

IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE PINPOINT BEARINGS, INC.) No. 17, 2011
SHAREHOLDERS LITIGATION)

EDWARD MILLER,)
 Plaintiff Below-Appellant,)
)
) v.)
)
MICHAEL SANCHEZ, CLAIRE) Court Below:
MITCHELL, BRENDAN ELLSWORTH,) Court of chancery of the State
TIMOTHY FLETCHER, MARSHA) of Delaware in and for New
FRANKLIN, DAPHNE KEYES AND ERIC) Castle County
LAM,)
))
 Defendants Below-Appellees,) Civil Action No. 4958-VCM
)
) and)
)
POINPOINT BEARINGS, INC.,)
 Nominal Defendant Below-)
 Appellee.)
)

APPELLEES' ANSWERING BRIEF ON APPEAL

Team F
*Attorney for the Defendants
Below, Appellants*

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NATURE OF PROCEEDINGS

Plaintiff Edward Miller ("plaintiff") is a shareholder of Pinpoint Bearings, Inc. ("Pinpoint"). This case arises from an investigation and ultimate settlement of a suit instituted by the federal Office of Inspector General (OIG) against Pinpoint for alleged violations of the False Claims Act. 31 U.S.C. § 3729 (2009).

On December 1, 2010, one day after the settlement was announced, plaintiff filed an action in the United States District Court for the Southern District of Texas ("Federal Action") against the Board of Directors of Pinpoint ("the Board"). Plaintiff's suit alleged violations of federal securities statutes and that the Board breached its fiduciary duty under state substantive law.

On December 2, plaintiffs Eileen Webb, Richard Patrick and Harold Kohn, all Pinpoint shareholders, separately filed breach of fiduciary duty actions against the Board in the Court of Chancery of the State of Delaware ("Original Delaware Actions"), asserting almost the same claim as plaintiff's state court claim in the Federal Action. On December 8, the Court of Chancery consolidated the Original Delaware Actions under one caption, *In re Pinpoint Bearings, Inc. Shareholders Litigation* ("Consolidated Delaware Action").

On December 15, plaintiff filed a second fiduciary action against the Board, but this time in the Court of Chancery ("Miller Delaware Action"). The Miller Delaware Action alleges the same state law breach of fiduciary duty claim as his Federal Action. On the same day, plaintiff also filed a motion to include the Miller Delaware Action in the Consolidated Delaware Action. Lastly, plaintiff filed a

Motion to Stay the Consolidated Delaware Action in favor of his first-filed Federal Action.

The Board opposed plaintiff's Motion to Stay, arguing that Pinpoint's Exclusive Forum Bylaw ("the Bylaw") binds its shareholders to litigating all derivative and fiduciary claims in the Court of Chancery of the State of Delaware. (R 2, n.4) Accordingly, the Board argued that the Southern District of Texas does not have jurisdiction over the state law claims. The Board also filed a Motion to Enjoin plaintiff from pursuing any derivative or fiduciary claims in any forum other than the Court of Chancery.

On January 12, 2010, the Court of Chancery granted the Board's Motion to Enjoin plaintiff and denied plaintiff's Motion to Stay the current Delaware action.

Plaintiff now appeals these decisions, arguing that the Bylaw is invalid as a matter of Delaware law and that the Court of Chancery incorrectly granted the Board's Motion to Enjoin and denied plaintiff's Motion to Stay

SUMMARY OF ARGUMENT

Pinpoint's Exclusive Forum Bylaw is consistent with Delaware law and therefore valid and enforceable. The Bylaw is within the presumption of validity granted to corporate bylaws by this Court and also within the presumption of validity the Supreme Court of the United States grants exclusive forum provisions. The very high burden of invalidating an exclusive forum provision is not overcome because no hardship falls upon plaintiff by enforcing the Bylaw.

Additionally, the Board's adoption of the Bylaw is subject to the presumption of the business judgment rule rather than the entire fairness standard or the *Unocal* and *Unitrin* heightened level of judicial scrutiny. Under Delaware law, director-approved transactions are subject to the business judgment rule unless the shareholder plaintiff can rebut the presumption of the rule by proving the directors' conduct is deserving of a heightened level of scrutiny. The business judgment rule is applicable to the Board's decision to adopt the Bylaw because plaintiff has failed to meet this burden. The entire fairness standard is inapplicable to the Board's conduct because plaintiff has failed to prove the Board breached its fiduciary duties of loyalty and due care when it adopted the Exclusive Forum Bylaw. Furthermore, the *Unocal* and *Unitrin* standard is inapplicable to the Board's conduct because plaintiff has failed to prove the adoption of the Bylaw constituted a defensive measure in response to a perceived threat to corporate policy or effectiveness and a limitation of the shareholder franchise. Therefore, the Board's conduct should be subject to the business judgment rule and this Court should affirm the lower court's holding that the adoption of the Bylaw was equitable because it was supported by a rational business purpose.

