.2d 308 (1953), *aff'd*, Del.Supr., 104 A.2d 903 (1954). They question is not that DuPont did not know this would occur. The just did not plan on it. They should have known of the many ways a license could be restricted, including the type of restriction they wish in this case. *Cf. Westinghouse Electric & Mfg. Co. v. Tri-City Radio Electric Supply Co.*, 23 F.2d 628 (8th Cir. 1927); *4-One Box Machine Makers v. Wirebounds Patents Co.*, Me.Supr., 163 A. 167 (1932); *Gesing v. Grand Rapids Hardware Co.*, 362 F.2d 363 (6th Cir. 1966); Davis, *Practical Patent Licensing* (Practicing Law Institute 1966), at 237. Instead, DuPont proceeded to draft the agreements, incorporating the results of their negotiations and then passed it to Shell for execution. If there is to be any construction of the License Agreement, it must be construed against the drafter, DuPont. 3 *Corbin on Contracts* § 559 (1960); *Philadelphia Storage Battery, supra; Cf. Ruckstell*

Sales & Mfg. Co. v. Perfecto Gear Differential Co., 28 1 .2d 407 (S.D.Cal. 1928). To contend now that the prohibition against a sublicense is a restriction against Shell selling methomyl to its toll converter engrafts a restriction on Shell's otherwise unrestricted right to "sell." But nowhere in the negotiations or in the document itself is there to be found a restriction on Shell's right to sell. The parties bargained for and obtained the right to openly and aggressively compete against each other. In this particular instance, Shell has won the contest and the Court is not about to intervene, to upset the natural order of the market place by rewriting DuPont's own agreement. The general rule is this: If a competent party, uninfluenced by improper forces, binds himself by an agreement which he later realizes is improvident, that is something for which he may blame himself alone, and he may not importune the courts for relief. *In Re Mason's Estate,* N.Y.Surr., 20 N.Y.S.2d 501, 505 (1940); *Restatement (Second) of Contracts*, Ch. 11 (1981); 17 C.J.S. *Contracts* § 135 (1963).

DuPont has failed to carry its burden in proving that the License Agreement prevents the Shell/Carbide Toll Conversion and Purchase and Sale Agreement. The requested relief is denied. Judgment is entered for the Defendant with costs assessed against the Plaintiff.

IT IS SO ORDERED.

GOOD v. TEXACO, INC.

No. 7501

Court of Chancery of the State of Delaware, New Castle

May 14, 1984

Plaintiff, a Texaco shareholder, brought this suit derivatively on behalf of Texaco, Inc. and also as a class action for the benefit of all shareholders of Texaco. Defendants moved to dismiss the derivative action on the ground that plaintiff failed to comply with the demand requirement under Chancery Rule 23.1 and to dismiss the class action on the ground that its true purpose was an avoidance of Chancery Rule 23.1 and not to benefit the shareholders of Texaco.

Plaintiff alleged that the board of directors engaged in corporate waste by purchasing outstanding stock at a premium some twelve percent over the market price and that the board of directors sought to

entrench themselves in their positions of management by using a voting agreement with other defendants to gain control of five percent of the voting stock, and then proposing a high vote requirement (eighty percent) of which the board would control twenty-five percent of the veto power. Plaintiff alleged that in this situation it would have been futile to make a demand on the board since all of the directors were personally interested in the transaction in which they used corporate funds to acquire the right to control the vote of corporate shares they do not own.

The court denied the motion to dismiss the derivative suit on the ground that once the directors have been shown to be interested by the factual allegations in plaintiff's complaint, the business judgment rule is inapplicable. Hence, the futility of demand has been established. The court granted the motion to dismiss the class action on the ground that the facts alleged and relied upon for the class action were the same as those for the derivative suit, clearly indicating a wrong to the corporation and not a wrong to all the shareholders individually.

1. Corporation ⇐ 206(4), 320(5)

Compliance with the demand requirement of Rule 23.1 is tested against that which the plaintiff has alleged in his complaint and not against factual matter put forth by the defendants by way of explanation or mitigation of the factual allegations of the complaint. DEL. CH. CT. R. 23.1.

2. Corporations ⇐ 206(4)

In determining demand futility, the court of chancery in the proper exercise of its discretion must decide whether, under the particular facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent; and (2) the challenged transaction was otherwise the product of business judgment.

3. Corporations ⇐ 310(1)

Directors are protected by the presumption of the business judgment rule in any consideration as to whether a demand should have been made on them by a derivative plaintiff prior to filing suit.

4. Corporations ⇐ 310(1)

The protection of the business judgment rule can only be claimed by disinterested directors; that is, the directors can neither appear on

both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing. This differs from a benefit which devolves upon a corporation or all stockholders generally.

