committees were reconstituted. The Brown Group asks the Court to rule on the validity of the May 2 meeting or provide for the calling of a board meeting within 48 hours after the entry of an order determining the election results. In addition, the Brown Group asks that the provisions of an interim order dated May 8, 1986 concerning payments under an Indemnification Trust be continued in effect for 45 days and be supplemented by a similar provision concerning payments scheduled to be received by Hampshire National under an irrevocable letter of credit.

After considering these requests, I find that it would create unnecessary uncertainty to rule on the validity of the May 2 meeting when the Garrett Group has remained in control of Stater Bros. throughout these proceedings. If the May 2 meeting were declared valid, questions would undoubtedly arise as to whether any actions taken by the Garrett Group after May 2 are valid and binding on the corporation. I, likewise, see no reason why the provisions of an interim order or other similar provisions should be included in a final order as long as a mechanism is established for the prompt and orderly transfer of control. I request counsel for the Brown Group to submit a form of order, on notice, at their earliest convenience.

GILBERT v. EL PASO

Nos. 7075 & 7079

Court of Chancery of the State of Delaware, New Castle

June 17, 1986

Plaintiffs brought a class action on behalf of shareholders of the El Paso Company who had tendered their shares to Burlington Northern, Inc., which had previously made a hostile tender offer for El Paso stock. Burlington withdrew its offer after it reached an

agreement with El Paso. When plaintiffs moved for certification as a class, it was discovered that a list of the names and addresses of the El Paso shareholders who had tendered their shares in response to Burlington's offer did not exist. As a result, plaintiffs filed a motion entitled "Motion for an Order Delineating the Responsibility for Dissemination of Notice to Members Of the Class." The motion requested an order directing that defendants prepare and deliver a list of the names and addresses of all class members to plaintiff's counsel.

The court of chancery, per Vice-Chancellor Jacobs, held that: (1) cost of assembling the names and addresses of the plaintiff class should be borne by Burlington as it was partly responsible for having created the problem that gave rise to such cost; (2) plaintiffs must perform the task of actually assembling the names and addresses of the class members since Burlington would be unable to perform the task more efficiently; and (3) plaintiffs must cause notice to be made to the individual class members in the appropriate publications.

1. Courts ⟹ 85(2), 97(1), 97(5), 97(6)

When interpreting its own rules, the court of chancery often looks to federal court decisions interpreting the counterpart Federal Rules of Civil procedure for persuasive, albeit nonbinding, guidance.

2. Parties ⟹ 9

Pretrial Procedure ⟹ 40

In a class action, Rule 23, not the discovery rules, is the source of authority for an order directing a defendant to assist the representative plaintiff in identifying class members to whom individual notice will be sent.

3. Parties ⟹ 9

Pretrial Procedure ⟹ 40

The district court has discretion to order a defendant to perform one or more of the tasks necessary to the giving of notice, including class member identification.

4. Parties ⟹ 9

Pretrial Procedure ⟹ 40

A district court may exercise its discretion to order a defendant to perform tasks necessary to the giving of notice in a class action where the defendant is able to perform the task more efficiently than can the representative plaintiff.

5. Parties ⟹ 9

Pretrial Procedure ⟹ 40

In a federal class action suit, where a task necessary to the giving of notice to class members can be performed with substantially the same effort by either the representative plaintiff or by the defendant, the representative plaintiff should perform the task.

6. Parties ⟹ 9

Pretrial Procedure ⟹ 40

Regardless of who physically performs the task of identifying class members in a federal class action suit, the cost of performing that task must normally be borne by the representative plaintiff; however, that cost can be shifted to the defendant where it is not "substantial."

7. Pretrial Procedure ⟹ 1, 40

In a class action the cost of performing task of identifying names and addresses of class members for certification of class under Chancery Rule 23 must normally be borne by the representative plaintiff, except where the cost is not substantial or where defendant is responsible for causing problem which gave rise to such cost, in which case defendant may be ordered to bear that cost. DEL. CH. CT. R. 23.

8. Pretrial Procedure ⟹ 1, 40

Where 3 1/2 years had elapsed since the termination of a tender

offer which gave rise to a state class action suit, and where there was a substantial likelihood that during that period many members of the shareholder class had changed their addresses and thus would be unlikely to receive mailed individual notices, the best practicable notice to those class members would be by publication.

William Prickett, Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; Rubin Baum Levin Constant & Friedman; and Mordecai Rosenfeld, Esquire, New York City, New York, for plaintiffs.

A. Gilchrist Sparks, III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Fried, Frank, Harris, Shriver & Jacobson, New York City, New York, for Burlington defendants. Robert K. Payson, Esquire, of Potter Anderson & Corroon, Wilmington, Delaware, for defendant The El Paso Co.

JACOBS, *Vice-Chancellor*

Plaintiffs have filed a Motion for an Order Delineating the Responsibility for Dissemination of Notice To Members Of The Class. This is the decision of the Court on that motion.

I.

Plaintiffs brought this class action on January 17, 1983 on behalf of a class of stockholders of the El Paso Company ("El Paso") who tendered their shares to Burlington Northern, Inc. ("Burlington") in response to a hostile tender offer commenced by Burlington for El Paso on December 21, 1982. Burlington and El Paso reached an accord, and as a result, the December 21, 1982 Burlington offer was terminated. In its place Burlington made a second, friendly offer for a smaller number of El Paso shares than had been solicited in Burlington's first (December 21, 1982) Offer. In this lawsuit the plaintiffs claimed that under these circumstances the termination of the first offer was illegal in various respects. On a motion to dismiss, then Vice Chancellor (now Justice) Walsh ruled that the complaint stated claims against defendants for breach of fiduciary duty and for conspiracy to breach fiduciary duties. The Court dismissed the balance of the claims in the complaint. *Gilbert v. the El Paso Company*, Del.Ch., 490 A.2d 1050 (1984).

On January 18, 1983, plaintiffs moved for class certification, and shortly thereafter the class was certified under Chancery Rule 23. However, no steps were taken to give notice to the class as required by that Rule until May, 1985. At that point counsel for the parties engaged in extensive discussion and correspondence over how to identify the names and addresses of the class members. Dissatisfied with the progress of these discussions, the defendants moved in February, 1986 for an order requiring plaintiffs to give notice to the class or, alternatively, decertifying the class. Plaintiffs responded on March 7, 1986 by filing a motion for an Order Concerning Notice to the Class. No notice has yet been given, however, because plaintiffs' counsel discovered that certain records pertinent to the notice issue had been discarded by Burlington's depository for the 1982 tender offer, First Fidelity Bank, N.A., New Jersey ("Fidelity"). Upon learning of this, plaintiffs filed a motion styled as a "Motion for an Order Delineating the Responsibility for Dissemination of Notice To Members Of The Class". The purpose of that motion was to obtain an Order directing the defendants to prepare and deliver to plaintiffs' counsel a list of the names and addresses of all class members. That motion is vigorously opposed.

The underlying problem is that neither Burlington nor its depository, Fidelity, ever compiled a list of names and addresses of those El Paso shareholders who tendered their shares in response to the December 21, 1982 Burlington offer. The entire recordkeeping and mailing function in connection with that offer was performed by Fidelity, which received all tendered shares and, after the Burlington-El Paso accord was reached, returned those shares to members of the class. The return of the tendered shares was accomplished during a ten-day period beginning approximately on January 13, 1983 and ending on January 23, 1983. To perform that task, Fidelity addressed the return envelopes to each stockholder class member individually, using information from one or more of three documentary sources: (i) letters of transmittal, (ii) notices of guaranteed delivery and (iii) envelopes in which the letters of transmittal or notices of delivery had been sent by tendering El Paso shareholders ("the envelopes"). Although no list of stockholder names and addresses had been prepared, the above documentation enabled Fidelity to return the stock to over 9200 tendering stockholders within a ten-day period, and without any need to utilize the El Paso shareholder list. (Transcript of May 15, 1986, pp. 26-27).

At some point after the shares were returned, Fidelity discarded the envelopes, retaining only the transmittal letters and notices of guaranteed delivery. However, Fidelity did prepare, and has retained, a log book containing the names of those stockholders to whom the shares were returned, their ZIP codes (but not their addresses) and the certified mail receipt numbers for each of the return mailings.

Plaintiffs argue that the discarding of those envelopes will make it considerably more burdensome for plaintiffs to give the required notice to the class. Plaintiffs contend that Fidelity was Burlington's agent, and that Burlington knew at least as of January 18, 1983 (the date plaintiffs served their motion for class certification) that the identity and addresses of class members would become important in the litigation. Accordingly, Burlington should have directed Fidelity to retain all relevant records, and Fidelity, as a professional in this field, should independently have known not to discard those envelopes. Since it was Burlington who created the situation that will increase the burden of giving notice, plaintiffs concluded in their original moving papers that Burlington should be required to assemble a complete list of the names and addresses of all class members.

In response, Burlington argued that under *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 356 (1978) ("*Oppenheimer*") it had no obligation to create specially for this lawsuit a list of class members that had never been prepared or maintained in the ordinary course of business either at the time of the challenged transaction or thereafter. Defendants further contend that the record does not support the plaintiff's contention that the loss of the envelopes has made the task of giving notice more burdensome. All the plaintiffs need to do, defendants say, is to match the names found on the transmittal letters and in the log book against the names and addresses contained on the El Paso stockholder list as of December 31, 1982 (December 31st being the proration date for Burlington's December 21, 1982 offer).

Thereafter, the plaintiffs abandoned their request for an order directing the defendants to prepare a list of the names and addresses of class members. In its place what the plaintiffs now seek is an order that would require Burlington to take the clerical steps

> ". . . . to reassemble the information as to the addresses, and stockholdings from the stock list and attach such information to the letters of transmittal and letters of guar-

> antee so that the plaintiff can send the class notice (at his own expense) to all stockholders and fiduciaries who transmitted shares (or who had letters of guarantee) sent in connection with the first tender." (Letter of May 20, 1986 to Court from plaintiffs' counsel)

Plaintiffs insist that this is necessary to restore the situation to where it would have been but for the unexplained destruction of the envelopes. Otherwise, they will be unfairly burdened by a situation of Burlington's (agent's) own making—one with which Fidelity itself never had to contend when it returned the shares in January, 1983.[1]

Defendants' view of the matter is that under *Oppenheimer, supra*, the plaintiffs are not entitled to even the revised relief which they now seek, because they have not shown that the loss of the envelopes has prejudiced them in any way. Defendants point out that, of the 9200 letters of transmittal received in the tender offer, plaintiffs' claim boils down to 535 illegible addresses, and to 57 missing or illegible names. Defendants argue that at worst this means that plaintiffs would have to resort to the stockholders list to locate the 535 addresses and to the originals of the transmittal letters to ascertain the 57 illegible names.[2] Defendants insist that by utilizing these information sources, the plaintiffs should be able to give the required notice without suffering any undue burdens.

II.

A.