STATEMENT OF FACTS

I. The Parties

Pinpoint is a Delaware corporation with its corporate headquarters and manufacturing operations in Houston, Texas. (R. 4) Its shares are traded on the New York Stock Exchange and its current market capitalization is approximately \$4 billion. (R. 4) Pinpoint is

in the business of manufacturing highly engineered precision roller and ball bearings for aerospace applications. Its principal customers are the U.S. military and commercial aircraft manufacturers. (R. 4)

The defendants consist of the seven directors on Pinpoint's Board. (R. 5) Three of these directors are executive officers and four are outside directors. (R. 5) The inside directors are: Michael Sanchez, Chief Executive Officer; Clare Mitchell, President; and Brendan Ellsworth, Chief Financial Officer. The outside directors are: Timothy Fletcher, Marsha Franklin, Daphne Keyes and Eric Lam (R. 5).

Plaintiff Miller is a Pinpoint shareholder and former employee owning 5,000 shares of Pinpoint common stock. (R. 3) Plaintiffs Webb, Patrick and Kohn are Pinpoint shareholders owning 200 or less shares of Pinpoint common stock. (R. 3)

II. Pinpoint Board Adopts the Exclusive Forum Bylaw.

On June 10, 2010 the Board adopted the Bylaw pursuant to its powers in the Articles of Incorporation, which designates the Court of Chancery as the exclusive forum for derivative actions and claims of breach of fiduciary duty brought on behalf of Pinpoint or its shareholders against the directors. (R. 2)

III. OIG Gives Notice of Investigation and Pinpoint Independent Special Committee Investigates The Matter.

In September 2010, the OIG gave notice of investigation to Pinpoint after it had been advised by a Pinpoint engineer that required performance and safety stress tests had been omitted by three mid-level managers. (R. 5) Pinpoint's government contracts require

Pinpoint to conduct certain performance and safety stress tests before shipment.

Two days following the OIG's notice of investigation, CEO Sanchez called an emergency meeting of the Board. The Board appointed independent directors Keyes and Lam to a special investigation committee to investigate the matter and make recommendations under the counsel of the Houston law firm of Venner and Lee LLP. (R. 6) The special investigation committee found cost-cutting steps had been taken on a number of government contracts from early 2009 through October 2010. (R. 6)

IV. Pinpoint and OIG Enter Into a Settlement.

The Board approved a settlement between Pinpoint and OIG. Under the terms of the settlement, Pinpoint entered into a consent decree acknowledging five violations of the False Claims Act, agreed to a payment of \$500 million in fines and penalties and committed to a prompt firing of the three employees who had executed the scheme. (R. 6) Pinpoint retained its status as an eligible contractor with the U.S. military and was not criminally indicted in the matter. (R. 7) On the day of the settlement, Pinpoint issued a press release disclosing the OIG investigation and the terms of the settlement.

ARGUMENT

I. **PINPOINT'S EXCLUSIVE FORUM BYLAW IS VALID UNDER DELAWARE LAW AND THEREFORE BINDING ON PINPOINT AND ITS SHAREHOLDERS.**

A. Question Presented

Is an exclusive forum bylaw, adopted by the Board of Directors of a corporation without a vote of the corporation's shareholders valid under Delaware law, and thus binding on any and all shareholders?

B. Standard of Review

The assessment of a corporate bylaw is reviewed de novo. *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 926 (Del. 1990); *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 231 (Del. 2008). The Supreme Court of Delaware may only overturn the Court of Chancery's finding that the Bylaw is valid if the Court of Chancery misapplied the law of the State. *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1142 (Del. 1990).

