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ENFORCEABILITY OF MANDATORY ARBITRATION CLAUSES FOR SHAREHOLDER-CORPORATION DISPUTES

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Investor litigation is an increasingly vexatious field of law. Nearly every time a significant change of control or corporate ownership occurs, plaintiffs' attorneys file standardized complaints to set in motion class action suits.[1] Ultimately, the settlements shareholders receive fail to achieve the practical effects that parties on both sides desire. Shareholders may receive pennies on the dollar of what they allege was lost by corporate wrongdoing, and, in some cases, shareholders may not receive monetary recovery as the settlement requires only that the corporation to make changes to its governing documents.[2] These suits distract directors and management from the core operational aspects of their business.[3] Corporations will pay enormous fees to attorneys and experts to defend against the suits.[4] Often times, as a result of director and officer liability insurance, neither corporations nor directors pay

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1. *See* Natalia Steele, *Mergers & Acquisitions Strike Suits: What's a Bank To Do?*, Safe Talk (Am. Bankers Ass'n Ins. Servs.), Sept. 2014, at 1, 1–2, *available at* http://abais.com/Data/Sites/1/downloads/SafeTalk2014/SafeTalk.September2014-Merger_and_Acquisition_Strike_Suits-NS.pdf.

2. *See* Paul D. Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws*, 2013 BYU L. Rev. 65, 67, 73 (2013).

3. *See* Andrew J. Pincus, What's Wrong with Securities Class Action Lawsuits? 7 (2014), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/Securities_Class_Actions_Final1.pdf.

4. *See id.* at 6, 9.

damages out of pocket, making it unlikely that the suits serve a deterrent function, one of the principal policy goals behind allowing for such suits.[5]

Consequently, corporations have increasingly turned to arbitration as a way to settle corporate disputes, including those with shareholders. "An agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that posits not only the situs of suit but also the procedure to be used in resolving the dispute."[6] Several scholars have addressed the merits of arbitration as it pertains to corporate strategy or judicial economy. This Note instead will focus on the statutory provisions, judicial decisions, and external factors that impact the implementation and legality of arbitration provisions in a shareholder litigation context. In doing so, this Note will seek to answer (1) whether a corporation may adopt an arbitration provision that binds investors—who are often shareholders—and the corporation to mandatory individual arbitration, and if so, (2) what language or types of features a permissible provision would contain.

This Note will proceed in five parts. Part I presents a definition of an arbitration provision to guide this discussion. Part II addresses the statutory basis for implementing arbitration clauses under the Delaware General Corporation Law (DGCL)[7] and discusses which actors have the authority to adopt arbitration clauses, concluding that incorporators, directors, or shareholders may implement arbitration clauses by including them in the articles of incorporation or the bylaws. Part III discusses the Federal Arbitration Act (FAA)[8] and related US Supreme Court cases, which present additional federal tests for assessing the validity of arbitration clauses. Part IV analyzes state law contract considerations, focusing on mutual assent and unconscionability. Part V presents the United States Securities and Exchange Commission's (the "Commission") role in regulating arbitration clauses. While the Commission can pressure corporations in order to prevent inclusion of arbitration clauses in such offerings, it has refrained from issuing formal decisions against arbitration clauses. Part VI concludes by addressing key practical consequences of the current state of affairs and raising questions for corporations and courts to consider in the future.

Part I: Possible Forms of Arbitration Provisions

Arbitration clauses, like other contractual terms, can be written to meet the parties' specific needs. For example, a corporation could draft a provision so that it only applied to certain disputes above or below a given

5. *See* Weitzel, *supra* note 2, at 73–75.

6. Scherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974).

7. *See generally* Del. Code Ann. tit. 8, ch. 1 (2014).

8. Federal Arbitration Act, Pub. L. No 68-401, 43 Stat. 883 (1925) (codified at 9 U.S.C. § 1 *et seq.* (2014)).

monetary threshold, as some corporations have done.[9] Additionally, arbitration provisions may be written to require individual arbitration, thereby preventing class resolution. For the purposes of this Note, discussion of arbitration provisions will refer to mandatory binding arbitration on an individual basis, without regard to a monetary threshold. This definition is appropriate because corporations are most likely to propose clauses in this manner and because a focus on individual suits allows for a more clear illustration of the dichotomy between the current class-action centered regime, thus providing an opportunity for a more fruitful legal discussion of baseline state law requirements.

Part II: Implementation of Arbitration Provisions

A corporation could implement mandatory arbitration provisions in a variety of ways. Because corporate law is a state matter, the methods available to enact arbitration provisions may vary state-by-state, but this Note will focus on Delaware law. Legal support for various methods of implementation within Delaware come from statues, principally the DGCL, and judicial opinions interpreting the same.

Arbitration provisions may be implemented in one of three ways. They can be: (1) written into the corporation's articles of incorporation; (2) included in the corporation's bylaws, either as an initial bylaw or added as a subsequent amendment; or (3) negotiated between the corporation and shareholders on an individual basis. The third method, individual contracting, is least appealing because it would entail prohibitively high transaction costs. Attorneys would have to contact and negotiate with each shareholder to ensure all shareholder disputes were arbitrated, thus defeating a primary purpose of arbitration.

DGCL Section 102(b)(1) authorizes the first method, inclusion in the articles of incorporation. The code states that the "certificate of incorporation may also contain any or all of the following matters: (1) Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders."[10] Broadly speaking, an arbitration provision, if mandatory, requires the shareholder to forego bringing any claims in a legal proceeding. By requiring shareholders to forego a right, the arbitration provision "limit[s] . . . the powers . . . of the stockholders," and is within the broad scope of Section 102(b).

DGCL Sections 109(a) and (b) set forth the second way by which arbitration provisions could be adopted —corporation bylaws. Section 109(b) delimits the permissible scope of bylaws, stating "[t]he bylaws may contain

9. Letter from Kevin L. Vold, Partner, Hogan Lovells, on behalf of Gannett Co., Inc., to Office of Chief Counsel, Div. of Corp. Fin., U.S. Sec. & Exch. Comm'n, at 20 (Dec. 27, 2011), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/2donaldvuchetich022212-14a8.pdf [hereinafter Vold].

10. Del Code Ann. tit. 8, § 102(b) (2010) (section label omitted).

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 or the rights or powers of its stockholders, directors, officers or employees." As with the articles of incorporation, this definitional section casts a wide net under which arbitration would fall. Significantly, arbitration relates to "the rights or powers of its stockholders." Moreover, insofar as claims were brought derivatively, such as claims against an inside director, the arbitration provision would relate to the rights or powers of directors. Consequently, an arbitration clause would be appropriate in the bylaws.

With an understanding of how arbitration clauses could be implemented, one must next ascertain who could place the arbitration clause in the articles of incorporation or the bylaws. The original incorporators have the ability to draft the articles of incorporation. Alternatively, if a corporation is to include the arbitration clause in its bylaws, when the provision is adopted affects who has the ability to implement the term. Section 109(a) provides that "[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, before a corporation . . . has received any payment for any of its stock, by its board of directors."[11] If, however, the corporation has sold stock, Section 109(a) stipulates, "the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote."[12] Nevertheless, regardless of when the provision is proposed, the corporation has the ability to, "in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors."[13] Just because an election under Section 109(a) to empower boards to amend the bylaws has been implemented does not preclude shareholders from retaining their rights to modify the bylaws.[14] Thus, in practice, three groups may implement an arbitration provision on behalf of the corporation: the original incorporators, the board of directors, and the stockholders, with the latter two being the most likely actors.

One commentator believes that shareholder proxy votes might not be appropriate for adopting arbitration provisions that bind all shareholders because the power of a majority of shareholders to alter the bylaws is not absolute.[15] On the contrary, Delaware courts have favorably addressed efforts to include procedures analogous to arbitration in corporate bylaws, thus affirming the ability of the original incorporators, the board of directors, and the stockholders to implement provisions not inconsistent with

11. *Id.* § 109(a).

12. *Id*.

13. *Id. See also* Kidsco Inc. v. Dinsmore, 674 A.2d 483, 492 (Del. Ch. 1995).

14. Tit. 8, § 109(a) ("The fact that such power has been so conferred upon the directors or governing body . . . shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.").

15. *See generally* Barbara Black, *Arbitration of Investors' Claims Against Issuers: An Idea Whose Time has Come?*, 75 LAW & CONTEMP. PROBS. 107, 110 (2012).

the scope of Sections 102 and 109. For example, the Delaware Chancery Court upheld inclusion of a forum selection clause, stating, "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."[16] *Galaviz v. Berg* also suggests that a charter amendment adopted by a majority of shareholders would be enforceable, meaning that shareholders can bind each other to terms when properly put to a vote.[17] In *Berg*, a federal court addresses arguments about the effect of a venue provision for derivative actions in a corporation's articles of incorporation, stating "were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment."[18]

Even so, experts have suggested that Delaware courts may be hesitant to relinquish control over corporate lawsuits because the courts have developed a nuanced and well-developed corporate law regime.[19] Despite these concerns, Title 10 Chapter 3 of the Delaware Code sets forth general approval of arbitration as a dispute resolution procedure. In particular, Section 349, titled "Arbitration Proceedings for Business Disputes" provides that "[t]he Court of Chancery shall have the power to arbitrate business disputes when the parties request a member of the Court of Chancery, or such other person as may be authorized under rules of the Court, to arbitrate a dispute."[20] Two other provisions suggest that resolution of all corporate questions by Delaware courts is not mandatory. First, Section 102(b)(2) allows a corporation to include a term that states:

> Whenever a compromise or arrangement is proposed between this corporation and its creditors or any class of them and/or between this corporation and its stockholders . . . , any court . . . may, on the application in a summary way of this corporation or of any creditor or stockholder thereof . . . order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, . . . in such manner as the said court directs.[21]

Because Section 102(b)(2) is optional in that a corporation *may*, not *must*, include the term, it is possible to conclude that Delaware allows for disputes between the corporation and its stockholders to avoid resolution of a procedure that the court directs. Section 102(b)(7) addresses this issue directly, allowing a corporation to include "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a direc-

16. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010).
17. Galaviz v. Berg, 763 F. Supp. 2d 1170 (N.D. Cal. 2011).
18. *Id.* at 1175.
19. *See, e.g.*, Weitzel, *supra* note 2, at 93.
20. Del. Code Ann. tit. 10, § 349(a) (2014).
21. Tit. 8, § 102(b)(2)(i).

tor."[22] If a corporation could exempt itself from certain conduct, thereby preventing it from being haled into court, the corporation should similarly be able to modify its liability using procedural devices, such as arbitration. Together DGCL Sections 102(b)(2) and 102(b)(7) and Section 349 of Title 10 illustrate the permissive scope of the DGCL and indicate that a corporation incorporated in the state could use its articles of incorporation or bylaws to implement mandatory arbitration of shareholder-corporation disputes.

