IN THE

**SUPREME COURT OF THE STATE OF DELAWARE**

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

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| EDWARD MILLER,<br><br>Plaintiff Below,<br>Appellant<br><br>v.<br><br>MICHAEL SANCHEZ, CLARE MITCHELL, BRENDAN ELLSWORTH, TIMOTHY FLETCHER, MARSHA FRANKLIN, DAPHNE KEYES, and ERIC LAM,<br><br>Defendants Below,<br>Appellees,<br><br>and<br><br>PINPOINT BEARINGS, INC.<br><br>Nominal Defendant Below,<br>Appellee | : | Court Below:<br>Court of Chancery in and<br>for New Castle County<br>Civil Action No. 4958-VCM |

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APPELLANTS' OPENING BRIEF

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Team K
Counsel for Plaintiff
Below, Appellant

Dated: February 11, 2011

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## NATURE OF PROCEEDINGS

On December 2, 2010, Plaintiffs Webb, Patrick, and Kohn filed in the Court of Chancery complaints that were consolidated to form the present action (the "Delaware Action"). On December 15, 2010, Edward Miller ("Miller")——plaintiff below, appellant——made three simultaneous filings: (1) a complaint similar to that of Webb, Patrick, and Kohn, (2) a motion for a modified Order of Consolidation that would include Miller's action within the Delaware Action, and (3) a motion to stay the Delaware Action in favor of nearly identical proceedings previously commenced in the U.S. District Court for the Southern District of Texas. On January 12, 2011, Chancellor Jamie K. McCloskey denied Miller's motion to stay. On January 14, 2011, Miller filed a motion for interlocutory appeal, which was granted by Justice Randy J. Holland on January 18, 2011.

This is appellant Miller's opening brief.

## STATEMENT OF FACTS

Pinpoint Bearings, Inc., ("Pinpoint")——nominal defendant below, appellee——is a Delaware corporation with its principal place of business in Houston, Texas. Miller is a retired Pinpoint employee who is domiciled in Houston. Miller has owned Pinpoint stock at all times relevant to this litigation, and owns 5,000 shares of stock worth approximately $230,000, the majority of which he acquired in the course of his employment with Pinpoint.

Pinpoint specializes in manufacturing highly engineered precision roller and ball bearings for many critical aerospace applications. Pinpoint's corporate headquarters and manufacturing operations lie in Houston where it employs about 8,000 people. Its market capitalization is approximately $4 billion, with 88 million shares outstanding that trade for about $46 per share. There are over 28,000 Pinpoint shareholders of record who collectively hail from each of the 50 States. Although Pinpoint conducts business with commercial airline manufacturers, the U.S. military accounts for more than 60% of Pinpoint's annual revenues.

By Pinpoint's admission, three mid-level managers began, in early 2009, to omit certain tests required under Pinpoint's contracts with the U.S. military because the managers believed that the tests were redundant. This pattern of misconduct forms the basis of this litigation between Miller and the named-defendant members of Pinpoint's Board of Directors (the "Board").

About eighteen months after the testing omissions began, the Board adopted a bylaw dated June 10, 2010 (the "exclusive forum bylaw"

or the "bylaw") that purports to designate the Court of Chancery as the exclusive forum for any derivative action brought on Pinpoint's behalf, any claim that asserts a breach of a fiduciary duty, as well as any other claim owed by any director or officer of the company. The exclusive forum bylaw provides:

> 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.

In early September 2010, the Office of Inspector General of the United States (the "OIG") received a complaint of Pinpoint's testing omissions. The OIG promptly commenced an investigation and discovered the omissions and the false invoice submissions to the military. Upon learning of the investigation's outcome, Pinpoint acquiesced to the OIG's findings and sought a settlement.

