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 SANCHEZ, CLARE MITCHELL, BRENDAN ELLSWORTH, TIMOTHY FLETCHER, MARSHA FRANKLIN, DAPHNE KEYES 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

APPELLEE'S OPENING BRIEF

TEAM L

Attorneys for Defendants Below, Appellees

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

DELAWARE SUPREME COURT CASES

DELAWARE COURT OF CHANCERY CASES

OTHER CASES

STATUTES

NATURE OF THE PROCEEDINGS

Edward Miller, on December 1, 2010, filed an action in the United States District Court in Houston, Texas, arising out of Pinpoint's False Claims Act violations. Miller also filed a derivative claim for breach of fiduciary duty under Delaware law, alleging the Director Defendants breached their state law fiduciary duty of oversight.

One day later on December 2, Eileen Webb, Richard Patrick and Harold Kohn, each filed complaints in Delaware, ("Original Delaware Actions") alleging substantially the same derivative oversight claim as in Miller's Federal Action. On December 6, the three plaintiffs submitted a stipulated proposed Order of Consolidation, which the court entered on December 8.

On December 13, Pinpoint and the Director Defendants filed a motion in federal court to stay that action in favor of the consolidated Delaware Action. On December 15, Miller filed another action, this time in Delaware, alleging the same fiduciary duty claim as the federal and Delaware actions, and asking the court to include his Delaware claim in the consolidated Delaware Action. In addition, Miller filed a second motion, requesting stay of all fiduciary duty claims under Delaware state law while his federal action proceeds. The Director Defendants, Pinpoint, and the three Delaware Plaintiffs all oppose Miller's motion to stay.

SUMMARY OF THE ARGUMENT

This Court should affirm the Court of Chancery's decision finding that the Exclusive Forum Bylaw is valid and enforceable because the Board acted within the powers granted to it by the certificate of incorporation, the internal governance contract. The Board of Directors had the authority to make or amend bylaws to further the best interest of the corporation. This authority is consistent with section 102 of Delaware General Corporation Law. Further, the Bylaw is valid because the Board acted consistently with sections 109 and 141 in making a substantive business decision. The creation of the bylaw places it firmly within the bounds of the internal governance contract between the corporation and the shareholders.

Additionally, this Court should affirm the Court of Chancery's decision finding that the Exclusive Forum Bylaw, as an equitable matter, is valid and enforceable. The Court of Chancery was correct in assessing the bylaw using the business judgment rule, because the bylaw is related to a rational business purpose. The Director Defendants did not act in their own self-interest, which dictates that the entire fairness test is not appropriate. Further, strict judicial scrutiny of the Bylaw is not appropriate because it does not preclude or impair Plaintiff Miller from litigating his claims.

For these reasons, this Court should affirm the judgment of the Court of Chancery.

STATEMENT OF FACTS

Background

Pinpoint Bearings, Inc. ("Pinpoint") is a Delaware corporation headquartered in Houston, Texas, employing over 8,000 individuals. (Opinion ("Op.") at 4.) Pinpoint shares are listed on the New York Stock Exchange, and the company has a market capitalization of slightly more than $4 billion. (Op. at 4, n. 6.) The shareholders controlling the 88 million outstanding shares of Pinpoint stock are numerous and wide-spread. In total, there are over 28,000 shareholders of record, representing each of the fifty States. (Op. at 4 n.6.) To manage and direct the affairs of a $4 billion company, Pinpoint's corporate structure includes a seven-member board of directors. (Op. at 5.) Of the seven directors, four are considered independent or outside directors, while the three remaining directors are all executives of Pinpoint. (*Id.*)

In March 2010, the Court of Chancery of Delaware decided *In re Revlon, Inc. Shareholders Litig.,* 990 A.2d 940, 960 (Del. Ch. 2010). In *Revlon*, the Court noted that Delaware corporations are free to adopt bylaws selecting a "particular forum [that] would provide an efficient and value-promoting locus for dispute resolution . . . [of] intra-entity disputes." *Id.* In response, many companies amended corporate bylaws to select the Court of Chancery as the exclusive forum for litigating fiduciary or other internal claims, and on June 10, the Pinpoint Board followed suit. (R. at 2.) The Board adopted a bylaw designating the Court of Chancery as the exclusive forum for, among other actions, any derivative action or claim of breach of

fiduciary duty owed by a director or officer of Pinpoint ("Bylaw" or "Exclusive Forum Bylaw").[1] (*Id.* at n4.)