Part III: Federal Authority

The FAA, codified in Title 9 of the United States Code, specifies the requisite components of an arbitration agreement and the procedural process by which courts will direct parties to arbitration.[23] Section 2 of the FAA concerns matters of validity, irrevocability, and enforcement of agreements to arbitrate.[24] It provides that a written provision in any contract evidencing a transaction involving "commerce" to arbitrate a controversy "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[25] This is the principal statutory proclamation that illustrates Congressional intent to permit arbitration agreements. Section 1 of the FAA gives Section 2 expansive scope by defining "commerce," as the traditional articulation of *interstate* commerce. Impliedly, via statutory interpretation maxim *expressio unius est exclusio alterius*, Section 1 excludes from its scope contracts entered into between parties on a strictly *intrastate* basis.[26] Section 1 also excludes "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."[27] Of significance, Section 1 does not exclude shareholder-corporation agreements from its scope.[28] Because securities laws have indicated a broad view as to what constitutes interstate activity, it is likely that the majority of arbitration agreements will be subject to the FAA. Finally, Section 3 provides the procedure through which Section 2 may be implemented, requiring US courts to stay any matter subject to arbitration that is submitted to the court.[29]

Following its passage, the Supreme Court enshrined applicability of the FAA by declaring arbitration to be the equivalent of litigation, stating, "contractually required arbitration of claims satisfies the statutory pre-

22. *Id.* at § 102(b)(7).

23. *See generally* 9 U.S.C. §§ 1-16 (2014).

24. *Id.* § 2.

25. *Id.*

26. *See, e.g.*, Bradley v. Brentwood Homes, Inc., 730 S.E.2d 312 (S.C. 2012) (applying the distinction between interstate and intrastate commerce).

27. 9 U.S.C. § 1 (2014).

28. *Id.*

29. *Id.* § 3.

scription of civil liability in court."[30] To defend the FAA, federal courts have been concerned with three primary tasks: (1) ensuring that arbitration agreements are not undermined by substantive state law; (2) ensuring that the FAA is not undermined by substantive regulations of other federal laws; and (3) validating arbitration agreements against federal common law venue rules.

First, courts enforce the FAA against state law intrusions.[31] Parties are given contractual latitude with respect to the procedural way in which claims are brought so long as the substantive goals of the underlying statutes are not undermined. The Supreme Court first articulated this logic in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, where the Court stated, "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."[32]

The line between procedure and substance was not always obvious, leading to several preemption cases. In *Southland Corp. v. Keating*, the Court addressed whether a California franchising law voiding any clause in an agreement that required franchisees to waive their rights under that law was able to allow a party to escape enforcement of an arbitration clause.[33] Holding that it was not, the Supreme Court stated that "the 'involving commerce' requirement in § 2" is "a necessary qualification on a statute intended to apply in state and federal courts."[34] Consequently, the Court construed Congressional intent "to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."[35] The Court reinforced this holding in the recent case of *AT&T Mobility LLC v. Concepcion*, holding that "[s]tates cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."[36] The *Concepcion* plaintiffs sought to avoid an arbitration clause by relying on the Ninth Circuit's *Discover Bank* rule, which provided that class-action waivers in consumer contracts of adhesion were unconscionable under certain circumstances. *Concepcion* preempted the *Discover Bank* rule because it "[stood] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[37]

States also may not give parties different rights or apply different legal standards to arbitration agreements than they would otherwise apply to

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30. CompuCredit Corp. v. Greenwood, 132 S.Ct. 665, 671 (2012).

31. *See, e.g.*, AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1746, 1753 (2011) (holding that the FAA preempts California's rule classifying most collective-arbitration waivers in consumer contracts as unconscionable).

32. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985).

33. Southland Corp. v. Keating, 465 U.S. 1 (1984).

34. *Id.* at 14–15.

35. *Id.* at 16.

36. AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1753 (2011).

37. *Id.* (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

contract law cases. In the words of the Supreme Court, "courts must place arbitration agreements on an equal footing with other contracts."[38] As is the purpose of enforcing contracts in general, "the FAA's central purpose is to ensure that 'private agreements to arbitrate are enforced according to their terms.'"[39] Justice Scalia issued the *Concepcion* opinion over the dissent's argument that class proceedings had independent value because they are "necessary to prosecute small-dollar claims that might otherwise slip through the legal system."[40] Instead, the decision stressed the intent of the parties, stating "class arbitration, to the extent it is manufactured . . . rather than consensual, is inconsistent with the FAA."[41] Such logic built upon prior Supreme Court decisions in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* and *First Options of Chicago, Inc. v. Kaplan.*[42] As these cases illustrate, the policies read into FAA seek to prevent the parties from being surprised and from being forced to address their claims in unanticipated manners.[43]

Second, courts seek to ensure that other federal laws do not interfere with the enforcement of the FAA. "Arbitration provisions are presumed to be valid unless 'the party opposing arbitration carries the burden of showing that Congress intended in a separate statute to preclude a waiver of judicial remedies, or that such a waiver of judicial remedies inherently conflicts with underlying purposes of that other statute.'"[44] General anti-waiver provisions (which some contend includes Section 29(a) of the Exchange Act) are not barriers to the enforcement of arbitration provisions pursuant to the FAA.[45] Moreover, if a statute providing a substantive right is silent on whether claims can proceed in an arbitrable forum, the FAA requires the arbitration agreement to be enforced according to its terms.[46]

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38. *Id.* at 1742.

39. Stolt-Nielsen S. A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 664 (2010) (quoting Volt Info. Sci., Inc. v. Bd. of Tr. of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989)).

40. *Concepcion*, 131 S.Ct. at 1753.

41. *Id.* at 1751.

42. *Volt Info. Scis.* 489 U.S. at 479 (discussing arbitration as "a matter of consent"); First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995) (describing arbitration "is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration.").

43. *Cf.* Century Indem. Co. v. Certain Underwriters at Lloyd's, London, 584 F.3d 513, 531–32. (3d Cir. 2009) (recognizing that it could not require arbitration agreements to be "express" and "unequivocal" as a predicate of being enforced because to do so would "impermissibly . . . require more of arbitration agreements than of contracts generally to be enforced whenever the standard differed from the applicable state-law principles of contract law.").

44. Letter from Cyril Moscow, Professor, Univ. of Mich. Law Sch., to Office of Chief Counsel, Div. of Corp. Fin., U.S. Sec. & Exch. Comm'n (Jan. 12, 2012) (on file with the U.S. Securities & Exchange Commission) (quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 483 (1989)) (in response to Gannett No Action Letter Request).

45. *See* CompuCredit Corp. v. Greenwood, 132 S.Ct. 665 (2012).

46. *Id.* at 673.

Third, federal courts assess the validity of arbitration agreements in the context of traditional venue rules. Because arbitration clauses are derivative of traditional forum selection clauses, venue laws subsume them and, as one court stated, "[T]he enforceability of a purported venue requirement is a matter of federal common law."[47] Under the leading case in this area, *M/S Bremen v. Zapata Off-Shore Co.,* a venue provision in a "freely negotiated" contract should not be set aside "unless Zapata could clearly show that that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching."[48] Building on the *Zapata* decision, in *Carnival Cruise Lines, Inc. v. Shute* the Court upheld a forum-selection clause contained on the back of a cruise ticket.[49] In *Carnival Cruise*, the Court rejected the argument that the passenger's lack of opportunity or bargaining power to negotiate the contract terms rendered enforcement of the venue clause unreasonable.[50]

Relying on these decisions, the District Court for the Northern District of California addressed the validity of an arbitration clause unilaterally adopted by a corporation's directors in *Berg*. The terms of the underlying agreement in this case skewed in favor of the corporation vis-à-vis shareholders: the individual corporate directors who would eventually be named as defendants unilaterally adopted the bylaw after the alleged wrongdoing took place. *Berg* distinguished its facts from those contained in the prior decisions of *Zapata* and *Carnival Cruise*, noting that in both of those cases "the provision was present in the original agreement" entered into by both parties.[51] Consequently, the District Court deemed an agreement adopted under these circumstances invalid because "there is no element of mutual consent to the forum choice at all, at least with respect to shareholders who purchased their shares prior to the time the bylaw was adopted."[52] When the *Berg* court issued its decision, it acknowledged that the matter was one of first impression.