[1] When interpreting the Court of Chancery Rules, this Court often looks to federal court decisions interpreting the counterpart Federal Rules of Civil Procedure for persuasive (albeit nonbinding) guidance. The parties agree that *Oppenheimer Fund, Inc. v. Sanders,*

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1. Plaintiffs claim that the transmittal letters acount for only a small number of the letters transmitted, that the letters themselves are incomplete as to addresses, shareholdings, and in some cases, names, and that the mail log is non-alphabetical and contains no addresses or information as to responses to the letters of guarantee.

2. Defendants argue that the fact that names may be illegible on the copies of the transmittal letters does not necessarily mean that they are illegible on the originals. They further argue that there is no evidence that the missing envelopes would have contained all of the required information in any event.

supra sets forth several principles that are relevant to this controversy. Because of the guidance that case affords, *Oppenheimer* is discussed in some detail.

Oppenheimer was a stockholders' class action brought against a mutual fund for violations of the federal securities laws. In that case, as here, the relevant shareholder records were maintained by an independent corporate agent (the mutual fund's transfer agent), which had never prepared a list of the names and addresses of the members of the shareholder class. To compile such a list for the specific purpose of giving notice to the class, the transfer agent would have had to sort manually through many records, to keypunch 150,000 to 300,000 computer cards, and to create several new computer programs, at an estimated cost of $16,000. The United States Supreme Court held that the lower Federal Courts had erred in ordering the corporate defendant to bear the $16,000 expense of preparing such a list.

[2-6] In arriving at that result, the Supreme Court articulated several important principles; namely: (1) in a class action, Rule 23, not the discovery rules, is the source of authority for an order directing a defendant to assist the representative plaintiff in identifying class members to whom individual notice will be sent; (2) the District Court has discretion to order a defendant to perform one or more of the tasks necessary to the giving of notice, including class member identification; (3) such discretion may be exercised in cases where the defendant is able to perform the task more efficiently than can the representative plaintiff; (4) where the task can be performed with substantially the same effort by either the representative plaintiff or by the defendant, the representative plaintiff should perform the task; and (5) regardless of who physically performs the task of identifying class members, the cost of performing that task must normally be borne by the representative plaintiff; however, that cost can be shifted to the defendant where it is not "substantial".

Applying those principles to the facts before it, the *Oppenheimer* Court found that neither side was able to prepare the list more efficiently than the other, because the only entity capable of preparing the list was the transfer agent. The question thus became one of who would bear the cost. The Supreme Court held that the cost should be borne by the representative plaintiffs, because $16,000 could not be viewed as "insubstantial". Given those circumstances, and because the corporate defendant had never maintained a list of class members as part of its normal recordkeeping practices, it had

no duty to specially create such a list, after the fact, for litigation purposes.[3]

B.

[7] Turning finally to the facts of this case, *Oppenheimer* suggests two relevant lines of inquiry: First, should Burlington be required to perform the mechanical task of assembling and collating the names and addresses of each class member on a single document, in this case, each transmittal letter? Second, apart from who performs the task, should some or all of the cost of identifying the names and addresses of the class members be borne by Burlington?

The answer to both these questions depends, at least in part, upon what, if any, practical burdens were occasioned by the loss of the envelopes. As best as I can gather, additional burdens, both financial and logistical, did result from that loss. When Fidelity returned the stock to those El Paso shareholders who tendered into the December 21, 1982 offer, it was able to do so in 10 days by using the envelopes, transmittal letters and the notices of guaranteed delivery, and without the need to resort to the El Paso shareholders' list. In all probability this is because each transmittal letter was stapled or otherwise affixed to the envelope in which it had been enclosed. That would have enabled Fidelity's clerical personnel to determine each stockholder's name and address by simply referring to the combined transmittal letter/envelope. Now that the envelopes are no longer available, the stockholders' addresses must now come from other sources, namely, the El Paso December 31, 1982 stockholders list and the log book. Plaintiffs advise the Court that the list alone will cost $5,000. Moreover, each of the names on most, if not all, of the transmittal letters will now have to be correlated with the names on the stockholders list, in order to locate the corresponding address. Thus, to the extent that none of the foregoing was necessary in January 1983, the loss of the envelopes will create additional financial and logistical burdens.

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3. The *Oppenheimer* Court held:

. . .[W]e do not think a defendant should be penalized for not maintaining his records in the form most convenient to some potential future litigants whose identity and personal needs could not be anticipated.

(437 U.S. at 363, 98 S.Ct. at 2395)

Who should mechanically discharge the burden of assembling the names and addresses of the members of the class—the plaintiffs or Burlington? Under *Oppenheimer* the answer depends upon who is better able to perform the task more efficiently. From an efficiency standpoint, neither side appears to have any particular advantage: the task would be equally burdensome for both. No showing has been made that Burlington personnel would bring to the task skills or capabilities superior to those possessed by plaintiff's personnel. Accordingly, the task will be performed by the plaintiffs.

However, as *Oppenheimer* makes clear, it does not necessarily follow that the plaintiffs must also shoulder the financial cost of performing that mechanical task. For the reasons that follow, I conclude that the cost should be borne by Burlington.

Oppenheimer expressly permits cost-shifting in situations where the cost is not "substantial". In this case, the record does not disclose the amount of the incremental cost, apart from the $5,000 cost of the shareholders list. However, defendants contend that the loss of the envelopes will not create any significant incremental burdens. From that contention, it would follow that there should be no significant incremental cost either.

However, my determination does not rest on that basis alone. For even if the incremental cost involved were "substantial", it is still fair that it be borne by Burlington, because Burlington was partly responsible for having created the problem that will give rise to such costs.

This is not a case, like *Oppenheimer*, where the corporate defendant was entirely blameless in having caused the problem giving rise to the increased burden and cost of giving notice. In *Oppenheimer* it would have been inequitable to shift that substantial cost to a blameless defendant. Here, however, Burlington had notice of both this lawsuit and the plaintiff's motion to certify the class, within the ten-day period during which its agent, Fidelity was returning the tendered El Paso shares. If Burlington had directed Fidelity to retain all relevant records, including the envelopes, there is no basis to conclude that Fidelity would not have done so. The entire problem would thereby have been avoided.

Burlington argues that under *Oppenheimer*, no classmember identification costs can be shifted to it, unless it acted in bad faith, which clearly it did not. I do not read *Oppenheimer* to so hold. The *Oppenheimer* Court did observe that the corporate defendant had not acted in bad

faith, but it made that observation as one reason for rejecting the plaintiffs' argument that absent cost-shifting, corporate defendants might be tempted to use computers "irretrievably [to bury] information to immunize business activity from later scrutiny," (437 U.S. at 362, quoting 558 F.2d at 645, n. 1). In that specific context the Supreme Court responded that the corporate defendant had not acted in bad faith to conceal such information. To elevate such a fact-specific observation into a broad principle that bad faith must be first shown in order to shift to a defendant the (substantial) cost of class member identification, is to overstate what *Oppenheimer* holds. *Oppenheimer* does not address the issue of what degree of fault is required to justify shifting the cost of class member identification to the corporate defendant.

For the above reasons, I conclude as a matter of discretion that the plaintiffs should not be required to bear (1) the cost of obtaining the December 31, 1982 El Paso stockholders list or (2) the incremental expense attributable to having to collate the names of class members found in the transmittal letters and the log book, with the addresses contained on the shareholders list. The present record does not permit quantification of the entire incremental expense; however, I am hopeful that the parties will cooperate so as to obviate the need for any such quantification. That might be done either by defendants making available, at their expense, personnel employed or engaged by them who would assist the plaintiff's personnel in performing the necessary mechanical tasks; or by the defendants agreeing in advance to sharing the expense on a percentage basis or otherwise.

III.

[8] Finally, the defendants have requested this Court to direct the plaintiffs to give notice by publication, in addition to mailing individual notices to class members. Rule 23(c)(2) requires that the notice shall be "the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." The defendants stress that, because 3 1/2 years have elapsed since the termination of the December, 1982 tender offer, there is a substantial likelihood that during that period many members of the shareholder class have changed their addresses, and thus would be unlikely to receive mailed individual notices. Under those circumstances, defendants argue, the best practicable notice to those class members would be by publication. I am inclined to agree. The plaintiffs will be directed to cause the notice to be

published in the appropriate publications. Counsel are encouraged to reach agreement on the specifics of the publication (e.g., which media, the frequency of publication, etc.), as well as on the mechanics of implementing the other rulings contained herein.

Counsel may submit an appropriate form of order.

GREENFIELD v. NATIONAL MEDICAL CARE, INC.

Nos. 7720 & 7765 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

June 6, 1986

At issue are motions to dismiss a class action attacking the leveraged buy-out of defendant National Medical Care, Inc. (NMC). NMC negotiated a merger with W.R. Grace and Company (Grace) after discussions with another interested corporation were discontinued. NMC appointed a special committee of independent directors to evaluate the proposed transaction. Shareholders approved the final terms, which included a merger with a wholly-owned subsidiary formed by an investor group consisting of members of NMC's management and physicians associated with the company. Grace was also granted two options to buy a quantity of stock which amounted to less than two percent of the outstanding shares. Plaintiff shareholders alleged that the defendant directors breached their fiduciary duties by granting the options, failing to evaluate adequately NMC's worth, and failing to disclose the directors' interest in the merger.

The court, per Vice-Chancellor Berger, held that the allegations challenging the merger price and the objectivity of the directors and special committee sufficiently stated a claim for breach of fiduciary duty. The claim against Grace for aiding and abetting the breach was dismissed, however, for lack of allegations sufficient to support the claim.

1. Judgment ⟹ 181(1), 181(31)

Pretrial Procedure ⟹ 621, 622

A complaint may not be dismissed for failure to state a claim unless no set of facts could be proven in support of the well pleaded allegations which would entitle plaintiff to relief.

2. Corporations ⟹ 307, 310(1)

Judgment ⟹ 181(31)

Pretrial Procedure ⟹ 621, 622

The mere allegation of a lock-up is not sufficient to state a breach of fiduciary duty claim since the use of such a device is not per se illegal.

3. Corporations ⟹ 310(1)

Because of their potential impact on bidding, lock-ups must be given careful scrutiny to see if under all the facts and circumstances they are fair to the shareholders.

4. Corporations ⟹ 307, 310(1)

Judgment ⟹ 181(31)

Pretrial Procedure ⟹ 622

A complaint sufficiently states a claim for breach of fiduciary duty where it is alleged that a merger price was unfair, that a lock-up prevented a higher offer, that an interested board approved the merger, and that a member of a special committee to evaluate the proposal was not independent.

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

Lawrence A. Hamermesh, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for defendants National Medical

Care, Inc., Constantine L. Hampers, E.B. Hager, Edmund G. Lowrie, and Paul Paganucci.

Allen M. Terrell, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware, for defendants Jonathan Moore, F.G.P. Thorne, and Carl Tiedemann.

Rodman Ward, Jr., Esquire, and Robert L. Ciociola, Esquire, of Skadden, Arps, Slate, Meagher & Flom, Wilmington, Delaware, for defendant W. R. Grace & Co.

