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

APPELLANT'S OPENING BRIEF

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Dated: February 11, 2011

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NATURE OF PROCEEDINGS

On December 1, 2010, Plaintiff Miller filed suit in the United States District Court for the Southern District of Texas, alleging breaches of fiduciary duties under Delaware law and violations of federal securities laws against Nominal Defendant Pinpoint and the Director Defendants. On December 2, three other plaintiffs filed the same fiduciary duties claims in the Delaware Chancery court, with these claims being consolidated under the caption *In re Pinpoint Bearings, Inc. Shareholders Litigation*.

In response to a partial motion to stay filed by the Defendants in the Texas court, Plaintiff Miller filed the same fiduciary duty claims in the Delaware Chancery Court. Simultaneously, Plaintiff Miller filed a motion to consolidate his action with the pending Delaware action, as well as a motion to stay the Consolidated Delaware Action in favor of the previously filed Federal Action. As a result, Defendants moved for an injunction barring Plaintiff Miller from litigating in any forum other than the Delaware Chancery Court.

The Chancery Court, noting that the motions depended upon the validity of a Bylaw mandating exclusive litigation of fiduciary claims in Delaware, upheld the Bylaw and denied Plaintiff Miller's motion to stay in an Opinion and Order dated January 12, 2011. The Opinion and Order also granted the Defendants' motion to enjoin litigation of the fiduciary claims in any forum other than the Chancery Court.

Plaintiff Miller's application for interlocutory appeal to this court was granted pursuant to Supreme Court Rule 42 in an Order dated January 14, 2011.

SUMMARY OF ARGUMENT

The exclusive forum Bylaw is either invalid as a matter of law or was invalidly adopted as an equitable matter. Thus, the *McWane* analysis supporting Plaintiff's Motion to Stay is not displaced.

A board's unilateral amendment to a corporation's bylaws, designating an exclusive forum for derivative fiduciary duty actions, is invalid and unenforceable. Even conceding that a forum selection provision may be permissibly included in a corporation's governance documents, a unilateral bylaw amendment is an improper means of accomplishing this end. A unilateral amendment invites shareholder challenges and will lead to substantial litigation, thereby reducing the overarching goal of efficiency in Delaware corporate law. This court should not validate a forum restriction unilaterally adopted in a corporation's bylaws as a permissible means of restricting plaintiff-shareholders' choice of forum.

Even if the Bylaw is valid as a matter of law, it was invalidly adopted as an equitable manner. Primarily, the self-interest motivating the Directors' decision to enact the Bylaw embodies a breach of loyalty sufficient to warrant entire fairness review, a stringent standard that Defendants will not meet. Alternatively, the Bylaw acts as an entrenchment device and fails to satisfy the reasonableness and proportionality test of *Unocal*.

Ultimately, due to the invalid nature of the Bylaw or its invalid implementation as an equitable matter, the conventional *McWane* analysis is not displaced, and Plaintiff's Motion to Stay should be granted.

STATEMENT OF FACTS

On September 8, 2010, the board of directors for Pinpoint, Inc. ("Pinpoint") was formally notified by the Office of the Inspector General ("OIG") of an investigation into a failure by Pinpoint managers to perform all required testing of bearings. (Op. 4-6). Pinpoint does a large amount of business with the military. (Op. 4). Under the terms of Pinpoint's contracts with the military, it had to run its bearings through rigorous testing before shipping the orders. (Op. 5).

An internal investigation conducted by independent directors on Pinpoint's board and a Houston based law firm revealed that the allegations had merit. (Op.6). The terms of Pinpoint's settlement with OIG included Pinpoint paying $500 million in fines and penalties. Id. Pinpoint did not disclose the investigation until November 30, 2010, the day the settlement was reached. (Op. 7)

Pinpoint is incorporated in Delaware, but its headquarters and manufacturing center, including 8,000 employees, are in Houston, Texas. (Op. 4). On June 10, 2010, the board amended Pinpoint's bylaws to include a forum selection clause, limiting all shareholder derivative actions and any other claims alleging breach of fiduciary duties by the board to the Court of Chancery. (Op. 2).

