
IN THE SUPREME COURT OF THE STATE OF DELAWARE

IN RE PINPOINT BEARINGS, INC.)
SHAREHOLDERS LITIGATION)

No. 17, 2011

EDWARD MILLER,)
)
 Plaintiff Below-)
 Appellant,)
)
 v.)

MICHAEL SNACHEZ, CLARE MITCHELL,)
BRENDAN ELLSWORTH, TIMOTHY)
FLETCHER, MARSHA FRANKLIN,)
DAPHNE KEYS AND ERIC LAM,)

Defendants Below-)
Appellees,)

and)

PINPOINT BEARINGS, INC.,)
)
 Nominal Defendant Below-)
 Appellee.)

Court Below:
Court of Chancery of the
State of Delaware in and
for New Castle County
Civil Action No. 4958-VCM

APPELLEES' OPENING BRIEF

TEAM **T**
ATTORNEYS FOR APPELLEES

FEBURARY 11, 2011

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NATURE OF THE PROCEEDINGS

This appeal arises after the Court of Chancery denied a shareholder derivative suit by Appellant ("Mr. Miller") and upheld the validity of an exclusive forum selection bylaw that was adopted by the Board of Directors (the "Board") of Pinpoint Bearings, Inc.

("Pinpoint"). In an opinion dated January 12, 2011, Chancellor McCloskey denied Mr. Miller's Motion to Stay the proceedings in Delaware and further emphasized that the exclusive forum selection bylaw is valid under Delaware law and binding on all shareholders.

In support for the validity of the exclusive forum selection bylaw, Chancellor McCloskey provided great deference to Pinpoint's Board because of 8 Del. C. § 109. Since Pinpoint's charter expressly confers power on Pinpoint's Board to "adopt, amend, or repeal bylaws," Chancellor McCloskey was clearly guided by the rule of law as provided by the legislature of the State of Delaware. Additionally, Chancellor McCloskey's opinion provides ample authority with regard to the business judgment rule and how it mandates that the Board's informed decision to adopt the bylaw be protected.

In an order dated January 14, 2011, Chancellor McCloskey granted Mr. Miller's application pursuant to Delaware Supreme Court Rule 42 to certify the Court of Chancery's opinion for interlocutory appeal. On January 18, 2011, this Court granted Mr. Miller's petition to accept an appeal from the Court of Chancery's interlocutory opinion.

SUMMARY OF THE ARGUMENT

This Court should affirm the Court of Chancery's ruling that the exclusive forum selection bylaw was validly adopted and not the product of fraud or overreaching. Pinpoint's charter expressly confers power on the Board to adopt, amend, or repeal bylaws. Furthermore, Pinpoint's bylaws also provide that they may be amended at any time by either the Board or the shareholders. Additionally, the exclusive forum selection bylaw is not unreasonable or overreaching because it serves to provide a convenient forum for all shareholder derivative actions. With the presence of more than 28,000 shareholders throughout each of the fifty states, it is well within the bounds of reason for Pinpoint to want to protect itself from inconsistent verdicts and the enormous cost associated with defending lawsuits brought in a multitude of unfamiliar forums.

This Court should also affirm the Court of Chancery's ruling that Pinpoint's Board did not breach any fiduciary duties when it decided to adopt and implement the forum selection bylaw. The decision to adopt the bylaw by Pinpoint's Board should be reviewed under the deferential business judgment rule because the rational business purpose of the bylaw is to promote convenience, efficiency, and predictability in derivative litigation. Lastly, The enhanced scrutiny that this Court applied in Unocal Corp. v. Mesa Petroleum Co. 493 A.2d 946 (Del. 1985) should not be applied to the facts of this case because the exclusive forum bylaw is not defensive and may in no way be considered to relate to an external struggle for corporate control.

STATEMENT OF FACTS

Pinpoint Bearings, Inc. ("Pinpoint"), a publicly traded corporation, is incorporated under the laws of Delaware and currently has more than 28,000 shareholders located throughout each of the fifty States. (R. 4, 13). With operations located in the State of Texas, Pinpoint manufactures precision roller and ball bearings for aerospace applications. (R. 4).

