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NATURE OF PROCEEDINGS

This is an interlocutory appeal from the Chancery Court from an order granting Defendants' motion to enjoin the federal action and dismissing Plaintiffs' motion to stay the Delaware action. Defendants respectfully request that this Court affirm the lower court's ruling and dismiss Plaintiff's appeal.

The Board of Directors of Pinpoint Bearings, Inc., (Pinpoint), on June 10, 2010, amended the Pinpoint bylaws to include a bylaw assigning the Court of Chancery of the State of Delaware as the exclusive forum for derivative actions and actions claiming a director's breach of fiduciary duty (Exclusive Forum Bylaw).

On November 30, 2010, as a result of an investigation by the Office of the Inspector General (OIG), Pinpoint entered into a settlement agreement with OIG. As a part of that settlement, Pinpoint admitted to violations of the False Claims Act and paid fines and penalties. The following day, December 1, 2010, Plaintiff Edward Miller filed a derivative action against the Directors in the United States District Court for the Southern District of Texas, alleging state law violations of the breach of fiduciary duty and federal securities law claims. One day later, on December 2, 2010, three more Plaintiffs filed actions in Delaware Chancery Court alleging state breach of fiduciary duty claims nearly identical to those of Plaintiff Miller. The Chancery Court consolidated the three Delaware plaintiffs'

actions under the caption *In re Pinpoint Bearings, Inc. Shareholders Litigation*.

Pinpoint and the Directors filed a motion to enjoin Plaintiff Miller from pursuing the federal action, citing to Pinpoint's Exclusive Forum Bylaw. In response, Plaintiff Miller filed suit in the Delaware Chancery Court, again asserting the breach of fiduciary duty claim. Plaintiff Miller filed 2 motions at that time. One was a motion to consolidate, which was unopposed and granted. The second motion filed was a motion to stay the Delaware action in favor of his first-filed Federal Action.

The court below denied Plaintiff Miller's motion to stay the Delaware action and granted the Defendants' motion to enjoin Plaintiff Miller from continuing the Federal Action. Plaintiff Miller appealed to this Court.

SUMMARY OF ARGUMENT

1. The Chancery Court properly concluded that the Exclusive Forum Bylaw is Valid and Enforceable.
2. The Directors had authority to adopt the Exclusive Forum Bylaw.
3. Bylaws are presumptively valid contracts between shareholders and the corporation.
4. Forum selection clauses are presumptively valid.
5. To overcome the presumptions of validity, a challenger must prove that the clause is unjust or unreasonable.
6. Plaintiff Edward Miller has not proven enforcement of the Exclusive Forum Bylaw would be unjust or unreasonable.
7. *Galaviz v. Berg*, a similar case in the Northern District of California, is not controlling and was applying federal common law, not Delaware corporate law.
8. The Chancery Court properly concluded that the Business Judgment Rule applies to the adoption of the Bylaw.
9. The decision to adopt the Bylaw was rational and within authority of the Directors.
10. The Directors did not violate their fiduciary duties by adopting the Bylaw.
11. The Entire Fairness Doctrine does not apply to the decision to adopt the Bylaw.

STATEMENT OF FACTS

Pinpoint Bearings, Inc. (Pinpoint) is a Delaware corporation that manufactures precision roller and ball bearings for the aerospace industry. (Mem. Op. 4.) The Board consists of seven directors: Michael Sanchez, Clare Mitchell, Brendan Ellsworth, Timothy Fletcher, Marsha Franklin, Daphne Keyes, and Eric Lam (collectively, Directors or Board). (Mem. Op. 5.) Pinpoint's primary customer is the U.S. military, but it also serves commercial aircraft manufacturers. (Mem. Op. 4-5.) The headquarters and manufacturing operations of Pinpoint are in Houston, Texas. (Mem. Op. 4.)

Directors, on June 10, 2010, adopted a bylaw assigning the Court of Chancery of the State of Delaware as the "sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the corporation, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director . . . ." (Exclusive Forum Bylaw). (Mem. Op. 2-3 n.4.)