Government Investigation

Pinpoint manufactures highly engineered precision roller and ball bearings specially designed for aerospace applications. (Op. at 4.) The majority of Pinpoint revenue is derived from United States military contracts, which accounted for over sixty percent of Pinpoint's revenues each of the last five years. (Op. at 5.) As a condition of each of its government contracts, Pinpoint is required to conduct a variety of performance and safety stress tests on all specialty bearings for military aircraft. (*Id.*) In addition to the stress tests, Pinpoint must certify to the government that it performed all required tests and each component yielded satisfactory results. (*Id.*)

In early September 2010, Roland Thompson, a Pinpoint engineer, contacted the United States Office of the Inspector General ("OIG"), alerting the government to improper cost-cutting measures. (*Id.*) Thompson regularly participated in the testing process, and discovered in early 2009 that three mid-level managers began omitting some of the required testing in an effort to cut costs. (*Id.*) Thompson later

[1] Specifically, the Pinpoint Bylaw reads:

> Article 12. Forum. The Court of Chancery of the State of Delaware shall be 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, officer or other employee of the corporation to the corporation or the corporation's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law or the corporation's certificate of incorporation or bylaws, or (iv) any other action asserting a claim governed by the internal affairs doctrine.

learned that on Pinpoint's billing and invoice submissions, the government was given the representation that the omitted tests were conducted. (Op. at 6.) None of Pinpoint's products failed to perform as a result of the omitted testing (Op. at 5.)

After Thompson's report, the OIG launched an official investigation into Pinpoint's testing and billing practices. (Op. at 6.) Pinpoint received formal notice of the investigation on September 8, 2010. (*Id.*) The Board cooperated fully, and, at an emergency meeting on September 10, the Board appointed two independent directors to a special investigation committee ("Special Committee"). (*Id.*) The Board directed the Special Committee to examine the issue and make recommendations. To further aid in its investigation, the Special Committee hired the Houston law firm of Venner and Lee, LLP. (*Id.*)

Upon completing its investigation, the Special Committee determined the complaint was meritorious and found that the undisclosed cost-cutting measures were inappropriate. (*Id.*) At an October 28 meeting, the Board authorized Venner and Lee to negotiate a settlement with the OIG on behalf of Pinpoint. (*Id.*) The terms of the settlement, finalized on November 30, required Pinpoint (1) enter a consent decree, admitting five violations of the False Claims Act, (2) pay $500 million in fines and penalties, and (3) promptly fire the three mid-level managers responsible for orchestrating the scheme. (*Id.*) Due in large part to the Board's full cooperation and agreement on terms, the settlement allowed Pinpoint to maintain its status as an eligible U.S. military contractor. (Op. at 6, 7) Furthermore, Pinpoint avoided any criminal indictment. (Op. at 7.) That same day, after the

close of the stock market, Pinpoint disclosed in a press release the OIG investigation and settlement.

ARGUMENT

I. THE EXCLUSIVE FORUM BYLAW IS VALID AND ENFORCEABLE UNDER DELAWARE STATE LAW AND IS WITHIN THE AUTHORITY GRANTED TO THE BOARD BY THE SHAREHOLDERS, THROUGH THE CERTIFICATE OF INCORPORATION, THE INTERNAL GOVERNANCE CONTRACT.

A. Question Presented

Whether the Exclusive Forum Bylaw passed by Pinpoint's Board of Directors is valid under both Delaware corporate law and the general contract law that governs a corporations bylaws.

B. Scope of Review

This is a question of the validity of the Exclusive Forum Bylaw adopted by the Director Defendants of Pinpoint. Validity is determined by statute and conformance with contract law. There is no question of fact, only law. Therefore, the standard of review is de novo. *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 231 (Del. 2008).

C. Merits of the Argument

The exclusive forum bylaw adopted by Pinpoint's board of directors is valid because it is consistent with the mandatory provisions of Delaware law. The certificate of incorporation gives the power to amend, add and repeal bylaws to the board of directors. The bylaw is a substantive business provision that is allowed under section 109 when read with section 141.

The exclusive forum bylaw is also valid under contract law. The bylaws are viewed as the internal governance contract between the shareholders and the directors. Such provisions are presumed to be valid in a contract unless the plaintiff can show that the bylaw is so

unfair that it has the practical effect of not allowing his day in court.