C. Merits of the Argument

1. Pinpoint's Board of Directors had the authority to unilaterally adopt the Exclusive Forum Bylaw.

Corporate bylaws are presumed valid unless they contravene the law. *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985); see also *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1079-80 (Del. Ch. 2004). Delaware General Corporation Law ("DGCL") Section 109(a) outlines the rules for adopting, amending and repealing corporate bylaws. DEL. CODE ANN. tit. 8, § 109 (2010). Under Section 109 the Board of Directors of a corporation holds the power to adopt and amend bylaws without a vote of the shareholders if such authority is bestowed upon the directors in the corporation's certificate of

incorporation. *Id.* Pinpoint's Certificate of Incorporation confers such authority upon its directors, stating that the bylaws may be "made, altered, amended or repealed by vote of a majority of the directors." (R. 14, n.31) Therefore, the Board did not contravene the law when exercising its right to amend Pinpoint's bylaws to include the exclusive forum provision.

Delaware bylaws are regarded as contracts between the shareholders and directors of a corporation, but unlike contracts, bylaws can be unilaterally amended. *See Salaman v. Nat'l Media Corp.*, No. 92C-01-161, 1992 WL 808095, at * 6 (Del. Super. Ct. Oct. 8, 1992). Corporate governing principles dictate that "although the by-laws are a contract between the corporation and its stockholders, the contract [is] subject to the board's power to amend the by-laws unilaterally." *Kidsco, Inc. v. Dinsmore*, 674 A.2d 483, 492 (Del. Ch. 1995) (internal citations omitted). Pinpoint's Articles of Incorporation explicitly authorize the power to adopt or amend bylaws solely by a vote of the directors. (R. 14, n.31) "[W]here a corporation's by-laws put all on notice that the by-laws may be amended at any time, no vested rights can arise that contractually prohibit an amendment." *Kidsco*, 674 A.2d at 492. This means that shareholders have no right to expect the continuation of an existing bylaw, nor the right to contest a lawful bylaw amendment passed by the directors. *Id.* at 492, n.6. Plaintiff consented to Pinpoint's charter when he became a shareholder of the corporation. He was, therefore, on notice of and is bound by the bylaws and retains no right to impede the directors from amending them.

Recently, a federal district court in the Northern District of California held that contract principles apply to exclusive forum provisions and so a board of directors could not unilaterally adopt an exclusive forum bylaw because contracts cannot be unilaterally amended. *Galaviz v. Berg*, Nos. 10-3392, 10-4233, 2011 WL 135215, at *4 (N.D.Cal. Jan. 3, 2011). While potentially persuasive, *Galaviz* is not binding because plaintiff argues that the Bylaw is void as a matter of Delaware, not federal, law. (R. 9) More importantly, it does not represent the outlook of the courts of Delaware. The Court of Chancery's opinion in this very case rejects *Galaviz*, and the law of the State supports the court's decision. (R. 15) In *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 928 (Del. 1990) (emphasis added), this Court stated that "the general rules of contract *interpretation*" apply to bylaws. As a result, contract principles are applied by Delaware courts only when the meaning of a bylaw is in question, but DGCL and Delaware common law apply when the validity of a bylaw is at issue. The principles of contract law are consequently inapplicable in this case because the Court is being asked to determine the validity of the Bylaw, not interpret its meaning and intent. The Board retains the power to adopt the Bylaw under Pinpoint's Articles of Incorporation. The validity of the Bylaw is governed by DGCL and Delaware common law, which are discussed in the following section.

2. Plaintiff fails to overcome the presumption of the Exclusive Forum Bylaw's validity.

The United States Supreme Court declared that exclusive forum provisions are presumptively valid "absent a strong showing that [they] should be set aside." *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972). An influencing factor in the Court's decision was that exclusive forum provisions accord with "ancient concepts of freedom of contract." *Id.* at 11. The Court rearticulated its position on exclusive forum provisions in *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991), holding that they are enforceable even in non-negotiable form contracts. The Court explained that the test for validity of an exclusive forum provision is thus not whether it was freely negotiated, but whether it is reasonable. *Id.* at 595.

Delaware recognizes the use of exclusive forum provisions in both contracts and in organizational charters. See *Meli v. Rembrandt IP Mgmt., LLC*, No. 09C-09-108, 2010 WL 2681853, at *2 (Del. Super. June 28, 2010). The Court of Chancery explicitly recognized the authority of corporations to act in the exact manner as defendants in this litigation have done. In *Revlon, Inc., S'holder Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010), the court professed that "corporations are free to . . . [select] an exclusive forum" for disputes that arise between the shareholders and the board. In addition to *Revlon*, this Court upheld an exclusive forum provision in a Limited Liability Company agreement, which restricted resolution to arbitration. *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999). *Revlon* and *Elf Atochem* illustrate Delaware's positive view of exclusive forum provisions for corporate charters and, generally, the State's outlook

that businesses be allowed the freedom to organize how they choose. "The DGCL is intentionally designed to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation." *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004). Because courts will not interfere with private parties' agreements absent a persuasive reason, exclusive forum provisions are presumed valid. The burden then falls on plaintiff to overcome this presumption by proving the unreasonableness of the clause.

