COURT OF CHANCERY
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LEO E. STRINE, JR.
CHANCELLOR

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RE: *Harold Grill 2 IRA v. Louis R. Chênevert, et al.*
Civil Action No. 7999-CS

Dear Counsel:

This is my decision on a motion to dismiss a derivative suit brought on behalf of United Technologies Corporation ("UTC"), a technology conglomerate. Harold Grill 2 IRA, the plaintiff, a stockholder in UTC, alleges that the UTC board of directors consciously caused UTC to misrepresent violations of export controls by two of its subsidiaries, Hamilton Sundstrand ("Hamilton") and Pratt & Whitney Canada ("Pratt & Whitney"), to the federal government in July and September 2006. As a result of these misrepresentations, UTC was charged with violating federal law and paid a $55 million fine.[1]

[1] The complaint erroneously states, multiple times, that UTC pled guilty to violating federal law. Compl. ¶¶ 1, 114, 132. As the plaintiffs concede, that was not so, and public records make this clear. *See* Letter to the Ct. from Counsel to Defs. (June 21, 2013); Defs.' Br. in Supp. Ex. B ¶ 4 (UTC Deferred Prosecution Agreement (June 28, 2012)).

The defendants in this suit are the thirteen-member UTC board at the time of the complaint, together with the former Chairman and CEO of UTC, George David. The plaintiffs have not alleged that any of these individuals, other than David and the first-named defendant, Louis Chênevert, the current Chairman and CEO, are not independent.[2] Under our law, these defendants are therefore presumed to be independent.[3]

The plaintiff did not make a demand on the board to prosecute this action, and the defendants have moved to dismiss the complaint on the ground that the plaintiff has not pled facts that support an inference that a majority of the board faces a "substantial likelihood of personal liability."[4] The plaintiff has alleged only that David was aware of the false disclosures at the time they were made. David left the board in 2009, and the plaintiff has not pled facts that allege that any of the thirteen directors who constituted UTC's board at the time of the complaint, twelve of whom are independent, were aware of the false disclosures or have otherwise breached their duty of loyalty. Therefore, the complaint is dismissed with prejudice as to the named plaintiff.[5]

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[2] Compl. ¶¶ 15, 28.
[3] *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984).
[4] *Guttman v. Huang*, 823 A.2d 492, 501 (Del. Ch. 2003) (citing *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993)).
[5] *See* Del. Ct. Ch. R. 15(aaa) ("In the event a party fails to timely file an amended complaint or motion to amend under this subsection (aaa) and the Court thereafter concludes that the complaint should be dismissed under Rule 12(b)(6) or 23.1, such dismissal shall be with prejudice (and in the case of complaints brought pursuant to Rules 23 or 23.1 with prejudice to the named plaintiffs only) . . . .").

I. Background

The facts are drawn from the complaint. For the purposes of this motion, I accept them as true, and draw reasonable inferences in the plaintiff's favor.[6] But, mere notice pleading is inadequate to plead demand excusal, and I cannot accept vague allegations of wrongdoing as a substitute for well-pled particularized facts.[7]

In January 2001, Pratt & Whitney signed a contract with China Aviation Industry Corporation II, a Chinese state-owned aviation company, to export ten helicopter engines to China.[8] The Chinese represented that the engines were to be used in helicopters that would be produced in both military and civilian versions.[9] Pratt & Whitney, which is a Canadian corporation, obtained a Canadian export license for the engines.[10] But, in order to be used in the military version of the helicopters, the engines required software from Hamilton.[11] Pratt & Whitney ordered twelve versions of the software from Hamilton, and re-exported six of these versions to China.[12]

Hamilton is a U.S. subsidiary of UTC. Under federal regulations, a license is required for the export of arms from the United States to China, and such licenses are

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[6] *See, e.g.*, *Grobow v. Perot*, 539 A.2d 180, 186-87 (Del. 1988).
[7] *Guttman*, 823 A.2d at 499.
[8] Compl. ¶ 47.
[9] *Id.* at 14 ¶ 38.
[10] *Id.* ¶ 46.
[11] *Id.* ¶¶ 7, 47.
[12] *Id.* ¶ 52.

always denied.[13] The license requirement also covers the export of arms to intermediary countries en route to China.[14] The software that was needed for the engines to run in the military versions of the helicopters was covered by the arms export regulations.[15] Hamilton was required to determine the end-use of the software it was exporting.[16]