5. Corporations ⟹ 206(4), 211(5)

Where the transaction under attack is an "interested" director transaction, the business judgment rule is inapplicable and the inquiry of the court is at an end. In such an event, the futility of demand has been established.

6. Corporations ⟹ 202, 211

Where the facts alleged and relied upon to support a class action claim are the same as those relied upon to support the derivative claim, they clearly indicate a wrong to the corporation and not a wrong to all of the common shareholders individually. Therefore, the cause of action is in the nature of a derivative suit and the class action should be dismissed.

Joseph A. Rosenthal, Esquire, of Morris & Rosenthal, P.A., Wilmington, Delaware, for plaintiff.

Rodman Ward, Jr., Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, and Watchell, Lipton, Rosen & Katz, New York, for defendant.

BROWN, *Chancellor*

Plaintiff alleges that he is a shareholder of the defendant Texaco, Inc. He brings this suit derivatively on behalf of Texaco and also as a class action for the purported benefit of all shareholders of Texaco other than the named defendants. Plaintiff purposely made no demand upon the board of directors of Texaco prior to filing the derivative claim on the grounds that to do so would have been a futile act. Accordingly, in keeping with their role in the newest game in town, Texaco and the individual members of its board of directors ("the Texaco defendants") have moved to dismiss the derivative count of the complaint for the failure of the plaintiff to comply with Chancery Rule 23.1. They have also moved to dismiss the class action count on the grounds that it is nothing more than a derivative claim being masqueraded as a class action claim by the plaintiff in an effort to get around Rule 23.1.

The latest word on the demand requirement of Rule 23.1 has been spoken by the Supreme Court in *Aronson v. Lewis,* Del.Supr., 473 A.2d 805 (1984). In that decision the Supreme Court stated the function of the Court of Chancery on a motion such as that under consideration to be as follows:

> ". . . in determining demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, *under the particularized facts alleged,* a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. Hence, the Court of Chancery must make two inquiries, one into the independence and disinterestedness of the directors and the other into the substantive nature of the challenged transaction and the board's approval thereof. As to the latter inquiry the court does not assume that the transaction is a wrong to the corporation requiring corrective steps by the board. Rather, *the alleged wrong is substantially reviewed against the factual background alleged in the complaint.* As to the former inquiry, directorial independence and disinterestedness, the court reviews *the factual allegations* to decide whether they raise a reasonable doubt, as a threshold mater that the protections of the business judgment rule are available to the board. Certainly, if [it] is an 'interested' director transaction, such that the business judgment rule is inapplicable to the board majority approving the transaction, then the inquiry ceases. In that event futility of demand has been established by any objective or subjective standard.
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> . . . In sum *the entire review is factual in nature.* The Court of Chancery in the exercise of its sound discretion must be satisfied that a plaintiff *has alleged facts with particularity* which, taken as true, support a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment. Only in that context is demand excused." (Emphasis added.)

I.

This standard prompts a preliminary observation on the manner in which the motion to dismiss for failure to make a demand has been

argued and presented here. In essence, the complaint charges the defendant members of Texaco's board of directors with engaging in a waste of Texaco's assets in furtherance of a plan to entrench themselves in office so as to perpetuate their control of the corporation and to preserve their lucrative compensation and benefits of office in disregard of the interests of Texaco and its public shareholders. The complaint sets forth the salaries and other compensation allegedly received by the three members of the board who also serve as managerial officers of the corporation. None of the other eleven members of Texaco's fourteen-member board are employed by Texaco, but apparently all directors receive a base annual retainer of $20,000 for serving as such. In addition, it is alleged that certain members of the board receive from $2,000 to $6,000 per year for serving as chairman of various committees of the board, and it is alleged that all directors receive $500 per meeting for each meeting of the board or of a committee attended by them.

In an effort to dispel any thought that its board members, and particularly its eleven outside board members, would stoop to any such exorbitant and wrongful scheme as alleged by the plaintiff merely to preserve the $22,000 to $30,000 that they might receive each year for serving as a director and attending board and committee meetings, the Texaco defendants set forth in their brief a short background sketch of each of the fourteen directors reflecting the many business positions and honors achieved by them over their respective careers. For example, it is said that six directors either are now or have been the chief executive officers of other major corporations; one is a British Earl; another is a retired admiral; etc. If true—and I have no reason to doubt it—their qualifications are truly impressive. The implication suggested by this is that all of these men are well established financially and professionally and thus are certainly above being influenced in their decision on behalf of Texaco by a desire to preserve a mere $20,000 to $30,000 in annual director income. Thus, the suggested conclusion is that these men are above reproach on such menial financial grounds, and thus are disinterested directors on which a demand should have been made.