On November 30, the Board and the OIG finalized a settlement, under which Pinpoint (1) acknowledged five separate violations of 31 U.S.C. §3729 (the "False Claims Act"), (2) consented to a payment of $500 million in fines and penalties, and (3) agreed to terminate the three mid-level employees who managed the cost-cutting scheme. Later that day, Pinpoint disclosed the OIG's investigation and its outcome to the public, which caused Pinpoint's market capitalization to plummet $360 million before trading closed.

On December 1, one day after the press release, Miller filed suit in the U.S. District Court for the Southern District of Texas (the "Original Action") and alleged that the Board: (1) violated federal securities law when it knowingly withheld disclosure of Pinpoint's wrongdoing and the OIG investigation, and (2) violated its state law fiduciary duty of oversight when it failed to implement and maintain an adequate compliance system to ensure that Pinpoint met its contractual obligations.

On December 2, Plaintiffs Webb, Patrick, and Kohn filed complaints in the Court of Chancery and alleged virtually the same derivative oversight claim that Miller asserted in the Original Action. Their three claims were consolidated to form the Delaware Action.

## ARGUMENT

### First Question Presented

**Delaware law binds parties to exclusive forum provisions in a variety of contexts where the parties consented to the provision. Pinpoint's Board attempts to bind shareholders to an exclusive forum provision through a board-adopted bylaw. Does the reasoning that supports upholding exclusive forum provisions in other contractual contexts extend to provide for their enforcement in board-adopted bylaws?**

### Scope of Review

The construction of the certificate of incorporation, corporate bylaws, and portions of the DGCL raise legal questions subject to *de novo* review by this Court. Baldwin v. Benge, 606 A.2d 64 (Del. 1992); Oberly v. Kirby, 592 A.2d 445 (Del. 1991).

### Merits of Argument

**I. The motion to stay the Delaware proceedings should be granted because the board-adopted exclusive forum bylaw is invalid.**

While Boards of Directors may unilaterally adopt bylaws that concern many matters, exclusive forum provisions do not fall within this category. Because of the restrictive nature of exclusive forum provisions, such provisions may only be adopted with shareholder consent. The board-adopted bylaw imposes an exclusive forum provision, and consistent with case law and the reasoning that supports exclusive forum provisions in other contexts, the bylaw is invalid. This Court should therefore reverse the Court of Chancery and stay the Delaware Action in favor of the prior-filed Original Action.

**A. The exclusive forum provision is invalid because it was adopted in the form of a corporate bylaw without notice to, or consent from, shareholders.**

The bylaw at issue unlawfully prohibits Miller from litigating in the Southern District of Texas. The Board did not have the power to

adopt a bylaw designating a forum for all fiduciary and derivative litigation without shareholder consent. Shareholders could not have consented to the provision's adoption where the provision was not part of the original agreement and the Board withheld notice.

When an exclusive forum provision is adopted unilaterally in the form of a bylaw, shareholders are denied their rights of forum selection. This Court has recognized as a general rule that "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). While granting a motion to stay is undoubtedly within the discretion of this Court, the present case warrants that such discretion be exercised in favor of a stay. McWane, 263 A.2d at 282-83.

This Court in McWane pronounced a list of factors it held sufficient to impel a stay. Id. at 283. Because the McWane factors are present here, this Court should likewise grant the requested stay. First, the bylaw, like the contract in McWane, was executed in Texas. Id. Moreover, the majority of Miller's shares were acquired in the course of his employment with Pinpoint in Texas. R.3-4. Second, there is no contact with Delaware except that Pinpoint is incorporated there. McWane, at 283. Third, the parties have available in the Texas action "all the discovery, pretrial, and trial advantages" they would have in the Court of Chancery for a "speedy, just and complete disposition of the claims" of those involved. Id.

In addition to these considerations, allowing such a result in the present case would thwart the purpose of diversity jurisdiction by

denying shareholders "an opportunity[,] at their option, to assert their rights in federal rather than state courts." Meredith v. City of Winter Haven, 320 U.S. 228, 234 (1943).