The burden of proving that a exclusive forum provision is unreasonable is on the party "seeking to escape" the designated forum. *Bremen*, 407 U.S. at 18. The moving party must show that the forum is "so gravely difficult and inconvenient that [the moving party] will for all practical purposes be deprived of his day in court." *Id.* The presumption of validity is a high burden to overcome and "[m]ere inconvenience" is not sufficient. *Eisenmann Corp. v. Gen. Motors Corp.*, No. 99C-07-260, 2000 WL 140781, at *7 (Del. Super. Ct. Jan. 28, 2000). Plaintiff fails to satisfy this very high burden especially considering he voluntarily joined this litigation but now complains of hardship. He has presented no evidence that litigating in Delaware would severely inconvenience him or impair his rights to such a degree that the Bylaw should be voided. He may favor the Texas Federal Court but personal preference is utterly insufficient to rebut the presumption of the Bylaw's validity.

Exclusive forum provisions are only set aside when there was an inequity in the dealings of the parties or it would be unjust for the

court to force the parties to litigate in the specified forum. For example, in *Aveta, Inc. v. Colón*, 942 A.2d 603 (Del. Ch. 2008), a Puerto Rican doctor, who spoke little English, was sued for breaching a contract that specified Delaware as the exclusive forum for litigation. The contract at issue was written and breached in Puerto Rico as well as based on Puerto Rican law. The Court of Chancery voided the provision because they found that litigating the case in Delaware would create an overwhelming hardship for the defendant legally and personally. The court's decision was based on their findings that; it would be illogical for a Delaware court to apply Puerto Rico law; the majority of the evidence was in Puerto Rico, while none was in Delaware; and litigating in Delaware would pose significant difficulties for the defendant such as the language barrier and the traveling expenses. None of the probative factors in *Aveta* are present here; the Court of Chancery would not have to apply the law of a foreign jurisdiction and there is no language or financial barrier standing in plaintiff's way.

The Board's selection of Delaware as the sole forum for litigation is not only reasonable in regards to plaintiff's convenience, but it is also a reasonable selection for the corporation. Pinpoint is incorporated in Delaware and this dispute is governed by Delaware law. Plaintiff was plainly aware of these facts when he became a shareholder of Pinpoint, so he cannot now argue that Delaware is a "remote alien forum," that would deprive him of any substantial litigation right. *Bremen*, 407 U.S. at 17. Delaware is also the more appropriate forum for fiduciary litigation. In *Bremen*,

the Court found the defendant's forum selection reasonable because of its known capability in resolving the subject matter of the litigation. 407 U.S. at 17. Plaintiff's claim is based on Delaware law, making the Court of Chancery the most appropriate and capable court to resolve the matter.

The Board's selection of Delaware does not deprive plaintiff and the other shareholders of their day in court, it merely specifies in which court that day will occur. Litigating in the Court of Chancery does not prohibit plaintiff from bringing any of his desired claims and the court affords the same opportunity for recovery than his desired federal jurisdiction in Texas. Moreover, as in *Carnival*, the Board's adoption of the Bylaw was not intended to prevent the shareholders from filing suit. 499 U.S. at 595. The Board's position is not that its shareholders cannot or should not bring suit, but that any derivative or fiduciary action be litigated in a single, central jurisdiction. By failing to prove the unreasonableness of the Bylaw, plaintiff fails to overcome the Bylaw's presumed validity.