Presently, other Circuits have neither endorsed nor disputed the *Berg* holding. Further, *Berg* presented only one of several possible fact patterns; for example, a corporation could have adopted the provision after investors purchased shares but before alleged corporate wrongdoing occurred. As a result, the exact federal demands of arbitration clauses relative to federal common law standards remain open for further clarification. Nevertheless, *Berg* remains a significant decision because it illustrates that independent federal law concerns must be evaluated when

47. Galaviz v. Berg, 763 F. Supp. 2d 1170, 1175 (N.D. Cal. 2011) (citing Manetti-Farrow, Inc. v. Gucci Am., Inc., 858 F.2d 509, 512–513 (9th Cir. 1988)); *see also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974).

48. M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972).

49. Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991).

50. *Id.* at 593.

51. *Berg*, 763 F. Supp. 2d at 1174.

52. *Id.* at 1771.

assessing the validity of arbitration agreements in the corporation-shareholder litigation context.

Part IV: State Laws

After satisfying implementation under state corporate law and federal pronouncements about the use of arbitration, proponents of arbitration clauses must still satisfy traditional state substantive law demands. These substantive law demands commonly relate to contract law because "arbitration is a matter of contract"[53] and because a corporation's governance documents are "a contract between the State and the corporation, and the corporation and its shareholders."[54] Additionally, some states have their own catchall provisions. In Delaware, for example, DGCL Section 102(b)(1) contains a catchall requirement that provisions in a corporation's articles of incorporation must "not [be] contrary to the laws of this State."[55] Because this limit governs the articles of incorporation and because the arbitration clause will be adopted in the articles of incorporation or in bylaws, which must stay within the scope of the articles of incorporation, any arbitration clause must not be contrary to the laws of the state where they are adopted. State laws contain a variety of rules that arbitration clauses may implicate, principally those concerned with mutual assent, unconscionability, and retroactivity. The following will examine how various states apply these doctrines.

A. *Mutual Assent*

Under state laws generally, a valid contract requires mutual assent of the parties, meaning agreement by both parties to a contract. "[A] party cannot be required to submit any dispute to arbitration that it has not agreed to submit."[56] Rather than decide for itself when parties have agreed to submit to arbitration, the Supreme Court defers to states on questions such as mutual assent. Thus, "courts generally . . . apply ordinary state-law principles that govern the formation of contracts" when "deciding whether the parties agreed to arbitrate a certain matter (including arbitrability)."[57]

The Third Circuit addressed the issue of mutual assent in the context of arbitration bylaws in *Kirleis v. Dickie, McCamey & Chilcote, P.C.*[58] In *Kirleis*, a law firm sought to enforce a bylaw arbitration clause against a lawyer-shareholder of the firm in a dispute that later arose between the

53. Rent-A-Center, W., Inc. v. Jackson, 561 U.S. 63, 67 (2010).

54. STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del. 1991) (citing Lawson v. Household Finance Corp., 152 A. 723, 727 (Del. Supr. 1930)).

55. Del. Code Ann. tit. 8, § 102(b)(1) (2014).

56. Cheek v. United Healthcare of the Mid-Atl., Inc., 835 A.2d 656, 661 (2003) (citing Curtis G. Testerman Co. v. Buck, 667 A.2d 649, 654 (1995)).

57. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995).

58. Kirleis v. Dickie, McCamey & Chilcote, P.C., 560 F.3d 156 (3d Cir. 2009).

lawyer and the firm.[59] Three factors motivated the court to strike down the mandatory arbitration provision for lack of mutual assent: first, and most importantly, the lawyer was never provided a copy of the bylaws;[60] second, the lawyer was never informed of the existence of the arbitration provision in the bylaws;[61] and third, the lawyer never signed any document that referred to the arbitration provision.[62] The Third Circuit did not go so far as to require the presence of all of these elements to satisfy mutual assent; rather, it remains possible that the existence of any or a combination of these factors would have been a sufficient basis from which a court could find mutual assent satisfied.[63] Because the lawyer never knew of the arbitration bylaw, the court reasoned that it would have been impossible for the lawyer to consent to the terms contained therein.[64] The *Kirleis* decision, however, represents an easy case. A more difficult question arises when the shareholder either has been given notice, or could be deemed on constructive notice.[65]

Lower courts in Maryland have adopted a broad understanding of mutual assent, particularly in regard to the concept of notice. As one Maryland court stated, "Maryland courts as well as courts from other jurisdictions have frequently ruled that constructive knowledge, constructive notice, and knowledge/notice through incorporation-by-reference are adequate to inform and bind a party to a contract, thereby satisfying mutuality."[66] In *Corvex Management LP v. Commonwealth REIT*, stockholders brought suit against a real estate investment trust (REIT) whose bylaws contained both a mandatory arbitration provision and a ban on class actions, including shareholder derivative suits.[67] The court found

59. *Id.* at 158–59.

60. *Id.* at 159, 165 (explaining that Kirleis could not have explicitly agreed to arbitrate her claims because she never received a copy of the bylaws and was unaware of the existence of the arbitration provision contained therein).

61. *Id.*

62. *Id.* at 159, 161–62 ("Had the Firm submitted contradictory evidence showing that Kirleis had received the bylaws or had signed them, its argument regarding the sufficiency of Kirleis's affidavit would merit further discussion.").

63. *See id.* at 160–61 ("Under Pennsylvania law, contract formation requires: (1) a mutual manifestation of an intention to be bound, (2) terms sufficiently definite to be enforced, and (3) consideration." (citing Blair v. Scott Specialty Gases, 283 F.3d 595, 603 (2002)). "In the employment context, arbitration agreements will be upheld when they are 'specific enough (i.e. unambiguous) to cover the employee's claims' and 'the employee has expressly agreed to abide by the terms of [the] agreement.'" (quoting Quiles v. Fin. Exch. Co., 879 A.2d 281, 285.)).

64. *Id.* at 165.

65. *See* Black, *supra* note 15, at 113–14 ("There has been considerable litigation over assent to arbitration in cases where a document containing a purported agreement to arbitrate is made available (either physically or online) to an individual who then takes some action consistent with contract performance, such as keeping the purchased goods . . . .").

66. Corvex Mgmt. LP v. Commonwealth REIT, 2013 Md. Cir. Ct. LEXIS 3 at *27 (Md. Cir. Ct. 2013).

67. *Id.* at *4, *5–6.

mutual assent was established, holding, "[p]laintiffs purchased shares with at least constructive knowledge that the Arbitration Bylaws were in effect and that their shares were subject to them."[68] The shareholders were found to have *actual* knowledge of the corporate bylaws because the plaintiffs purchased stock certificates that contained a legend informing shareholders that by keeping stock certificates they agree to be bound by bylaws, the arbitration bylaw itself stated that "any shareholder of the Trust" would be bound.[69] The shareholders were also deemed to have constructive notice: "[b]ecause bylaws constitute part of a binding flexible contract among the directors, officers, and stockholders, CWH stockholders are on notice that . . . the board itself may act unilaterally . . . ."[70] Plaintiffs were not entitled to demand affirmative written assent in regard to the arbitration provision, the third *Kirleis* factor.[71] Yet the court distinguished *Corvex* from the third *Kirleis* factor, noting, "[t]here is a difference between realizing that one is party to an agreement, yet refusing to consent to it, and failing to comprehend that an agreement to which one is subject to exists altogether."[72] In *Kirleis* the party to be bound by the arbitration agreement never knew the arbitration agreement existed, whereas the *Corvex* plaintiffs ignored the written provisions on their stock certificates.

Corvex is not the only time that Maryland courts have addressed the issue of notice with respect to arbitration agreements; the Circuit Court of Maryland, Baltimore City ruled on a related matter in *Katz v. CommonWealth REIT*.[73] In *Katz*, individual shareholders and a pension fund, who sought to brand themselves as "ordinary shareholders," brought a consolidated class and derivative suit against alleging that the defendant breached certain fiduciary duties.[74] The *Katz* plaintiffs sought to distinguish themselves from the *Corvex* plaintiffs by alleging that they lacked knowledge of the arbitration bylaws at the time they purchased their shares.[75] Rejecting this argument, the court ruled that because shareholders had constructive

68. *Id.* at *29.

69. *Id.* at *5–6, *29.

70. The Trustee Defendants' Motion for Leave to File a Notice of Supplemental Authority in Further Opposition to Plaintiffs' Motion for a Speedy Declaratory Hearing Under Rule 57 of the Federal Rules of Civil Procedure and for Declaratory and/or Injunctive Relief at 28–29, Del. Cnty. Employees Ret. Fund. v. Portnoy, No. 13-cv-10405-DJC (D. Mass. Feb. 20, 2014).

71. *Corvex*, 2013 Md. Cir. Ct. LEXIS 3 at *26–27 ("This Court cannot demand any higher standard of an arbitration agreement than what would be demanded of a typical contract under Maryland law. . . . Maryland courts as well as courts from other jurisdictions have frequently ruled that constructive knowledge, constructive notice, and knowledge/notice through incorporation-by-reference are adequate to inform and bind a party to a contract.")

72. *Id.* at *20.

73. Katz v. CommonWealth REIT No. 24-C-13-001299 (Md. Cir. Ct. Balt. City, Feb. 19, 2014).

74. *Id.* at *8–9.

75. *Id.* at *9.

knowledge of the arbitration bylaw, the provision was also enforceable against them.[76] Thus, constructive notice is an expansive doctrine in Maryland.