Hamilton did not try to obtain authorization to export the modified software to China, and only discovered that the software it was exporting would have a military use in early 2004.[17] The complaint alleges, however, that an unnamed official at UTC knew by at least May 2003 that the Chinese helicopters had a military use, and that this information was not passed on to Hamilton.[18] And, as late as autumn 2003, Hamilton's software was being exported by Pratt & Whitney to China.[19] Hamilton only stopped work on the program in February 2004, after Pratt & Whitney had informed it that the helicopters had a military use.[20]

By the middle of 2005, lawyers at UTC were investigating whether the company had broken U.S. export regulations.[21] In May 2006, UTC determined that it had violated the law, and resolved to make disclosures to the State Department.[22]

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[13] *Id.* ¶¶ 55-56.
[14] *Id.* ¶ 65.
[15] *Id.* ¶ 54.
[16] *Id.* ¶ 68.
[17] *Id.* ¶¶ 52, 63.
[18] *Id.* ¶¶ 62-63.
[19] *Id.* ¶ 63.
[20] *Id.* ¶¶ 71-72.
[21] *Id.* ¶¶ 79-80.

In July, August, and September 2006, UTC made disclosures to the State Department concerning the export of Hamilton software to Pratt & Whitney and then to China.[23] The disclosures were false in the following respects:

- UTC stated falsely that the Chinese told Pratt & Whitney that civilian and military versions of the helicopter would be developed in parallel out of the same program. In reality, the Chinese always told Pratt & Whitney, and Pratt & Whitney always knew, that a military application would come first.[24]
- UTC stated falsely that Pratt & Whitney did not know that the Chinese were building an attack helicopter until 2003. In reality, Pratt & Whitney knew in 2000 that the Chinese were building an attack helicopter.[25]
- UTC stated falsely that after Pratt & Whitney engineers saw the first attack helicopter prototype, Pratt & Whitney continued to believe that the Chinese were also developing a civil version.[26] Pratt & Whitney was always dubious about the existence of a civilian application.[27]

The complaint alleges that an unnamed UTC executive was aware that the disclosures were false, but did nothing to correct them.[28]

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[22] *Id.* ¶ 91.
[23] *Id.* ¶¶ 92-93.
[24] *Id.* ¶¶ 94-96.
[25] *Id.* ¶ 97.
[26] *Id.*
[27] *Id.* ¶ 96.
[28] *Id.* ¶ 98.

In November 2011, the State Department informed UTC that it believed that the disclosures were improper, and that they warranted sanctions.[29] In June 2012, UTC was charged with violating 18 U.S.C. § 1001, which provides for penalties on anyone who "knowingly and willfully (1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact [or] (2) makes any materially false, fictitious, or fraudulent statement or representation" in a matter subject to the jurisdiction of the federal government.[30] As part of the consent agreement it entered into with the State Department, UTC changed its compliance practices and paid a fine of $55 million.[31]

II. Demand Is Not Excused And The Complaint Is Dismissed

The plaintiff made a books and records demand on UTC in July 2012, and, having received documents, filed this complaint in November 2012.[32] The plaintiff seeks to recover from the defendant directors, on UTC's behalf, the losses UTC has sustained on account of this violation of federal law.[33] The complaint alleges that the director defendants breached their fiduciary duties to UTC and its stockholders.[34] The complaint

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[29] *Id.* ¶ 111.
[30] *Id.* ¶ 114; *see* 18 U.S.C. § 1001(a)(1)-(2). Although the complaint alleges that UTC made false disclosures to the government in July, August, and September 2006, the government only charged UTC with false disclosures in July and September. *See* Defs.' Br. in Supp. Ex. B ¶ 2(b) (UTC Deferred Prosecution Agreement (June 28, 2012)); *id.* Ex. C ¶ 33 (Information, *United States v. United Techs. Corp.* (D. Conn. June 28, 2012)).
[31] Compl. ¶ 115.
[32] *Id.* Ex. A (books and records demand (July 10, 2012)).
[33] *Id.* ¶¶ 118-19.
[34] *Id.* ¶¶ 138-51.

also claims that demand on the board is excused because the directors "face a substantial likelihood of liability."[35]

Under our law, a plaintiff must show, with particularity, why demand is excused under Rule 23.1.[36] The complaint here does not meet that standard. The complaint is written like a *Caremark* complaint, with many references to internal controls and compliance.[37] But, in its briefing, the plaintiff specifically disclaimed this theory of liability.[38] The plaintiff's move away from the *Caremark* theory may have been in response to the defendants' observation that the plaintiff only owned stock from July 2006 onwards, and thus can only sue for events from that time onwards.[39] Instead, the plaintiff's brief argues only that the UTC board knowingly caused UTC to violate 18