On June 10, 2010, under express authority of its charter and Article 14 of its current bylaws, Pinpoint's Board adopted a bylaw that provides for the Delaware Court of Chancery to be the sole and exclusive forum for any derivative action brought on behalf of Pinpoint or any breach of fiduciary duty claim brought against it.¹ (R. 2, 12, 14). In exercising due diligence, Pinpoint's Board sought the advice of outside legal counsel before deciding to adopt the forum selection bylaw.² (R. 17, n. 39). In properly analyzing the benefits to Pinpoint as a whole, the Board focused on the advantages of convenience, efficiency, and relative predictability if claims brought against the corporation were dealt with solely by the Delaware Court of Chancery. (R. 17). The Appellant ("Mr. Miller") does not dispute that Pinpoint's charter expressly confers such power on Pinpoint's Board. (R. 12).

¹ ARTICLE 14: Amendments: These bylaws may be made, altered, amended or repealed by vote of a majority of the directors in office or by vote of a majority of the stock outstanding and entitled to vote.

² See Affidavit of Director Defendant Daphne Keyes (summarizing legal advice provided to the Board by the Company's outside counsel, Jackson and Sheehan LLP of Houston, Texas, at a meeting of the Director Defendants on June 10, 2010 and listing the factors considered by the Board in adopting the Exclusive Forum Bylaw.)

Mr. Miller, who currently resides in Houston, Texas, is a former employee and current shareholder of Pinpoint. (R. 3,4). Mr. Miller purchased common stock in Pinpoint both before and after the Board's adoption of the exclusive forum selection bylaw. (R. 3, 4). Mr. Miller first brought suit in the United States District Court for the Southern District of Texas, in which he asserted a derivative claim against Pinpoint's seven Directors alleging that they breached their fiduciary duty of oversight. This alleged breach by Pinpoint is claimed to have occurred when Pinpoint entered into a settlement agreement with the United States Government. This settlement was the end result after a special investigation committee (formed by Pinpoint's Board) found a pattern of improper cost-cutting steps that were taken on certain contracts with the United States Government. (R. 5, 6). Acting on the advice of outside legal counsel, representatives of Pinpoint negotiated a settlement with the Office of Inspector General in the amount of \$500,000,000. (R. 1, 6).

Mr. Miller also filed a complaint in the Court of Chancery on December 15, 2010. (R. 1, 8). Mr. Miller's claims that the bylaw was invalidly adopted and that the bylaw should be held unenforceable under equity principles because the Director's decision to adopt the bylaw will not be able to meet a heightened scrutiny analysis. (R. 11). Pinpoint asserts that the bylaw was validly adopted and heightened judicial review is unwarranted. (R. 11)

QUESTIONS PRESENTED

- I. WHETHER THE EXCLUSIVE FORUM SELECTION BYLAW ADOPTED BY PINPOINT'S BOARD OF DIRECTORS, IS INVALID AS A MATTER OF DELAWARE LAW WHEN THE BYLAW IS NOT THE PRODUCT OF FRAUD OR OVERREACHING AND IS IN FULL COMPLIANCE WITH 8 DEL. C. §109 AND 8 DEL. C. §102 BECAUSE PINPOINT'S CHARTER EXPRESSLY CONFERS POWER ON THE BOARD TO ADOPT, AMEND, OR REPEAL BYLAWS THAT ARE NOT INCONSISTENT WITH THE LAW.

- II. WHETHER PINPOINT'S BOARD OF DIRECTORS, IN ADOPTING AND IMPLEMENTING THE EXCLUSIVE FORUM SELECTION BYLAW, SHOULD BE AFFORDED THE PROTECTION OF THE BUSINESS JUDGMENT RULE WHEN THE DIRECTORS CAREFULLY EXERCISED THEIR FIDUCIARY DUTIES OF CARE AND LOYALTY.

ARGUMENT

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WHETHER THE EXCLUSIVE FORUM SELECTION BYLAW ADOPTED BY PINPOINT'S BOARD OF DIRECTORS, IS INVALID AS A MATTER OF DELAWARE LAW WHEN THE BYLAW IS NOT THE PRODUCT OF FRAUD OR OVERREACHING AND IS IN FULL COMPLIANCE WITH 8 DEL. C. §109 AND 8 DEL. C. §102 BECAUSE PINPOINT'S CHARTER EXPRESSLY CONFERS POWER ON THE BOARD TO ADOPT, AMEND, OR REPEAL BYLAWS THAT ARE NOT INCONSISTENT WITH THE LAW.