Other Circuits have made similarly attenuated findings of mutual assent in the context of investor-corporation arbitration clauses. In *Sandalwood Debt Fund A, L.P. v. KPMG, LLP*, a New Jersey court upheld the applicability of an arbitration clause to investors when the clause was contained in a hedge fund's engagement letters with its auditor.[77] The Sandalwood plaintiffs—limited partners of feeder funds—brought suit against the auditor, KPMG, after the funds lost substantially all of their value. Even though the limited partners lacked input in choosing the auditor and did not consent to the terms of engagement, the court enforced the arbitration agreement against them, reasoning that because the claims were derivative and not direct, investors had to comply with the corporation's contractual relationships with third parties regarding claims brought on behalf of the corporation.[78]

While the above decisions concerning assent provide some guidance, the particulars as to the permissibility of corporation-shareholder arbitration clauses remain ambiguous. For example, does publicly filing bylaws with the Commission constitute adequate notice? On one hand, disclosure is the principal mechanism by which securities laws are believed to achieve their goals, which is why it is a defense for a variety of Securities Act and Exchange Act claims.[79] It is not immediately clear why disclosure, a mechanism found to be reliable in other contexts, would not be sufficient to make shareholders aware of the existence of arbitration bylaws. Alternatively, opponents would suggest that mere maintenance of a stock position and passive ownership of shares is not a sufficient indication that the shareholders manifested assent.[80] After *Corvex* and *Katz* there seems to be more support for the former viewpoint, but shareholders in that case had one thing that might well make a difference to subsequent courts: a legend.

The second question concerning adequacy of notice is whether a corporation must include a legend on its securities indicating the shareholder will agree to be bound by the bylaws. Legends are valuable procedural devices that serve to alert shareholders that they need to look at the bylaws and that continued ownership will constitute assent. But, a securities legend is unlikely to be a necessary feature of an arbitration bylaw. In today's world of electronic communication, filing with the Commission might function in place of a legend. Additionally, legends may not even

76. *Id.* at *29.

77. Sandalwood Debt Fund A, L.P. v. KPMG, LLP, 2013 N.J. Super. Unpub. LEXIS 1624 (App. Div. July 1, 2013).

78. *Id.* at *21.

79. *See The Laws that Govern the Securities Industry,* U.S. Sec. & Exch. Comm'n, http://www.sec.gov/about/laws.shtml (last visited Dec. 22, 2014).

80. *See* Black, *supra* note 15, at 114.

be effective because shareholders no longer receive paper stock certificates in the mail; instead, centralized brokerage firms hold the certificates. Thus, even if the certificate contained a legend, perhaps shareholders would still be able to claim that they never had the opportunity to read the provision and that they should consequently not be bound by it. Such claims sound similar to those made by the lawyer-plaintiff in *Kirleis* and are likely to find favor by courts.[81] In lieu of these challenges, the next best solution to a paper legend may be a notice on the corporation's website.[82]

Corporations might be able to avoid mutual assent challenges by seeking a different form of implementation: shareholder proxy vote. Such a vote would function as an affirmative act of assent, which would allow courts to avoid having to decipher what exactly constitutes constructive notice. A shareholder vote implicates another question: whether non-assenting shareholders are bound. Binding objectors would not raise a notice problem because voting shareholders would be aware of the provisions the corporation adopted. By continuing to remain a shareholder, investors would make a conscious choice and thus they would not be entitled to claim surprise (an element of unconscionability discussed below). Nevertheless, one scholar asserted that "there is a serious question of fairness about taking away rights from current shareholders who did not assent to the provision,"[83] which would likely enable shareholders to assert that binding them to arbitration was invalid on retroactivity grounds. It has been suggested that corporations could alleviate the mutual assent problem with dissenting shareholders by offering such shareholders appraisal rights.[84] Under Maryland and New Jersey law, offering appraisal rights is not a necessary concession.[85] Further, under the DGCL, shareholders are allowed to make corporate governance changes in other contexts without requiring the corporation to compensate objectors.[86] If appraisal rights were to be granted every time a shareholder disagreed with a particular vote, the corporation's ability to manage its affairs efficiently would be greatly impaired. Nevertheless, appraisal

81. *See supra* notes 60–62 and accompanying text.

82. U.S. Chamber Inst. for Legal Reform, Securities Class Action Litigation: The Problem, Its Impact, and the Path to Reform 42 (2008), *available at* http://ilr.iwssites.com/uploads/sites/1/SecuritiesBooklet.pdf; *See* Joseph W. Bartlett, *Tort Reform in the Securities Sector*, 12 J. Private Equity 99, 101–06 (2008) (describing recommendations for adequate notice that both support and oppose the argument that a paper legend does not effectively cure lack of notice).

83. Black, *supra* note 15, at 110.

84. *Id.* at 111.

85. *See* Md. Code Ann., Corps. & Ass'ns § 3-208 (West 2014) (only referencing appraisal rights in the context of shareholders receiving fair value of their shares following transfer of those shares to a successor organization); NJ Stat Ann. § 14A:11-1 (West 2014) (strictly limiting the situations in which a shareholder can dissent).

86. *See* Del Code Ann. tit. 8, § 262(b)(1) (2010) (limiting the situations in which appraisal rights will be available).

rights would be likely to help a corporation obtain court and the Commission's approval, especially if they were inclined to follow *Kirleis*.

B. *Unconscionability*

The second state law issue implicated by arbitration clauses is unconscionability. Barbara Black asserts that "[a] class action waiver . . . may be unenforceable because it is unconscionable under the FAA."[87] This argument rests upon a belief that "particularly small retail investors . . . claims will not be sufficiently large to make it economically feasible to bring individual arbitration claims."[88] Economic infeasibility is evidenced by reference to "[t]he costs of proving a federal securities fraud claim—including falsity, materiality, efficient market, scienter, causation, and damages."[89] Under Black's view, allowing an individual to engage in a contract that would in effect preclude her from bringing claims against a corporation because the financial incentives are tilted so far away from the shareholder's favor would be so one-sided as to be unconscionable. This section will assess the validity of such claims by comparing laws of states that appear to reach different conclusions on the issue. First, this section discusses California's strict unconscionability laws and the factors that courts would likely apply to arbitration clauses. An analysis of California law is favored over Delaware law because California's elements present more difficult hurdles for arbitration clauses;[90] if a prospective arbitration clause would withstand California scrutiny, it is likely to survive Delaware scrutiny. Second, this section explores more permissive laws, such as those in Maryland, to rebut claims of unconscionability, highlighting a modern trend among courts that provides strong support for finding shareholder-corporation arbitration clauses valid.

1. California

California statutory law sets forth a state preference for the existence of an unconscionability doctrine and empowers California courts with the discretion to decide the exact contours of the rule.[91] The Supreme Court of California has established that procedural and substantive unconscionability must both be present in order for a court to exercise its discretion to

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87. *Id.* at 124.

88. *Id.* at 125.

89. *Id.*

90. For example, instead of shielding consumers from potential costs that would deter suit, Delaware courts have been willing to uphold the validity of corporate bylaw provisions that shift fees and expenses that result from intra-corporate litigation to an unsuccessful litigant. *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014) ("Legally permissible bylaws adopted for an improper purpose are unenforceable in equity. The intent to deter litigation, however, is not invariably an improper purpose. Fee-shifting provisions, by their nature, deter litigation. Because fee-shifting provisions are not per se invalid, an intent to deter litigation would not necessarily render the bylaw unenforceable in equity.").

91. Cal. Civ. Code § 1670.5(a) (West 2014).

refuse to enforce a contract or clause under the doctrine of unconscionability.[92] Procedural unconscionability concerns contract negotiation and the respective circumstances of the parties at that time, aspects which are assessed by the oppression and surprise involved in the agreement.[93] Oppression addresses the weaker party's absence of choice and unequal bargaining power that results in "no real negotiation."[94] Surprise involves the extent to which the contract clearly discloses its terms as well as the reasonable expectations of the weaker party.[95] Courts assess oppression and surprise using a multi-factor test. Relevant factors include whether the agreement in question was a standardized contract, was drafted by the party of superior bargaining strength, and whether it relegated to the subscribing party only the opportunity to adhere to the contract or reject it.[96] The presence of any of those factors suggests procedural unconscionability. The degree of procedural unconscionability is enhanced when a contract binds an individual to terms that are not provided at the time of the agreement[97] or where the non-drafting party was forced to obtain the terms from another source.[98] A contract is substantively unconscionable when it is unjustifiably one-sided to such an extent that it "shocks the conscience."[99] In assessing whether arbitration contracts are one-sided, the Ninth Circuit considers, among other factors, how arbitrators are selected, the rules and procedures of the arbitration, division of fees, and the ability to modify agreements.[100]

Chavarria v. Ralphs Grocery Co. illustrates how California courts assess unconscionability factors in the context of an arbitration agreement between a grocery store, Ralphs, and one of its employees, Chavarria.[101] The arbitration agreement was presented on a "take it or leave it" basis, Chavarria had no opportunity to negotiate its terms, and the terms were not provided to Chavarria until three weeks after he signed the agreement; meanwhile, Ralphs was given the practical ability to select the arbitrator, who was required to be a retired judge, could modify the agreement at its discretion, and required that the arbitration fees be split and paid up front

92. Pinnacle Museum Tower Ass'n v. Pinnacle Mkt. Dev. (US), LLC, 282 P.3d 1217, 1232 (2012); Armendariz v. Foundation Health Psychcare Services, Inc., 6 P.3d 669, 690 (Cal 2000) (citing Stirlen v. Supercuts, Inc., 60 Cal. Rptr. 2d 138, 145 (Cal. Ct. App. 1997)). Lower state courts have subsequently applied this rule. *See, e.g.*, Chavarria v. Ralphs Grocery Co., 733 F.3d 916, 922 (9th Cir. 2013) (citing Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 690 (Cal. 2000)).