BERGER, *Vice-Chancellor*

This is the decision on motions to dismiss a purported class action attacking the leveraged buy-out of defendant National Medical Care, Inc. ("NMC") whereby the public stockholders of NMC were paid $19.25 in cash. The Consolidated Amended Complaint (the "Complaint") names as defendants NMC, its directors—Carl H. Tiedemann, P. D. Pagnucci, Edmund G. Lowrie, Jonathan Moore, F. G. P. Thorne, E. B. Hager and Constantine L. Hampers, an officer of NMC who was not a director, W. R. Grace & Co. ("Grace"), the company that, together with certain members of NMC's management and physicians associated witht he company (the "Investor Group"), acquired NMC and Dillon, Read & Co., Inc. ("Dillon Read"), the investment banking firm that rendered a fairness opinion in connection with the merger. The pending motions to dismiss were filed on behalf of all defendants except the NMC officer and Dillon Read.

The relevant facts, as gleaned from the Complaint and the NMC proxy statement, *see*, *Patents Management Corporation v. O'Connor*, Del. Ch., Civil Action No. 7110, Walsh, V. C. (June 10, 1985), may be summarized as follows. NMC manufactures and distributes medical products and operates out-patient artificial kidney treatment facilities and programs for the control of health risk obesity and hypertension. Immediately prior to the merger, NMC had approximately 18.3 million shares of common stock outstanding which shares were traded on the New York Stock Exchange. For the year ending December 31, 1983, NMC reported net income of approximately $23 million on revenues of approximately $311 million. Its revenues for the first half of 1984 increased 3% over those for the comparable period in 1983 and the company contemplated significant growth in

revenues and income for the period from 1984 through 1987. During 1983, NMC's common stock traded at prices ranging from $9.50 per share to $19.75 per share and during the first three quarters of 1984 the stock price ranged from $10.25 per share to $18.125 per share.

The events leading up to the merger at issue may be traced back to September, 1983, at which time National Medical Enterprises, Inc. ("NME"), a publicly held company engaged in diverse health care services, expressed interest in a business combination with NMC. Following discussions and an extensive review by NME of NMC's financial condition and prospects, on April 9, 1984, the two companies reached an agreement in principle on a stock-for-stock merger at an exchange rate that was valued at approximately $19.59 per share at the time it was proposed by NMC. NMC's board approved the merger on April 10, 1984. However, on the same day, NME's president gave notice that he would not present the proposal to his board of directors because, based upon NME's review of NMC's business and prospects, he could not recommend the transaction at the negotiated exchange rate (then valued at approximately $18.41 per share). He asked that NMC negotiate a lower exchange rate but Dr. Hampers, NMC's President and Chief Executive Officer, rejected the request and no further negotiations took place.

Shortly thereafter, discussions began between NMC and Grace, a publicly held company primarily engaged in the chemical business and in natural resource activities. Initially, representatives of the two companies discussed various alternatives for the acquisition of NMC including a stock-for-stock merger. However Dr. Hampers advised that he would not recommend an acquisition unless the price was in the range of the price negotiated with NME and on July 17, 1984, Grace advised Dr. Hampers that a merger involving the issuance of Grace stock would not be feasible. Instead, Grace suggested a leveraged buy-out.

At a meeting held on July 23, 1984, Grace advised that continued acquisition discussions would be conditioned upon NMC's agreement to grant Grace an option to purchase 1 million shares of NMC common stock at the current market price. Grace required the option because of the substantial time and expense that would be involved in structuring the transaction and arranging financing. At a meeting held on July 26, 1984, after negotiations, the parties tentatively agreed on a merger price of $19.50 per share. That evening, Dr. Hampers advised the NMC board of the proposal and the directors

discussed both the merger price and the 1 million share option, but took no formal action on those two matters. The board directed Dr. Hampers to continue negotiation with Grace over the option terms and appointed a special committee of independent directors—Messrs. Thorne, Tiedemann, Moore and Hager—to review and evaluate the proposed transaction.

On July 30, 1984, Grace indicated that it would not go forward unless NMC would agree to grant it a second option for approximately 2.4 million shares exercisable at the current market price only in the event that a third party made a higher offer for the company. The following day, Grace advised Dr. Hampers that the price of $19.50 per share was not acceptable and proposed $19.00 per share. After further negotiations between NMC and Grace and separate negotiations between the special committee and Grace, the board of directors of NMC, with the recommendation of the special committee, unanimously approved the merger agreement and options.

The final terms of the transaction were: (1) a merger at $19.25 per share whereby NMC merged with a wholly-owned subsidiary of NMC Holding Corp. ("NMC Holding"), the corporation formed by the Investor Group to effectuate the leveraged buy-out; (2) the grant of an option to Grace to purchase 1 million shares of NMC common stock at $12.875 per share exercisable before May 1, 1985 if a third party were to make an offer to acquire a majority interest in NMC or if the NMC stockholders did not approve the merger; and (3) the grant of an option to Grace to purchase approximately 2.4 million shares at the same price exercisable only in the event that a third party made an offer to acquire a majority interest in NMC at a price higher than $19.25 per share. Dillon Read, the investment banking firm selected by the special committee, thereafter opined that the merger consideration was fair from a financial point of view. At a special stockholders' meeting held on November 15, 1984, the merger was approved.

The Complaint alleges that the individual defendants, aided and abetted by Grace, Dillon Read and others, breached their fiduciary duties by depriving NMC's public stockholders of their investment at a grossly inadequate price. It goes on to charge that the individual defendants are interested because certain officers and directors and other key management personnel of NMC will be substantial stockholders in NMC Holding or otherwise benefit from the merger. The Proxy Statement reveals that Messrs. Hampers, Lowrie and Hager

were to own approximately 25% of the common stock of NMC Holding at the effective time of the merger. Mr. Paganucci is a director of a Grace subsidiary and the Vice President—Finance of Dartmouth College. NMC Holding agreed, if the merger were effected, to contribute $2.5 million to Dartmouth College over a period of years.

The independence of all of NMC's directors, including those appointed to the special committee, is challenged because they allegedly owe their appointments to Dr. Hampers "by virtue of business, social or other relationships" with him. Complaint, ¶23. The special committee is also attacked on the grounds that one of its members—Dr. Hager—was a paid consultant to NMC, later was asked to become a director of and was allowed to purchase stock in NMC Holding and did not withdraw from the committee until after it had recommended the merger.

In approving the merger, the defendant directors allegedly breached their fiduciary duties by (1) granting the Grace options when they knew or should have known that those options would "protect their own positions with respect to Grace" and deter competitive bidding for the company; (2) failing to adequately evaluate NMC's worth or to solicit other possible purchasers; and (3) disseminating a false and misleading proxy statement that did not disclose the directors' alleged relationships with Dr. Hampers and highlighted the Dillon Read fairness opinion to mislead the stockholders into believing that the merger price was fair. Plaintiffs also claim that the price paid for the Dillon Read fairness opinion was wholly unrelated to the services performed, although it is unclear whether this allegation is meant to suggest waste or other wrong doing on the part of NMC's directors or is the basis for a claim against Dillon Read.

Defendants argue that the Complaint fails because plaintiffs are complaining only about the price of the merger. They point out that the company had been engaged in arms-length merger negotiations with NME for months before this merger was approved. There is no majority stockholder—the combined holdings of all of NMC's directors amounted to less than 5% of the outstanding common stock—and the conflicts of interest of the directors who were participating in the leveraged buy-out were fully disclosed and were appropriately neutralized by the formation of the special committee. They argue that the options granted to Grace were not a "lock-up," as described by plaintiffs, but at best a "leg up" since they

amounted to less than 2% of the outstanding stock. In short, defendants contend that no breach of fiduciary duty has been alleged and plaintiffs' dissatisfaction with the merger price should have been resolved in an appraisal proceeding.

[1] A complaint may not be dismissed for failure to state a claim unless no set of facts could be proven in support of the well pleaded allegations which would entitle plaintiff to relief. *Del. State Troopers Lodge No. 6 v. O'Rourke*, Del. Ch., 403 A.2d 1109 (1979). Plaintiffs say that their complaint adequately alleges that the defendant directors breached their fiduciary duties by granting the Grace options.

[2,3] Given the small percentage of stock involved in the Grace options, it is questionable whether they, in fact, operated as any sort of lock-up in the sense of foreclosing further bidding. However, inasmuch as the options would make it more costly for another entity to acquire NMC, for purposes of these motions, the options will be considered to constitute a form of lock-up. The mere allegation of a lock-up is not sufficient to state a breach of fiduciary duty claim since the use of such a device is not *per se* illegal. *Revlon, Inc. v. McAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 176 (1986). As the *Revlon* court noted, "while those lock-ups which draw bidders into the battle [to acquire the corporation] benefit shareholders, similar measures which end an active auction and foreclose further bidding operate to the shareholders' detriment. *Id.* at 183. In light of their potential impact on the bidding process, this Court has ruled that lock-ups "must be given careful scrutiny. . .to see if under all the facts and circumstances. . .they are fair to the shareholders." *Thompson v. Enstar Corporation*, Del. Ch., Civil Action Nos. 7641, 7643, Hartnett, V. C. (August 16, 1984) slip op. at 11.

[4] Although the complaint does not allege that there were any other bidders, it does allege that the merger price was unfair and that the lock-up prevented the stockholders from obtaining a higher offer. When combined with the allegations that the merger was approved by an interested board and that one of the members of the special committee was not independent but did not resign until after the committee recommended the merger, I conclude that the complaint sufficiently states a claim for breach of fiduciary duty. *Cf. Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264 (2d Cir., 1986).

The claim against Grace, however, must be dismissed. The Complaint alleges that Grace aided and abetted the defendant directors in breaching their fiduciary duties to the NMC stockholders.

Complaint, ¶18. Nowhere in the Complaint are there any allegations supporting this conclusion. In their brief, plaintiffs argue, summarily, that Grace knew that NMC's directors had not informed themselves about the value of their company and knew that they were breaching their fiduciary duty by agreeing to the Grace options. Plaintiffs cite to no paragraph of their Complaint which directly or by inference alleges facts which would support these conclusions.

As noted above, the granting of stock options is not inherently wrongful. There is nothing alleged about the timing of the transaction or the nature of the negotiations between NMC and Grace from which it could be inferred that Grace was aware of the defendant directors' alleged failure to properly inform themselves with respect to the transaction. This is not a case such as *Gilbert v. The El Paso Company*, Del. Ch., 490 A.2d 1050 (1984), where, by the very terms of the transaction, the alleged conspirator was charged with knowledge that the target company's directors were preferring themselves to their stockholders.

Based upon the foregoing, Grace's motion to dismiss is granted and the remaining motions to dismiss are denied.

IT IS SO ORDERED.

HECCO VENTURES v. TEXAS AMERICAN ENERGY CORP.