3. Pinpoint's Exclusive Forum Bylaw is binding on plaintiff and all other shareholders.

In compliance with the Bylaw, the Court of Chancery of the State of Delaware is the proper jurisdiction for this litigation. Plaintiff argues that because he filed the Federal Action prior to the filing of the Original Delaware Actions and the Miller Delaware Action, (R 7, 8), the Southern District of Texas takes jurisdictional precedence under *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Engineering Co.*, 263 A.2d 281 (Del. 1970). However, *McWane* is inapplicable if an

enforceable forum selection clause exists. See *Ingres Corp. v. CA, Inc.*, 8 A.3d 1143, 1145-46 (Del. 2010); *In re IBP, Inc.*, No. A.18373, 2001 WL 406292, at *1 (Del. Ch. Apr. 18, 2001). In *Choice Hotels International, Inc. v. Columbus-Hunt Park DR. BNK Investors, L.L.C.*, No. 4353, 2009 WL 3335332, at *4 (Del. Ch. Oct. 15 2009), the court stated that a *McWane* analysis is still necessary when a forum selection clause merely binds the parties to consent to a specific jurisdiction but does not name the jurisdiction as the exclusive forum for litigation. Because the Bylaw expressly specifies the Court of Chancery as the exclusive forum for litigation, the Bylaw is automatically binding on the directors and shareholders. (R 2, n. 4) The Court of Chancery is, therefore, the proper court of jurisdiction for this litigation and all other derivative or fiduciary litigation between Pinpoint and its directors and shareholders.

II. THE COURT SHOULD AFFIRM THE COURT OF CHANCERY'S HOLDING THAT THE BOARD'S ADOPTION OF THE EXCLUSIVE FORUM BYLAW WAS EQUITABLE BECAUSE THE BOARD'S DECISION IS SUBJECT TO THE BUSINESS JUDGMENT RULE RATHER THAN THE ENTIRE FAIRNESS STANDARD OR UNOCAL AND UNITRIN STANDARD.

A. Question Presented

Whether the Board's decision to adopt the Bylaw in accordance with the Articles of Incorporation should be subject to the presumption of the business judgment rule rather than the entire fairness standard or the *Unocal* and *Unitrin* enhanced level of judicial scrutiny.

B. Standard of Review

Determination of the level of judicial scrutiny applicable to defendants' conduct involves questions of law that are subject to de novo review by this Court. The trial court's holding involved mixed questions of law and fact. The Court reviews the entire record to test the trial court's findings and will review the factual findings to determine if they are sufficiently supported by the record and are the product of an orderly and logical deductive process. *Nixon v. Blackwell*, 626 A.2d 1366,1375 (Del. 1993).

C. Merits of Argument

When shareholders challenge director-approved transactions on the grounds that the directors breached an equitable duty, the board's decision is subject to one of three standards of judicial scrutiny: the business judgment rule, the *Unocal* and *Unitrin* standard of enhanced judicial scrutiny, or the entire fairness standard. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1371 (Del. 1994). Under

Delaware corporate law, directors' decisions are subject to the business judgment rule, which prevents the court from substituting its judgment for that of the board's as long as the decision can be attributed to any rational business purpose. *Brehm v. Eisner*, 906 A.2d 27,52 (Del. 2006). "The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors." *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). A board's decision is presumptively subject to the business judgment rule unless the plaintiff can prove the decision should be scrutinized under the entire fairness standard or the *Unocal* and *Unitrin* standard of enhanced judicial scrutiny. *Cede & Co. v. Technicolor*, 634 A.2d 345, 360 (Del. 1993). Plaintiff argues the business judgment rule is not applicable and advocates for the entire fairness standard or the *Unocal* and *Unitrin* standard. However, as discussed in the following sections, plaintiff has not successfully shown that the two heightened standards of scrutiny are applicable. Therefore, the Board's decision to adopt the Bylaw should be subject to the business judgment rule.

1. The Court Should Affirm The Court Of Chancery's Refusal To Apply the Entire Fairness Standard To The Board's Decision Because the Board Complied With Its Duties of Loyalty and Due Care.

The Court reviews a board's decision under the entire fairness standard if the plaintiff rebuts the presumption of the business judgment rule by proving the board breached its duty of loyalty or due care. Under the entire fairness standard, the defendant must prove the challenged decision did not constitute fair dealing. *Weinberger*

v. *UOP*, 457 A.2d 701, 711 (Del. 1983). A court applying the entire fairness standard looks at a variety of factors including: the timing of the business decision; how it was initiated, structured and negotiated; and how the approval of the directors and stockholders was obtained. *Id.* In the instant case, since plaintiff failed to prove the Board breached either fiduciary duty, the presumption of the business judgment rule has not been rebutted and the entire fairness standard is inappropriate.

- a. The Board did not breach its duty of loyalty by adopting the Exclusive Forum Bylaw.