Plaintiff Edward Miller, a Pinpoint shareholder, filed suit in federal court in Texas, alleging both federal securities and state fiduciary duty claims. (Op. 1). Plaintiff Miller then sought a stay of the Delaware proceedings so that the entire case could be litigated in Texas.

ARGUMENT

The exclusive forum Bylaw is either invalid as a matter of law or was invalidly adopted as an equitable matter. Thus, the conventional *McWane* analysis is not displaced and Plaintiff Miller's Delaware Motion to Stay in favor of the Federal Action should be granted.

I. THE BYLAW IS INVALID AS A MATTER OF LAW BECAUSE IT USURPS SHAREHOLDER RIGHTS AND INVITES LITIGATION THAT WOULD UNDERMINE THE EFFICIENCY EXCLUSIVE FORUM BYLAWS ALLEGEDLY PROMOTE.

A. QUESTION PRESENTED

Is the Bylaw requiring all claims for breach of fiduciary duty to be litigated exclusively in Delaware valid as a matter of law?

B. SCOPE OF REVIEW

The validity of the Bylaw represents a mixed question of law and fact. *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985). Accordingly, deference is granted to the factual findings of the Chancery Court. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1995). However, review of the "formulation and application of legal principles . . . is plenary and requires no deference." *Kahn v. Lynch Commc'n Sys.*, 669 A.2d 79, 84 (Del. 1995), quoting *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1142 (Del. 1990).

C. MERITS OF ARGUMENT

Based on principles of efficiency and comity, the Bylaw is invalid as a matter of law. Therefore, *McWane* analysis is not displaced and this Court should reverse the denial of Plaintiff's Motion to Stay in favor of the pending Texas Federal Action.

1. Corporations cannot validly adopt unilateral amendments to corporate bylaws mandating a chosen forum for intra-entity litigation.

Forum selection provisions in corporate governance documents are recent developments, prompted by *dicta* in a 2010 decision commenting that, "if boards of directors *and stockholders* believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes." *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010) (emphasis added). *Revlon* did not involve a forum dispute, but an issue of whether lead counsel should be replaced in a shareholder representative action. *See id.*

The court noted that the DGCL permits a corporate charter to broadly determine how a corporation's internal affairs are prescribed. *Id.* at 961 (citing 8 Del. C. § 102(b)(1) (2001)). However, the court recognized that the "issues implicated by an exclusive forum selection provision must await resolution in an appropriate case." *Id.*

To date, only one court has addressed the issue of whether corporate directors may designate an exclusive forum for shareholder derivative actions by adopting a bylaw. *Galaviz v. Berg*, 2011 U.S. Dist. LEXIS 1626 (N.D. Cal. 2011). The court declined to enforce the bylaw specifying the Chancery Court of Delaware as the sole forum for derivative actions, but its decision did not resolve the issue whether the adoption of the bylaw was within the directors' powers under Delaware corporate law. The court noted that whether or not the bylaw's adoption was a valid exercise of corporate power, the

unilateral action nonetheless could not be accomplished under principles of contract law. *Id.* at *11-12. Importantly, the director defendants were unable to persuade the court that federal law requires or even permits federal courts to defer to any provision of state corporate law that might purport to give a corporation's directors the power to control forum under these circumstances. *Id.* at *13-14.

There are strong reasons to believe that forum selection provisions will not be given effect in federal courts. In addition, Delaware courts should exercise caution in attempting to limit shareholder-plaintiffs' freedom to litigate in other state courts. Any measures to limit shareholder-plaintiffs' otherwise legitimate access to the federal courts raise constitutional concerns and invite challenge. Delaware should avoid entering the crosshairs of federal law, which, under the Commerce Clause, could preempt Delaware corporate law and erode its stronghold if a problem is perceived with the entrenching effort of Delaware corporations and courts.

The Chancery Court itself declined to enforce contractual provisions selecting non-Delaware forums, even in the context of highly negotiated corporate and commercial contracts. *In re Topps Co. S'holders Litig.*, 924 A.2d 951. In *Topps*, the merger agreement included a New York choice of forum clause. Notably, the Chancery Court cited efficiency concerns in support of its decision to invalidate the clause.