SCOPE OF REVIEW

In determining the validity of an amended bylaw, this Court in Oberly v. Kirby, 592 A.2d 445, 457 (Del. 1991), explained that, "Because the certificate of incorporation is a document in the nature of a contract, its construction raises questions that are subject to *de novo* review by this Court." When applying *de novo* review, "The trial court's legal rulings will be affirmed unless there was an error in formulating or applying legal principles." Brody v. Zaucha, 697 A.2d 749, 753 (Del. 1997). Furthermore, in its review of corporate bylaws, this Court emphasized that "bylaws of a corporation are presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws." Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985). Since this matter involves questions regarding the legality of a recently adopted bylaw by Pinpoint's Board, *de novo* review is the correct standard for this Court to apply.

MERTIS OF THE ARGUMENT

Mr. Miller does not dispute that Article 14 of Pinpoint's bylaws expressly provide the Board with authority to alter, amend, or repeal bylaws at any time by a vote of the majority of the directors in office. Furthermore, the exclusive forum bylaw is reasonable because

each shareholder who purchased shares after the adoption of the bylaw was put on "constructive notice" of the exclusive forum provision.³ Individuals that held shares prior to the Board's adoption of the bylaw also fail to have a claim because Delaware law generally permits bylaws to be amended at any time. Lastly, with regard to the exclusive forum selection provision, this Court should focus on the unique advantages that Delaware courts, along with Delaware corporations, can benefit from in the long run if these types of bylaws become a common practice. These advantages include greater consistency with regard to corporate governance law judgments and the possibility of greater shareholder returns because of the decrease in costly legal expenses that result from defending lawsuits filed in multiple forums. Although this matter is one of first impression in this Court, exclusive forum selection provisions are bound to appear out of corporate necessity because of the increased efficiency coupled with a duty to provide maximum return to shareholders.

A. This Court should affirm the Court of Chancery's decision holding that the bylaw binds all shareholders because it was lawfully adopted by Pinpoint's Board under express authority provided by its charter and 8 Del. C. §109.

As indicated by this Court, "bylaws of a corporation are presumed to be valid." Frantz Mfg. Co., 501 A.2d at 407. Additionally, "where a

³ See, e.g., Sara Lewis, Transforming the 'Anywhere but Chancery' Problem into the 'Nowhere but Chancery' Solution, 14 Stan. J.L. Bus. & Fin. 199, 212 (2008) ("Bylaw amendments require shareholder vote unless the corporation has provided in its charter that the board will also have the power to amend." Additionally, "a lack of actual-notice argument probably will be unsuccessful here as well. For the same reasons as above, shareholders would have had constructive notice of the provision, particularly if they actually received the proxy statement.")

corporation's bylaws put all on notice that the bylaws may be amended at any time, no vested rights can arise that would contractually prohibit an amendment." Kidsco Inc. v. Dinsmore, 674 A.2d 483,492 (Del. Ch. 1995). With regard to Delaware General Corporation Law, 8 Del. C. §109(a) provides that "any corporation may, in its certificate of incorporation, confer the power to adopt, amend, or repeal bylaws upon the directors." Furthermore, 8 Del. C. §102(b)(1) provides that the articles of incorporation may contain "Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders." This is precisely why shareholder derivative suits challenging the validity of properly enacted corporate bylaws seldom prevail.

In Stroud v. Grace, 606 A.2d 75, 75 (Del. 1992), a group of minority shareholders challenged the validity of a newly adopted bylaw, along with various charter amendments. This Court held that the shareholders did not "sustain" their burden of proving that the bylaw and charter amendments were not "properly adopted or that their adoption was the product of fraud, manipulation, or other inequitable conduct." Id. at 93. This Court further reasoned that, "Delaware corporations have broad authority to adopt charter provisions." Id. After considering the merits, this Court upheld the validity of the challenged bylaw because there was "no showing of abuse." Id. at 96.

Delaware law provides broad authority to directors with respect to implementing and amending bylaws. In Frantz Mfg. Co., this Court

provided key insight into statutory interpretation with respect to bylaw amendment procedures. 501 A.2d at 408. This Court was faced with a question concerning the reasonableness of certain bylaw amendments made by an acquiring corporation to protect its interests in the target corporation. Id. at 407. In holding in favor of the acquiring corporation, this Court explained that the "Board of Directors is given the statutory power to deal in its own stock along with the authority to make and amend bylaws and to manage the business of a corporation under the protection afforded by the business judgment rule." Id.

