

# INSIGHTS

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## STATE CORNER

### Court Sanctions Forum Selection Arrangements and Confirms Power to Restrict Books and Records Inspections

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In *United Technologies Corp. v. Treppel*,<sup>1</sup> the Delaware Supreme Court unanimously reversed the Court of Chancery's ruling<sup>2</sup> denying the defendant's request to restrict the use of information obtained in plaintiff's inspection of books and records to actions in the Delaware courts. The opinion sends a clear signal that the Delaware Supreme Court is in favor of forum selection bylaws, which have previously been upheld in the Court of Chancery,<sup>3</sup> and that the Court of Chancery has broad power to limit the nature and scope of an inspection of books and records pursuant to Section 220 of the Delaware General Corporation Law (DGCL).<sup>4</sup>

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### Background

The *Treppel* opinion arose out of a not uncommon fact pattern in which, following the announcement of allegations or investigations into purported corporate wrongdoing, one or more stockholders make litigation demands or demands under Section 220 of the DGCL to inspect books and records in connection with the alleged wrongdoing. In *Treppel*, Lawrence Treppel, a stockholder of United Technologies Corp. (Company), sent the Company a litigation demand letter in August 2012 demanding that it commence proceedings against certain of its officers and directors following the announcement, in June 2012, that the United States Department of Justice had initiated an investigation into violations of federal law by the Company.<sup>5</sup>

Treppel's litigation demand, however, was not the first action to arise from the Justice Department's investigation. In July 2012, another stockholder, Harold Grill, sent the Company a demand under Section 220 of the DGCL to inspect the Company's books and records in relation to the investigation. The Company furnished documents to Grill after receiving the demand, and Grill subsequently brought a derivative suit. Grill's derivative suit, however, was dismissed on the grounds that he had failed to make a pre-suit litigation demand and had not established that demand was excused.<sup>6</sup>

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While Grill's suit was pending, the Company's board of directors considered Treppel's litigation demand and sent him a brief response advising him of its determination that pursuing the litigation he had demanded was not in the Company's best interests.<sup>7</sup> The board's rejection letter precipitated another response from Treppel—this time a request under Section 220 of the DGCL to inspect the Company's books and records to investigate the Company's rejection of his litigation demand. The Company agreed to provide Treppel certain books and records, subject to his agreeing to a confidentiality agreement containing a provision requiring that all actions arising out of the inspection be brought exclusively in the Delaware courts.<sup>8</sup>

### The Court of Chancery Proceeding

Rather than signing the agreement, Treppel brought suit in the Delaware Court of Chancery, demanding under Section 220 of the DGCL that the Company allow him to inspect its books and records without any usage restrictions.<sup>9</sup> In support of the Company's request that the information obtained from the inspection be restricted to suits filed in the Delaware courts, the Company argued that Treppel's desire to use such information in a proceeding outside of Delaware "negated" the "proper purpose" he was required to show in order to conduct the inspection.<sup>10</sup> The Company argued in the alternative that, even if Treppel had demonstrated a proper purpose, the Court of Chancery should use the discretion afforded to it under Section 220(c) to limit the use of information obtained from the inspection to proceedings in a Delaware court.<sup>11</sup>

While the parties focused primarily on whether Treppel's purpose for the inspection was proper, the Court of Chancery was apparently more concerned with the restrictions on the use of the documents in proceedings outside of Delaware,<sup>12</sup> and in its ruling held that Section 220(c) did not contemplate the imposition of such a restriction. Because that ruling represented a conclusion of law, the Delaware Supreme Court reviewed it *de novo*.

### The Delaware Supreme Court Decision

At the outset, the Delaware Supreme Court noted that Section 220(c) gives the Court of Chancery broad authority to impose limitations and restrictions on an inspection of books and records, but that, due to breadth of the provision, the Delaware courts have wielded such authority on a case-by-case basis, giving regard to the specific facts at hand.<sup>13</sup> The Delaware Supreme Court further explained, however, that such authority includes not only the authority to limit the scope of the inspection itself, but also the authority to limit the use of information gathered from an inspection and that such use restrictions have "long been recognized as within the Court of Chancery's discretion."<sup>14</sup>