[1] This suggested conclusion may also prove to be true. But the point of the matter is that none of these facts pertaining to the personal backgrounds of the defendant directors are in the record. They are not set forth in the plaintiff's complaint nor are they before the Court through affidavit or discovery. Indeed, in view of *Aronson's* requirement that the issue of the futility of a demand must be measured against the factual allegations of the complaint, one would be led to

assume that the record on a motion to dismiss for failure to make a demand under Rule 23.1 cannot properly be supplemented by affidavit or discovery by either the plaintiff or the defendants.

Under *Aronson* compliance with the demand requirement of Rule 23.1 is tested against that which the plaintiff has alleged in his complaint and not against factual matter put forth by the defendants by way of explanation or mitigation of the factual allegations of the complaint. (See Footnote 2 in *Aronson* where the Supreme Court observed that the trial court had stated a fact in its decision which was not alleged in the complaint). Under *Aronson*, Rule 11 is intended to provide assurance that there is good ground to support the facts that are alleged in the complaint through the requirement that plaintiff's counsel sign the pleadings.

Thus, the basis for determining the motion of the Texaco defendants to dismiss the complaint for failure to comply with the demand requirement of Rule 23.1 is the sum of factual allegations of the plaintiff's complaint and not those of the Texaco defendants' brief. Accordingly, the background information on the members of Texaco's board of directors will not be considered. In this regard I note too that plaintiff has attached a copy of the proxy statement for the forthcoming Texaco shareholders' meeting to his answering brief. That is also not a part of the complaint, and for the purpose of this motion it will not be considered either.

II.

Another preliminary matter must be addressed before the merits of the motion to dismiss can be considered. The motion to dismiss was directed against the original complaint. After the motion was filed, the Texaco defendants also served an answer to the original complaint. After the Texaco defendants had filed their opening brief in support of the motion to dismiss, the plaintiff moved to file an amended and supplemental complaint. Plaintiff noticed this motion for the day on which the motion to dismiss was to be argued. The amended and supplemental complaint primarily adds information in Texaco's proxy statement, which was not released until after the original complaint was filed. It alleges no new cause of action but merely adds detail to the original charges. In his answering brief plaintiff thereafter relies on the allegations of the amended and supplemental complaint. In their reply the Texaco defendants indicated their opposition to permitting the plaintiff to amend and supplement his complaint, but proceeded to address the plaintiff's arguments which had been made with reference to the factual allegations of the amended and supplemental complaint.

Faced with this situation, it is my decision to grant the plaintiff's motion and to weigh the motion to dismiss against the allegations of the amended and supplemental complaint. Under the circumstances, I think that it is proper to permit the amendment and supplementation of the original complaint to be made, and I see no prejudice to the defendants in so doing.

III.

Turning to the motion to dismiss the derivative count, the relevant factual allegations of the plaintiff may be summarized as follows. It is alleged that certain of the named individuals defendants ("the Bass defendants") accumulated collectively a 9.7% interest in the outstanding common stock of Texaco, thereby giving rise to speculation that an attempted takeover of Texaco might be forthcoming. Thereafter, the Texaco board entered into an agreement to have Texaco purchase the shares of the Bass defendants at a premium which was some 12% over the market price of Texaco shares at the time and which was at an even more substantial premium over the market price of Texaco shares prior to the public disclosure of the 9.7% interest accumulated by the Bass defendants.

The total amount of Texaco stock purchased from the Bass defendants by Texaco was in excess of 25 million shares. The purchase was publicly announced on March 6, 1984. Under the terms of the transaction Texaco became obligated to purchase some 13 million of its outstanding shares from the Bass defendants for $50 per share in cash. In return for the remaining 12 million shares Texaco agreed to issue preferred stock of Texaco to the Bass defendants having a value of $50 per share. This preferred stock carries a favorable dividend rate and it is redeemable after five years, with the added requirement that at the end of six years from its issuance it must be redeemed by Texaco at the rate of 20% per year.

The preferred stock carries with it the same voting rights as the common stock of Texaco. However, under the terms of the agreement of purchase the Bass defendants have agreed that they will vote the preferred stock in accordance with the recommendation of Texaco's board of directors. At the time of the announced transaction the members of Texaco's board, including its three officer directors, owned collectively 3/10ths of 1% of all outstanding shares of Texaco. As a result of the transaction between Texaco and the Bass defendants, the defendant board of directors will possess the right hereafter to control the vote of approximately 5% of the outstanding shares of Texaco represented by the preferred stock being held by the Bass defendants.

At the forthcoming annual meeting of Texaco's shareholders, now set for May 25, Texaco's management and board have proposed that the shareholders adopt certain amendments to Texaco's certificate of incorporation which, among other things, are designed to discourage the accumulation of substantial stock positions in the corporation. One such proposed amendment would require an 80% vote of Texaco's shareholders to approve any business combination not approved by Texaco's board unless certain price conditions were met by the entity proposing the combination. Another proposed amendment would require an 80% vote to remove directors of Texaco from office. Finally, it is proposed that an 80% vote be required hereafter in order to alter, amend or repeal such amendments.