Even if forum selection clauses are generally permissible, they should not be permitted by means of a unilateral bylaw amendment. A unilateral amendment by the board invites skepticism and compels

challenges by shareholders. This significantly undermines the overarching goal of efficiency in Delaware corporate law.

Charter amendments require approval by the board and a majority of shareholders. 8 Del. C. § 242 (2001). In contrast, corporate bylaws can be implemented or amended by board action alone. 8 Del. C.§ 109(a) (2001). Therefore, under Delaware corporate law, shareholders and directors have concurrent ability to amend, adopt, or repeal bylaws.

The forum selection Bylaw unilaterally adopted by the Pinpoint Board should be held invalid as a matter of law. This Court should not uphold forum selection provisions enacted by means of unilateral director adoption, because doing so would erode established jurisprudence and statutory rights conferred upon shareholders under Delaware law.

2. This court should reaffirm its well-reasoned jurisprudence pertaining to forum disputes and curtail the pattern of divergence in the Chancery Court, which undermines its validity and invites inconsistency.

This Court should reverse the Chancery Court by returning to the dual framework it has established for the resolution of forum disputes. The Court of Chancery has departed from the well-reasoned law of the Delaware Supreme Court regarding forum disputes and filing chronology, deviating from the forum non conveniens and *McWane* doctrines. These doctrines generally apply filing chronology to resolve forum disputes absent some exceptional circumstances. *See Berger v. Intelident Solutions, Inc.*, 906 A.2d 134 (Del. 2006); *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281 (Del. 1970). This approach advances laudable goals of objectivity and predictability. A departure from filing chronology and respect for

plaintiffs' choice of forum instead invites challenge at both the state and federal level.

a. The Chancery Court significantly departed from this Court's jurisprudence, which typically gives substantial weight to plaintiffs' choice of forum, absent exceptional circumstances.

Plaintiff-shareholders normally have the option to pursue Delaware corporate law cases in state courts other than Delaware, as well as federal forums, and great respect is afforded plaintiffs' choice of forum by the Delaware courts. *See Mar-Land Indus. Contractors, Inc. v. Caribbean Petroleum Ref., L.P.*, 777 A.2d 774, 779 (Del. 2001). This Court should return to its twin doctrinal framework of *McWane* and forum non conveniens jurisprudence and curtail efforts by corporate boards to restrict the rights of shareholders to bring litigation in their chosen forum.

The *McWane* framework, which is applied to later-filed claims in Delaware, generally favors the grant of a stay. *McWane*, 263 A.2d at 283. The Chancery Court asserted that the *McWane* doctrine prevents defendants from defeating 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. *Biondi v. Scrushy*, 820 A.2d 1148, 1159 (Del. Ch. 2003).

Pursuant to Delaware's well-established forum non conveniens jurisprudence governing motions to stay first-filed claims in Delaware, a plaintiff's choice of forum is given substantial weight and "Delaware courts consistently uphold a plaintiff's choice of forum except in rare cases." *Berger*, 906 A.2d at 135 (acknowledging that "dismissal should be granted only in rare cases where a defendant

would be subjected to overwhelming hardship"); *See also Mar-Land*, 777 A.2d at 777-78 ("A plaintiff seeking to litigate in Delaware is afforded the presumption that its choice of forum is proper and a defendant who attempts to obtain dismissal based on grounds of forum non conveniens bears a heavy burden.") (internal citations omitted). These cases demonstrate a consistent pattern by this Court of deference to filing chronology and plaintiffs' choice of forum.

Despite these considerations, the Chancery Court in this case has deviated from filing chronology and this Court's established jurisprudence, introducing the possibility that corporations can unilaterally mandate that intra-entity disputes be litigated in a designated forum. Despite claims to the contrary, the Court of Chancery is not promoting clarity in Delaware corporate law. The choice before the court today is whether to adhere to two established lines of jurisprudence or, alternatively, to cede to a reactive development that does not promote efficiency.

b. Permitting this and other unilateral exclusive forum bylaws will prompt litigation, thereby reducing efficiency.

Shareholders' right to pursue effective enforcement of the fiduciary duties owed to them is a fundamental right. It is inevitable that some shareholders will challenge a unilaterally adopted forum selection provision, arguing that their right to litigate in the forum of their choosing has been unlawfully restricted. When a forum selection bylaw is unilaterally adopted, courts may be particularly averse to allowing directors to limit shareholder's right to litigate in the forum of their choosing.

