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JURISDICTION AND PROCEDURE

Delaware Supreme Court Opinion on Forum Use Restrictions in Stockholder Books and Records Actions Highlights Desirability of Forum Selection Charter and Bylaw Provisions



BY MATTHEW D. STACHEL

In *United Technologies Corporation v. Treppel*, Delaware's Supreme Court ("the Supreme Court"), sitting *en banc*, reversed the Delaware Court of Chancery's bench ruling that it lacked the statutory authority to impose a forum use restriction on the corporate books and records obtained by a stockholder in an inspection under 8 Del. C. § 220 ("Section 220"). __ A.3d __, 2014 BL 361333, at *6 (Del. Dec. 23, 2014). The forum use restriction requested by the corporation would have prevented the stockholder from using the corporate books and records in litigation asserted outside of Delaware state or federal courts.

After reversing and holding that the Court of Chancery has "wide discretion to shape the breadth and use of inspections under § 220 to protect the legitimate in-

terests of Delaware corporations," the Supreme Court remanded for the Court of Chancery to determine whether the forum use restriction was appropriate. *Id.*, at *4. In so doing, the Supreme Court provided a non-exclusive list of considerations that the Court of Chancery may weigh in exercising its discretion, including prior litigation concerning the same subject matter that the corporation had defended in Delaware state courts and the existence of a forum selection bylaw that was adopted by the corporation while the Section 220 action was pending.

At the same time, the Supreme Court instructed the Court of Chancery to give weight to the importance of the summary nature of Section 220 actions, noting that Delaware corporations with forum selection charter or bylaw provisions can move to dismiss internal affairs litigation filed in improper jurisdictions. The Supreme Court also observed that the "case-specific" nature of Section 220 use restrictions in general may weigh in favor of not imposing a forum use restriction absent pre-existing litigation concerning the same subject matter having been litigated in Delaware courts – even where a Delaware corporation has adopted a forum selection charter or bylaw provision.

Given the Supreme Court's guidance to the Court of Chancery for imposing forum use restrictions, Delaware corporations seeking a cost-effective means to avoid multi-jurisdiction litigation would likely be better

Matthew D. Stachel is a litigation associate at Paul, Weiss, Rifkind, Wharton & Garrison LLP. This views expressed in this article are those of the author only and are not necessarily the views of Paul, Weiss, Rifkind, Wharton & Garrison LLP or its clients. The author would like to express his appreciation to former Vice Chancellor Stephen P. Lamb for his comments on this article.

served by adopting forum selection charter or bylaw provisions. Such provisions would enable Delaware corporations to seek the dismissal of any internal affairs litigation improperly filed in other jurisdictions and also avoid the costs (and uncertainty) attendant in seeking to impose forum use restrictions in Section 220 actions.¹

Background of the Case

In June 2012, the U.S. Department of Justice investigated violations of federal law by United Technologies Corporation (“UTC”) in exporting software to the Chinese government to be used in a military helicopter. As a result of that investigation, UTC paid \$20 million and implemented certain remedial measures under a deferred prosecution agreement. UTC also entered into a consent agreement with the U.S. Department of State relating to certain false statements, under which UTC agreed to pay \$55 million.

In August 2012, Lawrence Treppel, a UTC stockholder, sent UTC a litigation demand letter, insisting that UTC conduct an internal investigation into the misconduct revealed by the Department of Justice’s investigation and institute legal proceedings against certain UTC officers and directors. UTC’s board of directors ultimately rejected Mr. Treppel’s litigation demand in December 2012.

In November 2012, another UTC stockholder, Harold Grill, commenced a derivative action against UTC in the Court of Chancery relating to the same misconduct revealed by the Department of Justice’s investigation. That derivative action was dismissed in June 2013 because Mr. Grill had failed to make a demand on the UTC board or to establish demand futility.

In March 2013, Mr. Treppel demanded inspection, pursuant to Section 220, of UTC’s books and records relating to the board’s rejection of his litigation demand. UTC agreed to permit inspection of most of the books and records Mr. Treppel sought to inspect, but conditioned those documents upon the execution of a confidentiality agreement. UTC’s proposed confidentiality agreement contained a forum use restriction, which would have required any action relating to the books and records themselves or the subject matter of the books and records inspection to be asserted exclusively in the Court of Chancery (or any other Delaware state or federal court if the Court of Chancery declined to exercise jurisdiction over the action).

Mr. Treppel refused to sign a confidentiality agreement containing the forum use restriction and instituted suit in the Court of Chancery to obtain the requested

books and records unencumbered by the proposed forum use restriction. When Mr. Treppel commenced his lawsuit, neither UTC’s charter nor bylaws contained a forum selection provision. In December 2013, while Mr. Treppel’s lawsuit was pending, UTC’s board of directors adopted a forum selection bylaw.

In a post-trial bench ruling, the Court of Chancery ruled that it lacked the statutory authority to impose a forum use restriction. Among other things, the Court of Chancery reasoned that forum use provisions are “not the type of restriction that [Section 220] seeks to impose. There is a mechanism for limiting which forum a suit may be brought in to enforce corporate interests, and that is through either a charter or bylaw provision.”

__ A.3d __, 2014 BL 361333, at *3 (quoting *Treppel v. United Techs. Corp.*, C.A. No. 8624-VCG (Del. Ch. Jan. 13, 2014), at 77-78 (TRANSCRIPT)). The Court of Chancery thus permitted Mr. Treppel to inspect certain of UTC’s books and records absent the forum use restriction.