While the foregoing does not represent all of the factual allegations relied upon by the plaintiff in his complaint, I feel that they are sufficient to defeat the motion of the Texaco defendants to dismiss the derivative count of the complaint because of the failure of the plaintiff to make a demand. One of the reasons alleged by the plaintiff for failing to make a demand is that it would have been a futile act to do so since "[a]ll of the directors are interested in the transaction complained of in that they all thereby seek to entrench themselves in their positions of management."

[2] In *Aronson*, as noted previously, the Supreme Court held that the issues of demand futility rest upon the allegations of the complaint and that in determining demand futility the Court must decide under the particularized facts alleged whether a reasonable doubt is created that the directors are disinterested and independent when viewed in light of the transaction under attack and whether a reasonable doubt is created that the challenged transaction was otherwise the product of a valid exercise of business judgment.

[3-5] *Aronson* states that in concept directors are protected by the presumption of the business judgment rule in any consideration by this Court as to whether or not a demand should have been made upon them by a derivative plaintiff prior to filing suit. It states further, however, that the protection of the business judgment rule can only be claimed by disinterested directors, pointing out that "[f]rom the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." (Slip opinion at page 13). *Aronson* further states that the transaction under attack is an "interested" director transaction, the business judg-

ment rule is inapplicable and the inquiry of this Court is at an end. In such an event, the futility of demand has been established.

Here, the complaint alleges facts which, among other things, charge the members of the defendant board of directors with engaging in a waste of corporate assets by using corporate funds to purchase at a premium from the Bass defendants that which amounts to a 5% shareholder voting power to be used by the board of directors itself for at least the next six years. The wrong alleged to the corporation is the misuse of its funds to buy shares to be voted by its board of directors rather than by its shareholders. The interestedness charged to the directors is that they have benefited personally from the transaction complained of by acquiring at corporate expense the right to control the vote of corporate shares which they do not own.

The personal interest of the individual members of the board of directors is compounded by the fact that they have acquired a right to control the vote of 5% of Texaco's outstanding shares at the forthcoming annual shareholders meeting which they can cast in favor of the amendments to the certificate of incorporation that they are recommending. Moreover, if these amendments are adopted, the defendant directors will also have acquired the right to control 25% of the vote which will be needed hereafter to veto or vote down any attempt by Texaco's shareholders to vote them, or any of their number, out of office, or to approve a business combination not favored by them which might result in their removal from office. This is because the amendments, if approved, will require an 80% shareholder vote to remove a director or to approve a business combination opposed by the board. Thus, slightly more than 20% of Texaco's vote is all that will be needed to defeat such an effort and the board, with the contractual right to control the 5% voting power of the Bass defendants, will control 25% of that 20% requirement.

Since this power to vote the shares of the Bass defendants hereafter is alleged to be a power acquired for the board of directors itself, it follows that all board members are necessarily interested personally in the transaction that they are alleged to have wrongfully approved. Under these circumstances, it seems without question that the defendant directors have such an interest as would deprive them of the protection of the business judgment rule at this threshold stage of the proceedings. As such, as I view the factual allegations of the complaint, and as indicated by *Aronson*, futility of demand has been established.

IV.

[6] Finally, I am in agreement with the arguments of the Texaco defendants that Count II of the complaint does not allege a cause of action that would support a class action recovery on behalf of all common shareholders of Texaco. The facts alleged and relied upon for the class action count are the same as those relied upon to support the derivative claim. Those facts and the legal theories relied upon in support of them, if proved, would clearly indicate a wrong to the corporation and not a wrong to all of its common shareholders individually. I see no need to discuss or analyze the contention at any length. The decision seems obvious.

V.

Accordingly, the motion of the Texaco defendants to dismiss the derivative court of the amended and supplemental complaint for failure of the plaintiff to comply with Rule 23.1 is denied. The motion of the Texaco defendants to dismiss the class action count of the complaint for failure to state a claim, presumably pursuant to Rule 12(b)(6), is granted.

IT IS SO ORDERED.

HOBAN *v.* DARDANELLA ELECTRIC CORP.

No. 7615

Court of Chancery of the State of Delaware, New Castle

June 12, 1984

This action was brought by one of the two shareholders of defendant in order to have a custodian appointed to manage the affairs of the business. It was alleged that the two equal shareholders were so at odds with each other as to make crucial refinancing decisions for the business impossible.

In holding that a custodian was to be appointed, the court determined that there were three requirements necessary in order for the case to be brought within the corporate protection intended by the statute, DEL. CODE ANN. tit. 8, § 226(a)(2): first, the business must be threatened with irreparable injury; second, the cause of the malady