1. The Bylaw passed by the Board of Directors is valid because they had the authority under Delaware state law.

a. The Board of Directors had the authority under the Certificate of Incorporation to unilaterally make or amend the bylaws, consistent with section 102 of the Delaware General Corporation Law.

Any analysis of a board of director's ability to amend or add bylaws must begin with section 102 and that corporation's certificate of incorporation. Section 102(b)(1)of the Delaware General Corporation Law states the certificate of incorporation may have a provision "creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders… if such provisions are not contrary to the laws of the State." Del. Code Ann. tit. 8, § 102(b)(1) (2010). If a bylaw is inconsistent with the Certificate of Incorporation, then the bylaw is automatically void. *Centaur Partners IV v. National Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990). In *Centaur*, the defendant corporation attempted to pass a bylaw that set the number of directors at fifteen and make it impervious to future change. 582 A.2d at 929. However, the certificate of incorporation expressly stated that the number of directors should be set by the bylaws and may be amended periodically. *Id*. at 923. Because the bylaw was in direct conflict with the articles of incorporation, it was thus ruled invalid. *Id*. at 929.

It is not disputed that Pinpoint's charter expressly gives the power to adopt a new bylaw to the Board, and the charter provisions are consistent with Delaware state law. Since the Board acted within

the authority conferred upon it by the shareholders, it necessarily acted consistent with section 102 of the Delaware General Corporation Law.

b. The Bylaw is valid because the Board, in making a substantive business decision, acted consistent with sections 109 and 141 of the Delaware General Corporation Law.

A corporation has the power to make and amend its bylaws; a feature that has long been considered inherent to the corporate structure. *Frantz Manufacturing Company v. EAC Industries*, 501 A.2d 401, 407 (Del. 1985). As part of that power, "[t]he original or other bylaws of a corporation may be adopted, amended, or repealed by the incorporators, by the initial directors of a corporation… or… by its board of directors." Del. Code Ann. tit. 8, § 109(a)(2010). However, "[a] bylaw that is inconsistent with any statute or rule of common law . . . is void." *Frantz Mfg. Co.*, 501 A.2d at 407. Bylaws that are procedural in nature, which define a board of directors' substantive decision-making process, must be left to the shareholders. *CA, Inc.*, 953 A.2d at 235-36. Where the power to make or amend bylaws is given to the directors, the directors are empowered to amend the bylaws that are necessary for substantive decisions and are only limited by their fiduciary obligations. *Kidsco, Inc. v. The Learning Co.*, 674 A.2d 483,493 (Del. Ch. 1995).

Section 109 allows corporations to give the Board of Directors the power to make and amend bylaws. Del. Code Ann. tit. 8, § 109(b)(2010). Specifically, a corporation may "confer the power to adopt, amend or repeal bylaws upon the directors." *Id*. However, such a power given to the directors cannot divest the shareholders of their

right to the same. *Id.* In other words, this provision allows the directors to make substantive decisions for the company, but not strip the shareholders of their power to vote. Furthermore, the bylaws may "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs and its rights or powers of its stockholders [or] directors[.]" § 109(b). The Court of Chancery cited this statute, reasoning that a corporation by its directors may create a provision with an exclusive forum for intra-entity disputes. *In re Revlon, Inc*, 990 A.2d at 960.

Section 109 must also be read in connection with section 141(a). *CA, Inc.,* 953 A.2d at 232. Essentially, section 141 states that the board of directors will have the ability to make any decision as necessary to run the business except as limited by the certificate of incorporation or by state law. Del. Code Ann. tit. 8, § 141(2010). If the board of directors adopts a bylaw that is inconsistent with section 141, or eliminates a power of the shareholders inconsistent with section 109, the bylaw is not valid. *Frantz Mfg.,* 501 A.2d at 407. Process-oriented bylaws are left to a shareholder vote only, and cannot be amended, removed or added by the board. *CA, Inc.,*953 A.2d at 232. This statute codifies the public policy that the board of directors has the authority to make substantive business decisions. *Id.* at 234-35.