All corporate directors are bound to a duty of loyalty requiring them to carry out their responsibilities independently and out of interest for the corporation rather than in self-interest. *Emerald Partners v. Berlin*, 787 A.2d 85,90 (Del.2001).

This Court has consistently cited two classic examples of director self-interest. In the first example, a director appears on both sides of a transaction. In the second example, a director receives a personal benefit from a transaction not received by shareholders. *Cede & Co. v. Technicolor*, 634 A.2d 345,362 (Del. 1993). However, self-interest alone does not constitute a breach of fiduciary duty. *Id.* at 363. The plaintiff shareholder must also prove the board's self-interest was material to its decision in order to adequately prove disloyalty. *Id.* In order to qualify as material to its decision the personal benefit "must be so significant that it is improbable that the director could perform her fiduciary duties ... without being influenced by her overriding personal interest." *Pfeffer v. Redstone*, 965 A.2d 676, 690 (Del.2009).

The Board's conduct did not reach the level of self-interest required to amount to a breach of the duty of loyalty. Plaintiff failed to present evidence that the Board appeared on both sides of the transaction or that the directors received a personal benefit from adopting the Bylaw. Furthermore, the Board's conduct does not reach the level of materiality required by *Pfeffer*. *Id.* This Court's decisions in *Weinberger* and *Nixon* are illustrative of director conduct that constitutes a breach of duty of loyalty.

In *Weinberger*, this Court applied the entire fairness standard. This Court found the UOP board had breached its duty of loyalty in connection with its decision to merge with its majority shareholder since there were common directors serving on the boards of the two corporations, who had acted out of self-interest in setting the terms of the merger. *Weinberger*, 457 A.2d at 710-11. In *Weinberger* the directors sat on both sides of the transaction and were therefore not independent due to their divided loyalties. *Id.*

In *Nixon*, this Court found the directors had breached their duty of loyalty by adopting stock ownership and life insurance plans that benefitted the directors but not certain minority shareholders. *Nixon v. Blackwell*, 626 A.2d 1366,1375 (Del. 1993). *Nixon* is an example where members of the board received personal financial benefits as a result of their self-interested decision, which other shareholders did not serve to benefit from.

The Board's conduct in no way rises to the level of self-interest exemplified in *Weinberger* or *Nixon*. The Bylaw does not provide the directors with a financial interest analogous to the interests

involved in the cited cases. The Board did not personally gain from the decision to litigate all claims in Delaware. The Bylaw is only procedural, so in no way limits the substantive relief options available to a shareholder plaintiff. The directors are still subject to an injunction or monetary damages if found liable by the Delaware courts in a particular suit. As indicated by the Court of Chancery, "the only 'interest' in having such claims exclusively litigated in Delaware is one of convenience, efficiency and relative predictability." (R. 17) In fact, both shareholders and directors are beneficiaries of the Bylaw. As a result of the Bylaw, shareholder plaintiffs are notified of where to file and litigate claims, can predict the success of their claims by applying Delaware precedent, and can lower litigation costs.

Moreover, the Board did not adopt the Bylaw as a shield to litigation because it was enacted on June 10, 2010, which preceded the OIG investigation, the settlement between Pinpoint and OIG, and most importantly, the plaintiff's first filing in Texas, which occurred on December 1, 2010. (R. 5-R. 7) The Bylaw is a general forum selection clause and is not a response to any specific litigation or enacted to protect any alleged board self-interest.

The decision to adopt the Bylaw is therefore entirely based on the corporate merits of the Bylaw rather than any personal or extraneous influences. *Cede & Co.*, 634 A.2d at 345. The Board effectively complied with its duty of loyalty.

- b. The Board did not breach its duty of care in adopting the Bylaw because the Board complied with its duty by utilizing outside counsel.

In addition to its duty of loyalty, the Board complied with its duty of care by acting in an informed and deliberate manner when adopting the Bylaw. *Van Gorkom*, 488 A.2d at 858. The duty of care mandates directors to "consider all material information reasonably available." *Brehm*, 746 A.2d at 259. The presumption of the business judgment rule will only be overcome if the process is proven to be grossly negligent. *See id.* Plaintiff has not sufficiently overcome this presumption.