Given the likelihood of litigation, clarity and efficiency will not result from forum selection provisions. One state's conclusion about the enforceability of the forum selection provision would not be binding on another. Furthermore, a forum selection provision does little to guarantee that litigation will be commenced in the chosen forum. Instead, the more likely result is that current forum selection jurisprudence will be replaced by litigation regarding the enforceability of the provision.

This Court should not facilitate the adoption of forum selection provisions in corporate bylaws when arguments of efficiency and clarity are weak and the reception of other state courts is unknown and likely skeptical. At the very least, such a decision will in all probability be met with numerous challenges based on due process and equity concerns. Plaintiff Miller requests that this Court re-affirm its established jurisprudence regarding forum disputes in the dual framework of forum non conveniens and *McWane*. Plaintiff Miller submits that this Court should find that forum selection clauses unilaterally adopted in corporate bylaws are legally invalid.

II. THE BYLAW WAS INVALIDLY ADOPTED AS AN EQUITABLE MATTER; THUS, IT CANNOT DISPLACE CONVENTIONAL *MCWANE* ANALYSIS.

A. QUESTION PRESENTED

Was the Director Defendants' unilateral enactment of the exclusive forum Bylaw valid as an equitable matter?

B. SCOPE OF REVIEW

The implementation of a Bylaw represents a mixed question of law and fact. *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del.

1985). As such, factual findings of the Chancery Court are given deference, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1995), while the application of law is not. *Kahn v. Lynch Commc'n Sys.*, 669 A.2d 79, 84 (Del. 1995).

C. MERITS OF ARGUMENT

Even if the Bylaw is valid, it was invalidly adopted as an equitable matter. First, the unilateral Board decision to adopt the Bylaw represents self-interested behavior; thus, the application of entire fairness is appropriate rather than the deferential business judgment rule. Alternatively, the Bylaw warrants the application of enhanced judicial scrutiny for reasonableness and proportionality under *Unitrin* and *Unocal*. Therefore, the conventional *McWane* analysis is not displaced and Plaintiff Miller's Delaware Motion to Stay in favor of the Federal Action should be granted.

1. The Board's decision to enact the Bylaw demonstrates self-interested behavior or a decision that otherwise is the product of a breach of fiduciary duty; therefore, the entire fairness test should be applied and the Bylaw subsequently invalidated as an equitable matter.

The Board's action in enacting the Bylaw embodies either self-interested behavior or is the product of a breach of fiduciary duty because the decision mandates that litigation holding the Director Defendants accountable as fiduciaries occur only in Delaware. Thus, the Defendants have usurped control over any and all shareholder litigation asserting a breach of fiduciary duty—a result dictating the entire fairness analysis and subsequent invalidation of the Bylaw.

To warrant the application of entire fairness review, a plaintiff must first rebut the business judgment rule presumption in favor of

leaving loyal and informed board decisions undisturbed. *Emerald Partners v. Berlin*, 787 A.2d 85, 90-91 (Del. 2001); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971). A plaintiff can successfully rebut the presumption of the business judgment rule in one of two ways. First, a plaintiff rebuts the business judgment rule by providing evidence that the directors were not disinterested in their decision. *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988). Secondly, alleging that the directors breached any one of their fiduciary duties of good faith, loyalty, or due care is sufficient to rebut application of the business judgment rule. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). If the rule is rebutted through either of these avenues, the burden shifts to the defendant directors to prove the entire fairness of the decision. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983).

When the stringent entire fairness standard is applied to decisions by a corporate board, the application is essentially outcome determinative. *AC Acquisitions v. Anderson, Clayton & Co.,* 519 A.2d 103 (Del. Ch. 1986). Therefore, when the entire fairness standard applies to a board decision, the presumption in favor of deference to the board is rebutted, and defendants face the difficult task of proving that the decision was entirely fair to the corporation, including its entire shareholder franchise.