Deference must be given to the Directors of Pinpoint because they have the ultimate responsibility when it comes to the unique decision making process within its corporate structure. In CA Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 238 (Del. 2008), this Court explained that in reviewing a proposed bylaw, it would "start with the presumption that the bylaw is valid and, if possible, construe it in a manner consistent with the law." This Court further reasoned that, "The factual context in which the bylaw was challenged would inform our analysis, and we would exercise caution before invalidating corporate acts based upon hypothetical injuries." Id. In performing a thorough analysis of the ability of shareholders to amend a corporation's bylaws, this Court emphasized that the "DGCL empowers both the board of directors and the shareholders of a Delaware corporation to adopt, amend or repeal the corporation's bylaws." Id. at 231. However, this Court expressly limited the authority of shareholders by explaining that, "the shareholders' statutory power to adopt, amend or repeal

bylaws is not coextensive with the board's concurrent power and is limited by the board's management prerogatives." Id. at 232.

In Centaur Partners v. Nat'l Intergroup, Inc., 582 A.2d 923, 923 (Del. 1990), this Court was faced with interpreting a charter provision concerning the ability of shareholders to amend a corporation's bylaws. In applying the general rules of contract interpretation, this Court held that the charter at issue was "clear and unambiguous in requiring that 80% supermajority was required in amending bylaws." Id. This Court explained that, "Where a bylaw provision is in conflict with a provision of the charter, the bylaw provision is a nullity." Id. at 929. However, the charter and bylaw provisions at issue were "not unclear or ambiguous." Id. at 927. In the case at bar, Pinpoint's charter provides express authority on the Board to adopt, amend, or repeal any bylaw. Therefore, as with the bylaw in Centaur Partners, Article 14 of Pinpoint's bylaws is clear and not in direct conflict with any provision of its charter.

In Kidsco Inc., the Court of Chancery held that the "board of directors did not breach shareholders' contract rights in bylaws by amending the bylaws." 674 A.2d at 483. In denying the shareholders' claim that the bylaws were invalidly amended, the court stated that "8 Del. C. § 109(a) provides that the power to adopt, amend or repeal bylaws shall be in the shareholders entitled to vote, *except* that the certificate of incorporation may also confer that power upon the directors." Id. at 492. Since the articles of incorporation contained such a provision, the court reasoned that, "although the bylaws are a contract between the corporation and its stockholders, the contract was

subject to the board's power to amend the bylaws unilaterally." Id. Lastly, the court emphasized that the plaintiffs could "cite no authority that supports their vested rights claim." Id.

Mr. Miller will likely focus this Court's attention on Galaviz v. Berg, 2011 WL 135215 (N.D. Cal. 2011). In Berg, the court was presented with an issue concerning the ability of directors to unilaterally adopt a bylaw containing a forum selection provision. Id. The bylaw directed that the Chancery Court of Delaware would be the "sole proper venue for derivative actions against it." Id. Although the court disfavored the adopted bylaw containing the forum selection provision, there seems to be a question regarding the fact that the court neglected to apply relevant Delaware General Corporation Law provisions. The court seemed to avoid discussing the application of 8 Del. C. § 109 and 8 Del. C. § 102. Furthermore, this decision is not binding on this Court.

The order of the Court of Chancery should be affirmed because Pinpoint has lawfully followed the express guidelines provided by this Court and the laws of Delaware under 8 Del. C. § 109. Furthermore, Mr. Miller will also not be able to overcome the presumption of validity of the bylaw because Article 14 of Pinpoint's bylaws expressly provide that the Board or the shareholders may amend them at any time.

With regard to a potential argument concerning Mr. Miller's vested right in the status-quo prior to the June 10, 2010 adoption of the bylaw, this argument will fail because of this Court's jurisprudence in Frantz Mfg. Co., which provides great deference to the directors to make or amend bylaws. 501 A.2d at 408. Lastly, the Court of Chancery has also been clear in explaining that the contractual rights between

shareholders and directors are subject to change at any time if expressly provided for in advance. Kidsco, Inc., 674 A.2d at 492.

B. This Court should affirm the Court of Chancery's decision upholding the validity of the exclusive forum provision contained in Pinpoint's bylaw because it is reasonable and not the product of fraud or overreaching.