Beginning in September of 2010, Pinpoint was involved in an investigation by the Office of Inspector General of the United States (OIG). (Mem. Op. 6.) After being notified of the investigation, the Board held an emergency Board meeting, at which a special investigations committee (Committee) was appointed. (Mem. Op. 6.) The Committee hired a law firm to assist with the investigation. (Mem. Op. 6.) By the end of November, a settlement had been finalized between Pinpoint and OIG. (Mem. Op.

6.) As a result of the settlement, Pinpoint (1) admitted to violations of the False Claims Act, (2) paid \$500,000 in fines and penalties, and (3) fired the managers who had devised the illegal activities. (Mem. Op. 6.)

Plaintiffs, Eileen Webb, Richard Patrick, Harold Kohn, and Edward Miller (Plaintiff Miller) (collectively, Plaintiffs), all subsequently filed derivative actions against the Directors, alleging breach of fiduciary duty after Pinpoint settled with the OIG. (Mem. Op. 1, 6.) Plaintiff Miller won the race to the courthouse by filing federal and state claims in the United States District Court for the Southern District of Texas (Federal Action). (Mem. Op. 4.) Plaintiff Miller is a former employee of Pinpoint, owning some 5,000 shares of Pinpoint common stock. Plaintiffs Webb, Patrick, and Kohn filed suit in Delaware's Chancery Court the next day. (Mem. Op. 7-8.) These three plaintiffs each own 200 or less shares of Pinpoint common stock. (Mem. Op. 4.) Plaintiff Miller also filed duplicate state claims in the Chancery Court of Delaware. (Mem. Op. 8.) The four Delaware claims were consolidated. (Mem. Op. 1.) Plaintiff Miller appealed to this Court, seeking to stay the Delaware actions and proceed with his federal action. Defendant Directors respectfully request that this court deny Plaintiff Miller's request to reverse the Chancery court.

## ARGUMENT

### **I. THE COURT OF CHANCERY PROPERLY CONCLUDED THAT THE EXCLUSIVE FORUM BYLAW IS VALID.**

#### Question Presented

Whether, under Delaware Law, the Exclusive Forum Bylaw is valid and enforceable where the Directors unilaterally adopted the Bylaw.

#### Scope of Review

Whether a bylaw is valid and fair is both a question of law and of fact. *Frantz Mfg. Co. v. EAC Indus.*, 501 A.3d 401, 407 (Del. 1985). Therefore, the Supreme Court should "reverse the findings of the lower court only if the findings below are 'clearly wrong and the doing of justice requires their overturn.'" *Id.* (quoting *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. Super. Ct. 1972)). If the findings below "are sufficiently supported by the record and are the product of an orderly and logical deductive process," the Court should accept those findings. *Levitt*, 287 A.2d at 673.

#### Merits of Argument

The Exclusive Forum Bylaw is valid and therefore enforceable. The Directors were granted authority to adopt the Bylaw in Pinpoint's certificate of incorporation. The Bylaw is a presumptively valid contract, rebuttable only by a showing that enforcing it would be unreasonable or unjust - something Plaintiff Miller has failed to do. Finally, Delaware courts are not bound to follow, and it would be unwise to do so, the

Northern District of California on this issue. Therefore, the Bylaw is valid, should be enforced, and the order enjoining the federal action should be affirmed.

**1. The Chancery Court Properly Concluded that the Directors had Authority to Adopt the Exclusive Forum Bylaw.**

The Directors were granted the authority to adopt the Exclusive Forum Bylaw by Pinpoint's certificate of incorporation. Under Delaware General Corporation Law, the power to adopt or amend bylaws can be conferred upon the directors through the certificate of incorporation. *Del. Code Ann. tit. 9, § 109(a)* (2010). Bylaws may "contain any provision . . . relating to . . . the rights or powers of its stockholders, directors, officers or employees." § 109(b).