As aforementioned, the business judgment rule is rebutted when a plaintiff provides evidence that the directors were not disinterested in a challenged decision. *Weinberger*, 457 A.2d at 703. The most apparent example of such self-interested behavior appears when

directors have a financial interest in both sides of a transaction. In *Weinberger*, a former shareholder of UOP challenged the elimination of UOP's minority shareholders through a cash-out merger between UOP and its majority owner, Signal. *Id.* at 702. Two Signal officers, individuals who were also directors of UOP, performed a feasibility study concerning the possible acquisition of the remainder of UOP's outstanding shares. *Id.* The court, citing the clear conflict of interest facing these directors, concluded that the business judgment rule was rebutted and the defendants must prove the entire fairness of the board's decision to pursue the merger. *Id.* at 710. As the court explained, informed minority shareholder approval of the board decision would shift the burden to the plaintiff to demonstrate unfairness, *Id.* at 703; however, since the minority shareholder vote in *Weinberger* was not informed, the court held that the merger did not meet the standard of entire fairness. *Id.*

However, self-interest sufficient to elevate scrutiny is not only found when a director has a direct financial stake in both sides of a transaction; entire fairness is also demanded when a board's deliberative process reflects a breach of fiduciary duty, including the duty of loyalty. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (1991). In *Cede*, the court explained the duty of loyalty as a mandate that the "best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." *Id.* at 361. However, simply alleging that one director has a colorable interest, without more, is not sufficient to rebut the protection of

the business judgment rule; instead, the director's self-interest must translate into disloyalty by the entire board. *Id.* at 364. Accordingly, when a plaintiff provides evidence that the entire board's decision was motivated by self-interest—a spectrum of factors not limited to personal financial involvement—the business judgment rule is rebutted and entire fairness is applied. *See, e.g.*, *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (explaining that the "fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest").

Here, the protection of the business judgment rule is sufficiently rebutted due to the apparent interest that the Director Defendants had in enacting the Bylaw. Primarily, although there is no allegation that the Director Defendants stand on two sides of the same financial transaction as in *Weinberger*, this Court has previously recognized that the entire fairness standard is not limited to self-interest regarding a financial conflict in the merger context. *See, e.g.*, *Cede*,634 A.2d at 361-62; *Stone*, 911 A.2d at 370. Therefore, any argument that the Director Defendants lack a qualifying financial interest in the Bylaw's enactment is not dispositive of the application of entire fairness.

Furthermore, the Director Defendants' decision to enact the Bylaw embodies the type of self-interest that the court in *Cede* cited as a violation of the duty of loyalty sufficient to apply the entire fairness standard. The duty of loyalty mandates that board decisions must not place the interests of directors over those of the shareholders generally; however, the Bylaw violates that very

principle. The decision to limit fiduciary duty violation claims to Delaware courts ensures that directors benefit from efficiency, convenience, and predictability; however, these same benefits are denied to shareholders, as evidenced by the dual litigation facing Plaintiff Miller. The structure of the Bylaw ensures that a shareholder plaintiff will be forced to litigate any fiduciary claims against the directors in Delaware, even if the location of the evidence and the convenience of the plaintiff urges suit in another jurisdiction. Thus, if a shareholder asserts dual state and federal claims against Pinpoint or its directors, that shareholder's only option is to litigate entirely in Delaware, regardless of inconvenience. Thus, the Bylaw ensures that the directors receive the benefits of convenience while the shareholders do not. This inequity directly reflects the type of disqualifying board decision in violation of the duty of loyalty that demands the application of entire fairness under the precedent of *Cede*.

Additionally, the Bylaw does not reflect disloyalty by only one director: Pinpoint Directors all share an interest in litigation convenient to themselves. Since all the Directors share this self-interest, the application of entire fairness does not run afoul of the court's conclusion in *Cede* that a single director's self-interest is insufficient to warrant entire fairness. *Cede*, 634 A.2d at 634.

Finally, the burden to prove the entire fairness of the Bylaw remains with the Director Defendants. As the court noted in *Weinberger*, informed shareholder approval of a board decision shifts the burden to the plaintiff to prove the decision was unfair,

Weinberger, 457 A.2d at 703; however, no such shareholder approval of the Bylaw occurred in this circumstance. Instead, the Pinpoint Board adopted the Bylaw unilaterally without shareholder approval. Thus, the burden remains on the Director Defendants to demonstrate that the forum selection Bylaw was entirely fair to the shareholder franchise—a task they will be unable to accomplish due to the inherent unfairness in limiting shareholder litigation choices while ensuring protection for the Director Defendants' desires for convenience.