Under Delaware law, "Forum selection clauses are 'presumptively valid' and should be 'specifically' enforced unless the resisting party clearly shows that enforcement would be unreasonable and unjust, or that the clause is invalid for such reasons as fraud and overreaching." Ingres Corp. v. CA, Inc., 8 A.3d 1143, 1146 (Del. 2010). With regard to a forum selection provision, "Such an agreement is unreasonable only when its enforcement would, under the circumstances then existing, seriously impair the plaintiff's ability to pursue his cause of action." Elia Corp. v. Paul B. Howard, Co. 391 A.2d 214, 216 (Del. 1978). However, "Mere inconvenience or additional expense is not the test of unreasonableness." Id. Furthermore, as indicated by this Court in Ingres Corp., "Courts should assess the reasonableness of a forum selection clause on a case-by-case basis." 8 A.3d at 1146.

Although the issue of reasonableness of an exclusive forum selection clause is one of first impression, a recent decision from this Court indicates that such a provision will likely be enforced in the context of a limited liability company. In Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 286 (Del. 1990), this Court held that "contractual provisions directing that all disputes be resolved exclusively by arbitration or court proceedings in California were valid." In Elf Atochem, this Court was presented with an LLC agreement that contained an arbitration clause that governed all disputes. Id. at

289. The arbitration clause clearly contained a reasonable forum selection provision within the four-corners of the document and was therefore held to be enforceable. Id.

In Ingres Corp., this Court specifically enforced a contractual agreement that included an express forum selection clause between two software corporations. 8 A.3d at 1143. In upholding the validity of the contractual agreements that designated a specific forum for all disputes, this Court emphasized that, "So long as there is nothing unreasonable in such a provision, there is no basis for viewing it as an affront to the judicial power." Id. at 1146. This Court was especially direct in providing that, "Mere inconvenience or additional expense is not the test of unreasonableness" and in "light of present day commercial realities, a forum clause should control absent a strong showing that it should be set aside." Id.

The United States Supreme Court has also held that a corporation's forum selection provisions should be specifically enforced. In Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 585 (U.S. 1991), the Court held that a "forum selection clause in a cruise line's passage contract ticket, requiring litigation of all disputes in Florida, was reasonable and enforceable." This case involved a lawsuit by a passenger who was injured during a cruise ship tour. Id. at 588. The passenger brought suit in the State of Washington for his injuries. Id. However, Carnival moved for summary judgment because of the exclusive forum selection clause contained in the cruise ticket purchased by the passenger. Id. The Court explained that, "forum selection clauses, although not historically favored, are prima facie valid." Id. at 589 (quoting M/S

Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (U.S. 1972)). Although the forum selection provision was not "the product of negotiation," the Court was adamant that there was no evidence that Carnival "obtained the respondents accession to the forum clause by fraud or overreaching." Id. at 595. Lastly, in evaluating the reasonableness of the forum selection clause, the Court indicated that the cruise line has an interest in limiting "the fora in which it could potentially be subject to suit" because "it is not unlikely that a mishap on a cruise could subject the cruise line to litigation in several different fora." Id. at 593. Furthermore, a forum selection clause would also provide the unique advantage of relieving litigants "of any confusion about where suits arising from the contract must be brought or defended, sparing litigants the time and expense of pretrial motions to determine the correct forum and conserving judicial resources that would otherwise be devoted to deciding those motions." Id. at 594.

Courts have continuously become more favorable to the unique advantages of a forum selection clause. In M/S Bremen, the Court followed the widely-accepted view "that such clauses are prima-facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances." 407 U.S. at 10. The Court emphasized that a forum selection provision could possibly be "unreasonable" if "the chosen forum is seriously inconvenient for the trial of the action." Id. at 16. Although Mr. Miller will likely focus this Court's attention on the location where the harm occurred and the transportation expense associated with this forum, the United States Supreme Court in Carnival Cruise Lines, Inc.,

clearly explained that "in light of present-day commercial realities and expanding international trade, we conclude that the forum clause should control absent a *strong* showing that it should be set aside." 499 U.S. at 591.

Claims of inconvenience and overreaching on behalf of parties opposing forum selection provisions have only been successful in very limited circumstances. In Aveta, Inc. v. Colon, 942 A.2d 603,603 (Del. Ch. 2008), the court held that a "physician was entitled to stay under the doctrine of *forum non conveniens*, despite a valid forum selection clause." The physician was afforded great deference by the court because he could not speak English and practiced medicine solely in Puerto Rico. Id. at 615. Although the physician was required to prove "overwhelming hardship from being required to litigate in Delaware," the court explained that,

This is not a dispute implicating any aspect of the substantive law of Delaware. It is not a dispute where any of the relevant evidence or witnesses are located in Delaware. It is not a dispute between Fortune 500 companies incorporated in Delaware, and it is not a dispute between corporations at all. In fact, it is not even a dispute that can be explained by the primary actors in English.