No. 8520

Court of Chancery of the State of Delaware, New Castle

July 7, 1986

Plaintiff, Hecco Ventures (Hecco), is a stockholder of Texas American Energy Corporation (TAE). In December 1985, TAE amended its bylaws in order to fend off a possible takeover by Hecco. On December 31, 1985, TAE created an Employee Stock Option Plan (ESOP) owning 15.2% of the company's stock. Hecco filed suit against TAE seeking, *inter alia*, preliminary and permanent

injunctions restraining TAE from voting any TAE stock held by ESOP and to require TAE to hold an annual meeting on August 4, 1986 rather than on the date TAE intended to schedule the meeting—on or before October 15, 1986. TAE argues that at least 15 days would be necessary to obtain SEC clearance of the company's proxy materials and at least 30 days should be provided between the time the proxy materials are mailed and the date of the annual meeting in order to allow those materials to reach the beneficial owners and to give the stockholders sufficient time to analyze them and respond. The court, per Vice-Chancellor Berger, concluded that, based upon the company's representations as to the amount of time necessary to clear its proxy materials, the annual meeting should be held on or before September 5, 1986.

1. Corporations ⟹ 192, 201

In an action to compel the holding of a stockholder's meeting under DEL. CODE ANN. tit. 8, § 211, the specific date on which the meeting will be held is a matter within the court's discretion. DEL. CODE ANN. tit. 8, § 211 (1981).

2. Corporations ⟹ 192

The mandate of a prompt meeting under DEL. CODE ANN. tit. 8, § 211 outweighs the possible benefit of awaiting the conclusion of a consent solicitation. DEL. CODE ANN. tit. 8, § 211 (1981).

Michael Houghton, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, for plaintiff.

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

BERGER, *Vice-Chancellor*

This is the decision in an action brought pursuant to 8 *Del. C.* §211 by Hecco Ventures ("Hecco") seeking an order requiring Texas American Energy Corporation ("TAE") to hold an annual meeting. It is undisputed that Hecco is a stockholder of TAE and that the company's last annual meeting was held on May 21, 1985. TAE opposes the relief sought only insofar as Hecco asks that the meeting

be held on August 4, 1986 rather than on the date TAE intends to schedule the meeting—on or before October 15, 1986.

[1] The parties recognize that under §211 the specific date on which the meeting will be held is a matter within the Court's discretion. *Savin Business Machines Corp. v. Rapifax Corp.*, Del. Ch., 375 A.2d 469 (1977). Hecco argues that the meeting should be scheduled "as promptly as possible," *Meredith v. Security America Corp.*, Del. Ch., 7 Del. J. Corp. L.. 341, 344 (1981), and that the time frame suggested by TAE is but another in a series of efforts by the company to block Hecco in its bid for control of the company. TAE acknowledges that its decision to delay scheduling the annual meeting was prompted by Hecco's conduct, but denies that the decision was prompted by entrenchment or other improper motives. Rather, it says that the schedule it proposes is necessary to avoid the confusion that would result from soliciting the stockholders for an earlier meeting date.

The factual context is highlighted as follows. On September 6, 1985, Hecco and others (the "Hecco Group") filed a Schedule 13D disclosing its ownership of approximately 5.2% of TAE's common stock and the possibility that it would seek control of the company. In December, 1985, TAE amended its bylaws to provide procedures governing the use of written consents and nomination procedures for the election of directors either by consent or at a stockholders' meeting. On December 31, 1985, TAE created an Employee Stock Option Plan ("ESOP") owning 15.2% of the company's stock. On March 24, 1986, Hecco filed suit against TAE in the United States District Court for the Western District of Kentucky alleging that TAE's directors breached their fiduciary duty by creating and funding the ESOP for the sole purpose of entrenching management and diluting Hecco's voting rights. The complaint seeks, among other relief, preliminary and permanent injunctions restraining defendants from voting any TAE stock held by the ESOP. In a Schedule 13D also filed on March 24, 1986, the Hecco Group disclosed that it then owned approximately 9.9% of TAE's stock and that it had determined to seek control of TAE through a proxy contest to elect its own slate of directors at the 1986 annual meeting. On June 4, 1986 the Hecco Group commenced a consent solicitation to amend TAE's bylaws, remove its current directors and elect the Hecco Group's nominees.

In his affidavit, William F. Judd, a director and the President of TAE, states that, in the board's opinion, the pendency of two

concurrent proxy solicitations (the Hecco Group consent solicitation and an annual meeting proxy solicitation) would be confusing to the TAE stockholders and cause unnecessary additional expense to TAE. Judd explains that the TAE stockholders are already receiving consent solicitation materials from both parties with white cards for the execution of consents and blue cards for their revocation. Those solicitations may continue until August 21, 1986. He states that the cards that would be sent in connection with the parties' proxy solicitations would be substantially similar to the consent cards and would generate confusion not only because of the similarity of the cards but also the similarity of the action requested by each solicitation.

Judd states that at least 15 days would be necessary to obtain SEC clearance of the company's proxy materials and that at least 30 days should be provided between the time the proxy materials are mailed and the date of the annual meeting in order to allow those materials to reach the beneficial owners and to give the stockholders sufficient time to analyze them and respond. He also suggests that, by waiting until October 15, 1986, there may be a ruling in the ESOP litigation which would resolve the question of the validity of the voting of the ESOP's stock.

[2] After considering the company's position, I conclude that the mandate of a prompt meeting under §211 outweighs the possible "benefit" of awaiting the conclusion of the consent solicitation. Although it undoubtedly would be simpler to engage in one solicitation at a time, if the solicitation materials are clear and accurate, there is no reason to believe that the stockholders will be unable to understand and appropriately respond to the materials they receive. *See, Garrett, et al. v. Brown, et al.*, Del. Ch., Consolidated Civil Action Nos. 8423 and 8427, Berger, V. C., April 22, 1986. Based upon the company's representations as to the amount of time necessary to clear its proxy materials and to allow the stockholders a meaningful opportunity to digest that information, I conclude that the annual meeting should be held on or before September 5, 1986.

I request that counsel consult upon an appropriate form of order fixing the specific date, time and place of the meeting as well as the record date. Absent agreement on such an order, the Court will consider the parties' positions at an office conference on July 9, 1986 at 10:00 a.m.

IN RE HYBRILONICS, INC.

No. 8035 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

July 28, 1986

The petitioners, Richard and Thaddeus Fabiniak, controlled Hybrilonics, Inc., a Delaware corporation. In April 1986, the intervenors, Richard Freeman, Gregory H. Hill, William Lerner, and Atlantic Financial Concepts, Inc., took control of the corporation away from the Fabiniaks, and the Fabiniaks were removed from the board of Hybrilonics. The petitioners are now seeking to challenge their removal from the board of Hybrilonics pursuant to purported stockholder consents executed pursuant to DEL. CODE ANN. tit. 8, § 228. The intervenors seek to have a default judgment entered against the Fabiniaks for their failure to file a brief in response to a pleading filed in No. 8035. The court, per Vice-Chancellor Hartnett, addressed petitioners' challenge by stating that even though the petitioners meet all the requirements for injunctive relief, their application still must be denied because the court must balance the competing equities between the parties. The court concluded that the intervenors' request for a default judgment must also be denied. The issues to be briefed have changed dramatically, and it is likely that the issues will either become moot by an election to be held on September 30, 1986, or will require an evidentiary hearing to ascertain the true facts.

1. Injunction ⟹ 132, 134, 137(1), 151

Even assuming, *arguendo*, that petitioners seeking a preliminary injunction had established the reasonable probability of success on the merits and had established that if a preliminary injunction is not granted they will suffer irreparable harm, the chancery court must still balance the competing equities between the parties and, where those equities do not favor the petitioners, their application must be denied.

2. Injunction ⟹ 132, 134, 137(4)

Preliminary relief is always to be avoided, if possible, because controversies should only be determined after all the parties had a full opportunity to present the facts.

3. Injunction ⟹ 132, 137(1)

The court of chancery is especially reluctant to grant preliminary relief if by doing so it will grant all the relief which the applicant may ultimately be entitled to after trial.

4. Judgment ⟹ 92, 106(1), 132

The entry of a default judgment is the ultimate sanction which is to be granted only under extreme circumstances. Thus, a motion seeking a default judgment because of petitioners' failure to file a brief in response to a pleading filed before consolidation of two suits at chancery was denied.

Clark W. Furlow, Esquire, of Lassen, Smith, Katzenstein & Furlow, Wilmington, Delaware, for Thaddeus and Richard Fabiniak.

Januar D. Bove, Jr., Esquire, of Connolly, Bove, Lodge & Hutz, of Wilmington, Delaware, for Atlantic Financial Concepts, Inc.

Thomas Herlihy, III, Esquire, of Herlihy & Wier, Wilmington, Delaware, for Hybrilonics, Inc.

HARTNETT, *Vice-Chancellor*

The applicants seek a preliminary injunction restoring themselves as directors of Hybrilonics, Inc., a Delaware corporation. The application must be denied.

I.

This is a most unusual case in which it is difficult even to ascertain the alignment of the parties and by whom they are represented, due in part to the shifting of allegiances which have occurred since *Freeman v. Fabiniak*, Del. Ch., C.A. No. 8035- N.C., was filed on May 28, 1985. That case has now been consolidated with *Fabiniak v. Dwyer*, Del. Ch., C.A. No. 8500- N.C., under the caption *In the Matter of: HYBRILONICS, INC.*

For convenience "the Fabiniaks" shall refer to Thaddeus J. Fabiniak and Richard C. Fabiniak, petitioners in C.A. No. 8500 and defendants in C.A. No. 8035. "The Intervenors" shall refer to Richard S. Freeman, Gregory H. Hill, William Lerner and Atlantic

Financial Concepts, Inc. ("Atlantic Financial"), the intervenors in C.A. No. 8500. They are, with the exception of Atlantic Financial, the plaintiffs in C.A. No. 8035. "The Insurgents" shall refer to Herbert E. Dwyer, F. Emerson Ivey and Gerry Ashenberg. They are the respondents in C.A. No. 8500. Mr. Dwyer is a defendant in C.A. No. 8035. Messrs. Emerson and Ashenberg are not involved in C.A. No. 8035.

The corporation is also unusual. It is obviously in dire financial straits. It has assets of less than $2 million and over one hundred million shares of stock issued and outstanding. It has been the center of a prior bitter battle for corporate control. *Freeman v. Fabiniak*, C.A. No. 8035-N.C., Hartnett, V.C. (Aug. 15, 1985). The conduct of both sides leaves something to be desired. For example, while the corporation was being run by the Fabiniak interests, during the past year, 5 million shares of stock in the corporation were issued for little or no consideration to the Fabiniaks. Not to be outdone, after the Intervenors took control of the corporation in April of this year by methods which were at least partially defective, they issued over 7 million shares to themselves in trade for an antecedent debt.

II.

As set forth in my opinion in C.A. No. 8500 dated June 12, 1986, the Fabiniaks are seeking to challenge their removal from the Board of Hybrilonics pursuant to purported stockholder consents executed pursuant to 8 *Del. C.* §228.