93. *Chavarria*, 733 F.3d at 922 (citing *Armendariz*, 6 P.3d at 690).

94. *Id.* (quoting A & M Produce Co. v. FMC Corp., 186 Cal. Rptr. 114, 122 (1982)).

95. *Id.*; *see also* Parada v. Superior Ct., 98 Cal. Rptr. 3d 743, 757 (Cal. Ct. App. 2009).

96. *Chavarria*, 733 F.3d at 923 (citing Pokorny v. Quixtar, Inc., 601 F.3d 987, 996 (9th Cir. 2010)).

97. *Id.* (citing Pokorny, 601 F.3d at 997).

98. *See* Harper v. Ultimo, 113 Cal. App. 4th 1402 (Ct. App. 2003).

99. *Chavarria,* 733 F.3d at 923 (quoting Parada, 98 Cal. Rptr. 3d at 1578).

100. *See infra* notes 97–101 and accompanying text.

101. *Chavarria,* 733 F.3d at 916.

before the claim would be heard.[102] The *Chavarria* court addressed each of these elements in highlighting how they collectively violated California law regarding unconscionability. It is important to note that while the court was critical of certain terms contained in an arbitration agreement, California law is not unfavorable towards arbitration more generally.[103] Instead, it reflects a generally applicable policy against abuses of bargaining power.[104]

The court found the agreement both procedurally and substantively unconscionable.[105] With regard to procedure, both oppression and surprise were present.[106] The contract was oppressive because consent to the agreement was a condition of applying for employment, the terms were presented on a "take it or leave it" basis, and Chavarria lacked an opportunity to negotiate the terms.[107] The agreement was a surprise because the terms were not provided until three weeks after Chavarria agreed to be bound by the terms.[108] The court also found the agreement substantively unconscionable.[109] First, under the agreement, the party who did not bring the arbitration would select the arbitrator.[110] This provision was problematic because any time the employee properly brought a complaint to an arbitrator, the corporation would be able to make the selection as to who decided the dispute.[111] Second, the court found that requiring a retired judge to conduct the arbitration as opposed to an institutional arbitrator, who is subject to rules and procedures that ensure neutrality, was problematic.[112] Were such a selection process permissible, a corporation could define the procedures for arbitrator selection in an unfair manner and avoid the oversight of an institutional arbitrator who would require more balanced rules, thus creating a regime that leaned in its favor.[113] Third, the court found that two provisions regarding fees were problematic: first, that the arbitrator's fees must be paid up front; second, that the

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102. *Id.* at 922–23.

103. *Id.* at 927.

104. *Id.*

105. *Id.* at 926 ("here we have both").

106. *See id.* at 922.

107. *Id.*

108. *Id.*

109. *Id.* at 926.

110. *Id.* at 927.

111. *Id.*

112. *Id.* at 920, n.1, 923 (highlighting the problem is not with the selection of judges themselves, but instead the preclusion of institutional arbitration administrators, namely AAA or JAMS, which have established rules and procedures to select a neutral arbitrator).

113. By contrast, the American Arbitration Association's arbitrator selection rules takes into account the preferences of both parties and the Association conducts a conflict check before seating a panel, which prevents one party from having the ability to individually select those who will resolve the dispute. *See AAA Arbitrator Select*, AM. ARBITRATION ASS'N 2, https://www.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTG_016003&RevisionSelectionMethod=LatestReleased (last visited Dec. 22, 2014).

arbitrator had to divide these costs equally, disregarding any state provisions regarding cost-shifting.[114] Fourth, this agreement could be modified at the sole discretion of Ralphs, which ran afoul of prior precedent that found unilateral modification provisions to be substantively unconscionable.[115]

Using the Ninth Circuit jurisprudence outlined above, one can predict whether shareholder arbitration agreements as a whole would be permissible, even without having a particular shareholder arbitration agreement at issue. First, with regard to procedural unconscionability, most shareholder suits would not pass the oppression test because individual investors rarely have the ability to negotiate terms with the corporation. Instead, they purchase shares over online trading platforms or through brokers. In either situation they do not have the ability to conduct negotiations directly with the issuer about the terms under which stock is purchased. Perhaps it would be possible that institutional investors who have access to the issuer's executives would be able to negotiate terms through a private placement, but such an occurrence would differ factually from the prototypical shareholder litigation predicated upon exchange-based transactions. An argument could be made that all investors—individuals, controllers, and institutions—can negotiate different terms through a proxy solicitation and vote. Such an argument is open for dispute. On one hand, mere presence in a meeting, as in *Chavarria*, was found insufficient to constitute a "real" opportunity for negotiation.[116] On the other hand, Chavarria was *required* to consent to the terms as a condition of filing an application for employment,[117] suggesting a potential way to distinguish existing and prospective shareholders: existing shareholders have an ability to negotiate implementation of new terms at an annual meeting whereas prospective shareholders may only enter into a securities contract on a "take it or leave it" basis.

Satisfaction of the second aspect of procedural unconscionability, surprise, depends upon how the bylaw is proposed. If the board enacts an arbitration clause through a unilateral change of corporation bylaws, then the terms would clearly come as a surprise to shareholders. If, however, the terms were passed through a corporate election, then shareholders would have notice of the terms. Claims brought by shareholders who purchased shares of a public corporation on the secondary market after the arbitration clause was enacted would have the weakest claims of surprise because they may be deemed to be on constructive notice. A public cor-

114. *Chavarria*, 733 F.3d at 925.

115. *Id.* at 926 (citing Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1179 (9th Cir. 2003)).

116. *Id.* at 922.

117. *Id.* at 919 ("By completing an employment application with Ralphs, all potential employees agree to be bound by Ralphs' arbitration policy. The application contains an acknowledgment that the terms of the mandatory and binding arbitration policy have been provided for the applicant's review.").

poration's bylaws are filed with the Commission and could be accessed by the general public via EDGAR online.[118] Because anybody could find out what the terms of the stock purchase were by looking at the stock certificate or by going to the Commission website, prospective shareholders would have difficulty alleging that their "reasonable expectations" were disappointed.[119] It should be noted, however, that under the *Harper* guidance, the "reasonable expectations" of surprise interact with the element of oppression, an element which is established when a contracting party must to go to another source to find the terms of the agreement—the very thing that happens when shareholders must access the Commission filings in addition to their online trading system.[120] Furthermore, under *Pokorny*, this requirement to find information externally is especially problematic when the agreement is presented on a "take-it-or-leave-it" basis.[121] Accordingly, new and existing shareholders of corporations whose boards act unilaterally are able to satisfy both elements of procedural unconscionability, while shareholders who vote have weaker claims.

Analysis of substantive unconscionability is more complicated because California uses a multi-factor test and the court in *Chavarria* did not articulate exactly how many factors would need to be present. Nevertheless, it is likely that establishing as few as one of the relevant factors would be enough because the *Chavarria* court stated that the terms in question in that case "lie far beyond the line required to render an agreement invalid."[122] The first and second *Chavarria* factors are likely to be easily avoided by corporations.[123] By simply stating that the arbitration would be conducted by and under the procedures of a respected arbitral institution, such as the American Arbitration Association (AAA), the corporation would ensure that the arbitrator selection process was fair and in compliance with standard practice. Using the AAA's terms satisfies directly the second objection (mandating a retired judge conduct arbitration) and indirectly the first (unilateral control of selection). Notably, the AAA uses a process whereby both parties rank out their preferences for arbitrators after striking those who would be unsatisfactory, with those

118. 17 C.F.R. § 229.601 (2012) (see exhibit 3 on the exhibit table).

119. Harper v. Ultimo, 113 Cal. App. 4th 1402, 1406 (Ct. App. 2003).

120. *Id.* ("Here is the oppression: . . . The customer is forced to go to another source to find out the full import of what he or she is about to sign – and must go to that effort *prior* to signing.").

121. Pokorny v. Quixtar, Inc., 601 F.3d 987, 996–97 (9th Cir. 2010).

122. *Chavarria*, 733 F.3d at 926.

123. *See, e.g.*, Donald M. Vuchetich and Susan G. Vuchetich, Gannett Co., Inc. Shareholder Arbitration Proposal (2011) *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2012/2donaldvuchetich022212-14a8.pdf ("[A]ny controversy or claim . . . shall be settled . . . in accordance with the commercial arbitration rules of the American Arbitration Association . . . .").

whose total score is collectively most satisfactory conducting the arbitration.[124]

The third aspect of substantive unconscionability presents a murkier challenge. In *Chavarria*, the court was troubled by the agreement's requirement that the arbitrator must, at the outset of the proceedings, apportion the arbitrator's fees between Ralphs and Chavarria regardless of the merits of the claim. Ralphs argued that the provision was not problematic because it complies with the "American Rule," articulated by the AAA, that each party shall bear its own fees and costs.[125] The Ninth Circuit demurred, identifying this provision as "a model of how employers can draft fee provisions to price almost any employee out of the dispute resolution process."[126] In reaching this decision, the court differentiated allocation of arbitrator fees from attorney fees, finding apportionment of the former impermissible, while finding AAA-based provisions governing the latter acceptable.[127] The Supreme Court stated that filing and administrative fees attached to arbitration that are so high as to make access to a forum impracticable may render an agreement unenforceable.[128]

Whether or not apportionment of arbitration fees is permissible depends upon how assuredly a cost would be incurred. Ironically, if a corporation specifies a given forum, the provision is more likely to be found impermissible than if the corporation drafted a vague, open-ended term. For example, in *Kilgore v. KeyBank National Ass'n*, plaintiffs asserted that students would not be able to afford arbitration fees as a basis for arguing unconscionability.[129] The Ninth Circuit rejected Kilgore's claims, relying on Supreme Court guidance in *Green Tree Financial Corp.-Alabama v. Randolph*, which held that "the 'risk' that a [plaintiff] will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement."[130] While *Green Tree* recognized that "[i]t may well be that the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum," the "record reveal[ed] only the arbitration agreement's silence on the subject."[131] Silence alone, without proof of actual costs, is "plainly

124. AM. ARBITRATION ASS'N, MODEL RULES FOR COMMERCIAL ARBITRATION 15 (2013), *available at* https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG_004103&revision=latestreleased (see R-12. Appointment from National Roster for exact procedures).