Ultimately, due to the interested nature of the Director Defendants' decision-making process, the business judgment rule is rebutted and the application of the stringent entire fairness standard is warranted. Thus, the inherent unfairness of favoring the protection of directors over the ability of shareholders to file suit in a jurisdiction convenient to them demonstrates that the Bylaw was invalidly adopted as an equitable matter. Hence, the Delaware Motion to Stay in favor of the Federal Action in Texas should have been granted.

2. Should this Court determine that it would be inappropriate to apply entire fairness to the Director Defendants' decision to enact the Bylaw, it should apply the *Unocal* enhanced scrutiny standard, thus invalidating the Bylaw.

This Court should apply *Unocal* enhanced scrutiny to the actions taken by Pinpoint's board of directors in adopting the Bylaw. Under *Unocal*, a court will apply the business judgment rule to defensive tactics undertaken by a board of directors unless the tactics are deemed unreasonable and disproportionate to a perceived threat. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985).

Under the two-part *Unocal* standard, before a board of directors is afforded the protection of the business judgment rule, the board carries a two-part burden. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995). First, the board must demonstrate that it had reasonable grounds for believing that a threat to corporate policy and effectiveness existed. *Id.* Second, the board must demonstrate that the actions it took were reasonable in relation to the threat posed. *Id.* Only if the board demonstrates both reasonableness and proportionality will the board receive the protection of the business judgment rule. *Id.*

Here, the Court should apply the *Unocal* enhanced scrutiny standard because the Bylaw was a defensive measure that lacked reasonableness and proportionality.

a. The board's decision to amend Pinpoint's bylaws to include the forum selection clause was a defensive tactic in response to the future threat of shareholder litigation.

Unocal enhanced scrutiny applies to the present case because the Bylaw, which requires all derivative and fiduciary claims to be brought in Delaware, was a defensive tactic utilized to perpetuate the directors control of the corporation. Before the *Unocal* standard of enhanced scrutiny can be applied to the actions of a board of directors, courts must first determine whether the conduct of the board was defensive. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1372 (Del. 1995).

Although *Unocal* scrutiny has predominantly been applied to cases involving defensive measures taken in response to attempted hostile takeovers, this Court has asserted that it is not limited to such a

context. *Stroud v. Grace*, 606 A.2d 75, 82 (Del. 1992). *Unocal* scrutiny has also been applied to cases where a corporation is not under attack. *See Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1350 (Del. 1985). Ultimately, a court should apply *Unocal* when a board of directors takes defensive action in response to a "threat to corporate policy and effectiveness which touch upon issues of control." *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1144 (Del. 1990).

In *Moran*, the board of directors adopted a preferred share purchase rights plan, which would discourage prospective raiders from making a tender offer. *Moran*, 500 A.2d at 1348. At the time the plan was adopted, Household International was not the target of any other corporations for the purposes of a takeover. *Id*. at 1349. Household's directors adopted the plan because of the prevailing takeover climate at that time. *Id*. Despite the fact that the record demonstrated that the board's initiative in adopting the plan was a reaction to nothing more than an abstract, future threat to the corporation, the court still found that the repurchase plan was a defensive tactic strong enough to initiate *Unocal* enhanced scrutiny. *Id*.

Here, Pinpoint's board amended the bylaws to include the forum selection clause on June 10, 2010. (Op. 2). This was three months before the board was informed by the OIG of the official investigation it would conduct in regards to accusations of false representation to the United States military. (Op. 6). Similarly to *Moran*, where the board adopted a purchase plan despite the fact that the corporation did not face any actual threats of a takeover, Pinpoint's board

enacted the exclusive forum Bylaw, despite the fact that it was not currently facing any actual threat of litigation.

Not only was the board's decision to amend the bylaws a defensive tactic, but it was a defensive tactic in response to a future threat to Pinpoint's corporate policy and effectiveness. The Defendant Directors should have been aware of the illegal cost-cutting mechanisms Pinpoint's managers were using. It is apparent that three managers had adopted the policy of not performing the required tests on bearings ordered by the military. (Op. 5-6). Therefore, a shareholder suit alleging this misconduct would have threatened that policy and eliminated its cost-effective results.