In my June 12, 1986 opinion in which I denied the Fabiniaks' application for a temporary restraining order I stated:

> "There exist, in the present case, disputed questions of fact as to a large number of the written consents, which cannot he resolved within the framework of an application for a temporary restraining order."

The Fabiniaks' motion for a preliminary injunction is basically a restatement of the same facts and arguments which they made at the hearing on the temporary restraining order held on June 6, 1986, supplemented by new affidavits, and the alleged admissions contained in the pleadings which have been filed since June 6.

After an examination of the record and the arguments and briefs of the parties, although there seem to he certain technical deficiencies in some of the stockholder consents obtained by the Intervenors, I am still convinced that it is impossible to determine from the present

record which side controls a majority of the stock of the corporation. I also find that the Fabiniaks have not sustained their burden of establishing the reasonable probability of success on the merits.

[1] Even if the Fabiniaks had established the reasonable probability of success on the merits and had established that if a preliminary injunction is not granted they will suffer irreparable harm, their application still must he denied because the Court must still balance the competing equities between the parties. *Thomas C. Marshall, Inc. v. Holiday Inn, Inc.*, Del. Ch., 174 A.2d 27 (1961).

The Intervenors are now in charge of the corporation and have been operating it since May 19, 1986. At the Court's urging they proposed that the annual meeting of the stockholders be moved forward and be held on August 27, 1986 which is but a few weeks away. At the insistance of the Fabiniaks, however, the Court set September 30, 1986 as the date for the annual meeting which will be conducted under the supervision of a Special Master appointed by the Court. It is likely that the annual meeting will resolve many of the issues now being put forward by the parties. It is even possible that it may resolve almost the entire controversy.

To permit the Fabiniaks to resume control of the corporation for only a few weeks would not be in the best interests of the corporation or its stockholders. It would also grant to the Fabiniaks substantially all the relief they are requesting on a record in which almost every allegation and fact is disputed.

[2,3] Preliminary relief is always to be avoided, if possible, because controversies should only be determined after all the parties have had a full opportunity to present the facts. Experience has shown that the true facts and the correct law are often difficult to ascertain without the advantage of a full hearing. This Court is also especially reluctant to grant preliminary relief if by doing so it will grant all the relief which the applicant may ultimately be entitled to after trial. *Thomas C. Marshall, Inc. v. Holiday Inn*, supra.

III.

The Intervenors also seek to have a default judgment entered against the Fabiniaks for their failure to file a brief in response to a pleading filed in C.A. No. 8035 before the two suits were consolidated.

[4] The motion for default judgment must be denied. The entry of a default judgment is the ultimate sanction which is to be granted only under extreme circumstances. Here the nature of the case and

the issues to be briefed have dramatically changed since the original brief schedule. Quite frankly I do not know precisely what issues would now be briefed because some of the issues are now moot and it is likely that most or all of the other issues will either be mooted by the election to be held on September 30, 1986 or will require an evidentiary hearing to ascertain the true facts. The Intervenors have continually urged that the entire matter be stayed or held in abeyance pending the annual meeting. While I have denied a stay, I agree that any further briefing should be held in abeyance until after the annual meeting.

I have previously directed that the present directors of Hybrilonics are to be considered as custodians of the corporation until the annual meeting and ordered that Hybrilonics be prohibited from making any extraordinary transactions prior to the certification of the results of the annual meeting. This shall remain in effect.

In conclusion, the motion for a preliminary injunction and the motion for default judgment are denied. IT IS SO ORDERED.

JAMES JULIAN, INC. v. WILSON

No. 8593

WILSON v. JAMES JULIAN, INC.

No. 921-K

Court of Chancery of the State of Delaware, New Castle

September 22, 1986

These were consolidated actions on cross-motions for preliminary injunctive relief arising out of the operation of an asphalt plant owned and operated by James Julian, Inc. (Julian) and located near Harrington, Delaware. The plant was operated in accordance with state and federal EPA standards and Julian used state of the art devices to minimize noxious emissions from the plant. Julian received operation permits from both the Kent County Board of Adjustment

and the Department of Natural Resources and Environmental Control (DNREC). The permits expire on February 21, 1987 and the plant will be closed after that date. The plant was in continuous operation from October 23, 1985 until December 9, 1985 and from April 2, 1986 until July 8, 1986. During those periods, Julian received no complaints about the emissions from the plant.

Beginning August, 1986 the individual defendants, who live near the plant, complained to DNREC about asphalt odors emanating from the plant. Soon thereafter the secretary of DNREC brought the present action seeking a preliminary injunction against continued operation of the plant. Julian entered cross-motion seeking preliminary injunctive relief against the institution by DNREC of further criminal and administrative proceedings against Julian in furtherance of DNREC's efforts to shut down the plant. Julian also sought to enjoin the individual defendants from engaging in certain activities which Julian characterizes as "business slander."

The court of chancery, per Vice-Chancellor Jacobs, held that neither side demonstrated entitlement to the preliminary injunctive relief. In denying DNREC's motion, the court held: (1) there were evidentiary conflicts on the source, duration, and harmful effects of the complained of odors; (2) the adverse impact of the odors was sporadic, temporary, and not threatening to health; (3) the plant was operated in compliance with the appropriate laws and nothing more could be done; (4) the emissions from the plant did not unreasonably interfere with the use and enjoyment of life and property. In denying Julian's motions, the court held: (1) equity will not enjoin a criminal prosecution, except where the prosecution is brought in bad faith and Julian did not prove bad faith; (2) Julian did not prove DNREC intended to institute future criminal actions or issue future Cease and Desist Orders; (3) Julian failed to prove the individuals defendants engaged in any wrongful act.

1. Injunction ⟹ 3, 89, 102, 103

The traditional standards for preliminary injunctive relief are applicable to cases involving claims of environmental law violations.

2. Injunction ⟹ 151

To obtain injunctive relief, a plaintiff must show a reasonable probability of success on the merits and the likelihood of irreparable injury absent the injunction.

3. Injunction ⟹ 151

In deciding whether to issue an injunction, the court may balance the conveniences and possible injuries to the parties.

4. Injunction ⟹ 137(1)

An injunction will not be granted to shut down an odor producing asphalt plant when there are evidentiary inconsistencies and conflicts regarding the source, duration and harmful effect of the complained of odors.

5. Injunction ⟹ 137(1)

An asphalt plant will not be enjoined from operation when the evidence shows that the adverse impact of the odors emitted therefrom upon the environment is sporadic, of temporary duration, and not threatening to health.

6. Injunction ⟹ 137(1)

An injunction to shut down an odor producing asphalt plant will not be granted when the plant has been operated in compliance with all state and federal environmental laws and when given the present state of asphalt plant technology, nothing more can be done to eliminate the odor problems.

7. Injunction ⟹ 137(1)

Injunctive relief is inappropriate where the evidence shows that the problem will either not recur, or that any recurrence will be minimal.

8. Injunction ⟹ 136(1)

Injunctive relief against an odor producing plant is appropriate only when the complained of activity unreasonably interferes with the use and enjoyment of life and property.

9. Injunction ⟹ 137(1), 151

The odors emitted from an asphalt plant do not unreasonably

interfere with the use and enjoyment of life and property when the inconvenience caused by the interference is outweighed by the impact an immediate shut down would have upon other affected interests such as those of the defendant, its employees and the public.

10. Injunction ⟹ 105(1), 137(1)

Equity will not enjoin a criminal prosecution, except where the prosecution is brought in bad faith.

11. Injunction ⟹ 105(1), 137(1)

An injunction will not be granted to enjoin a defendant from instituting further criminal prosecutions against the plaintiff when the plaintiff has not proved intent by the defendant to file future criminal actions.

12. Injunction ⟹ 137(1), 151

A request for preliminary injunctive relief against the issuance of future Cease and Desist Orders is inappropriate when the request is based on fears, not upon evidence, that such orders would be issued in the future; likelihood of irreparable harm is, thus, not proven.

13. Injunction ⟹ 137(1), 151

An order for injunctive relief against engaging in activities characterized as "business slander" will not be granted when the plaintiff makes no showing, or argument in its brief, that there has been any wrongful act committed, and where the defendants have done nothing more than exercise their constitutional right of free speech.

Kevin P. Maloney, Esquire, of the Department of Justice, Wilmington, Delaware, for John E. Wilson, III, Secretary, as both plaintiff and defendant, and for Individual Defendants in No. 8593.

Januar D. Bove, Jr., Esquire, Jeffrey B. Bove, Esquire, and Edward F. Eaton, Esquire, of Connolly, Bove, Lodge & Hutz, Wilmington, Delaware, for James Julian, Inc., as both plaintiff and defendant.

JACOBS, *Vice-Chancellor*

Presently pending in these consolidated actions are cross-motions for preliminary injunctive relief arising out of the operation of an asphalt plant owned and operated by James Julian, Inc. ("Julian") and located near Harrington, Delaware ("the plant"). In his motion, the Ssecretary of the Department of Natural Resources and Environmental Control ("DNREC") seeks a preliminary injunction against the continued operation of the plant. In its motion, Julian seeks preliminary injunctive relief against the institution by DNREC of further criminal and administrative proceedings against Julian in furtherance of DNREC's efforts to shut down the plant. Julian also seeks certain other relief against certain named individual defendants who live nearby the plant. Both motions were briefed on an expedited basis, and were argued on September 11, 1986. This is the decision of the Court on the cross-motions for preliminary injunctive relief.

I.

Except as otherwise noted, the facts, as set forth in the verified complaints and accompanying affidavits, are not contested.

The background leading up to the present dispute is best described in chronological terms. Julian has contracts with the Department of Transportation of the State of Delaware to perform road construction on Route 13 in Delaware. Those contracts require Julian to use recycled asphalt material from the roads being repaired. The plant, at its particular location near Harrington, is critical to this highway construction work, because it serves as the source for the asphalt being used for the resurfacing, and also because it is conveniently located in relation to the job site.

To construct and operate the plant at its present location, permits were required from both the Kent County Board of Adjustment and DNREC. In February, 1985 the Board of Adjustment, after a hearing and without public opposition, granted approval to permit the placement of a temporary asphalt batching plant at the plant's present location. Several months later, the Board of Adjustment granted an additional area for the use of the plant after finding that the additional area "would not be of substantial detriment to the public good." By its own terms the approval expires on February 21, 1987. Julian has represented that no extension of that approval has been or will be sought, and that after February 21, 1987 the plant will be closed.

In March, 1985, Julian applied to the DNREC for a permit to construct and operate the plant. The pollution control equipment at the plant was described in the application to DNREC as a "wet

venture scrubber" device in which exhaust gases were drawn through a wet scrubber. By this process particulate matter is removed, and exhaust gases are discharged through a stack. The application also contained a report which set forth test results establishing that the rate of emissions from the plant's scrubber, and the total contaminants by weight, were below limits set by the State of Maryland and by the United States Environmental Protection Agency ("EPA").[1] It is undisputed that the plant is equipped with a "state of the art" wet scrubber and that even with such a device in place, it is impossible to operate any asphalt plant without emitting some odor. That fact was known when the DNREC permit was granted. Approximately 15,000 asphalt plants of this type are presently operating in the United States, and 9 such plants are operating in Delaware, in addition to the Julian plant.