125. Chavarria, 733 F.3d at 925.

126. *Id.* at 923.

127. *Id.* at 923, 925 ("The troubling aspect of the cost allocation provision relates to the arbitrator fees, not attorney fees.").

128. Am. Express Corp. v. Italian Colors Rest., 133 S.Ct. 2304, 2310–11 (2013) [hereinafter Italian Colors].

129. Kilgore v. KeyBank Nat'l Ass'n, 718 F.3d 1052 (9th Cir. 2013).

130. *Id.* at 1058 (alteration in original) (quoting Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 90-91 (2000)).

131. *Green Tree Fin. Corp.-Ala.*, 531 U.S. at 90–91.

insufficient to render it unenforceable."[132] The Supreme Court deemed the record insufficient because the plaintiff had only *assumed* the AAA would conduct arbitration, that standard AAA fees would apply, and that the fees would not be waived in her specific situation.[133] Thus, the agreement's silence on arbitration prevented the plaintiff from the opportunity to adequately plead that arbitration under the given procedures precluded him from the chance to effectively vindicate his rights. Consequently, an arbitration clause that planned to split fees would be best written ambiguously.

Another distinction bears on the question of arbitration fees. The court in *Italian Colors* stated "the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy."[134] This declaration is not inconsistent with *Green Tree*. Significantly, *Italian Colors* speculated that the *Green Tree* argument about effective vindication of rights "would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable."[135] These cases indicate that the Court is concerned about high ex-ante costs as a predicate to access a decision-making body, not with internal decisions about how to litigate. Thus, a plaintiff's high attorneys' fees, high expert costs, or inability to dedicate the time necessary to pursue resolution of the dispute are factors that affect the choice a plaintiff makes. In contrast, where access to the courts—which are subsidized by taxpayers—has been precluded by an arbitration clause and the access to the arbitral tribunal is exceedingly costly, concerns arise that the plaintiff has lost the *ability* to access justice. The *Chavarria* court relied upon this very distinction in finding that the arbitration agreement's imposition of high fees, amounting to $3,500 to $7,000 for each day of the arbitration just to pay for her share of the arbitrator's fee was substantively unconscionable as a pre-condition to having a dispute heard.[136] Interestingly, the *Chavarria* court did not evaluate unconscionability in the abstract, but rather in light of the likely amount of the plaintiff's expected recovery, current occupation, and income.[137] Moreover, the court noted that the agreement fixed fee allocation on an equal basis, thus disregarding any default state laws that would reallocate filing fees.[138]

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132. *Id.* at 81.

133. *Id.* at 91 n.6 ("She stated that '[f]or the purposes of this discussion, we will assume filing with the [American Arbitration Association], the filing fee is $500 for claims under $10,000 and this does not include the cost of the arbitrator or administrative fees.' . . . None of this information affords a sufficient basis for concluding that Randolph would in fact have incurred substantial costs in the event her claim went to arbitration.").

134. *Italian Colors*, 133 U.S. at 2311.

135. *Id.* at 2310–11.

136. Chavarria v. Ralphs Grocery Co., 733 F.3d 916, 925 (9th Cir. 2013).

137. *Id.* at 925 n.5.

138. *Id.* at 925.

As a result of the *Green Tree* and *Kilgore* decisions, corporations may attempt to avoid specifying arbitral tribunals in order to avoid claims of substantive unconscionability. Of course, doing so may raise the procedural unconscionability concerns articulated above regarding selection of an arbitral tribunal. Moreover, excluding a forum name may not even be enough to save them—the *Chavarria* court reached its conclusion about costs without reference to any binding agreement, perhaps in violation of *Green Tree*'s mandate against speculative costs. One interpretation is that the assessment of costs, which paralleled the AAA's standard fees, follows from the court's prior ruling that the AAA should be used to satisfy the tests of procedural unconscionability. This culmination of factors would represent a worst-case scenario for corporations considering arbitration clauses: first, they must specify the AAA; and second, they cannot make plaintiff pay the AAA's high fees as a predicate for accessing the tribunal. Consequently, corporations would have to either pay the $7,000 to $14,000 filing fees ex-ante or they would have to keep using the current system of shareholder class-action litigation.

Even under the rigors of California's substantive unconscionability rules, corporations may still find a way to enforce mandatory arbitration agreements in shareholder litigation. First, it is possible the AAA would waive a plaintiff's up-front fees. To assess mandatory arbitration agreements in shareholder suits one would need to know how often plaintiff's fees were waived and in each individual case before the court whether or not the arbitral body had agreed to waive the particular plaintiff's fees. Second, because *Chavarria* used an individualized test, arbitration agreements may be enforceable for certain investors but not others. To assess this aspect one would need to determine (1) the amount of the individual claim and (2) the financial liquidity of a given investor. As to the first test, more money at stake would suggest a lower probability of substantive unconscionability. Thus, an investor alleging a loss of $100,000 may be forced to front $3,500 to have the claim be arbitrated, while a passive investor alleging a loss of $50 may not have to abide by the arbitration agreement. As for the second aspect, possession of more money suggests a greater ability to pay for up-front costs and, in turn, a lesser probability of being unable to access the dispute resolution system. Consequently, a billionaire may be forced to pay the filing fee and arbitrate his claims, whereas Chavarria, the Ralphs grocer, may not have to arbitrate his claims. Third, corporations should not articulate how fees will be split between the parties, or, at a minimum, should allow state laws governing fee allocation of particular categories of disputes to remain in force. A finding of unconscionability is less likely when the arbitration agreement allocates costs in a manner condoned by the legislative body that had the power to make such decisions.

In conclusion, arbitration agreements are likely to be procedurally unconscionable because they are oppressive when not negotiated and surprise shareholders when not voted upon by the shareholders to be bound. Agreements risk being found substantively unconscionable to the extent that the predicate fees to access a tribunal outweigh an investor's possible recovery. Consequently, under California law, investor-litigation arbitration clauses may only be able to bind certain, well-capitalized, voting shareholders, forcing the corporation to engage in multiple dispute resolution forums—the courts for those who cannot be bound and arbitration tribunals for those who can. Such an outcome undermines two principal benefits of arbitration: low cost and procedurally streamlined resolution of disputes.

2. Maryland

Maryland courts require similar elements as those in California regarding unconscionability. Even so, the way in which Maryland courts apply those elements permits substantially more arbitration agreements to remain valid than if California courts reviewed those same arbitration clauses. In Maryland, "[a]n unconscionable bargain or contract has been defined as one characterized by extreme unfairness, which is made evident by (1) one party's lack of meaningful choice, and (2) contractual terms that unreasonably favor the other party."[139] The court must consider whether the terms "are so one-sided as to oppress or unfairly surprise an innocent party or whether there exists an egregious imbalance in the obligations and rights imposed by the arbitration clause."[140] Applying these rules, in *Cheek v. United Healthcare of the Mid-Atlantic, Inc.*, the high court of Maryland found an arbitration provision illusory and thus unenforceable where it could be revoked at any time by the employer, even after the arbitration was initiated, and without notice to the other party because such terms unreasonably favor one party over the other.[141] Similarly, in the recent case, *Noohi v. Tool Brothers, Inc.*, the Fourth Circuit applied Maryland law in its decision to overturn an arbitration clause that waived the buyer's right to litigate, but not the seller's right, because such terms unreasonably favor one party.[142]

In contrast, the Federal District Court for the District of Massachusetts applied Maryland law to reach a contrary view about the first aspect of unconscionability—meaningful choice—in *Portnoy*.[143] *Portnoy* was a challenge related to the aforementioned *Corvex* decision in which the plaintiffs alleged that they had no notice whatsoever (actual, constructive or otherwise) because nearly every plaintiff purchased stock before the arbitration clause was inserted into the bylaws.[144] Plaintiffs supported their assertion by alleging that they could not read the stock certificates

139. Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 U.S. Dist. LEXIS 40107, at *44 (D. Mass. Mar. 26, 2014) (citing Walther v. Sovereign Bank, 872 A.2d 735, 743 (Md. 2005)).

140. Walther, 872 A.2d at 747.

141. Cheek v. United Healthcare of the Mid-Atl., Inc., 835 A.2d 656 (Md. 2003).

142. Noohi v. Tool Bros., Inc., 708 F.3d 599, 602, 610 (4th Cir. 2013).

143. *Portnoy*, 2014 U.S. Dist. LEXIS 40107.

144. *Id.* at *33, *35.

because such certificates are typically represented by only one or more immobilized jumbo stock certificates that they did not hold.[145] In dismissing the overall claim about notice, the court clarified the Maryland rule, stating, "Maryland law suggests that a party to a contract is presumed to have knowledge of company bylaws incorporated into the contract, even if they are not provided with a copy of them."[146] While notice is typically considered an issue pertaining to mutual consent, it also has relevance in unconscionability analysis because if a person does not have notice of a term, then they are unable to make a meaningful choice. The court ultimately dismissed claims of unconscionability because plaintiffs failed to establish both of the requisite elements: first, constructive notice impliedly rebutted claims of a lack of meaningful choice; and second, plaintiffs' ability to vindicate their rights through arbitration rebutted claims that the contractual terms unreasonably favored one side.[147] The effect of this decision is to make it virtually impossible for shareholders of Maryland corporations to win unconscionability claims.