**(1) The key to exclusive forum provisions is consent. Board-adopted bylaws lack shareholder consent. Thus, board-adopted bylaws that contain exclusive forum provisions are invalid.**

Exclusive forum provisions in contracts have long been accepted in American courts. *See* M/S Bremen v. Zapata, 407 U.S. 1 (1972). They provide a mechanism through which parties negotiate with the goal of selecting an acceptable forum for future litigation. 31 A.L.R. 4th §404 (2011). Mutual consent by the parties is an inherent requirement of these contractual provisions. In contrast, neither negotiation nor consent are required when a board exercises its powers by unilaterally amending a corporate bylaw. CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227, 232 (Del. 2008). Thus, a unilaterally-adopted exclusive forum provision fails to satisfy the requirements of contract law while simultaneously overstepping what is permitted under corporate law.

Galaviz v. Berg recognized consent as the lynchpin in the enforceability of exclusive forum provisions, and thus, as a requirement remaining even where such provisions take the form of corporate bylaws. 2011 U.S. Dist. LEXIS 1626, 12 (N.D. Ca. Jan. 3, 2011). Galaviz held that where "there was no element of mutual consent" to an exclusive forum bylaw, there was "no basis for the Court to disregard the plaintiffs' choice of forum..." Id. at *12. The court acknowledged that while "a plaintiff can be said to have consented to the forum selection clause" in a contract "when he ...

elected to enter ... that contract," board-adopted bylaws stands "on a different footing." Id. at *2. The court reasoned, "[u]nder contract law, a party's consent to a written agreement may serve as consent to all the terms therein[,]" and is why exclusive forum clauses provisions are favored in contracts. Id. at *10. However, the same cannot be said when a party attempts to "thereafter unilaterally add or modify contractual provisions." Id. Thus, while bylaws may be contractual in nature, when amended to include an exclusive forum provision, consent is still required.

Galaviz parallels the present case in at least three respects. First, the Board's unilateral adoption of the exclusive forum bylaw abrogates contractual consent. In both Galaviz and the present case, a bylaw "was unilaterally adopted by the directors ... after the ... purported wrongdoing ... occurred." Id. at *12. Second, an otherwise invalid bylaw is not made valid merely because it is classified as part of a pre-existing contract. Id. at *9. The Board claims the bylaw should be treated as a contract "among shareholders of the corporation." R.13. However, this does not negate the requirement of consent that attaches to all exclusive forum provisions. Moreover, consent cannot lie where such provisions, absent at the time of contracting, are subsequently added by one party without notice. Third, exclusive forum provisions upheld in different contexts have no bearing on the validity of board-adopted bylaws. Classification of bylaws as contracts suggests bylaw amendments should be analyzed in a contractual context. However, the Board has failed to provide "any commercial contract case upholding..." an elusive forum bylaw

"inserted by ... unilateral amendment to existing contract terms." Id. at *10. Therefore, the Bylaw is invalid as it contains an exclusive forum provision adopted by the Board without shareholder consent.

**(2) Exclusive forum provisions upheld in other contexts do not support the present bylaw's validity because it was board-adopted and not part of a pre-existing agreement.**

The Board insists that valid bylaws form an "internal governance contract" among shareholders of a corporation. R.13. This may be true, but it would be Procrustean to contend that the unilaterally-adopted bylaw at issue falls within this contract. Under Delaware law, "the most basic elements of a contract" are: "(1) a bargain, (2) in which there is manifestation of mutual assent to the exchange, and (3) consideration." James Cable, LLC v. Millennium Digital Media Sys., 2009 WL 1638634 at *7 (Del. Ch., June 11, 2009). Thus, a unilaterally-adopted bylaw, lacking mutual consent by definition, cannot be considered as part of any pre-existing agreement.

Exclusive forum provisions have been upheld in a number of contexts where principles of general contract law were applied. However, the reasoning used fails to support similar results here where shareholder consent is absent.