In this connection, the Delaware Supreme Court noted that it was well within the Court of Chancery's discretion to impose reasonable restrictions on stockholders' inspection rights in the context of a suit brought under Section 220 of the DGCL. The Delaware Supreme Court cited multiple examples in which the Court of Chancery denied the plaintiff's request for books and records entirely because the plaintiff would not have had standing to pursue the underlying claim even if the inspection request had been granted.<sup>15</sup> The Delaware Supreme Court also noted that the Court of Chancery has denied or severely conditioned inspection rights where other related litigation was pending and discovery would be the more appropriate means of securing information.<sup>16</sup> Stating that the stockholder's right to books and records under Section 220 is a "'qualified' one," and that nothing in the text of Section 220 of the DGCL or prior Delaware precedent limits the Court of Chancery's power to restrict the stockholder's inspection rights when the corporation's legitimate interests are threatened, the Delaware Supreme Court held that the Court of Chancery had erred in holding that it did not have the power by statute to impose the restriction on the inspection that the Company had sought.<sup>17</sup>

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Since the Court of Chancery had ruled that it lacked the statutory power to impose the restriction, it did not engage in an analysis of whether the restriction the Company had sought should be granted. The Delaware Supreme Court concluded that it would be inappropriate to conduct that analysis on an appellate record, outlining instead the factors that the Court of Chancery may consider in determining whether to grant the restriction requested by the Company. The Delaware Supreme Court indicated that the Court of Chancery should consider, among other things, the fact that the subject of Treppel’s ultimate suit was already the subject of derivative litigation in the Court of Chancery and the Delaware Supreme Court (and had been dismissed); the Company’s legitimate interests in having consistent rulings on Delaware law issues “and having those rulings made by [Delaware] courts”;<sup>18</sup> and the fact that the Company subsequently adopted a forum selection bylaw—which represented a “non-case-specific determination by its board of directors that internal affairs litigation involving the company should proceed in a single forum.”<sup>19</sup>

In identifying these factors, the Delaware Supreme Court explained that the Court of Chancery should take them into account because “they involve a legitimate concern on United Technologies’ part that it and its stockholders could face excessive costs and the risk of inconsistent rulings if Treppel were to file suit elsewhere.”<sup>20</sup> Thus, while the Delaware Supreme Court expressly stated that it was not engaging in its own analysis of whether to impose the restriction, its articulation of the factors it outlined for the Court of Chancery suggests that, if granted by the Court of Chancery, the Delaware Supreme Court would have upheld the restrictions sought by the Company.

The Delaware Supreme Court also expressed the view that the Court of Chancery should take measures generally to ensure that actions under Section 220 remain “streamlined, summary proceedings that do not get bogged down in

collateral issues.”<sup>21</sup> The Delaware Supreme Court noted that the importance of eschewing collateral issues was especially true in the current case, given that the Company, having adopted a Delaware forum selection bylaw after Treppel’s Section 220 action was filed, would be able to move to dismiss an action brought in another forum. Notwithstanding the Company’s ability to move to dismiss such an action, the Delaware Supreme Court cautioned stockholders seeking an inspection under Section 220 of the DGCL against “caus[ing] delay simply by asserting makeweight arguments that a relevant corporate bylaw is facially invalid or inapplicable” and categorically rejected Treppel’s argument that the forum selection bylaw did not apply to him because it was adopted after Treppel purchased his shares, stating that the argument was inconsistent with the plain operation of Section 109 of the DGCL.<sup>22</sup>

Although the Delaware Supreme Court stressed that the circumstances in which stockholders seek to inspect corporate books and records are diverse and that the Court of Chancery should exercise care in determining whether to grant a forum use restriction in the context of a proceeding under Section 220 of the DGCL, the *Treppel* opinion further evidences the Delaware courts’ recognition of the costs borne by corporations (and, ultimately, their stockholders) in connection with these inspections and in defending duplicative and multi-forum litigation. In the appropriate circumstances, requesting that the Court of Chancery impose forum use restrictions may, in addition to the adoption of a forum selection bylaw or charter provision, be another mechanism by which corporations could reduce the cost and complexity of corporate litigation.