Pinpoint's Exclusive Forum Bylaw requires that Court of Chancery of Delaware be the "sole and exclusive forum" for derivative actions and claims of breach of a fiduciary duty against Pinpoint's Directors. (Mem. Op. 2-3 n.4.) Plaintiff Miller may attempt to argue that the board cannot unilaterally adopt such a bylaw. This, however, cannot be supported. It is undisputed that Pinpoint's certificate of incorporation conferred the power to adopt or amend the bylaws upon the Directors. Further, the bylaws explicitly allow the Directors to amend them. It also cannot be disputed that the issue of where a stockholder may bring a derivative suit against the Directors is an issue relating to the rights of the stockholders. Where a stockholder may bring such a suit deals directly with the procedural rights

of stockholders. Therefore, the Directors had authority to amend the bylaws to create the Exclusive Forum Bylaw.

**2. The Exclusive Forum Bylaw is a Presumptively Valid Contract.**

The Exclusive Forum Bylaw is a presumptively valid contract, so it is enforceable. A corporation's bylaws are presumptively valid. *Frantz Mfg. Co.*, 501 A.3d at 407; *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 238 (Del. 2008). In interpreting bylaws, the courts are to construe them in a manner in harmony with the law. *Frantz Mfg. Co.*, 501 A.3d at 407; *CA, Inc.*, 953 A.2d at 238.

A bylaw is an "internal governance contract," to be interpreted according to the general rules of contracts. *CA, Inc.*, 953 A.2d at 239; *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) ("Corporate charters and bylaws are contracts among the shareholders of a corporation . . . ."). If the certificate of incorporation allows, the directors are permitted to unilaterally adopt bylaws. *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995). Where a contract contains a forum selection clause, that clause is "presumptively valid." *Ingres Corp. v. CA, Inc.*, 8 A.3d 1143, 1145-46 (Del. 2010) (citing *Capital Grp. Cos. v. Armour*, No. Civ.A. 422-N, 2004 WL 2521295, at \*3 (Del. Ch. Oct. 29, 2004)). Such a clause "should control absent a strong showing that it should be set aside." *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9-10 (1972). Further, the Supreme Court has stated that just because a forum-selection was not negotiated or does not does not mean the

clause cannot be enforced. *Carnival Cruise Lines v. Shute*, 499 U.S. 585, 593 (1991).

Here, Plaintiff Miller have failed to meet their burden to show that the Exclusive Forum Bylaw should be set aside. The shareholders are bound by the bylaws just as they would be bound by a contract. If the shareholders are unhappy with the actions of the Board, they have the ability to vote in board members of their choosing, or to sell their shares. By reviewing the charter, the shareholders would know that the Directors had the authority to amend the bylaws. Therefore, the Exclusive Forum Bylaw is presumptively valid and enforceable.

**3. Enforcing the Exclusive Forum Bylaw  
Would not be Unjust or Unreasonable.**

Plaintiff Miller is unable to show that enforcing the Exclusive Forum Bylaw would be unjust or unreasonable, so the Bylaw is enforceable. The party arguing against the forum selection clause has the burden of showing that enforcement of the clause would be "unreasonable and unjust." *Ingres Corp.*, 8 A.3d at 1146. The challenger must show the court that enforcement of the clause would essentially deprive him of his day in court. *Meli v. Rembrandt IP Mgmt., LLC*, 2010 Del. Super. LEXIS 227, at \*12 (Del. Supr. June 28, 2010) (citing *The Bremen*, 407 U.S. at 18).

First, Plaintiff Miller has failed to show that enforcing the Exclusive Forum Bylaw would deprive him of his day in court. Further, Delaware is a logical forum to litigate this action. Delaware is the place of incorporation. Plaintiff Miller is a

derivative plaintiff, so the inconvenience to him for having the suit away from his home is lessened and certainly not inconvenient to a level of making the suit in Delaware unjust or unreasonable. Therefore, the Exclusive Forum Bylaw is valid and enforceable.