The Board of Directors has the power to make all substantive business decisions of a corporation. *Id.* In *CA. Inc.*, the shareholders passed a bylaw requiring reimbursement of some

shareholder proxy expenses. *Id.* at 229-30. The corporation argued that the bylaw impermissibly intruded upon the directors' ability to manage the substantive business operations because it required the expenditure of company funds. *Id.* at 236. However, this Court determined that such a bylaw is procedural in nature and not substantive, and the right of the shareholders to pass procedural bylaws is protected by section 109(a). *Id.* at 234-35. Such procedural bylaws are the provisions that govern how the board of directors may manage the business. *Id.* at 235-36. A bylaw that requires the expenditure of company funds is not substantive simply because it requires spending company funds. *Id.* at 236. However, the bylaw was found to be invalid because it required an action by the board of directors that could cause a breach of the directors' fiduciary duty. *Id.*

The bylaws of a corporation are substantially similar to a governing agreement for a Limited Liability Company. Both are filed with the State of Delaware, both describe the internal governance of the company and they both operate under the general idea that they are contracts. In *Elf Atochem North America, Inc. v. Jaffari*, 727 A.2d 286, 287 (Del. 1999), this Court ruled that an exclusive forum clause in the operating agreement at issue was valid. That case involved one of the members bringing a derivative suit challenging the exclusive forum clause. *Id.* at 289. The *Elf Atochem* Court held that such a provision will only be struck down if it is inconsistent with mandatory statutory provisions. *Id.* 292.

Pinpoint's Exclusive Forum Bylaw is a substantive business decision that does not violate Delaware code section 109. The power to amend the bylaws can be and was conferred on the board of directors. It was not done at the expense of the same right to the shareholders. In fact, the bylaws expressly stated that the right concurrently belonged to the shareholders. By requiring all intra-entity claims to be brought in one forum, the conduct of the affairs has been altered. While the provision does affect a right of shareholders, it does not prevent them from exercising that right. It still allows the right to bring the suit, it simply requires it to be in one forum.

The Bylaw is a business related decision that is consistent with the public policy codified in Delaware code section 141. The decision to limit the forum for all intra-entity lawsuits also qualifies as a business-related provision. The resources that are saved by limiting these lawsuits to a single forum are significant. Certainly, the Board considered such savings when it adopted the Bylaw. As the Bylaw was adopted before the settlement with the OIG, the Board in no way attempted to discourage derivative suits. Instead, the Board merely directs such suits to the same jurisdiction. Without the Bylaw, the possibility arises that shareholders could file actions in all fifty states, as Pinpoint has shareholders in each one. Even if Pinpoint could get all suits moved to Delaware, it would come at considerable expense in legal and travel fees arguing the pre-trial motions.

2. The exclusive forum bylaw is valid because the bylaws of a corporation are an internal governance contract with the shareholders and the bylaw does not go beyond the terms of that contract.

The bylaws of a corporation are the contract by which the shareholders confer upon the directors the authority to run the company. *Kidsco*, 674 A.2d at 492. As the United States Supreme Court said in *Carnival Cruise Lines*, any exclusive forum analysis must begin with the *M/S Bremen v. Zapata Off-Shore Company* framework. *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 589 (1991). In *M/S Bremen*, the Supreme Court upheld a contract clause that called for all disputes to be made in front of the London Court of Justice. *M/S Bremen v. Zapata Off-Shore Company*, 407 U.S. 1, 3 (1972). Forum selection clauses in contracts "are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances." *Id.* at 10. The Court said the burden of proof must be on the plaintiff to overcome this presumption by showing that the clause was "so gravely difficult and inconvenient that he will for all practical purposes be deprived his day in court." *Id.* at 18.

Exclusive forum clauses have been upheld by the U.S. Supreme Court, even where there was no bargaining between the parties. *Carnival Cruise Lines, Inc.*, 499 U.S. at 593. The forum clause in *Carnival Cruise Lines* was also upheld even though there was no bargaining between the passengers who bought the ticket and the seller. *Id.* There, the Court applied *Bremen* and held that the clause would be valid unless it was found to be unreasonable. *Id.* In applying *Bremen*, the Court specifically rejects the contention that a

clause is unreasonable simply because there was not an arms-length negotiation. *Id.*

The Supreme Court, in *Carnival Cruise Lines*, laid out specific reasons why a forum selection clause that has not been negotiated is still reasonable. *Id.* First, a company has an interest in limiting the jurisdictions since, due to the nature of its business, it is open for liability in many places. *Id.* Second, limiting the jurisdictions adds predictability in the proceedings and saves all parties the expense of litigating pretrial motions to determine the proper venue. *Id.* at 593-94. Finally, the bylaw did not make any attempt to prevent or discourage any legitimate claims from being filed. *Id.* at 595. Had the contract attempted to make it more difficult to bring a legitimate claim, then the corporation would been deemed to act in bad faith and the clause would have failed scrutiny for fundamental fairness. *Id.* at 595.