On October 15, 1985, DNREC issued a permit authorizing the construction and operation of the plant. The DNREC permit was issued subject to five enumerated conditions. None of those conditions related to the emission of odors.

From October 23, 1985 until December 9, 1985, and from April 2, 1986 until July 8, 1986, the plant operated continuously. At no time during the operating history of the plant has there been any complaint or problem with the emission of particulates from the plant. Nor has DNREC made a claim that any of the enumerated specific conditions to the granting of the permit have been violated. Beginning in June, 1986 and continuing in July and August, 1986, the individual defendants, who live in homes on properties located near the Julian plant, complained to DNREC about asphalt odors emanating from the plant. On June 9, 1986, DNREC filed a criminal charge against Julian in the Justice of the Peace Court, in that County, claiming that Julian had violated Air Pollution Regulation XIX, Section 2.1. Julian pleaded *nolo contendere* to the charge and paid a $50 fine without admitting or denying guilt. Subsequently

1. In September, 1985 Mr. G. Sumner Buck, III, an expert in the field of environmental testing, reported to Julian on tests that his firm had conducted in August, 1984 and August, 1985 while Julian's plant was located in Maryland. Mr. Buck reported that (i) the only appropriate testing method was the one method employed by his firm and witnessed and sanctioned by representatives of the Maryland and Delaware environmental agencies, and (ii) the test results showed that the plant was operating in compliance with all federal and state pollutant emissions standards set by the EPA and the environmental protection agencies of Maryland and Delaware.

Julian moved to vacate that fine. Thereafter, on July 1, July 15, and August 12, 1986, DNREC filed eight additional criminal charges against Julian, claiming that Julian had, in each case, caused a condition of air pollution at the residences of the adjoining neighbors. Julian later caused those criminal actions to be transferred to the Court of Common Pleas, where Julian has moved for their dismissal on the basis that the statute and regulation upon which the charges are based are unconstitutionally vague.

Based on the foregoing incidents and upon its conclusion that the odors from the Julian plant constituted a violation of Section 2.1 of Regulation No. XIX governing air pollution, DNREC issued a Cease and Desist Order on July 8, 1986. As a result of that order, the plant was shut down. Julian contends that the Order was illegal, because DNREC issued it without conducting any hearing and without complying with Julian's request to produce all documentation supporting the Order.

Thereafter, the parties entered into prolonged discussions, during which DNREC requested that the plant remain inoperative. By letter dated July 24, 1986, Julian denied that request. Julian also denied that it had violated any applicable laws or standards, pointing out that the wet scrubber system utilized by its plant was the best system available. At a meeting held between DNREC and Julian representatives, those persons present agreed that, at present, there is no way that an asphalt plant can be operated without emitting some asphalt odor. Nevertheless, without prejudice to its position, Julian (after consulting with experts) took steps designed to minimize the odor, including reducing the hours of operation for the plant, adding 15 feet to the stack to direct the exhaust from the stack further into the atmosphere, and closing the plant on those occasions when the wind direction changed to the northwest.[2]

On July 24, 1986, DNREC withdrew the Cease and Desist Order. Since then, despite occasional shutdowns, the plant has operated continuously from July 29, 1986 to the present. Except for the operating changes made voluntarily by Julian as described above, there has been no change in the operation of the plant since it opened in October, 1985.

After it withdrew its Cease and Desist Order, DNREC (as previously noted) filed additional criminal actions against Julian. On

2. Julian also offered to add additional water to the scrubber and to use less recycled asphalt than was required by the mix design.

August 25, 1986, DNREC filed Civil Action No. 921(K) in this Court against Julian seeking an injunction directing closure of the plant. On the same day, Julian filed Civil Action No. 8593 to enjoin DNREC from initiating further criminal proceedings and from issuing further Cease and Desist Orders, and to enjoin the individual defendants from certain activities. DNREC's and Julian's cross-motions for preliminary injunctive relief soon followed.

II.

[1-3] The traditional standards for preliminary injunctive relief are applicable to cases involving claims of environmental law violations. As stated by the Delaware Supreme Court in *Formosa Plastics Corp. v. Wilson*, Del.Supr., 504 A.2d 1083, 1087-88 (1986):

> To obtain injunctive relief, a plaintiff must show a reasonable probability of success on the merits and the likelihood of irreparable injury absent the injunction. In deciding the matter the Court may balance the conveniences of and the possible injuries to the parties. *Gimbel v. Signal Cos.*, Del.Ch., 316 A.2d 599 (1974), *aff'd*, Del.Supr., 316 A.2d 619 (1974). In short, an injunction must be earned. It does not issue on any less significant basis.

Applying those standards to the facts and the record presently before me, I am constrained to conclude that neither side has demonstrated entitlement to the preliminary injunctive relief that it seeks.

A. *DNREC's Application For Injunctive Relief*

In support of its application for injunctive relief, DNREC relies upon Regulation No. XIX, Section 2.1 of the Delaware Regulations Governing the Control of Air Pollution ("the Regulations"). Regulation No. XIX, entitled "Control of Odorous Air Contaminants", provides as follows:

> Section 1—General Provisions
> 1.1 The purpose of this Regulation is to control odorous air contaminants which significantly effect the citizens of the State outside the boundaries of the air contaminant source.
> 1.2 Method for determining a condition of air pollution due to an odorous air contaminant may include, but are not limited to, scentometer tests, air quality monitoring,

> and affidavits from affected citizens and investigators.
> Section 2—Requirements
> 2.1 No person shall cause or allow the emission of an odorous *air contaminant* such as to cause a condition of *air pollution*. (emphasis added)

DNREC claims that Julian has, on various occasions allowed its plant to emit an "odorous air contaminant" that has caused a condition of "air pollution". Regulation No. 1, Section 1 defines "air contaminant" to include ". . .gas, mist, smoke or vapor or any contamination thereof, exclusive of uncombined water".

It is undisputed that the emissions from the plant constitute an "air contaminant", since those emissions include some combination of smoke, mist and/or vapor. What is disputed is whether such emissions have caused a condition of "air pollution". "Air pollution" is defined in both the statute (7 *Del. C.* §6002(3)) and in the Regulations (Regulation No. 1, Sec. 1) as:

> . . .the presence in the outdoor atmosphere of 1 or more air contaminants in sufficient quantities and of such characteristics and duration as to be injurious to human, plant or animal life or to property, plant or animal life or to property, or which unreasonably interferes with the enjoyment of life and property within the jurisdiction of this State, excluding all aspects of employer-employee relationships as to health and safety hazards.

DNREC makes no contention, nor has it presented any evidence, that the complained-of odors are "injurious to human, plant or animal life or to property". Rather, DNREC contends that the evidence meets the alternative, disjunctive statutory test, *viz.*, that the air contaminant ". . .unreasonably interferes with the enjoyment of life and property within the jurisdiction of this State". In support of that contention, DNREC has submitted the affidavits of ten persons, eight of whom live nearby the plant, and two of whom are DNREC Environmental Protection Officers.

The DNREC's affidavits, if credited, would establish that on various occasions during June, July and August, 1986, a strong odor, similar to fresh asphalt or the exhaust from a bus, emanated from the plant and caused one or more affiants to experience nausea, stomach upset, nasal congestion, vomiting and/or headaches. Moreover, when the plant was in operation, the odor lingered in the area, particularly on hot, humid days, forcing one or more affiants to

keep their windows closed, causing the interior of one or more houses to smell like tar, making it impossible for one resident to work in the garden, and requiring another neighbor to forbid her son from playing outside the house. This evidence, DNREC argues, is amply sufficient to establish that the odor emanating from the Julian plant "unreasonably interferes with the enjoyment of life and property" and, therefore, meets the standards of the Regulations and the test for a common law nuisance. *See Cain v. Roggero*, Del.Ch., 38 A.2d 735 (1944).[3]

[4] In response, Julian claims that the showing made by DNREC is totally insufficient to warrant a court-ordered closing of its plant. Julian argues (quite correctly) that the record in this case, including numerous affidavits filed by Julian, highlight serious evidentiary conflicts on several points, particularly the source, duration and harmful effect of the complained of odors. By way of example, there is conflicting testimony among the affiants as to whether, in fact, odors emanated from the plant on the days claimed by DNREC. The record shows that, in specific instances, odors were detected from the plant during the summer months, yet no complaints were made during the rest of the entire period that the plant has been in operation since October, 1985. The evidence is also conflicting as to whether the odors came from the plant or some other source. A major highway runs close to the affected area, on which there is a high volume of trucks and buses. A Conrail railroad track also runs next to that area, and diesel engines, which run on that track several times a day, emanate strong odors. Since the complaining neighbors compared the odors to auto or truck exhaust or diesel fuel odor, Julian argues that the possibility that the odor may emanate from those latter sources is as equally consistent with the evidence as is the possibility that the odor emanated from the plant.

Julian has also filed affidavits of numerous persons involved in the asphalt production process, including many of its employees, attesting to the fact that they have never experienced the dizziness, nausea, headaches, and other physical ailments complained of by the adjoining neighbors. Moreover, Julian points out that DNREC has supplied no medical records, testimony, or other documentation

3. Although the phrase "unreasonably interferes with the enjoyment of life and property" is not defined in either the Act or the Regulations, DNREC contends—and I agree—that that phrase represents a codification of the standard for a common law nuisance. *See Cain v. Roggero, supra.*

that corroborates the neighbors' health complaints or their claims that the odors have adversely affected the use and enjoyment of their life and property. These evidentiary inconsistencies and conflicts, Julian argues, preclude even a preliminary finding that its plant has caused a condition of "air pollution".

Finally, Julian argues that DNREC has not established any likelihood of irreparable harm to the public, because any inconvenience caused by the odors is temporary (the permit for the plant being due to expire in February, 1986, at which time the plant will relocate). In terms of the balancing of equities, Julian points out that, given the present state of technology, nothing else can be done to make the plant odor-free. To force the plant to close and relocate will, Julian argues, be highly costly to it, will cause many of its employees to become unemployed, and will disrupt the ongoing renovation of Route 13 which the State has contracted with Julian to repair.

Having considered the record in this matter, and having carefully weighed the contentions of the parties and the multitude of factors—human, legal and public policy—that are bound up in a dispute of this nature, I am forced to conclude that the present circumstances, while they admittedly have created reasons for concern, do not justify a remedy so harsh as closing the Julian plant.