## Notes

1. No. 127, 2014 (Del. Dec. 23, 2014).
2. *Treppel v. United Techs. Corp.*, C.A. No. 8624-VCG (Del. Ch. Jan. 13, 2014) (Transcript).
3. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013) (holding that a bylaw mandating that suits

involving the corporation's internal affairs, including claims of breach of fiduciary duty, be brought in the Delaware Court of Chancery, was valid under the DGCL); *see also* *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229, 231 (Del. Ch. 2014) (holding that a bylaw mandating that suits involving the internal affairs of a Delaware corporation headquartered in Raleigh, North Carolina, be brought in the courts of North Carolina was valid under Delaware law and rejecting the claim that the board's adoption of such bylaw concurrently with the announcement of a merger constituted a breach of fiduciary duty). *Cf. N. River Ins. Co. v. Mine Safety Appliances Co.*, — A.3d —, 2014 WL 5784588, at \*13, n.75 (Del. Nov. 6, 2014) (noting, in addressing the issue of multi-forum litigation outside the customary corporate context, that “[t]he inefficiencies inherent in multi-forum litigation have been the subject of much discussion by courts and commentators, most notably in the context of litigation challenging corporate transactions” and citing the cases upholding forum selection bylaws in illustrating the manner in which the issue has been addressed in the corporate transactional setting).

4. 8 *Del. C.* § 220.

5. *Treppel*, No. 127, 2014, slip op. at 1-2. The Justice Department's investigation into the Company ultimately resulted in the Company making a payment of \$20 million to the Justice Department and agreeing to implement remedial compliance measures under a Deferred Prosecution Agreement and making a payment of \$55 million as part of a consent agreement with the State Department. *Id.*

6. *Harold Grill 2 IRA v. Chenevert*, 2013 WL 3014120, at \*1 (Del. Ch. June 18, 2013), *aff'd* 83 A.3d 737 (Del. 2013) (Table).

7. *Treppel*, No. 127, 2014, slip op. at 3.

8. *Id.*

9. *Id.* At the time *Treppel* brought his 220 action, the Company did not have a forum selection bylaw. While the suit was pending, however, the Company's board of directors amended the bylaws to add a customary bylaw selecting the Delaware Court of Chancery as the sole and exclusive forum for internal affairs and similar disputes.

10. *Id.* at 4. Section 220(b) of the DGCL provides, in relevant part, that “[a]ny stockholder... shall, upon written demand under oath stating the purpose thereof, have the right during the usual hours for business to inspect for *any proper purpose*” the corporation's stock ledger,

stock list and other books and records. 8 *Del. C.* § 220(b) (emphasis added).

11. Section 220(c) generally provides that, if the corporation refuses to allow an inspection of books and records, the stockholder may seek an order of the Court of Chancery compelling the inspection, but specifies that the “Court may, in its discretion, prescribe any limitations or conditions with reference to the inspection, or award such other or further relief as the Court may deem just and proper.” 8 *Del. C.* § 220(c).

12. *Treppel*, No. 127, 2014, slip op. at 5.

13. *Id.* at 7.

14. *Id.* at 7-8.

15. *Id.* at 8 (citing, among others, *Graulich v. Dell*, 2011 WL 1843813 (Del. Ch. May 16, 2011)).

16. *Id.* at 8-9.

17. *Id.* at 9-10.

18. The Court noted, however, that in cases where a stockholder files an action to seek books and records and there has been no litigation in another forum, the Court could conclude that imposing a Delaware exclusive forum restriction may not be warranted, since the corporation and its stockholders would not have borne the costs of defending duplicative litigation. *Id.* at 13.

19. *Id.* at 10-11.

20. *Id.* at 11. The Supreme Court also stated that the Court of Chancery could give weight to “*Treppel's* inability to articulate any legitimate reasons why he needs to file suit in a forum other than Delaware,” and noted that *Treppel* had not been able to demonstrate how the forum selection clause would unreasonably restrict his rights as a stockholder. *Id.*

21. *Id.* at 12.

22. The Delaware Supreme Court largely restated the reasoning in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934, 939 (Del. Ch. 2013), stating that Section 109 of the DGCL provides that the corporation may in its certificate of incorporation confer on its board of directors the power to amend the bylaws. Because the Company's certificate of incorporation permitted its board of directors to amend the bylaws, *Treppel* was precluded from arguing that he was not on notice that the board would be able to amend the bylaws to add a forum selection clause, which is a matter subject to regulation through the bylaws. *Treppel*, No. 127, 2014, slip op. at 12.

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