The court in the Northern District of California recently struck down a forum selection bylaw that was passed by the board of directors without a shareholder vote. *Galaviz v. Berg,* 2011 U.S. Dist. Lexis 1626 at *14 (N.D. Cal. Jan. 3, 2011). The clause in that case limited all derivative suits on behalf of the corporation to the Court of Chancery of Delaware. *Id.* at *4. The Northern District decided that case based on federal common law for venue and not on contractual basis. *Id.* at *13-14. Furthermore, in dicta, Judge Seeborg states, "there is no basis for the Court to disregard the plaintiff's choice of forum." *Id.* at *12. Therefore, although the clause was not upheld

by the district court, it is not because the clause was otherwise invalid.

The Pinpoint Exclusive Forum Bylaw should be upheld, since such clauses are prima facie valid unless proven unreasonable by the plaintiff. *M/S Bremen*, 407 U.S. at 18. The simple lack of an arms-length negotiation between the shareholders and the board of directors cannot make the clause unreasonable. It would not be a reasonable action for the board of directors to call the owners of more than 50 percent of Pinpoint's stock. There are over 88 million shares owned by 28,000 shareholders. If more than half of Pinpoint's shareholders are so inclined, they may put the issue on the proxy statement and try to get a vote to overturn it.

The bylaw that allowed the Board to amend, adopt and repeal bylaws was in place long before the Exclusive Forum Bylaw. The shareholders would have been within their rights to pass a new bylaw that would have at least changed how the board of directors could have passed new bylaws. The exclusive forum bylaw was adopted in the manner required by Article 12. Consequently, the Director Defendants did not overreach in their authority to adopt the Exclusive Forum Bylaw.

The director defendants have also done nothing to discourage or prevent any of the shareholders from bringing legitimate claims on behalf of Pinpoint. It is simply a mechanism for ensuring all the claims are in one place. With such a high number of shareholders in all fifty states, the absence of an exclusive forum bylaw would lead to countless costly and unpredictable pretrial motions in various

states. Additionally, Pinpoint is incorporated in Delaware under those laws. All of the decisions made by the Board are made under Delaware law. The fair outcome for the Director Defendants is the use of Delaware law by a Chancery judge who is learned in the subject.

II. THE COURT OF CHANCERY CORRECTLY APPLIED THE BUSINESS JUDGMENT RULE TO DETERMINE WHETHER, ON EQUITABLE GROUNDS, THE BYLAW IS VALID AND ENFORCEABLE.

A. Question Presented

Whether the business judgment rule is the appropriate analytical framework for assessing a board of directors' managerial authority to adopt an exclusive forum bylaw.

B. Scope of Review

The threshold question is the applicable judicial standard by which this Court shall judge the Director Defendants' conduct. This is a question of law, and therefore reviewed *de novo*. *Nixon v. Blackwell*, 626 A.2d 1366, 1375 (Del. 1993).

C. Merits of the Argument

This Court should affirm the Court of Chancery decision and find that, as an equitable matter, the Board acted fairly and reasonably when it adopted the Exclusive Forum Bylaw. When shareholders attack board decisions, usually one of three levels of judicial review is applied: the entire fairness test, the traditional business judgment rule, or strict scrutiny established through the *Unocal* standard. *See, Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1371 (Del. 1995).

The Plaintiff asks this Court to first apply the entire fairness test. In the alternative, Miller argues the Board decision requires

enhanced judicial scrutiny for reasonableness and proportionality. Enhanced scrutiny is not appropriate, given the facts and circumstances of this case, as laid out in *Unocal* and *Unitrin*. In either case, Miller asserts that a greater level of judicial scrutiny is required in assessing the fairness of the Board's action.

Despite Miller's assertions, the facts and circumstances of this case do not warrant any level of heightened judicial scrutiny. Here, the Board acted with a legitimate rational business purpose. Moreover, the Bylaw does not seriously impair a shareholder's ability to litigate his claims. Therefore, the Bylaw should be examined through the traditional business judgment rule.