For example, the U.S. Supreme Court in Carnival Cruise Lines, Inc. v. Shute, upheld a forum selection provision in an adhesion contract, but Carnival differs from the present case in at least two respects. 499 U.S. 585, 590 (1991). First, contract law was appropriate because the clause was contained in a commercial contract for the purchase of a cruise ticket. Id. at 587. Second, because the purchasers had notice of the forum selection provision, they were held

to have consented to it when they did not avail themselves of the opportunity to void the contract. Id.

Carnival upheld the contractual exclusive forum provision, but its reasoning undermines the Board's exclusive forum bylaw for at least two reasons. First, because the Board-adopted bylaw was not contained in the any agreement between the shareholders and the corporation, shareholder consent cannot be inferred. Second, the Board's unilateral adoption of the bylaw denied shareholders notice and opportunity to protest, two factors that made the provisions in Carnival enforceable.

Like contracts, LLC arbitration agreements require consent of affected parties. Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286 (Del. 1999). For this reason, LLC arbitration agreements may contain exclusive forum provisions. In Elf Atochem, this Court upheld an exclusive forum provision by focusing on three distinct concepts: consent, an LLC's inherent characteristics, and Delaware public policy in favor of arbitration. 727 A.2d at 291-92. However, the reasoning in Elf Atochem compels the opposite result in the context of exclusive forum provisions in board-adopted corporate bylaws. First, consent in Elf Atochem was present where the parties knew of the exclusive forum provision when they entered into the agreement. Id. at 288. In contrast, Pinpoint's shareholders had no knowledge of the exclusive forum provision because it was adopted unilaterally by the Board without notice. Second, Elf Atochem focused on the flexible nature of an LLC, which can be contrasted with the rigid structure of a corporation. This Court reasoned that, "because the policy of the

Delaware LLC Act is to give maximum effect to the **principle of freedom of contract**...the parties may contract" to designate a particular forum. Id. at 295. The public policy that supports the strong freedom to contract within LLCs does not support the same freedom to contract in corporations because LLCs by their nature are far more flexible than corporations. Id. Third, this Court emphasized the importance of Delaware public policy in favor of arbitration as the preferred means of settling disputes. Id. at 291-92. However, no analogous policy extends to uphold board-imposed restrictions on the shareholders' ability to litigate.

### B. A board-adopted exclusive forum bylaw is not authorized by Revlon.

The Court of Chancery relied upon the dicta in its earlier Revlon decision, but a board-adopted exclusive forum bylaw exceeds what the Revlon court suggested. R.2.

In Revlon, the sole question was whether plaintiff's counsel failed to adequately litigate the case at bar. In re Revlon, Inc. S'holder Litig., 990 A.2d 940, 942 (Del. Ch. 2010). In a discussion regarding modern litigation issues, the court mentioned problems attributable to frequent filers, and within this discussion, the court speculated that exclusive forum charter amendments may be a solution. Id. at 960. Even so, Revlon concerned adequacy of representation——not corporate governance——and no exclusive forum provision was before the court. *See generally* id.

In applying Revlon to the present case, the Court of Chancery disregarded Revlon's plain language. The Revlon court stated that "if **boards of directors and stockholders** believe that a particular forum"

is preferable "then corporations are free to respond with **charter provisions** selecting an exclusive forum[.]" Id. at 960 (emphasis added). Thus, Revlon premised its speculation on two conditions: (1) agreement by the directors and shareholders and (2) placement of the provision in the corporate charter. Id.

Both of these factors require shareholder consent, which is lacking in board-adopted bylaws. The first factor directly speaks to the required consent of shareholders, which board-adopted bylaws do not require.