Id. This is precisely why the court found that it was "the sort of rare case for which the doctrine of *forum non conveniens* exists." Id. at 616. In contrast to the case at bar, Pinpoint is in fact incorporated under the laws of Delaware and Mr. Miller is certainly able to freely travel to Delaware if the need does arise. Therefore, Mr. Miller will not be able to prove overwhelming hardship in order to avoid litigating in this Court.

Although deference is given to the forum in which the plaintiff first files, courts must also take into account the substantive law and issues contained in the complaint in order to fully address whether the chosen forum has sufficient contacts with the matter being contested. In McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co., 263 A.2d 281, 283 (Del. 1970), this Court held that "as a general rule, litigation should be confined to the forum in which it is first commenced, and a defendant should not be permitted to defeat the plaintiff's choice of forum in a pending suit by commencing litigation involving the same cause of action in another jurisdiction of its own choosing." This case involved a claim by an engineering corporation against an iron producing company that already brought suit in the State of Alabama. Id. at 282. This Court held that the engineering corporation failed to meet its burden of proving *forum non conveniens* because the contract at issue was "executed in Alabama and the law of Alabama governs." Id. at 283. Conversely, in the case at bar, the law of Delaware expressly governs all disputes.

In the matter before this Court, the reasoning behind Pinpoint's adoption of the bylaw concerns the fact that Pinpoint is very interested in protecting its shareholders and encouraging more certainty in judgments. Corporations and shareholders will both benefit from a Delaware forum selection clause because it is the focal point for all corporate law decisions. Furthermore, because Pinpoint shareholders reside in all 50 states, a stipulated forum will aid parties with respect to the correct forum to potentially file derivative claims. As the cases above indicate, this Court and the

United States Supreme Court have both favored forum selection provisions relatively similar to that in the case at bar on efficiency grounds.

Furthermore, although there are numerous contacts with the State of Texas in this action, the fact that Pinpoint is incorporated in Delaware and that Delaware General Corporation Law governs should weigh very heavy in favor of this Court's exercise of jurisdiction. This Court is certainly in a better position to hear claims of alleged overreaching and unfairness on the part of Pinpoint's Board. Courts routinely look to this Court's jurisprudence as a form of guiding light when it comes to intra-corporation disputes. On policy grounds, both plaintiffs and defendants are better served by a forum that specializes in corporate law. Overreaching can simply not be found where a corporation is solely looking after the interests of the company as a whole and its shareholders.

QUESTION PRESENTED

WHETHER PINPOINT'S BOARD OF DIRECTORS, IN ADOPTING AND IMPLEMENTING THE EXCLUSIVE FORUM SELECTION BYLAW, SHOULD BE AFFORDED THE PROTECTION OF THE BUSINESS JUDGMENT RULE WHEN THE DIRECTORS CAREFULLY EXERCISED THEIR FIDUCIARY DUTIES OF CARE AND LOYALTY.

SCOPE OF REVIEW

The correct standard of review for this Court to apply when reviewing questions of law is *de novo*. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993). Questions of law include questions concerning the formulation of the duty of loyalty and the duty of care. Id.; Kahn. v. Household Acquisition Corp., 591 A.2d 166, 175-176 (Del. 1991). When the trial court correctly formulates elements to a rule, this Court should review the lower court's findings of fact under the clearly erroneous standard. Cede & Co., 634 A.2d at 360. Under the clearly erroneous standard, the lower court's findings of fact are entitled to substantial deference unless they are clearly erroneous or not the "product of a logical and deductive reasoning process." Id. Here, the Court of Chancery's conclusions of law regarding the application of the business judgment rule should be reviewed *de novo*. Additionally, as the Court of Chancery also made findings of fact concerning the fiduciary duties applicable to the decision of Pinpoint's Board, Chancellor McCloskey's findings should be upheld unless they are clearly erroneous.

MERITS OF THE ARGUMENT

Under Delaware law, reasonable and careful decisions by directors are entitled to the protection of the business judgment rule. Although Mr. Miller argues that entire fairness or enhanced scrutiny should guide this Court's analysis, neither of these tests are applicable to

the facts of this case because Pinpoint's Board acted on an informed basis and in good faith. Furthermore, Pinpoint's Board honestly believes that implementation of the forum selection bylaw greatly benefits the corporation and its shareholders as a whole.