1. The entire fairness test is not appropriate as the Director Defendants did not act in their own self interest.

The entire fairness test creates a framework for exposing directors to judicial scrutiny, and traditionally applies where a plaintiff alleges self-dealing transactions or board decisions that otherwise have been shown to be a breach of fiduciary duty. *See, e.g. Emerald Partners v. Berlin*, 787 A.2d 85, 94 (Del. 2001). However, the entire fairness test applies "only if the presumption of the business judgment rule is defeated." *Grobow v. Perot, Del. Supr.*, 539 A.2d 180, 187 (1988). Therefore, a plaintiff must show the board action was not related to a rational business purpose. *See, In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 74 (Del. 2006)

The purpose of the business judgment rule is to prevent unnecessary judicial review of otherwise valid business decisions by providing substantive protections for directors. *See, Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985)(overruled on other grounds). As

a matter of public policy, directors should not be held personally liable for a decision made with proper care, loyalty and good faith, yet does not produce a result to a particular shareholder's liking. Requiring any level of heightened scrutiny to these types of board decisions runs counter to the purpose for the rule.

The business judgment rule is the default analysis for all board decisions and the plaintiff bears the burden of rebutting the presumption. *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001). The rule presumes the directors acted on an informed basis, in good faith, and with the honest belief that their action was in the best interests of the company. *See, Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). To rebut the presumption, a shareholder plaintiff must show the board of directors, in reaching its decision, violated one its fiduciary duties of due care, loyalty, or good faith. Simply put, the "board's decision will be upheld unless it cannot be attributed to any rational purpose." *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d at 74(internal quotation marks omitted).

Here, Miller cannot overcome the presumption that the Board did not violate its fiduciary duty. Instead, the facts and circumstances of this case show the Director Defendants acted in good faith and in the best interest of the company when the Board adopted the Bylaw. First, the board of directors voted unanimously to adopt the Bylaw. This includes the independent directors, who together account for a majority of the Board. In addition, the Board took immediate action upon learning of the omitted testing, appointing two independent directors to the Special Committee tasked with investigating the

matter. Further, the Board hired outside counsel to assist the Special Committee.

The Board fully cooperated with the OIG in its investigation. This cooperation helped Pinpoint reach a settlement that, despite the hefty fine, is in the best interest of the company. Pinpoint will not see sixty percent of its annual revenue eliminated because it retained its status as a military contractor. In addition, the settlement avoided criminal prosecution, and the possibility of another multi-million dollar fine.

In the alternative, where the business judgment rule is rebutted, the Director Defendants may prove the transaction was entirely fair to the shareholder plaintiff. *See, Emerald Partners*, 787 A.2d at 90. The test focuses on two aspects of a transaction: fair dealing and fair price. Fair dealing considers when a transaction was timed, how it was structured, initiated, negotiated, and disclosed, and how the director approval was obtained. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983). Fair Price relates to the economic and financial considerations of the proposed transaction. *Id*.

Despite having two basic elements, the entire fairness test is not bifurcated. Rather, "[a]ll aspects of the issue must be examined as a whole since the question is one of entire fairness." *Id*. Viewing the Board's decision in its entirety displays its fairness. The fairness is further highlighted when viewed against a recent United Stated District Court decision.

The U.S. District Court for the Northern District of California recently took up a question of first impression concerning an

exclusive forum bylaw. In *Galaviz v. Berg*, 2011 U.S. Dist. LEXIS 1626 at *5 (N.D. Cal. Jan. 3, 2011), the District Court ruled an exclusive forum clause was not valid. *Id.* at *13-14. That case concerned an exclusive forum bylaw passed by the board of directors of Oracle Corporation shortly after the board learned of an alleged overbilling scheme that ran from 1998 to 2006. *Id.* at *12.

Distinguishing *Galaviz* from the present case is the temporal relation between the adoption of a bylaw and discovery of fraud. In *Galaviz*, the board only adopted the exclusive forum bylaw after learning of the fraud, likely to insulate its members from individual liability. *Id.* In contrast, the Director Defendants simply adopted the Bylaw after the *Revlon* decision. The timing of the action related only to what Pinpoint, and many other Delaware companies, viewed as a judicial blessing to adopt such bylaws. Unlike the Oracle board, the Pinpoint Board was unaware of any fraud at the time it passed the Bylaw. In fact, the OIG did not receive a complaint until three months after adoption. Further, it was only after the OIG contacted the Board that the Director Defendants learned of the omitted tests. In short, the decision to adopt the Bylaw was only for the purpose of convenience, efficiency and relative predictability.

