

## DELAWARE BUSINESS COURT INSIDER

# Chancery Lacks Jurisdiction to Award Damages for an Improvidently Entered Injunction in the Absence of a Bond

Can the Delaware Court of Chancery award damages to a defendant who was improperly enjoined by an order that dispensed with the need for a bond because of the parties' prior contractual waiver that a bond be required?

By **Barry M. Klayman and Mark E. Felger** | August 03, 2022



Barry M. Klayman, left, and Mark E. Felger, right. Courtesy photos

Can the Delaware Court of Chancery award damages to a defendant who was improperly enjoined by an order that dispensed with the need for a bond because of the parties' prior contractual waiver that a bond be required? In *DG BF v. Ray*, C.A. No. 2020-0459-MTZ, 2022 WL 2299281 (Del. Ch. June 27, 2022), Vice Chancellor Morgan Zurn concluded that the Court of Chancery lacked subject matter jurisdiction to award damages for an improvidently entered injunction in the absence of a bond or other security.

The plaintiffs brought this action against the defendants claiming that the defendants had fraudulently induced them to invest in the defendant company and had denied them certain rights under the company's operating agreement in connection with a prospective financing round. The complaint included a request to enjoin the financing round. The vice chancellor granted a temporary restraining order that enjoined the closing but not the shopping of the financing round pending a final

decision on what the operating agreement permitted. Applying Court of Chancery Rule 65(c), the vice chancellor determined an appropriate bond for the TRO would be \$100,000. However, the parties were unable to agree on a form of order or the type of bond, and sought additional guidance from the court.

The order implementing the TRO noted that the company's operating agreement stipulated that the members waived any requirement for security or the posting of a bond or other surety in connection with any temporary or permanent award of injunctive or other equitable relief. Accordingly, in light of this provision and the dispute surrounding the bond, the vice chancellor determined that a bond was not required to effectuate the TRO.

The vice chancellor later concluded that the company's operating agreement did not require the company to seek approval from the plaintiffs in order to proceed with the financing, denied the plaintiffs' request for a declaratory judgment on their claim, and terminated the TRO. The defendants then filed a motion seeking damages resulting from the TRO. After the remaining claims in the litigation were resolved, the vice chancellor returned to the motion for damages attributable to the TRO. The defendants sought as damages the salary costs for the time the company's executives spent addressing the request to enjoin the financing. In response, the plaintiffs argued that the Court of Chancery lacked subject matter jurisdiction to award damages for an improvidently granted injunction when the parties had contractually agreed to waive the bond requirement. The defendants argued that recovery was possible even where the posting of a bond had been waived.

The vice chancellor began her analysis by noting that prior to the advent of Court of Chancery Rule 65.1, the Court of Chancery lacked subject matter jurisdiction to award damages even on a Rule 65 injunction bond. In such a case, the aggrieved party had to pursue an independent action at law on the bond. Rule 65.1 provided for proceedings against sureties in the Court of Chancery without the need to resort to an independent action, including where security is given in the form of a bond, stipulation or other undertaking. However, according to the vice chancellor, it was not certain that the court could award damages where the parties contractually agreed to waive the bond requirement.

The vice chancellor then reviewed the leading cases in Delaware dealing with damages for an improvidently granted injunction. In *Guzzetta v. Service Corporation of Westover Hills*, 7 A.3d 567 (Del. 2010), the Delaware Supreme Court said, in dicta, that a wrongfully enjoined party had no recourse other than to the security, and that a party that was wrongfully enjoined may recover damages resulting from the injunction, but limited to the amount of the bond. In *Newall Rubbermaid v. Storm*, 2014 WL 1266827 (Del. Ch. Mar. 27, 2014), the Court of Chancery required a bond to be posted notwithstanding a contractual waiver "in order to assure the [enjoined party's] ability to recover damages if it turns out that the TRO was improperly issued." Finally, in *Concerned Citizens of Estates of Fairway Village v. Fairway Cap*, 256 A.3d 737 (Del. 2021), the Supreme Court held that the enjoined party could not recover damages for a wrongful injunction because it failed to ask that the injunction be lifted when the plaintiff failed to post a bond, and reversed the decision of the Court of Chancery allowing the enjoined party to recover damages on the grounds that it had been wrongfully enjoined despite the lack of a bond. The decision turned on the enjoined party's failure to seek enforcement of the court order requiring the bond and not the injunction bond rule itself. The court said, "Whether damages would have been recoverable had the court converted a secured

bond into an unsecured bond, or had the court issued a preliminary injunction without security, is ... irrelevant.”

Based on her review of the Delaware cases, the vice chancellor concluded that there was no explicit answer as to whether she could award damages to a defendant who was improperly enjoined by an order that did not require a bond to be posted because the parties contractually waived the bond requirement. She then looked to cases from other jurisdictions, and found that the weight of authority held that, in the absence of the elements of an action for malicious prosecution, no action would lie for damages for the wrongful entry of an injunction independent of a bond or undertaking. In effect, the injunction bond was an equitable innovation designed to provide relief for an improvidently entered injunction in the absence of malice. The vice chancellor cited with approval the U.S. Court of Appeals for the Third Circuit’s decision in *U.S. Steel v. United Mine Workers of America*, 456 F.2d 483 (3d Cir. 1972), in which the court explained that a bond represents the plaintiff’s consent to liability, up to the amount of the bond, as the price for the injunction, “otherwise, plaintiff could be found liable for damages only on the theory of malicious prosecution, an action at law.”

Given this background, the vice chancellor concluded that the Court of Chancery lacked subject matter jurisdiction to award damages for an improvidently entered injunction, because that claim must be brought as an independent claim for malicious prosecution in a court of law. The exception is when a bond is ordered and entered, which brings the claim within the Chancery proceeding due to Rule 65.1. Because a bond was not entered to secure the injunction due to the parties’ prior contractual waiver of a bond, the Court of Chancery lacked subject matter jurisdiction to award damages attributable to the wrongful entry of the injunction.

Does the holding in *Ray* mean that an enjoined party has no recourse in Chancery if there was a prior agreement to waive the posting of a bond or other security in the event that an injunction is wrongfully entered? In the *Ray* case, the parties were unable to agree on a form of order or the type of bond, and the order implementing the TRO noted that the company’s operating agreement waived any requirement for security or the posting of a bond, but neither party had raised this provision of the agreement. However, given the dispute surrounding the bond and the unambiguous nature of the waiver, the vice chancellor determined that a bond was not required. It is unclear whether the enjoined party could still have insisted on some form of security despite the agreement; whether, as suggested by the Supreme Court in the *Fairway Cap* decision, the enjoined party could have insisted on a stipulation or unsecured bond in some amount or, as in the *Storm* case, a bond could have been required notwithstanding the contractual waiver in order to assure the enjoined party’s ability to recover damages if the injunction were wrongfully issued. The lesson here is to insist on some form of security in order to preserve the right to claim damages in the event that it is later found that an injunction should not have been granted.

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