A. This Court should affirm the Court of Chancery's ruling that Pinpoint's Board exercised its fiduciary duties of care and loyalty by considering all reasonably available material information and acting in the best interest of the corporation.

Directors must constantly uphold their fiduciary duties in order to protect the interests of the corporation and to act in the best interests of the shareholders. Cede & Co., 634 A.2d at 360. These duties include: the duty of care, loyalty, and good faith. Id. at 361.

In the context of business decisions, directors that have considered all reasonably available material information have exercised their duty of due care. Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000). Once directors have complied with the duty of care (as well as loyalty), their informed decision is entitled to the deference provided by the business judgment rule. Cede & Co., 634 A.2d at 360. Only when a director's process of decision-making is grossly negligent will a court invalidate a board's decision. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Gross negligence is defined as, a "reckless indifference to or a deliberate disregard of the whole body of stockholders, or actions which are 'without the bounds of reason'." In Re Walt Disney Litig., 907 A.2d 693, 750 (Del. Ch. 2005). The clear burden is on the party challenging the decision to rebut this presumption. Aronson, 473 A.2d at 812. Furthermore, the fact that directors sought the advice of outside counsel is informative as to whether they were grossly

negligent. San Antonio Fire and Police Pension Fund v. Amylin Pharm. Inc., 983 A.2d 304, 318 (Del. Ch. 2009).

The duty of loyalty is satisfied when the directors and officers act in "the best interest of the corporation, and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally." Cede & Co., 634 A.2d at 361. A director's decision is independent when it "is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." Aronson, 473 A.2d at 816. Essential to the duty of loyalty is the separate, but intertwined, duty of good faith. As the duty of good faith is part of the duty of loyalty, the party alleging a breach of the duty of loyalty must show that the directors acted in bad faith. Stone v. Ritter, 911 A.2d 362, 369-370 (Del. 2006). A violation of the duty of good faith must be proven in order to impart liability under the duty of loyalty. Id. at 370. This was further expressed in Guttman v. Huang 823 A.2d 492, 506 n.34 (Del Ch. 2003), when the court stated that, "[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest." Conversely, a director has acted in bad faith "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation" or "acts with the intent to violate applicable positive law." Stone, 911 A.2d at 369.

There is little doubt that Pinpoint's Directors upheld their duty of due care in passing and implementing the exclusive forum bylaw because they have considered all reasonably available material

information. First, Pinpoint's Directors' relied in good faith on the advice of their outside legal counsel. Acting on independent legal advice when they adopted the bylaw, the Board believed that the exclusive forum bylaw would promote convenience, efficiency, and relative predictability. Additionally, as the Chancery Court noted, referencing the affidavit of Director Daphne Keyes, the Board was fully informed when they adopted the bylaw. (R. 17, n. 39). The fact that the Directors acted on advice given to them by outside legal counsel proves that they were fully informed when they adopted the bylaw.

The Directors did not act with gross negligence because their decision was not in deliberate disregard to the shareholders and was certainly not outside all bounds of reason. The Directors adopted this bylaw for the rational purposes of convenience, efficiency, and predictability. While the exclusive forum bylaw may be slightly inconvenient for certain shareholders, it does not deliberately disregard all shareholder interests.

The Directors of Pinpoint have adhered to the requirements of the duty of loyalty and good faith while adopting this bylaw because they have remained disinterested. At no point has the Board done anything besides act with a good faith belief that their actions are in the best interest of the corporation. First, Pinpoint's Directors are neither on both sides of the transaction nor receiving any personal gain. As Chancellor McCloskey explained, the exclusive forum bylaw does not limit the shareholder's ability to seek injunctive or monetary relief. Since a derivative action brought against Pinpoint would be litigated under Delaware law regardless of the forum, the bylaw does not limit

the substantive right of shareholder's to bring a derivative action in order to hold the Directors liable as fiduciaries. Furthermore, the Directors have no financial interests advanced by this bylaw. Secondly, the Directors have done nothing but act in the best interest of the corporation. By acting in the best interest of the corporation, the directors of Pinpoint have created a system to manage derivative litigation that is efficient and predictable. This bylaw serves the best interests of Pinpoint and Pinpoint's shareholders because it will lower litigation expenses and reduce risk.