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[35] *Id.* ¶ 134.
[36] *Guttman v. Huang*, 823 A.2d 492, 500-01 (Del. Ch. 2003) (citing *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), and *Rales v. Blasband*, 634 A.2d 927 (Del. 1993)).
[37] *See In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996); *see also, e.g.*, Compl. ¶ 124 ("The Director Defendants breached their fiduciary duties by abdicating their responsibilities of supervision and oversight of UTC's employees and business operations . . . ."); *id.* ¶ 133 ("[T]he Director Defendants failed to exercise sufficient oversight of the Company's . . . compliance controls, even though, as detailed herein, there was a litany of red flags demonstrating that the Company's . . . compliance controls were deficient."); *id.* ¶ 141 ("To discharge these [fiduciary] duties, each Director Defendant was required to exercise reasonable and prudent supervision over UTC's management, policies, practices, controls and financial affairs.").
[38] *See* Pl's. Br. in Opp'n 17 ("This is not a *Caremark* case."). In its briefing, the plaintiff also dropped its claim for corporate waste, a claim that is simply a way of describing a particular kind of breach of fiduciary duty. *Id.* at 20 n.9; *see Harbor Fin. P'rs v. Huizenga*, 751 A.2d 879, 895-902 (Del. Ch. 1999).
[39] Defs.' Br. in Supp. 37-38; *see* 8 *Del. C.* § 327 ("In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law.").

U.S.C. § 1001 by failing to timely correct misrepresentations made to the State Department.[40] Thus, the plaintiff says, the directors face a threat of liability, and demand is excused. The plaintiff notes that, under this theory, either the *Aronson* or *Rales* formulation of the demand excusal test could be applied to this case.[41]

Of course, it is a breach of the duty of loyalty for the directors of a corporation to knowingly cause that corporation to break the law.[42] But the complaint does not allege that the directors caused any legal breach, in the first instance, or even that they were aware before the end of 2011 that UTC had broken the law.[43] Not only that, but the complaint does not even plead any facts in an attempt to support a pleading stage inference that any particular director should have known that the disclosures were false, much less plead facts supporting a pleading stage inference of actual knowledge. The complaint is largely devoid of any attempt to plead facts connecting the directors to the disclosures made to the State Department about the export of the software, either before or after those disclosures were made. Rather, the complaint alleges only that an unnamed UTC executive was aware that the disclosures were deficient at the time that they were made.[44] The plaintiff's brief claims that the directors were informed about the false disclosures in board meetings between 2006 and 2008, but the complaint only alleges that

[40] Pl's. Br. in Opp'n 1-2, 17.
[41] *Id.* at 17-18.
[42] *See, e.g., Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).
[43] Compl. ¶¶ 111-12.
[44] *Id.* ¶ 98.

the board discussed the export violations in those meetings, *not* that the board was made aware that the company had made false disclosures and knowingly failed to cause UTC to correct them.[45]

The complaint also alleges that "UTC's Chairman of the Board [*i.e.*, David] and/or other directors" may "apparently" have been aware of the export violations as early as April 2006, but, again, this allegation does not state that the directors were aware of the false disclosures, or provide any rational basis for inferring that they were.[46] As important, the complaint does not identify *any* of the UTC directors "other" than David who may have known of the false disclosures, or even why they were in a position to know. The failure to allege facts compromising any of the independent directors, much less a majority of the board, is fatal because a plaintiff who wishes to proceed in this context must plead with particularity that a majority of the board faces a substantial risk of liability.[47]

Because the complaint does not allege that any of the directors named in the complaint faces a substantial risk of personal liability, let alone a majority of the board at

[45] Pl's. Br. in Opp'n 11, 13; Compl. ¶¶ 99-106.
[46] Compl. ¶ 89.
[47] *See, e.g.*, *Biondi v. Scrushy*, 820 A.2d 1148, 1154 (Del. Ch. 2003) (discussing a weak derivative complaint filed in another jurisdiction, and noting that "[u]nder Delaware case law, it is difficult to plead demand futility by filing a complaint that only identifies one of the nine directors and that does not attempt to plead breach of fiduciary duty on a particularized basis").

the time of the complaint, demand is not excused. The complaint is therefore dismissed, with prejudice as to the named plaintiff.

IT IS SO ORDERED.

Very truly yours,

/s/ Leo E. Strine, Jr.

Chancellor