Similarly, the second factor implies consent is required because corporate charter amendments, unlike bylaws, cannot be adopted unilaterally by the board. Section 242 gives the requisite procedure for amending a corporate charter. DEL. CODE ANN. tit. 8, §242 (2009). To amend charter provisions, the board is required to propose the amendment, and then await its adoption by a majority of outstanding shares. DEL. CODE ANN. tit. 8, §242(b) (2009). Because Revlon presumed that exclusive forum provisions would be adopted through charter amendments, it also presumed that such provisions could only be adopted with the consent of shareholders.

Thus, in the sentence upon which the Board relies, the Board's case is twice undermined. Revlon's speculation was premised upon shareholder consent and cannot apply to board-adopted exclusive forum bylaws.

## Second Question Presented

**Under Delaware law, inequitable action is not permissible simply because it is legally possible. The Board adopted an exclusive forum bylaw requiring all derivative litigation to take place in Delaware, including suits arising out of alleged director misconduct occurring before the bylaw's adoption. Is the bylaw invalid on equitable grounds?**

## Scope of Review

The question of the validity and fairness of Pinpoint's exclusive forum bylaw is a mixed question of law and fact. Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 407 (Del. 1985). The applicable standard by which the Board's conduct is to be judged is a legal question and subject to *de novo* review. Nixon v. Blackwell, 626 A.2d 1366, 1375 (Del. 1993). As to the findings of fact, the reviewing court looks at the entire record and the sufficiency of evidence to test the propriety of those findings. Levitt v. Bouvier, 287 A.2d 671, 673 (Del. 1972).

## Merits of Argument

### II. Equity defeats the exclusive forum bylaw because of the bylaw's inequitable purpose and effect on shareholder rights.

Under Delaware law, there are two types of corporate claims. The first type is a "legal claim, grounded in the argument that corporate action is improper because it violates a statute, the certificate of incorporation, a bylaw or other governing instrument[.]" Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1077-78 (Del. Ch. 2004). The second type is an "equitable claim[,] founded on the premise that the directors or officers have breached an equitable duty that they owe to the corporation and its stockholders." Id. Even if this Court finds

that the exclusive forum bylaw is valid as a matter of law, the bylaw must fail as a matter of equity.

### A. The exclusive forum bylaw is invalid because the Board adopted it for an inequitable purpose and the bylaw inequitably affects the shareholders' litigation rights.

Delaware corporate law has long recognized the Court of Chancery's powers of equity and its ability to adapt relief to the particular rights and liabilities of each party. Gilliland v. Motorola, Inc., 873 A.2d 305, 312 (Del. Ch. 2005). This principle is well exemplified in Schnell v. Chris-Craft Indus., Inc., in which this Court provided that "inequitable action does not become permissible simply because it is legally possible." 285 A.2d 437, 439 (Del. 1971). Stated another way, "inequitable action is not insulated from review simply because that action was accomplished in compliance with the statutory and contractual provisions governing the corporation." Grace Bros. v. Uniholding Corp., 2000 WL 982401, *14 (Del. Ch. 2000).

When bylaws are grounded in inequity, the Schnell doctrine calls for their invalidation. To determine whether a bylaw is inequitable, courts focus on two considerations: (1) whether the bylaw was adopted for an inequitable purpose and (2) whether the bylaw has an inequitable effect. *See* 285 A.2d at 439; *see also* Hollinger 844 A.2d at 1080-81; Frantz Mfg. Co., 501 A.2d at 407-08; Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1107 (Del. 1985).

#### (1) The Board adopted the exclusive forum bylaw for an inequitable purpose: to deter litigation that would arise out of the Board's prior misconduct.

Hollinger illustrates the Schnell doctrine's emphasis on the purpose behind a bylaw. In that case, the board chairman used his

power as the controlling shareholder to subvert the board's strategic process to engage in a value-maximizing transaction. Hollinger, 844 A.2d at 1061-62. Instead of fulfilling his fiduciary duties by complying, the chairman engaged in several self-dealing activities designed to frustrate that process. Id. Thereafter, the chairman imposed a bylaw that required the board's unanimous vote. Id. at 81. This bylaw prevented the remaining directors from alleviating the harm caused by the chairman's prior misconduct. Id. at 1077-81. The court found the chairman intended the bylaw to protect his own self-interests and to prevent the board from following through with the value-maximizing transaction. Id. Because the bylaw clearly had an inequitable purpose and an inequitable effect, it was invalidated on equitable grounds. Id.