**4. The Chancery Court was Correct in Concluding that *Galaviz v. Berg* is Not Controlling and the Chancery Court Properly Applied its Own Analysis.**

*Galaviz v. Berg*, is not controlling law as it was decided by the United State District Court for the Northern District of California. 2011 U.S. Dist. LEXIS 1626 (N.D. Cal. Jan. 3, 2011). *Galaviz* is a case with similar facts to this case and the same issue as presented in this appeal: whether a forum selection bylaw adopted unilaterally by the directors of a corporation is enforceable. *Id.* at \*1-\*4. The case was the first time a court was confronted with that issue and it held against the defendants that the bylaw was not enforceable because there was no "element of mutual consent." *Id.* at \*2, \*5.

*Galaviz* is decided under federal common law on venue, not Delaware corporate law. (Mem. Op. 15.) The court rejected the use of corporate law to decide the issue, relying instead on federal contact law. *Galaviz*, 2011 U.S. Dist. LEXIS 1626, at \*11-\*13. The court also decided not to follow the trend in Delaware. See *CA, Inc.*, 953 A.2d at 238-39 (holding that bylaws are presumptively valid internal governance contracts); *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular

forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.”). This is an issue undecided by Delaware courts, but a similar provision in an agreement creating an LLC was upheld as valid and enforceable by this Court in *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 296 (Del. 1999); see also *Douzinis v. Am. Bureau of Shipping, Inc.*, 888 A.2d 1146, 1149 (Del. Ch. 2006) (“enforcing provision in LLC agreement requiring that all intra-entity disputes be resolved in arbitration” *Revlon*, 990 A.2d at 960 n.8).

Here, the Chancery Court was correct in its analysis. It was correct in concluding that the shareholders were bound by the Exclusive Forum Bylaw, a presumptively valid contract between the shareholders and the corporation. Instead of following the lead of a district court, it followed the pattern in Delaware. The Chancery Court used other Delaware law to create a logical analysis and conclude that the Exclusive Forum Bylaw is valid and enforceable. The Chancery Court considered *Galaviz*, but recognized that it was not bound by the decision and correctly provided its own analysis. Defendants respectfully request that this Court does the same and affirm the Chancery Court’s decision.

**II. THE COURT OF CHANCERY WAS CORRECT IN APPLYING THE BUSINESS JUDGMENT RULE TO THE BOARD'S DECISION TO ADOPT THE BYLAW.**

Question Presented

Whether, under Delaware Law, a board's decision to adopt an Exclusive Forum Bylaw must be reviewed with strict scrutiny, enhanced judicial scrutiny, or the business judgment rule.

Scope of Review

The business judgment rule is an extension of the fundamental principle of Delaware law that the business and affairs of a corporation are managed by or under the direction of its board of directors. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 373 (Del. 1993). The rule posits a powerful presumption in favor of actions taken by the directors in that the courts will not overturn a decision made by a loyal and informed board unless it cannot be "attributed to any rational business purpose." *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

An application of the traditional business judgment rule places the burden on the "party challenging the decision to establish facts rebutting the presumption. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty—good faith, loyalty or due care. *Cintron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989). However, if the business judgment rule is not rebutted, a court will not substitute its judgment for

that of the board if the decision can be attributed to any rational business purpose. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

Merits of Argument

The business judgment rule should be applied to the Directors' decision to adopt the Bylaw. Their decision to adopt the Bylaw was rational and within their powers. Additionally, they did not violate their fiduciary duty to their shareholders in the adoption of the Bylaw. The entire fairness doctrine does not apply because the Directors had the best interest of Pinpoint in mind when they passed the Bylaws, not motivated by their individual interests. Therefore, the business judgment rule should be applied to the adoption of the Bylaws and the order enjoining the Chancery Court opinion should be affirmed.

**1. The Business Judgment Rule Should be Applied to the Board's Decision to Adopt the Exclusive Forum Bylaw.**

The Directors' decision to adopt the Exclusive Forum Bylaw was rational and within the powers granted to them by Pinpoint's certificate of incorporation, therefore the business judgment rule should apply to the board's decision to adopt the Exclusive Forum Bylaw. When shareholders challenge actions by a board of directors, one of three standards of judicial review is applied: the traditional business judgment rule, an intermediate standard of enhanced judicial scrutiny, or the entire fairness analysis. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). Delaware courts follow the business judgment rule and do not

interfere with the judgments of a board of directors unless there is a showing of gross and palpable overreaching (by the directors). *Id.*

The rule posits a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be "attributed to any rational business purpose." *Id.* Additionally, a court will not substitute its judgment for that of the board if the decision can be attributed to any rational business purpose. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

Here, the Directors did not overreach past the authority granted to them by Pinpoint's certificate of incorporation and there were no improprieties in the adoption of the Bylaw. The Directors adopted the Bylaw on June 20, 2010 and the investigation by the Office of the Inspector General of the United States did not begin until September 2010. The Bylaw was clearly not adopted by the Board in response to the investigation.