[5] First, this is not a situation like *Formosa Plastics*, which involved the emission of a substance that threatens human life and health. Compare *Formosa Plastics Corp. v. Wilson, supra* (upholding denial of injunction against the revocation of a permit to operate a plant that released VCM, an explosive gas and known carcinogen, on 50 separate occasions). Were this such a case, the result might well be different. The problem is, fortunately, of a much smaller order of magnitude. Although on this sharply contested record reliable findings of fact (even if only preliminary) are hazardous at best, it can fairly be said (viewing all of the evidence in the light most favorable to DNREC) that (a) the plant has emitted an odor that is either sporadic or has a sporadic effect; and (b) the odor does not adversely affect all persons exposed to it (approximately 11 adjoining neighbors have complained, but the approximately 24 persons working in the plant claim not to have suffered any ill effects from working with asphalt); and (c) the adverse effects, if any, involve no long-term health impact. Without intending in any way to minimize the genuineness or the intensity of the neighboring landowners' perceptions of and feelings about this subject, the record evidence shows that the adverse impact of the plant odors, while representing

an inconvenience that is annoying to some adjoining homeowners, is nonetheless sporadic, of temporary duration, and not threatening to health.

[6] Second, Julian's conduct in this matter has been responsible and, insofar as the record discloses, above reproach. Julian obtained all of the permits required to locate and operate its plant in its present location. At the time those permits were granted, the fact that asphalt plants cannot operate without emitting some odor was known to all concerned. This dispute to one side, Julian has operated its plant in compliance with all state and federal environmental laws. In response to the adjoining neighbors' complaints, Julian took reasonable steps to alleviate the problem, including lengthening its stack and changing the hours of its operations. However, the fact remains that given the present state of asphalt plant technology, nothing more can be done to eliminate the odor problems—other than to shut down the plant.[4]

[7] Third, the record indicates that any problem created by odors emitted from the plant, due to their seasonal nature, are unlikely to recur, and that after February 28, 1987, they definitely will not recur. During the fall and winter months of late 1985 and early 1986, the plant operated in the same manner as it does today, but without odor-related complaints. Only during the hot, humid summer months did such complaints surface. There is no basis in the record for concluding that this year's experience will be any different. Since the odors (or, more precisely, their noxious manifestation) are seasonal, and since the summer season is now past, it is not illogical to infer that the problem will either not recur, or that any recurrence will be minimal. In all events, this problem will cease to exist after February, 1987 when the plant is closed.[5]

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4. That is true not only for the Julian plant, but also for the 15 similar asphalt plants throughout the country, including 9 similar plants located in Delaware.

5. These circumstances make inapposite DNREC's reliance upon *Cain v. Roggero, supra*. In that case, a mushroom plant in Wilmington had, for 12 years, stored and processed 360 tons of manure on its premises during the summer months as part of its operation. The processing of the manure created offensive odors and caused flies to germinate and swarm about the area. For the first several years there were no neighboring residents, and, hence, no one complained of the odor. Gradually, an area of residential homes (which became known as "Westhaven") was built around the premises on which the mushroom plant was located. One adjoining neighbor filed an action to enjoin the storing and processing of the manure. This Court granted injunctive relief, holding that the offensive odors constituted a common law nuisance. *Cain* differs from this case in two respects. In *Cain*, the offensive odor, although seasonal, threated to continue every summer unless the

Fourth, and finally, against the inconvenience caused by the plant to its adjoining neighbors, there must be weighed the impact of any immediate plant closing upon other affected interests. There appears to be no dispute that Julian, its employees, and the State would be adversely affected. Julian would be forced to bear the cost (estimated at $484,000) of a plant relocation. Many of its employees would be put out of work. And the relocation would disrupt the ongoing repair of Route 13, a major north-south artery and (due to increased costs of transporting the asphalt) would increase both the cost to the State of repairing the highway and the time required to complete the project.

[8,9] To express the foregoing in terms of the standards for preliminary injunctive relief, I find that: DNREC has failed to establish a probability of success on the merits, because assuming (without deciding) that the odor from Julian's plant has caused some interference with the use and enjoyment of life and property, that interference is not unreasonable. Moreover, DNREC has failed to establish a likelihood of irreparable harm, because the complained-of odor will likely not recur and, in any event, will be of limited duration (5 months). Finally, balancing the equities, I am constrained to conclude that any temporary inconvenience to the adjoining neighbors, while undoubtedly regrettable, is outweighed by the costs and dislocation that would be visited upon Julian, its employees, and the public if the plant were prematurely closed.

B. *Julian's Application For Preliminary Injunctive Relief*

In its cross-motions for preliminary injunctive relief, Julian asks this Court (i) to enjoin DNREC from issuing future Cease and Desist Orders, (ii) to enjoin DNREC from instituting further criminal prosecutions against it based upon the matters now before the Court in these consolidated civil actions, and (iii) to enjoin the individual defendants from engaging in certain activities which Julian characterizes as "business slander". In my opinion, Julian has not shown its entitlement to injunctive relief in any respect.

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mushroom plant's operation was restrained. In this case the offending odor will probably not recur and in any event will certainly not recur after five months. In *Cain*, the plant, although originally situated on the periphery of a residential area, by virtue of the economic growth that occurred over the intervening years, ultimately became situated in the midst of an urban residential development. Here, in contrast, the Julian plant is located near an industrial highway and railroad track, *i.e.*, in an area that contains some residences but which is, in the main, primarily industrial.

[10,11] As for the criminal proceedings, Julian concedes that its constitutional attack on the statutory and regulatory provisions upon which the criminal actions are brought, may be raised defensively in the criminal proceedings themselves. Indeed, Julian is defending against the criminal actions on that basis. Julian also concedes the general rule that equity will not enjoin a criminal prosecution, except where the prosecution is brought in bad faith. *In Re Severns*, Del.Ch., 425 A.2d 156 (1980). However, Julian has made no showing that DNREC intends to file any further criminal actions based upon the plant emissions complained of in these actions. Should any such action be instituted, Julian will be free to apply for relief, if appropriate, at that time.

[12] Julian's request for preliminary injunctive relief against the issuance of future Cease and Desist Orders is of the same character. That is, it is based on fears—but not upon evidence—that DNREC will issue such orders in the future. Accordingly, Julian has failed to establish a likelihood that it is threatened with irreparable harm in that connection.

[13] Finally, Julian's claim that the individual defendants have committed actionable "business defamation" has no discernible basis. All the record discloses that those individuals have done is to (1) file complaints with the DNREC about the odors emanating from the plant and (2) in the case of one defendant, erect a billboard on her property, that makes arguably disparaging comments in large letters, but does not mention Julian or its plant by name.[6] Julian has made no showing, or any argument in its briefs, that the individual defendants have committed any wrongful act. As far as the present record discloses, those individuals have done nothing more than exercise their constitutional right of free speech.

* * *

For the foregoing reasons, the cross-motions for preliminary injunctive relief filed by DNREC and by Julian, respectively, are denied. IT IS SO ORDERED.

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6. CANCER CAUSING YES—NO
LUNGS, NAUSEA, HEADACHE
HAZARDOUS USE SITE
WHAT CAN THIS MONSTER
DO TO YOUR HEALTH AND
WATER—KNOWN ILLNESS
RESPIRATORY STOMACH

LEWIS v. McDERMOTT, INC.

Nos. 7034 & 7044 (Consolidated)

Court of Chancery of the State of Delaware, New Castle

July 17, 1986

Plaintiffs, stockholders of defendants, attacked part of the 1982 reorganization of defendant and McDermott International, Inc. (International), a Panamanian corporation. The reorganization allowed defendant, a Delaware corporation and 92% owned subsidiary of International, to vote 10% of the stock of International. The court of chancery, per Vice-Chancellor Berger, granted plaintiffs' motion for a partial summary judgment, holding that Panama would not apply its own law because a Panamanian law prohibiting a majority-owned subsidiary from voting the shares it owned in its parent when the parent's shares were traded in Panama showed that Panama had made a determination that its interest in transactions not falling under the purview of the statute was insufficient to warrant application of the law.

1. Corporations ⟹ 201, 638

Delaware courts consistently have followed the traditional choice of law principle that the internal affairs of a corporation are governed by the laws of the state of incorporation.

2. Corporations ⟹ 197

The rights of stockholders to vote their shares are within the scope of the internal affairs doctrine which states that the internal affairs of a corporation are governed by the laws of the state of incorporation.

3. Corporations ⟹ 197, 638

The absence of any laws prohibiting a majority-owned subsidiary from voting the shares it owns of its parent when the parent's shares are neither registered on the Panama National Securities Commission nor sold to more than ten persons in Panama annually is not an indication that Panama would allow such subsidiary to vote the shares of its parent, but rather, that Panama would not apply its

own law to the situation as it was not sufficiently interested in the transaction.

Norman M. Monhait, Esquire, of Morris and Rosenthal, Wilmington, Delaware, and Mordecai Rosenfeld, Esquire, of Mordecai Rosenfeld, New York, New York, and A. Arnold Gershon, Esquire, of A. Arnold Gershon, New York, New York, for plaintiffs.

Charles F. Richards, Jr., Esquire, of Richards, Layton & Finger, Wilmington, Delaware, and Richard E. Nolan, Esquire, and George B. Newhouse, Jr., Esquire, of Davis, Polk & Wardell, New York, New York, for defendants.

BERGER, *Vice-Chancellor*

Harry Lewis, a common stockholder of defendant McDermott Incorporated, a Delaware corporation ("McDermott Delaware"), filed this purported class action attacking the 1982 reorganization of McDermott Delaware and McDermott International, Inc., a Panamanian corporation ("International") (the "Reorganization"). Thereafter, Nina Altman, the owner of McDermott Delaware preferred stock, filed a similar action and the two cases were consolidated. However, the complaints remain separate and have been separately answered.

Plaintiff, Lewis, filed a motion for judgment on the pleadings declaring unlawful that aspect of the Reorganization which allows McDermott Delaware, a 92% owned subsidiary of International, to vote 10% of the stock of International. In response, defendants moved for partial summary judgment on the same issue as to both complaints. This is the decision on the pending motions.

McDermott Delaware is engaged in the business of marine construction services, power generation systems and equipment. The company and its subsidiaries operate throughout the United States. Its principal offices are located in New Orleans, Louisiana where McDermott Delaware is authorized to do business as a foreign corporation. According the the affidavit of John A. Lynott ("Lynott"), Executive Vice-President and Chief Financial and Administrative Officer of McDermott Delaware, the company has "no significant operations or business within the State of Delaware other than those necessitated by the fact of its incorporation here." Lynott Aff. ¶4.

International provides marine construction services in the oil

and gas industry principally in the North Sea, South East Asia and the Middle East. It has "no appreciable operations" in the United States and none in Delaware. Lynott Aff., ¶3. International's executive offices are located in New Orleans, Louisiana, where it is authorized to do business as a foreign corporation. Prior to the Reorganization, International was a wholly-owned subsidiary of McDermott Delaware.

By Prospectus dated November 24, 1982, International initiated the two-step Reorganization plan by offering to exchange one share of its common stock together with $.35 in cash for each share of McDermott Delaware common stock up to maximum of 30 million shares (80% of McDermott Delaware's outstanding common stock). Following the successful completion of the exchange offer, International, as the holder of approximately 69% of the voting power of McDermott Delaware, approved a merger whereby one of International's wholly-owned subsidiaries was merged into McDermott Delaware.