As in Hollinger, the Board adopted the exclusive forum bylaw to limit shareholder litigation, especially claims arising out of Pinpoint's prior contractual breaches with the U.S. military. It is undisputed that three Pinpoint managers defrauded the U.S. military, omitted product tests required by the company's contracts, and that Pinpoint must pay $500 million in fines and penalties as a result. R.6. It is further undisputed that the Board adopted the exclusive forum bylaw more than a year after the initial misconduct, which gave the Board sufficient opportunity to acquire knowledge of the misconduct before the bylaw's adoption.

At this preliminary stage of litigation, clear evidence of actual knowledge is not required because discovery has yet to be conducted. Therefore, for the purposes of this motion, the bylaw should be

treated as a defensive mechanism to protect the Board from personal liability for its lack of oversight.

For these reasons, the Board should be deemed to know of the misconduct and the threat of any future litigation that might arise from it. This knowledge manifests itself as the inequitable purpose to defend against future litigation at shareholder expense.

**(2) The exclusive forum bylaw has an inequitable effect because it places significant financial and logistical burdens on the shareholders' litigation rights.**

But "even if management understandably lacked knowledge of all the facts" leading to the Board's liability, the inequitable effect on shareholders alone may invalidate the bylaw. Lerman v. Diagnostic Data, Inc., 421 A.2d 906 (Del. Ch. 1980). The exclusive forum bylaw's adverse effects on shareholder litigation rights are sufficient to invalidate the bylaw.

In Lerman, the board amended the bylaws to terminate annual board meetings in favor of discretionary board meetings. Id. at 912. The board set its nominating meeting to occur 63 days later, which conflicted with another bylaw that required shareholders to submit board nominees at least 70 days in advance. Id. Because shareholders could no longer comply with the 70-day notice requirement, they were barred from nominating dissident slates of directors. Id. at 914. The Court of Chancery held that the board's action "whether designedly inequitable or not, has had a terminal effect on the aspirations" of shareholders, and invalidated the bylaw. Id. No credible improper motive was alleged; in fact, the court added that it failed to see how the bylaw amendment could be upheld "even if management understandably

lacked knowledge of all the facts and had no intention of thwarting a potential proxy context." Id. Because the Lerman bylaw deprived the shareholders of their fundamental right to nominate directors, equity demanded that the bylaw fail. Id.

As Lerman illustrates, there are at least two facets to Schnell: purpose and effect. While Schnell contemplates an inequitable purpose, later cases clarify that an improper purpose is not dispositive. Id. Board actions that substantially and adversely affect the rights of shareholders are sufficient to invalidate a bylaw. Therefore, even if this Court does not find an improper purpose behind the exclusive forum bylaw, that does not defeat Schnell's application. This Court must also evaluate the bylaw's adverse effects on the litigation rights of Pinpoint's shareholders.

The Board's exclusive forum bylaw inhibits Miller's ability to bring a broad range of claims on behalf of the corporation, including personal claims against the directors. R.3. The bylaw bars Miller's litigation in the Southern District of Texas even though Pinpoint's corporate headquarters and all of its manufacturing operations are located in the Southern District of Texas; Miller and the majority of Pinpoint's thousands of employees live in the Southern District of Texas; and all discovery, witnesses, and other evidence lies in the Southern District of Texas. Pinpoint has no connection to Delaware except that it is incorporated here. These facts coupled with the bylaw's requirement to bring all litigation in Delaware places a considerable financial and logistical burden on Miller and any similarly situated shareholder who wishes to bring claims against the

Board. This, in turn, deters claims to maximize shareholder welfare and to hold directors liable for their improper actions. Ultimately, this benefits the personal interests of the Board at the expense of shareholders and the corporation.