C. *Retroactivity*

Many states prohibit subsequent contract modifications from binding parties. This Note refers to such problems as retroactivity, which can also be understood in terms of fair notice. Prohibition of the retroactive effect of contract changes is analogous to the prohibition of ex post facto laws, which change the legal consequences or status of actions that were committed, or relationships that existed, before the enactment of the law. Just as the Constitution prohibits ex post facto legislation for criminal acts,[148] so too states seek to prohibit similar behavior in the context of contractual relationships.

Delaware has at least two relevant statutory provisions that would prohibit retroactivity in a shareholder-corporation dispute. The first concerns regulation of restricted shares, which contain a legend disclaiming that the shares cannot be transferred unless certain conditions are met. Section 202(b) of the DGCL prohibits these disclaimers from binding securities issued prior to the adoption of the restriction "unless the holders of the securities are parties to an agreement or voted in favor of the restriction."[149] The second statutory rule is more directly on point. While Section 102(b)(7) allows a corporation to limit the personal liability of a director to the corporation, it cabins the corporation's ability to limit liability, stating "[n]o such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such

145. *Id*. at *33.

146. *Id.* at *33–34.

147. *Id.* at *44.

148. U.S. Const. art. 1, § 9, cl. 3.

149. Del. Code Ann. tit. 8, § 202(b) (2014).

provision becomes effective."[150] Because of this term, a corporation could not seek to implement an arbitration provision governing a breach of corporate law after the conduct giving rise to the dispute or the dispute itself had taken place. Any adopted terms would only be able to modify the rights of stockholders for events that occur after the date of adoption. The particular language of Section 102(b)(7) indicates the legislators were concerned with providing adequate notice to shareholders. The rationale behind both 202(b) and 102(b)(7) is that drafters wanted to prevent corporations from impairing the value of shares after those shares had been priced and purchased with certain imbedded assumptions. Even though the DGCL does not contain any terms that expressly address retroactivity concerns in the context of arbitration clauses, the clauses may be viewed as impairing shareholders' rights by changing procedure through which shareholders prosecute their rights, and thus similar protection should be implied.

Despite Delaware's statutory protections, contrary precedent exists in other states. For example, the Georgia Court of Appeals decision in *Rushing v. Gold Kist, Inc.*, provided an expansive form of assent that went beyond the standard adopted by Maryland Circuit Court in *Corvex*.[151] The *Rushing* court deemed enforceable an arbitration clause added to bylaws *after* a member of an agricultural cooperative originally signed his membership agreement.[152] The court did not find a retroactivity problem because member had expressly agreed to be subject to existing bylaws and bylaws "hereafter in effect."[153] Consequently, cooperative members could be bound by terms adopted after they signed their contract because the original authorization was deemed to have included subsequently enacted provisions. Similarly, in *Portnoy*, the District Court of Massachusetts, applying Maryland law, offered a judiciability rationale, stating "the timing of a shareholder's stock purchase is a meaningless distinction in this context and will lead to inconsistent and contradictory rights and remedies for shareholders of the same company."[154]

It is clear that Delaware statutes conceptualize the retroactivity problem in a different fashion than the way in which Georgia and Maryland courts do. But, concerns of confusion and widely divergent requirements from state to state are mitigated for one principal reason—location of actors. The internal affairs doctrine requires courts resolving disputes about the adoption of or interpretation of charter and bylaw amendments to apply the law of the state of incorporation.[155] Delaware corporations will be subject to Delaware law and Georgia agricultural cooperatives will be sub-

150. Del. Code Ann. tit. 8, § 102(b)(7) (2014).

151. Rushing v. Gold Kist, Inc., 567 S.E.2d 384, 387–88 (Ga. Ct. App. 2002).

152. *Id.* at 385–86.

153. *Id.* at 388.

154. Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 U.S. Dist. LEXIS 40107, at *36 (D. Mass. Mar. 26, 2014).

155. Weitzel, *supra* note 2, at 109.

ject to Georgia law. More corporations are incorporated in Delaware than any other state.[156] Consequently, shareholders should not have reason to fear such adverse rulings concerning assent, particularly retroactive assent.

Nevertheless, recent dicta from the Delaware Supreme Court eroded the statutory foundation upon which shareholders would otherwise rely. In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court upheld the validity of a fee-shifting term that was included in the company's bylaws.[157] At the end of an opinion that highlighted the two tests for the legality of bylaw provisions—whether the language was facially valid or invalid, and whether or not the provision was enacted for a permissible purpose—the court turned to its attention to when bylaw amendments could be enacted. The court reasoned that because the ATP Tour had included a clause in its certification of incorporation which specified that bylaws "may be adopted and/or amended from time to time," and because the ATP Tour conferred upon directors the power to enact and amend bylaws, that it was permissible for the directors to exercise their right to draft rules at a later date.[158] In a comment that implicitly adopted the notion that ATP members had given carte blanche consent to all subsequent changes, the court simply stated "[i]f directors are so authorized, 'stockholders will be bound by bylaws adopted unilaterally by their boards.'"[159]

In part, the rationale behind the *ATP* court's decision can be understood when united with Delaware courts' generally deferential view of bylaws, expressed, principally, through a presumption of validity.[160] Nevertheless, these deferential remarks are commonly supplemented by qualifying language that confirms that the presumption is rebuttable.[161] In particular, courts have stated two reservations to the presumption: (1) a bylaw that is inconsistent with any statute or rule of common law is void;[162] and (2) bylaws must be reasonably applied.[163]

While the *ATP* opinion would appear to have far-reaching consequences for future investor litigation, it is factually distinguishable from

156. *See* Lewis S. Black, Jr., Why Corporations Choose Delaware 1 (2007), *available at* http://corp.delaware.gov/whycorporations_web.pdf; *About Agency*, Del. Dep't of State Div. of Corp., http://www.corp.delaware.gov/aboutagency.shtml (last visited Dec. 22, 2014).

157. ATP Tour, Inc. v. Deutscher Tennis Bund (ATP), 91 A.3d 554 (Del. 2014).

158. *Id.* at 560 (citing Certification of Questions of Law from the United States District Court for the District of Delaware, 2013 at 9).

159. *Id.*

160. *See id.* at 557 (quoting Frantz Mfg. Co. v. EAC Indus. (Frantz), 501 A.2d 401, 407 (Del. 1985) (bylaws of a corporation are "presumed to be valid, and the courts will construe the bylaws in a manner consistent with the law rather than strike down the bylaws.").

161. *See, e.g.*, Frantz, 501 A.2d at 407.

162. *Id.* (citing 8 William Meade Fletcher, Fletcher Cyclopedia of the Law of Corporations § 4184 (rev. perm. ed. 1982)).

163. *Id.* (quoting Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. Supr. 1971) and State v. Jessup & Moore Paper Co., 77 A. 16 (Del. Supr. 1910)).

the prototypical stock-drop case. The usual investor suit is brought against a public corporation; ATP, by contrast, was a non-stock corporation. Thus, although *ATP* might be read to apply to all Delaware corporations, this is the first—and, so far, the only—case to permit, let alone address, the retroactive application of bylaws against dissenting shareholders.[164] It remains to be seen whether Delaware courts will continue along this path, but when considered in conjunction with the court's clear proclamation that an intent to deter litigation will not result in a fee-shifting bylaw provision being declared unenforceable, the scales seem to tilt against prospective plaintiff shareholders.

D. *Securities and Exchange Commission Rules*

Assuming that an arbitration provision would satisfy all state law requirements regarding confirmation and enforceability of contracts, public corporations would still have to meet the demands of the Commission in order to enact mandatory arbitration agreements or a corporation cannot go through with its public offering. The Commission plays in integral role in regulating public offerings, namely in accelerating the effectiveness of a corporation's registration statement. Recent attempts to implement arbitration provisions have faced significant headwinds from the Commission. Although the Commission has not issued formal opinions or decisions prohibiting arbitration bylaws, it has still been able to exert pressure in guiding corporations away from including the terms. For example, the Carlyle Group, LP included an arbitration provision in its preparatory S-1 filing for an IPO, but it withdrew the provision "in response to pressure from shareholder rights activists, potential investors and the SEC."[165] Carlyle's attempt sought to include a clause in its partnership agreement that mandated all limited partners to submit any claims to binding arbitration.[166]

Such a clause should have presented less of a cause for concern within the Commission as compared with the agency's likely response to shareholder-based arbitration clauses.[167] Indeed, limited partners typically possess a closer relationship to corporate managers and the general partner of the partnership than passive shareholders possess to the managers of public corporations. Partnerships, even those which offer partnership inter-

164. Joseph L. Christensen, *Delaware Supreme Court Finds Fee-Shifting Bylaws Permissible*, Paul, Weiss, Rifkind, Wharton & Garrison LLP (May 9, 2014), http://www.paulweiss.com/media/2495878/9may14alert.pdf.

165. *See* Karan Singh Tyagi & Gide Loyrette Nouel, *Carlyle Leaves Out Mandatory Arbitration Clause in IPO*, Kluwer Arbitration Blog (Feb. 7, 2012), http://kluwerarbitrationblog.com/blog/2012/02/07/carlyle-leaves-out-mandatory-arbitration-clause-in-ipo/.

166. Kevin M. LaCroix, *Can Investors Be Required to Arbitrate Their Claims?*, The D&O Diary (Jan. 19, 2012), http://www.dandodiary.com/2012/01/articles/securities-litigation/can-investors-be-required-to-arbitrate-their-claims/.