B. This Court should affirm the Court of Chancery's finding that the Board's decision to adopt and implement the exclusive forum selection bylaw is subject to review under the business judgment rule and not a heightened standard because the Board's decision does not involve a threat to corporate policy or touch on issues of control.

Under Delaware law, shareholders of a public corporation delegate power to the board to manage the affairs of the business. 8 Del. C. § 141(a); Cede & Co., 634 A.2d at 367. In order to facilitate the management of the corporation, board decisions are ordinarily reviewed under the business judgment rule. 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, 871 (Del. 1985). Additionally, the business judgment rule "is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interest of the company." Aronson, 473 A.2d at 812. Most importantly, under the business judgment rule, director's decisions will be upheld if it is found that there is

any "rational business purpose" behind their actions. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

To defeat the presumption of the business judgment rule, the opposing party must show that, "the directors are interested or lack independence relative to the decision, did not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process." Brehm, 746 A.2d at 264. In plain terms, this means that the party attacking the transaction must prove that the directors breached one of their fiduciary duties. Cede & Co., 634 A.2d at 361. Without such a showing, "the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments." Id.

The decision by the Directors of Pinpoint to adopt and implement the bylaw should be reviewed under the business judgment rule, and not entire fairness, because the directors exercised their fiduciary duties of care and loyalty. Since the Board's actions of adopting and implementing the bylaw are subject to review under the business judgment rule, this Court may only invalidate that decision if the directors acted with no rational business purpose. Here, the rational business purpose underlying the Board's decision is that the Directors wished to promote efficiency, convenience, and predictability of derivative actions.

Additionally, the Court of Chancery was correct in holding that the Unocal standard of review does not apply to this case as the enhanced scrutiny of Unocal only applies when, "the record reflects

that the board of directors took defensive measures in response to a perceived threat to corporate policy and effectiveness which touch on issues of control.” Unitrin, Inc. v. American Gen. Corp., 651 A.2d 1361, 1372 n. 9 (Del. 1995); Gantler v. Stephens, 965 A.2d 695, 705 (Del. 2009). The Unocal enhanced scrutiny standard does require that directors justify their actions by showing reasonableness and proportionality before they are granted the deference of the business judgment rule. 493 A.2d at 955. Specifically, the directors must show that, (1) there were reasonable grounds to believe there was a threat to corporate policy or effectiveness, and (2) that the action of the Board was proportional to the threat posed. Unitrin, 651 A.2d at 1373. However, this enhanced scrutiny only applies to situations in which a board is addressing a pending takeover bid. Unocal at 954. This Court held in Unocal that because takeover bids pose an inherent risk that directors may be acting in their own best interests, rather than that of the shareholders, directors must exercise an enhanced duty when taking defensive transactions relating to a takeover. Id.

This Court has repeatedly refused to apply the Unocal analysis to cases outside of hostile takeover bids. In Gantler, this Court refused to apply the Unocal standard because there was no “hostile takeover attempt or similar threatened external action from which it could reasonably be inferred that the defendants acted ‘defensively.’” Gantler, 965 A.2d at 705. Since there was no defensive action at issue, this Court reviewed the decision of the board under the protection afforded by the business judgment rule. Id. Similarly, in Stroud, this Court rejected application of the Unocal test in the context of bylaw

amendments adopted at a shareholder meeting by holding that, "Unocal applies whenever a board takes defensive measures in response to a threat." 606 A.2d at 82.

In the case at bar, Pinpoint's bylaw cannot be accurately labeled as a "defensive" measure. The fact that the bylaw limits the forum for derivative actions to Delaware has no effect on any potential merger or acquisition. Finally, here, as in Gantler, there is no external struggle for corporate control. There is no danger that Pinpoint's Directors will use this exclusive forum bylaw to perpetuate their stay in office. Therefore, since the Unocal enhanced scrutiny standard does not apply to the facts of this matter, this Court should review the Board's decision under the business judgment rule.

CONCLUSION

For these reasons provided, this Court should affirm the Court of Chancery's decision to deny Mr. Miller from prosecuting any derivative or other fiduciary claims in any other forum than this Court. Since the exclusive forum selection bylaw is valid under Delaware law and not the product of fraud or overreaching, Pinpoint's Board of Directors are entitled to deference under the protection of the business judgment rule.

Respectfully Submitted,

Team T
Attorneys for Appellees