Because the exclusive forum bylaw imposes such substantial burdens on shareholder litigation efforts and greatly benefits director self-interests, the bylaw is invalid as a matter of equity under Schnell.

### B. The equitable powers of this Court reach beyond actions affecting the shareholder franchise and apply to a myriad of director actions including the adoption of the exclusive forum bylaw.

Without doubt, the DGCL grants directors broad discretion to conduct the business affairs of a corporation. McMullin v. Beran, 765 A.2d 910, 916 (Del. 2000). But "[t]hat capacious grant of power is policed in large part by the common law of equity[.]" Hollinger, 844 A.2d at 1078. When directors exploit their discretion for inequitable ends, "Delaware's public policy interest in vindicating the legitimate expectations that stockholders have of their corporate fiduciaries requires its courts to act[.]" Id.

The Schnell doctrine applies to all director actions regardless of whether those actions affect the shareholder franchise. *See e.g.*, Hollinger, 844 A.2d at 1081-82. When applying Schnell to a director's conduct, courts focus upon two considerations, (1) whether the conduct has an inequitable purpose, and (2) whether the conduct has an inequitable effect. *See e.g.*, Schnell, 285 A.2d at 437-40. Because the exclusive forum bylaw fails under these considerations, it fails under Schnell.

The Court of Chancery refused to invalidate the bylaw on equitable grounds because the bylaw does not affect the shareholder franchise. R.16-19. While Schnell itself involved board action that impaired the shareholder franchise, its application is not limited to that situation. *See* Hollinger, 844 A.2d 1022; Rabkin, 498 A.2d at 1105; Petty v. Penntech Papers, Inc., 347 A.2d 140, 143-44 (Del. Ch. 1975). The doctrine applies in any case where corporate fiduciaries exploit their statutory flexibility for inequitable ends.

In Hollinger, the controlling shareholder and board chairman abused his statutory powers by adopting a unanimous-vote bylaw to stop independent directors from taking action he opposed. 844 A.2d at 1080-81. Despite its validity under the DGCL, because the bylaw was adopted for an inequitable purpose and impaired the independent directors, the Court of Chancery invalidated it. Id. at 1082.

Hollinger illustrates that equity is not rendered lame outside of the shareholder franchise. Id. Inequity—not disenfranchisement—provides Schnell's ideological underpinning and triggers Schnell's application. Id. The Hollinger bylaw, for example, did not affect the shareholder franchise at all, but rather interfered with director management over business affairs. Id. Despite this distinction, equity called for the bylaw's invalidation. Schnell-like cases rest upon the simple proposition that inequitable bylaws will not be enforced, which the Hollinger court relied upon to decide the case. Id.

The Schnell doctrine applies whenever corporate fiduciaries exploit their statutory flexibility for inequitable ends. The doctrine is not limited to board conduct that infringes upon the shareholder

franchise. In this case, the exclusive forum bylaw adversely affects the shareholders' right to bring derivative suits and other corporate claims, which are fundamental shareholder rights. Michael P. Roch, 1 THE LAW OF TRANSNATIONAL BUSINESS TRANSACTIONS §2:16 (Ved P. Nanda ed., Thomson Reuters 2010). For these reasons, Schnell invalidates the exclusive forum bylaw.

## Conclusion

This Court should find that the board-adopted bylaw is unlawful because the Board cannot impose an exclusive forum provision upon shareholders without shareholder consent. Alternatively, even if this Court upholds the exclusive forum bylaw as a matter of law, it fails as a matter of equity because of the bylaw's inequitable purpose and effect on shareholder litigation rights. For these reasons, this Court should reverse the Court of Chancery and stay the Delaware Action in favor of the prior-filed Original Action.