The decision to adopt the Bylaw constituted an informed business judgment. In *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 494 (Del. Ch. 1995), the Court of Chancery addressed analogous procedures employed by another board and found the directors had complied with their duty of care. In *Kidsco*, the board adopted a bylaw as a defensive measure at a fifteen-minute meeting under the advisement of outside counsel. The court held the fact that discussion of the bylaw was brief did not establish the gross negligence of the directors. The degree of information required to adopt a bylaw does not equal the degree of information required to make business decisions regarding other matters such as whether to accept an offer for merger. *See id.* In the context of a bylaw amendment, no extensive analysis is necessary and the board only needs "information sufficient to . . . understand the change . . ." *Kidsco*, 674 A.2d at 494.

As in *Kidsco*, the Board complied with its duty of care by hiring outside disinterested counsel for the purpose of obtaining legal advice regarding the Bylaw amendment. (R. 17) At the meeting on June 10, 2010, the board, under the advisement of Jackson and Sheehan LLP,

an independent law firm, considered various factors prior to adopting the Bylaw. (R.17) The existence of these procedures and deliberations illustrate that the directors made deliberate attempts to be adequately informed about the consequences of the Bylaw prior to its adoption.

The presumption of the business judgment rule attaches to director approved transactions unless the plaintiff overcomes the burden of proving the board breached its fiduciary duty of loyalty or duty of care. Plaintiff failed to prove the Board breached its duty of loyalty because there is no evidence suggesting the Board's conduct rose to the level of self-interest that normally amounts to a breach of duty of loyalty. On the contrary, the board adopted the Bylaw in light of corporate interests including convenience, efficiency and predictability. Additionally, plaintiff has not proven the Board breached its duty of care because there is no evidence suggesting the Board failed to act in an informed and deliberate manner. The Board adopted the Bylaw on the basis of advice from outside counsel in compliance with the requisite duty of care for adoption of a bylaw amendment. Since the Board upheld its duty of care and its duty of loyalty, the entire fairness standard is inapplicable.

2. The Court Should Affirm The Court of Chancery's Rejection Of The *Unocal* and *Unitrin* Standard of Reasonableness and Proportionality Because The Challenged Decision Does Not Involve Adoption Of Defensive Measures In Response To A Perceived Threat To Corporate Policy Or A Limitation Of The Shareholder Franchise.

Plaintiff's argument that the Board's decision should be subject to the enhanced judicial scrutiny of *Unocal* and *Unitrin* lacks merit. See *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361,1375-76 (Del.

1995); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955-56 (Del. 1985). Under the *Unocal* standard, the Court must determine whether the board's decision was reasonable and proportional to the threat posed. *Id.* A threat, in the corporate context, is a danger to corporate policy and effectiveness that touches upon issues of control such as a hostile takeover, merger, or proxy contest. *Stroud v. Grace*, 606 A.2d 74, 82 (Del. 1992). However, the standard is only applicable in the specific context of a board implementing defensive measures in response to a perceived threat to corporate policy and effectiveness. *Unitrin*, 651 A.2d at 1372. Additionally, the standard only applies if the board's decision disenfranchises the shareholders. *Id.* at 1378-79. Since the nature of the Board's decision to adopt the Bylaw does not fall within either context, application of the *Unocal* standard is not warranted.

- a. The *Unocal* and *Unitrin* standard is not applicable because the adoption of the Bylaw was not a defensive measure made in response to a perceived corporate threat.

The enhanced judicial scrutiny adopted by this Court in *Unocal* and *Unitrin* applies exclusively to a board's approval of defensive measures made in response to a perceived threat to corporate policy and effectiveness. *Stroud*, 606 A.2d at 82; *Paramount Commc'n, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 (Del. 1989). The corporation need not be under immediate "attack" but the directors must have a reasonable belief that such a danger exists. *Stroud*, 606 A.2d at 82. The *Unocal* framework was adopted by this Court in order to address the unique fiduciary issues posed by a board's approval of defensive measures. Enhanced scrutiny is warranted because the approval of defensive

measures is often motivated by directors' interests rather than the interests of the corporation or the shareholders. Directors act with self-interest because they are concerned about maintaining their positions on the board if there is in fact a change in corporate control. *Unocal*, 493 A.2d at 954-55. Examples of measures that warrant the *Unocal* standard include approval of a self-tender offer, shareholder rights plan, or advance notice bylaw when there is a threat to corporate control. See *Unitrin*, 651 A.2d at 1370.