2. Strict judicial scrutiny of the Exclusive Forum Bylaw is not appropriate as it does not impair Miller's ability to litigate his claims

This Court should affirm the lower court's ruling that the Exclusive Forum Bylaw is valid and enforceable. First, forum selection clauses are presumptively valid clauses. *Elia Corp. v. Paul N. Howard Co.*, 391 A.2d 214, 216 (Del. Super. 1978). Moreover, forum

selection clauses are unreasonable only when its enforcement would, under the circumstances, seriously impair the plaintiff's ability to pursue his cause of action. *Id.* Thus, "[c]ourts should assess the reasonableness of a forum selection clause on a case-by-case basis." *Ingres Corporation v. CA, Inc.*, 8 A.3d 1143 (Del. 2010).

The enhanced judicial scrutiny framework suggested by Miller is laid out in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). A landmark case on corporate defense tactics, the Court in *Unocal* established the set of requirements a board must demonstrate. First, that after a reasonable investigation, it is determined in good faith that a threat to the company's policy and effectiveness exists; second, the board's action is a proportional response to the specific perceived threat. *Id.* However, the court must initially determine whether the particular conduct was defensive. *Unitrin*, 651 A.2d at 1372 (citing Dennis J. Block, et al., *The Business Judgment Rule*, 243 (4th ed. 1993)).

Heightened judicial scrutiny is generally used only where the primary purpose of the board's defensive measures is to interfere with, or impede the effective exercise of the shareholder franchise. *See, Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651, 660 (Del. Ch. 1988). A board's tactic is considered defensive when it is in response to a specific perceived threat. *Unitrin*, 651 A.2d at 1372. For example, a board's actions are defensive when purported to fend off a hostile takeover bid. Such is the case in both *Unocal* and *Unitrin*, where the boards dealt with the imminent threat of a merger

by engaging in stock buy-back tactics. In response, the boards adopted poison pills in the form of shareholder buy-back programs.

In addition to lacking a perceived threat, there is no shareholder impairment present. The shareholder franchise remains intact, suffering no loss in its ability to litigate a derivative claim. Furthermore, Miller has not demonstrated the clause does any more than impose a mere inconvenience, which is not the test of unreasonableness. *See, M/S Bremen*, 407 U.S. at 18. And though Miller may suffer additional expenses to bring his derivative claims in the Court of Chancery, the Bylaw "should control absent a strong showing that it should be set aside." *Id.*

Additionally, the clause does nothing to limit the board of director's liability for a breach of fiduciary duty claim. Miller, and all 28,000 Pinpoint shareholders, maintain the right to file a lawsuit for breach of fiduciary duty. The Bylaw merely selects the forum in which those lawsuits must be brought. As shown by his ability and willingness to join the class of Delaware Plaintiffs, Miller maintains the ability to pursue his breach of fiduciary duty claim against the directors.

Instead of the enhanced judicial scrutiny Miller suggests, the Exclusive Forum Bylaw should be reviewed applying the business judgment rule. An exclusive forum clause is not indicative of a transaction breaching a fiduciary duty. In fact, the Director Defendants retain their full fiduciary accountability as a result. The only interest of the directors is one of convenience, efficiency and relative predictability. Additionally, Miller is asking this

court to adopt an unworkable standard. There are 28,000 Pinpoint shareholders in each of the fifty states. Under Miller's view, shareholders would be required monitor all state and federal courts before filing a suit to prevent costly litigation simply to determine venue. In the end, Miller is asking the court to eliminate the exclusive forum clause in favor of approving his personal forum of choice.

In conclusion, the facts and circumstances of this case do not warrant a *Unocal*-style analysis. Further, shareholders of a company delegate authority to the board of directors. "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors[.]" § 141(a). While this delegation of authority can create an inherent conflict of interest for those directors who own company stock, this is not the case for Pinpoint. Rather, the Board decision was one made without personal financial consideration, and in the best interest of the company. Therefore, the business judgment rule applies.

CONCLUSION

The Court of Chancery correctly found the Exclusive Forum Bylaw is valid and enforceable since the Board acted within its authority granted by the certificate of incorporation, which is part of the corporate governance contract.

Further, this Court should uphold the Court of Chancery's decision that, as an equitable matter, the Bylaw is valid. Miller cannot rebut the presumption that the Bylaw is related to a rational business purpose. Thus, the Court of Chancery was correct in using the traditional business judgment rule.

February 11, 2011

Respectfully Submitted,

/s/ *Team L*
Team L

Attorneys for Appellee