In addition to the fact that the board's decision to amend the bylaws constituted a defensive act in response to a perceived threat to corporate policy and effectiveness, the board's decision also touched upon issues of control. Controlling the forum where a shareholder can bring a derivative suit limits a shareholder's ability to hold directors accountable for their actions. Pinpoint has all of its operations in Houston, Texas. (Op. 4). All of its 8,000 employees work there. *Id.* Requiring the transfer of all this evidence to Delaware would place a heavy financial burden on any shareholder who decides to initiate a suit. This burden will inevitably cause many shareholders to decide against filing suit. As a result, the board maintains more control because a court will not review its action.

This Court should apply *Unocal* enhanced scrutiny in determining whether or not the bylaw is enforceable because the board's decision to amend the bylaws constituted a defensive tactic.

b. The board did not have reasonable grounds to believe that a threat to corporate policy and effectiveness existed in the form of shareholder suits outside the state of Delaware.

The Director Defendants had no reasonable grounds to believe that shareholder suits in Texas, where Pinpoint has its headquarters and all of its business operations, was a threat to corporate policy or effectiveness. Under the first part of the test under *Unocal* enhanced scrutiny, the board must show that they had reasonable grounds to believe a threat to corporate policy or effectiveness was posed. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995).

In *Unitrin*, this Court clarified the reasonableness prong of *Unocal* enhanced scrutiny. *Id.* at 1375. According to the Court, the board must demonstrate that it determined in good faith, after reasonable investigation, that a threat was present which required defensive measures. *Id.*

The flexible principles set forth in *Unocal* can be applied to the present dispute over the board's adoption of the forum selection clause. As this Court recognized in *Unocal*, "Our corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985).

Here, the Pinpoint Board had no reasonable grounds to consider shareholder litigation a threat because there are only two likely jurisdictions where shareholder suits could be filed, Delaware, Pinpoint's state of incorporation, or Texas, Pinpoint's principal

place of business. (Op. 4). Having two possible forums for dispute rather than one would not substantially hinder the board's concern regarding predictability. Furthermore, the board unreasonably placed its own needs for convenience and efficiency over the needs of the shareholders who cannot all afford the costs of traveling during drawn out litigation.

Thus, the Director Defendants unreasonably believed that shareholder suits filed outside the state of Delaware posed a threat to Pinpoint's corporate policy and effectiveness.

c. The board's decision to amend Pinpoint's bylaws to include the forum selection clause was not reasonable in relation to the perceived threat posed by shareholder suits.

Unilaterally enacting the Bylaw was not proportionate to a threat of shareholder litigation. Under the proportionality prong of *Unocal*, the board must show that its actions were reasonable in relation to the threat posed. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995).

When considering the proportionality of the measures taken by a board in reaction to a threat, this Court asserted that a board may not use draconian means to repel the threat. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). In *Unitrin*, this Court recognized two defensive measures that are considered draconian for the purposes of a *Unocal* analysis: coercive and preclusive measures. *Unitrin*, 651 A.2d at 1387. A court should look to see if the board's decision is within a range of reasonableness. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994).

This Court concluded that a board of directors' decision to extend the minimum time for calling a shareholder meeting, which was sought by a corporation seeking to overthrow the board in a proxy contest, was a proportionate response to the hostile corporation's attempts at a takeover. *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 497 (Del. 1995). In *Kidsco*, the Court determined that a change in the corporation's bylaw was not a draconian measure because it only delayed, but did not preclude, a shareholder vote. *Id*. According to the court, the amendment was within a range of reasonable alternatives. *Id*.

In this case, the Bylaw is admittedly not coercive; however, it is preclusive. This Court has recognized that "as a general rule, litigation should be confined to the forum in which it is first commenced." *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970). Although the Board's decision to limit intra-corporation disputes to Delaware courts does not completely preclude shareholders from bringing an action against the board, it does preclude the right of a claimant to select a forum better suited to entertain the dispute.