The Bylaw was not defensive and was not adopted in response to a perceived hostile threat to corporate control. In order to be defensive, the board needs to be aware of a known threat to which a defense is required. There are no facts in the record to support a claim by plaintiff that the Board enacted the Bylaw in response to a known threat. To the contrary, the conduct of the Board is considerably similar to the conduct of the Milliken Enterprises board in *Stroud*. In *Stroud*, the directors implemented charter and bylaw amendments that established certain procedures for electing directors. See *Stroud*, 606 A.2d at 78. When analyzing the validity of the *Stroud* directors' actions, this Court applied the business judgment rule rather than the *Unocal* standard because there was "no danger to corporate policy and effectiveness." *Id.* at 83. Similarly, in the instant case, the Board acted within the power granted to it to enact the Bylaw, which was not a defensive maneuver aimed to protect against a threat to corporate policy.

In addition, no Delaware court has applied the *Unocal* standard in the absence of a danger to corporate policy and effectiveness.

Stroud, 606 A.2d at 83. Therefore, the lack of a perceived threat to Pinpoint's corporate policy and effectiveness in conjunction with the Board's power under the certificate of incorporation to unilaterally amend bylaws warrants an application of the business judgment rule rather than the *Unocal* and *Unitrin* enhanced level of scrutiny.

- b. The *Unocal* and *Unitrin* standard is not applicable because the adoption of the Bylaw does not obstruct the shareholders' ability to exercise their voting rights.

The Bylaw does not disenfranchise the shareholders or place any limitations on the shareholders' voting rights. Under Delaware law, when directors take action for the purpose of limiting the shareholder vote, the transaction is inequitable and will be set aside. *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1122 (Del.Ch 1990). Where the transaction constitutes a defensive measure that disenfranchises the shareholders or limits the shareholder franchise, the decision will be not be entitled to the presumption of the business judgment rule and will be evaluated under *Unocal*. *Kidsco v. Dinsmore*, 674 A.2d 483,495 (Del. Ch. 1995). Whether the Board's decision has impeded the shareholder franchise is contextual and depends on particularized facts. *Stahl*, 579 A.2d at 1122.

The *Unocal* standard is inapplicable because Pinpoint's shareholders retain their voting rights under DEL. CODE ANN. tit. 8, § 212 (2010), which provides for the effective exercise of the corporate franchise. The shareholders also retain the ability to sue the corporation and its directors in a court of law for any relevant cause of action. Despite the fact that shareholders can only bring a lawsuit in Delaware, this procedural check does not burden or limit

the shareholder franchise. Additionally, the shareholders continue to have the power to attend shareholder meetings, effectively utilize proxies, and vote in director elections in accordance with the bylaws and Delaware corporate law. See *Stahl*, 579 A.2d at 1123.

Furthermore, the Bylaw is distinguishable from the challenged bylaw amendment in *Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437,439 (1971). In *Schnell*, the board amended its bylaws in order to advance the date of the annual stockholders meeting for the purpose of impeding a proxy fight. *Id.* This Court held the adoption of the bylaw was inequitable because it "obstruct[ed] the legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management." *Id.* Whereas the bylaw in *Schnell* directly handicapped the stockholders' ability to meet and initiate a proxy contest, the Pinpoint bylaw has no similar effect. The Board did not adopt the Bylaw in an attempt to subvert shareholder rights like the defendant in *Schnell*.

The Court should affirm the lower court's finding that the Bylaw was equitable on the grounds that the business judgment rule is applicable and there was a rational business purpose supporting the Pinpoint Board's decision. In the absence of a showing of fraud, bad faith, or self-dealing, the presumption of the business judgment rule attaches to a director approved transaction. *Brehm*, 906 A.2d at 52. The Court, therefore, may "not substitute its judgment for that of the board if the decision can be attributed to any rational business purpose." *Unitrin*, 651 A.2d at 1373.

The decision to confine fiduciary litigation to the Court of Chancery was motivated by numerous rational business purposes including efficiency, convenience, the avoidance of litigating in multiple venues, and greater predictability of the outcome of litigation. It cannot be contended that these motivations were irrational. (R. 19) The application of the business judgment rule and the existence of a rational business purpose warrant a finding that the Board's adoption of the Bylaw was equitable.

Conclusion

For the foregoing reasons, Defendants ask this Court to affirm the Court of Chancery's holding that the Bylaw is valid and equitable under Delaware corporate law. Plaintiff's Delaware Motion to Stay should be denied and the Board's Motion to Enjoin should be granted.

Respectfully submitted,

/s/ Team F

Counsel For Appellees