The impact of the Reorganization on the parties' respective voting power was described in the Prospectus as follows:

> The public stockholders of [McDermott Delaware] currently hold 100% of the voting power of [McDermott Delaware]. . . .After completion of the Offer and the Merger, the public stockholders of International (all of whom will own International Shares which have been issued in exchange for [McDermott Delaware] Common Shares representing approximately 85% of the voting power of [McDermott Delaware]) will hold approximately90% of the voting power of International and [McDermottDelaware] will hold approximately 10% of the voting power of International. The purpose of providing [McDermott Delaware] with 10% of the voting power of International is to enable [McDermott Delaware] to claim foreign tax credits for income taxes paid to foreign countries; however the exercise of such voting power will be determined by International, as the parent of [McDermott Delaware], and such voting power could be used to oppose an attempt by a third party to acquire control of International if the management of International believes such use of the voting power would be in the best interests of the stockholders of International. Prospectus at 20.

In support of his motion, plaintiff argues that each of the three jurisdictions with any interest in this matter—Delaware, Panama and Louisiana—forbids a majority-owned subsidiary from voting the shares of its parent. Defendant contends that Panama law applies and permits McDermott Delaware to vote its International stock.

[1-2] Delaware courts consistently have followed the traditional choice of law principle that the internal affairs of a corporation are governed by the laws of the state of incorporation. *Ringling v. Ringling Brothers-Barnum & Bailey Combined Shows, Inc.*, Del. Ch., 49 A.2d 603 (1946), *modified*, 53 A.2d 441 (1947); *Beard v. Elster*, Del. Supr., 160 A.2d 731 (1960); *Palmer v. Arden-Mayfair, Inc.*, Del. Ch., Civil Action No. 5549, Brown, V. C. (July 6, 1978). *See also, Restatement (Second) of Conflict of Laws* (1971),§302 (" *Restatement*"). The rights of stockholders to vote their shares are within the scope of the internal affairs doctrine. *Restatement*,§304 Comment a; *Deibler v. Charles H. Elliott Co.*, Pa. Supr., 81 A.2d 557 (1951). Thus, I begin by looking to the law of Panama.

Under D. R. E. 202(e), the Court is given certain latitude in determining foreign law. It ". . .may consider any relevant material or source, including testimony whether or not submitted by a party or admissible under these rules." The parties have not provided the Court with any Panamanian case law or resource materials analyzing this issue and the Court has been unable to obtain any such authorities on its own initiative.

Initially, plaintiff relied upon the decision in *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984) and defendant relied on the affidavit of Ricardo Durling ("Durling"), a partner in the Panamanian law firm of Durling & Durling. Following the submission of supplemental materials, at the Court's request, plaintiff continues to rely on the *Norlin* decision and the fact that the *Norlin* court apparently rejected a similar affidavit submitted by Durling in that case. Defendant has now submitted a second Durling affidavit as well as the opinions of Messrs. Bonifacio Diaz Fernandez ("Fernandez"), Dean of the Law School of the University of Santa Maria La Antigua and Edgardo Molino Mola ("Mola"), Dean of the School of Law and Political Sciences of the University of Panama.

Article 35 of Panamanian Cabinet Decree No. 247 provides:

> Shares of a corporation owned by [an]other corporation in which the former corporation owns the majority of shares shall not be entitled to vote at Meetings of Shareholders

> nor shall be deemed as issued and outstanding shares for purposes of quorum.

However, pursuant to Article 37 of the same Cabinet Decree, this prohibition applies only to "corporations registered in the National Securities Commission and those whose shares are sold on the market, even though such corporations do not offer their own shares to the public." The General Attorney of Panama has ruled that the phrase "sold on the market" as used in Article 37 means sales of stock to more than ten persons in Panama annually. It is undisputed that International is not registered in the National Securities Commission and that its shares are not "sold on the market." As a result, the proscriptions contained in Article 35 do not apply. However, that does not end the matter. Plaintiff argues that companies not subject to the provisions of Article 35 are not governed by Panama law—at least as to the voting rights of majority-owned subsidiaries. He reads Article 37 as a statement that Panama declines jurisdiction in those cases where it has no interest, i.e. where the company's stock is not traded in Panama. Defendants argue that, by exempting certain corporations from the provisions of Article 35, Panama has not abdicated its authority over this aspect of the internal affairs of a Panama corporation. Instead, defendants say that the absence of any restriction on McDermott Delaware's right to vote its International shares means that, under Panama law, those shares may be voted.

As noted earlier, plaintiff asks this Court to adopt the reasoning and conclusion reached in *Norlin Corp. v. Rooney, Pace Inc.*, *supra*. The *Norlin* court addressed this issue in a different factual context. Norlin is a Panama corporation with no significant operations in that country. Its principal place of business and executive offices are located in New York, where stockholders' and directors' meetings are held. In an effort to defeat a threatened takeover attempt, Norlin transferred large blocks of its stock to Andean Enterprises, Inc. a wholly-owned subsidiary also incorporated in Panama. Those transfers, together with a transfer of a substantial block of stock to Norlin's employee stock option plan, resulted in Norlin controlling the votes of 49% of its outstanding stock. The stockholder whose purchases triggered these defensive measures alleged that the Norlin stock transfers violated Panama and New York law as well as the federal securities laws.

The *Norlin* court began its analysis by expressing doubt that a New York court would apply the internal affairs doctrine and decide the case by reference to Panama law. The federal court noted that

in *Greenspun v. Lindley*, N. Y. Ct. App., 330 N.E.2d 79 (1975) the New York Court of Appeals had left open the question of what law would be applied in a case where a foreign corporation has such significant contacts with New York as to warrant the application of New York law. Norlin's contacts with New York were described as being "far from insubstantial" but the *Norlin* court did not decide whether those contacts were sufficient to apply New York law. Instead, it held:

> In this case, Panama apparently would refrain from applying its own law to the transactions under scrutiny, because appellant does not meet the criteria of Article 37, as interpreted by the General Attorney. In essence, Panama has made a determination that its interest in Norlin's affairs is insufficient to warrant the application of Panamanian law to this dispute. New York, as the forum state, has a more than adequate number of contacts with Norlin to give it a legitimate interest in regulating these corporate actions.
>
> Moreover, it is of interest to note that the relevant rules of law in New York and Panama are identical on this point: A wholly-owned subsidiary may not vote shares of its parent's stock. In these circumstances, it would be an absurd result indeed if neither jurisdiction could apply its law, and the public policy of both should be frustrated. [Citation Omitted]. We therefore conclude that whatever choice of law principles would be applied [the stockholder] has made an adequate showing on these facts that the voting of Andean's shares would be unlawful. *Norlin Corp. v. Rooney, Pace Inc.*, *supra* at 264.

Plaintiff argues that the holding in *Norlin* is directly on point. He urges this Court to apply the law of the forum state and hold that McDermott Delaware may not vote its International stock. *See*, 8 *Del. C.* §160(c).

Defendants argue that *Norlin* is distinguishable on its facts; applies an inappropriate choice of law analysis; and misconstrues Panamanian law. On the issue of Panamanian law, as previously noted, defendants rely on the Durling affidavits and the Fernandez and Mola letter opinions. In his first affidavit, Durling states that he has devoted his law practice to the field of corporate law and is in the process of finishing what will be the first treatise on the subject of Panamanian corporate law. He goes on to opine:

> There is no general public policy of the Republic of Panama in favor of precluding Panamanian corporations from selling or issuing stock to their subsidiaries or precluding a subsidiary from voting any stock held of its Panamanian corporate parent, except for those corporations falling within the scope of Article 37. It is generally accepted by Panamanian counsel that, with the exceptions described above, subsidiaries may vote the stock held in their parent corporations. (Durling Aff. ¶ 10).

Durling's second affidavit restates his earlier opinion and adds that he is aware of no developments which would change that opinion.

The Fernandez and Mola opinions confirm Durling's analysis. Both opinions state the uncontested conclusion that the voting restrictions of Article 35 do not apply to a Panamanian corporation which is not registered in the National Securities Commission and whose shares are not sold on the market. They then go on to analyze whether any other provision of Panamanian law prohibits a majority owned subsidiary from voting the stock it holds of its parent. There being no such express prohibition, Messrs. Fernandez and Mola conclude that, since all acts not prohibited by law are permissible, a subsidiary may vote its parent's stock.

[3] Unfortunately, neither the Durling affidavits nor the opinion letters directly address the question of whether Panama would apply its own law under the circumstances presented here. I conclude that it would not. In explaining why Article 37 limits the applicability of Article 35, both Messrs. Fernandez and Mola cite to Article lst, Civil Code for the proposition that Panamanian laws apply only in the Republic of Panama except in certain cases involving family law matters. They say that, to apply the voting restrictions of Article 35 to a corporation whose stock is not traded in Panama would be an inappropriate grant of extraterritoriality to Panamanian law. Thus, it would appear that the absence of any laws prohibiting the voting rights at issue here is not an indication that Panama would permit McDermott Delaware to vote its International stock. Rather, as the *Norlin* court concluded, it seems that Panama would refrain from applying its own law in this situation.

I have considered the authorities relied upon by defendants and I note the positions of respect they hold, but I find that the result they endorse is unsupported by logic or policy. Durling is careful in his first affidavit to state that there is no "general" public policy prohibiting the voting rights at issue. However, it cannot be gainsaid

that Article 35 expresses just such a policy for those Panamanian corporations that have local stockholders. Why, then, are foreign stockholders of Panamanian corporations denied the same protection? Defendants offer no explanation and I can find none. While I recognize that other countries do not necessarily adhere to the same notions of justice fundamental to our laws, I am not prepared to find, on this showing, that the laws of Panama were designed to arbitrarily deny foreign minority stockholders the protections they grant to Panamanian minority stockholders. Accordingly, I find that Article 35 does not apply to International and that, consistent with its stated limitation upon the applicability of its laws, Panama would refrain from applying its law to determine the voting rights of International's stockholders.

Based upon the foregoing, the question then becomes what law to apply. In this case, it is not necessary to determine whether Louisiana or Delaware has the more substantial contacts with International inasmuch as both states prohibit a majority-owned subsidiary from voting its parent's stock. *See*, *Restatement*§302, Comment k; 8 *Del. C.* §160(c); Louisiana Business Corporation Law, R.S.§12:75(G). Accordingly, defendants' motion for partial summary judgment must be denied and plaintiff's motion for judgment on the pleadings, which will be treated as a motion for partial summary judgment, is hereby granted.

IT IS SO ORDERED.

MACFADDEN HOLDINGS, INC. v. JOHN BLAIR & CO.

No. 8489

Court of Chancery of the State of Delaware, New Castle

July 2, 1986

Plaintiff commenced this action for a temporary restraining order against John Blair & Co. to prevent it from tendering its shares to