The Supreme Court’s Decision on Appeal

UTC appealed the Court of Chancery’s bench ruling on the narrow issue of whether the Court of Chancery erred by concluding that it lacked the statutory power to impose the forum use restriction. Reversing the Court of Chancery, the Supreme Court confirmed that Section 220(c) provides the Court of Chancery with “broad discretion,” on a “case-by-case” and “fact specific” basis, to impose “any limitations or conditions” on a books and records inspection to protect the legitimate interests of Delaware corporations. __ A.3d __, 2014 BL 361333, at *3 (quoting Section 220(c); emphasis in original). The Supreme Court based its holding on the absence of restrictions (in both the statute and case law interpreting it) on the Court of Chancery’s discretion to impose case-specific limitations on the use of corporate books and records to protect those legitimate interests.

The Supreme Court then remanded to the Court of Chancery to determine whether the forum use restriction should be imposed in its discretion under Section 220. In exercising that discretion, the Supreme Court explained that the Court of Chancery was “entitled to give weight” to several non-exclusive considerations. *Id.*, at *4. Among these considerations were, (i) the fact that Mr. Treppel sought to assert claims “arising out of the same corporate conduct” that was challenged in the derivative litigation previously asserted by Mr. Grill, (ii) UTC’s “legitimate interest in having consistent rulings” on Delaware law made by Delaware courts, (iii) UTC’s ultimate adoption of a forum selection bylaw, and (iv) UTC’s investment in defending the derivative litigation brought by Mr. Grill and the Section 220 action brought by Mr. Treppel. *Id.*, at *4-5. The Supreme Court permitted the Court of Chancery to consider Mr. Treppel’s failure to “articulate any legitimate reason why he needs to file suit in a forum other than Delaware” and his ability to seek modification of the forum use restriction under Court of Chancery Rule 60(b) should such a need arise in the future. *Id.*, at *5.

The Supreme Court also directed the Court of Chancery to “give weight to the importance of maintaining § 220 actions as streamlined, summary proceedings that do not get bogged down in collateral issues.” *Id.*, at *5.

¹ Indeed, the efficacy of forum selection charter and bylaw provisions alone in stemming multi-jurisdiction litigation can be seen in a recent study by Cornerstone Research relating to mergers and acquisition litigation. According to that study, 60% of mergers and acquisition litigation in 2014 was filed in only one jurisdiction, reversing the trend during 2009-2013 “when multi-jurisdictional litigation prevailed.” Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies* (2015) at 3 (noting that “[o]nly 4 percent of 2014 deals were challenged in three or more jurisdictions, down from a peak of 20 percent in 2011”). The study attributed this reversal as “likely a result of widespread adoption of forum selection provisions in corporate bylaws.” *Id.* The study also noted that over 300 corporations adopted such provisions during 2013-2014. *Id.*

The Supreme Court noted that corporations that have adopted forum selection provisions in their charters or bylaws “can move to dismiss” if a petitioner files in an improper forum in violation of such a provision. *Id.*, at *5.

The Supreme Court further instructed the Court of Chancery to exercise “caution” because “use restrictions under § 220(c) have traditionally been tied to case-specific factors.” *Id.*, at *5. The Supreme Court highlighted that a forum use restriction may not be appropriate where there has been no prior litigation relating to the same subject matter because “the possible complications the restriction injects into the § 220 litigation may not be justified by any substantial interests” of the corporation. *Id.*, at *6. Indeed, the Supreme Court noted that the “absence of pre-existing litigation would be relevant because the company and its stockholders would not have suffered the costs of defending duplicative litigation, and the [stockholder seeking to inspect books and records] may decide not to pursue any plenary action at all.” *Id.*, at *6.

Considerations for Delaware Corporations

While confirming the broad discretion of the Court of Chancery to impose a forum use restriction (and potentially other use restrictions warranted by the facts of a given case), the Supreme Court’s decision highlights that such restrictions may not be routinely granted because of the fact-specific and summary nature of Section 220 actions. In some respects, the Supreme Court’s decision suggests that a forum use restriction may not be warranted absent pre-existing litigation in Delaware courts concerning the same subject matter and substantial sunk costs by the corporation in connection with

such litigation – even where the corporation has adopted a forum selection charter or bylaw provision.

Whether and how the Court of Chancery fashions forum use restrictions in light of the Supreme Court’s guidance remains to be seen. During proceedings on remand, Mr. Treppel’s counsel informed the Court of Chancery that he agreed to the imposition of the forum use restriction, without requiring further litigation of the issue.²

In the meantime, adopting forum selection charter or bylaw provisions likely remains a more effective means for Delaware corporations to avoid the costs of multi-jurisdiction litigation relating to the corporations’ internal affairs. Had the Court of Chancery imposed UTC’s requested forum use restriction on Mr. Treppel’s inspection, the Supreme Court observed that Mr. Treppel “would only be restricted from using the fruit of his inspection” in another suit outside of Delaware, but the restriction would not, *ipso facto*, “prevent Treppel from filing elsewhere.” *Id.*, at *5. While UTC could potentially pursue sanctions against Mr. Treppel for violation of court-ordered forum use restrictions in that scenario, to obtain dismissal of an improperly filed action outside of Delaware, UTC would presumably need to file a motion to dismiss in the improper forum. Significantly, UTC would have been permitted to file such a motion based on its adoption of the forum selection bylaw alone. Delaware corporations could thus avoid the costs (and uncertainty) of Section 220 actions in which they seek forum use restrictions by adopting a forum selection charter or bylaw provisions.

² See Letter dated March 6, 2015 from Blake A. Bennett to Vice Chancellor Sam Glasscock III in Case No. 8624-VCG (Del. Ch.).