The courts of Texas serve as a better forum in the present case because most of the evidence and witnesses that are necessary for trial reside in the state of Texas. Unlike in *Kidsco*, where the Court determined that shareholders rights were merely delayed, not precluded, in the present case a shareholder's right to choose an appropriate forum for a dispute has been completely eliminated.

As a result, the Bylaw precludes shareholders from choosing an appropriate forum for disputes. Therefore, the board's actions were disproportionate to the perceived threat. As a result, this Court should conclude that the board failed to carry its burden under *Unocal*.

III. THE BYLAW IS INVALID OR INOPERATIVE AS AN EQUITABLE MATTER; THUS, THE CONVENTIONAL *MCWANE* ANALYSIS IS APPROPRIATE AND PLAINTIFF MILLER'S DELAWARE MOTION TO STAY IN FAVOR OF THE FEDERAL ACTION SHOULD HAVE BEEN GRANTED.

A. QUESTION PRESENTED

In the face of an invalid or inequitably enacted exclusive forum Bylaw, does *McWane* analysis favor granting a motion to stay when there is prior litigation pending in another court capable of doing swift and complete justice?

A. SCOPE OF REVIEW

The proper application of the *McWane* standard is a mixed question of law and fact, calling for deference to the Chancery Court's factual findings, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1995), but plenary review of legal determinations. *Kahn v. Lynch Commc'n Sys.*, 669 A.2d 79, 84 (Del. 1995).

B. MERITS OF ARGUMENT

Should this Court determine that the bylaw is invalid or inoperative as an equitable matter, it should apply a conventional *McWane* analysis and grant Plaintiff Miller's Delaware Motion to Stay. The Court's discretion can be shifted in favor of granting a stay when there is prior litigation pending in another court capable of providing swift and complete justice. *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 283 (Del. 1970).

In *McWane*, this Court laid out a number of factors that should shift a court's discretion in favor a motion. *See Id*. These factors include: (1) the litigation in the other court involves the same parties and issues, (2) as a general rule, litigation should commence in the forum in which it was first initiated, and (3) a defendant should not be allowed an end around the plaintiff's choice of forum by commencing litigation involving the same claims in another jurisdiction of its choosing. *Id*.

The dispute in *McWane* involved a plaintiff who had filed suit in Alabama, where the contract between the plaintiff and the defendant was to be performed. *Id*. at 282. In response, the defendant filed a suit based on the exact same claims in Alabama, the Superior Court of Delaware, and the Court of Chancery. *Id*.

The Court determined that the Superior Court abused its discretion by dismissing the plaintiff's motion to stay the Delaware proceedings. *Id*. The Court asserted that the Superior Court should have granted the stay in order to avoid wasteful and duplicative litigation. *Id*.

Recently, this Court clarified *McWane* in circumstances where the parties negotiated for a forum selection clause within a contract. *See Ingres Corp. v. CA, Inc*., 8 A.3d 1143, 1145-46 (Del. 2010). In *Ingres*, the two parties were corporations that contracted with each other for services. *Id*. at 1145. In upholding the principles of *McWane*, the Court asserted that if parties expressly agree upon a legally enforceable forum selection clause within a contract, a court should

enforce the clause, even if, absent the clause, *McWane* would require a different result. *Id*.

The present case has all of the characteristics described in *McWane*. Litigation involving the same parties and issues was first filed in federal court in Texas by Plaintiff Miller. (Op. 1). Rather than seeking to move the forum to Delaware by filing suit in Delaware, Defendants attempted to move it based on a forum selection clause. Unlike the parties in *Ingres*, Plaintiff Miller did not negotiate for the Bylaw with Defendants.

In the interests of comity and efficiency, this Court should determine that the principles of *McWane* are prominent in the present case and as a result it should grant Plaintiff Miller's Motion to Stay the Delaware proceedings.

CONCLUSION

The exclusive forum Bylaw is invalid as a matter of law or was invalidly adopted as an equitable matter. As such, the conventional *McWane* analysis supporting resolution of Plaintiff Miller's claim in the jurisdiction in which it was first filed is not displaced. Thus, Plaintiff's Motion to Stay in favor of the first-filed Texas Federal Action should be granted and the Order of the Chancery Court reversed.