167. *See Can Companies Force Arbitration on Shareholders?*, Slinde Nelson Stanford, http://www.duvalbusinesslaw.com/Articles/Can-Companies-Force-Arbitration-on-Shareholders.shtml (last visited Oct. 26, 2014) [hereinafter *Force Arbitration*].

ests publicly, also tend to have a fewer number of limited partners than most public corporations have shareholders. Moreover, limited partnership agreements often provide more opportunities for collective action by limited partners, such as leaving open the periods during which limited partners can meet to vote on any of possible rights; by contrast, in a corporate context, shareholders generally can only vote in advance of an annual meeting or for certain statutorily codified corporate events.[168] Nevertheless, despite the several reasons why the government may choose a more deferential posture for limited partnership control issues, the Commission still chose to intervene. Consequently, the outlook for Commission abstention in a corporate shareholder context appears bleak. This outlook and the Commission's resistance to the adoption of mandatory arbitration bylaws have been further bolstered by some corporation's boards who have asked the Commission to support exclusion of arbitration proposals.[169]

The Commission opposes mandatory arbitration agreements that prohibit class-action suits because it believes that such agreements are contrary to the public policy interests underlying federal securities laws and would cause a corporation to violate Section 29(a) of the Exchange Act.[170] Section 29(a) relates to waiver provisions and states "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or any rule of regulation thereunder, or of any rule of a self-regulatory organization, shall be void."[171] Mr. Riesenberg, then an Assistant General Counsel of the Commission, believed that mandatory pre-dispute arbitration of shareholder claims would be inconsistent with investor protection because "it would be contrary to the public interest to require investors . . . to waive access to a judicial forum . . . where such a waiver is made through a corporate charter rather than through an individual investor's decision."[172] This logic may very well have been pivotal in the Commission's resistance to Carlyle when considered in conjunction with the nature of the desired provision. Carlyle

168. *Compare* Del. Code Ann. Tit. 6, § 15-401 (2014) (providing in subsection (f) that "[e]ach partner has equal rights in the management and conduct of the partnership business and affairs" and in subsection (j) that "[a] difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership may be undertaken only with the consent of all of the partners."), *with* Del. Code Ann. Tit. 8, § 211 (2014) (allowing the board, not shareholders, to determine when to hold meetings pursuant to each corporation's bylaws).

169. *See, e.g.*, Vold, *supra* note 9, at 2; s*ee also Investor Group Asks SEC to Stand Firm Against Forced Arbitration Corporate Bylaws*, BNA, Sec. L. Daily, Dec. 13, 2103, at *1.

170. *See* Black, *supra* note 15, at 108 (The Commission "has never repudiated its staff position that an arbitration provision in a publicly traded issuer's governance documents would violate the anti-waiver provisions."); Tyagi & Nouel, supra note 165; Vold, supra note 9, at 2.

171. 15 U.S.C. § 78cc (2012).

172. Thomas L. Riesenberg, *Arbitration and Corporate Governance: A Reply to Carl Schneider*, INSIGHTS (Aug. 1990).

wanted every limited partner to irrevocably agree that "any claims, suits, actions or proceedings arising out of or relating in any way to the partnership agreement or any interest in the partnership . . . shall be finally settled arbitration," and that each limited partner irrevocably waive any objection he or she may have to arbitration.[173] Insofar as the clause was contained in an investment contract, which include limited partnership agreements, these provisions would fall within Mr. Riesenberg's proscribed categories.

The Dodd-Frank Wall Street Reform and Consumer Protection ("Dodd-Frank") Act provides further support for the SECs restrictive posture.[174] In particular, the Dodd-Frank Act permits the Commission to "prohibit, or impose condition or limitation on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute."[175] It would not be unreasonable for the Commission to use this statutory language as an invitation to continue to oppose mandatory arbitration clauses. Indeed, if the Commission followed a popular canon of interpretation that specific provisions pertaining to a particular issue apply instead of provisions more generally covering the issue, it might choose to use the more specific Dodd-Frank Act commentary about arbitration in the context of securities over generally applicable arbitration statutes.[176]

Arbitration bylaw opponents would encourage the Commission to take a more restrictive perspective than Mr. Riesenberg's. Opponents would allege that all bylaw amendments requiring individual arbitration violate the anti-waiver rule because such bylaws substantially weaken securities investors' ability to pursue substantive Exchange Act rights, namely the private rights of action under Section 10(b) and Rule 10b-5.[177] Opponents relying on a Section 29 argument thus base their claim on in-effect rather than procedural rights: what, in light of practical circumstances, a rational shareholder would do. They would allege that because a rational shareholder without a substantial claim would not pursue a federal securities claim in arbitration, there is no remedy, and as a thus, a waiver of investor protections in violation of Section 29. The Commission has not formally addressed Mr. Riesenberg's theories or the arguments made by arbitration opponents, but it has granted No Action Letters after these claims were sent to the Commission, noting that there is "some basis for [the] view that

173. *See* LaCroix, *supra* note 166.

174. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203 (2010).

175. *Force Arbitration*, *supra* note 167.

176. Judge Russell E. Carparelli, *The Rehnquist Court's Canons of Statutory Construction*, (Sept. 2005), http://www.ncsl.org/documents/lsss/2013PDS/Rehnquist_Court_Canons_citations.pdf (citing two Supreme Court cases which use this canon: Green v. Bock Laundry Mach. Co., 490 U.S. 504, 524–26 (1989) and Crawford Fitting Co. v. J. T. Gibbons, Inc., 482 U.S. 437, 444–45 (1987)).

177. *E.g.*, Vold, *supra* note 9, at 3.

implementation of [such] proposal[s] would cause the company to violate the federal securities laws."[178]

Shearson/American Express Inc. v. McMahon could be read to support opponents' claims because it states that an agreement or provision that "weaken[s a party's] ability to recover under the [Exchange] Act" is grounds for voiding the agreement under § 29(a).[179] But *McMahon* likely cuts the other way. In *McMahon*, the U.S. Supreme Court "limited the scope of Section 29(a) to prohibit only waivers of the *substantive* obligations imposed by the Exchange Act."[180] *McMahon* held that "where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights, enforcement of an agreement to arbitrate does not affect a waiver of compliance with any provision of the Exchange Act under Section 29(a)."[181] The Court reasoned that because the Commission has the authority to control Self-Regulating Organizations (SROs), which adopted the mandatory arbitration clauses for disputes involving brokers, the Commission has de facto ability to ensure the arbitration provisions are adequate to vindicate Exchange Act rights.[182] Because the Commission did not object to the agreements adopted by the SROs, the agreements did not waive a substantive obligation of the Exchange Act. Investor-corporation litigation should not lead to a different result. The Commission has the ability to exercise its authority over arbitration provisions through a Release, but it has chosen not to do so with respect to arbitration clauses, just as it was silent with the arbitration clause in *McMahon*. Moreover, opponents' arguments about substantive or in-effect rights violate the explicit commands of the *Green Tree* and *Italian Colors* decisions discussed *supra*. The more recent *Italian Colors* decision overrules any precedent of older, attenuated cases. Thus, whatever basis the Commission believed suggested that arbitration provisions violate federal laws has been undermined by recent Supreme Court decisions.

Conclusion

The permissibility of arbitration clauses in shareholder-corporation dispute resolution is a developing but currently resolved field of law. The FAA and the Supreme Court cases upholding its effect suggest an expansive use of arbitration clauses remains possible. When corporations make public offerings, they engage in interstate commerce, thus making it possible for them to use the FAA. State law issues present a greater challenge for corporations, who must assess issues of mutual assent, unconscionabil-

178. Gannett Co., Inc., SEC No-Action Letter, 2011 WL 6859124 (Feb. 22, 2012); Pfizer Inc., SEC No-Action Letter, 2012 WL 587597 (Feb. 22, 2012).

179. Shearson/American Express Inc. v. McMahon, 428 U.S. 220, 230 (1987) (citing Wilko v. Swan, 346 U.S. 427, 432 (1953)).

180. Vold, *supra* note 9, at 3 (citing McMahon, 428 U.S. at 228).

181. *Id.* at 3–4 (citing McMahon, 428 U.S. at 238) (internal quotation marks omitted).

182. *McMahon*, 428 U.S. at 234.

ity, and retroactivity. While California and the Ninth Circuit have stringent understandings of unconscionability, other states such as Maryland, Massachusetts, and Georgia have more lenient standards for mutual assent and unconscionability. Delaware statutes evidence a desire to prohibit retroactive changes affecting shareholder rights, but recent cases have pushed against such interpretations. Consequently, corporations should adopt the arbitration clauses in their articles of incorporation prior to doing a public offering or should seek a shareholder proxy vote as the means by which to implement the arbitration clause.

The Commission has exerted pressure to oppose mandatory arbitration clauses in certain settings, such as with respect to the Carlyle Group's IPO. Nevertheless, the Commission has not taken administrative enforcement actions against corporations that have the provisions. Final resolution on this issue will require a challenge in court or with the Commission. A corporation should be successful in challenging the Commission should it wish to do so, finding adequate basis in Supreme Court precedent and state law jurisprudence, particularly from Maryland's *Corvex* and New Jersey's *Sandalwood* decisions. A challenge against the Commission would most likely arise as a corporation contemplated its IPO. But it would be more difficult for such a corporation to make the necessary challenge due to the antecedent costs associated with litigation. Moreover, established corporations will not desire risk the legal and reputational costs associated with being first if doing so will result in Commission sanctions. Until a corporation chooses to invest the financial resources in such a challenge, this question will remain open.