More importantly, the Bylaw was a forum designation clause. The adoption of the Bylaw is unrelated to Miller's federal securities law claims that the Directors failed to make timely disclosures. Perhaps the federal securities claims can be analyzed with a heightened level of scrutiny. However, this court is concerned with the level of judicial scrutiny that should be applied to the adoption of the Bylaw, not the federal securities

claims. Miller offers no evidence that the adoption of the Bylaw itself was not related to a rational business purpose. Therefore, the decision of the Directors to adopt the Bylaw must be analyzed using the business judgment rule.

**2. The Decision of the Board to Adopt the Bylaw did Not Violate Their Fiduciary Duty.**

The decision of the Board to adopt the Bylaw was not a violation of their fiduciary duty. Additionally, Miller offered no evidence the Directors acted in bad faith. When a board of directors makes decisions that result in a breach of their fiduciary duty, the decisions are reviewed with enhanced scrutiny, under the entire fairness standard of review. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993). To rebut the (business judgment) rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty—good faith, loyalty or due care. *Cintron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989).

Here, the Bylaw is a forum designation clause, designed to ensure that any litigation against Pinpoint would be conducted in Delaware. This is acceptable because Pinpoint is a Delaware corporation. The Directors clearly exercised good faith and loyalty to their shareholders because designating Delaware as the forum for litigation is advantageous to Pinpoint. Litigation in a foreign forum would mean higher costs to Pinpoint as well as the uncertainty of the laws in the particular forum. By designating

Delaware, Pinpoint can retain counsel in Delaware, where they are incorporated, and can be better equipped to handle litigation against them. Additionally, the Bylaws were adopted by the Directors pursuant to the Pinpoint's corporate policies. Therefore the Directors exercised due care.

**3. The Entire Fairness Doctrine is Inapplicable to Adoption of the Bylaw.**

The entire fairness doctrine should not be applied to the adoption of the Bylaw because the Directors were not motivated by self-interest when they adopted the Bylaw. Additionally, the entire fairness doctrine does not apply to the adoption of the Bylaws because the business judgment rule applies to the adoption of the Bylaws. The Delaware Chancery Court adheres to a more exacting entire fairness standard of judicial review to protect the minority shareholders, premised on the inapplicability of the business judgment rule where self-interest may have colored directors' actions. *In re LNR Property Corp. Shareholders Litigation*. 896 A.2d 169 (Del. 2005). If the (business judgment) rule is rebutted, the burden shifts to the defendant directors, the proponents of their challenged transaction, to prove to the trier of fact the "entire fairness" of the transaction to the shareholder plaintiff. *Cinerama v. Technicolor, Inc.*, 663 A.2d 1156, 46 (Del. 1993).

Here, the Directors adopted the Bylaws to ensure that Delaware would be the forum, should Pinpoint be taken to court. The directors did not gain anything personally from the adoption of the Bylaw. The Bylaw did not give the Directors added

authority nor did the Bylaw limit their personal liability. Additionally, Miller did not rebut the business judgment rule, which applies to the adoption of the Bylaws for the reasons stated in section II (1). Therefore, the entire fairness doctrine should not be applied to the adoption of the Bylaw.

CONCLUSION

For the foregoing reasons, Director Defendants respectfully request that this Court affirm the order of the Chancery Court (1) granting Defendants' motion to enjoin Plaintiff Miller from further action in the Federal Action and (2) denying Plaintiff Miller's motion to stay the Delaware proceedings.

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Counsel B

Dated: February 10, 2011