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A Blended Approach to Reducing the Costs of Shareholder Litigation

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NOTE

A BLENDED APPROACH TO REDUCING THE COSTS OF SHAREHOLDER LITIGATION

Valian A. Afshar*

Multiforum litigation and federal securities law class actions impose heavy costs on corporations and their shareholders without producing proportionate benefits. Both are largely the result of the agency problem between shareholders and their attorneys, driven more by the attorneys' interests in generating fees than by the interests of their clients. In response to each of these problems, commentators have recommended a number of solutions. Chief among them are forum selection and mandatory arbitration provisions in a corporation's charter or bylaws. This Note recommends that corporations unilaterally adopt both forum selection and mandatory arbitration bylaws to address shareholder lawsuits under state corporate and federal securities law, respectively. This Note also explains why each solution is particularly appropriate for its class of shareholder claims.

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INTRODUCTION

Shareholders have three rights with respect to the management of a corporation: the right to sell their shares, the right to vote their shares, and the right to sue both the corporation and its managers and directors.¹ The last right has proven increasingly problematic for U.S. corporations and their shareholders. In 2012, 96% of public-company acquisitions valued over \$500 million resulted in a shareholder lawsuit.² By contrast, shareholders challenged only 53% of similar deals in 2007.³ This startling shift in shareholder litigation raises the question: Are the vast majority of corporate deals actually illegal, or is something else driving this trend?

The right to sue has traditionally been viewed as a response to the agency problem of corporations,⁴ and it is intended to serve both a deterrent and compensatory role for shareholders. The deterrent aspect of shareholder litigation seeks to minimize agency costs and better align the interests of a corporation's managers and directors with those of shareholders by punishing managers and directors when they "misbehave."⁵ The compensatory aspect aims to mitigate agency costs by reimbursing shareholders for damages

1. Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, LAW & CONTEMP. PROBS., Summer 1999, at 215, 216.

2. ROBERT M. DAINES & OLGA KOUMRIAN, SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS: REVIEW OF 2012 M&A LITIGATION 1 (2013), available at http://www.cornerstone.com/files/upload/Cornerstone_Research_Shareholder_Litigation_Involving_M_and_A_Feb_2013.pdf.

3. *Id.* at 1 fig.2.

4. See THERESE H. MAYNARD, MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS 100–01 (3d ed. 2013) (“[T]he agency cost problem is inherent in the corporate form of business organization because of the separation of ownership from control over the company’s business operations. When the [shareholders] delegate managerial authority over the company’s business affairs to [the board of directors and managers], the resulting separation of ownership and managerial control creates divergent incentives.”).

5. Paul Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws*, 2013 BYU L. REV. 65, 75. Because the interests of managers and directors can diverge from the interests of shareholders, MAYNARD, *supra* note 4, at 100–01, the deterrence theory argues that managers and directors are less likely to act on their divergent interests if they can be punished through a shareholder lawsuit. Weitzel, *supra*, at 75.

caused by poor management.⁶ Over time, however, these two goals of shareholder litigation have deteriorated, and a new agency problem has arisen: the interests of many shareholder-plaintiffs' counsel now supersede those of their shareholder clients.⁷ As a result, much of shareholder litigation today merely transfers wealth from corporations and their insurance companies to the plaintiffs' bar, with few benefits accruing to the shareholders themselves.⁸

Private shareholder claims can arise under one of two distinct bodies of law: state corporate law or federal securities law. Each state has its own corporation law that controls the mechanics of the companies incorporated within that state. The most influential is the Delaware General Corporation Law ("DGCL"). Delaware is generally viewed as having the most well-developed and advanced state corporate legal system, and the majority of U.S. corporations are Delaware corporations.⁹ Because of the widespread influence of the DGCL, this Note focuses only on Delaware law and the federal laws that preempt it.

The term "federal securities law" describes a series of statutes adopted by the federal government regarding corporate securities and the regulations promulgated pursuant to those statutes. Publicly traded corporations and the securities they issue must comply with these statutes, the most important of which are the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act").¹⁰ In addition to granting various private rights of action to shareholders of public corporations, these statutes are also independently enforced by (1) the U.S. Securities and Exchange Commission (the "SEC"), a federal agency that can bring civil charges against individuals and corporations for violations of federal securities law; and (2) the U.S. Department of Justice (the "DOJ"), a federal department that can bring criminal charges against individual and corporate violators of federal law.¹¹ The corporations discussed in this Note are assumed to be publicly traded Delaware corporations, and as such they fall under both the DGCL and the federal securities laws.

Commentators have identified countless flaws in the U.S. shareholder litigation system,¹² but many of these flaws fall beyond the scope of this

6. See Weitzel, *supra* note 5, at 73–74.

7. See *infra* Part I.

8. See *infra* Part I.

9. See *infra* Section III.A.

10. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77(a)–(aa) (2012)); Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78(a)–(pp) (2012)).

11. See *infra* Section III.B.

12. See, e.g., James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903 (1996); Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465 (2004); Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, LAW & CONTEMP. PROBS., Autumn 1997, at 167; Jennifer Johnson, *What's Good for the Goose? A Critical Essay on "Best Practices" for Private Firms*, 2 J. BUS. & TECH. L. 251 (2007); Susan P. Koniak & George M. Cohen, *Under Cloak of*

Note. Instead, this Note focuses on two specific aspects of shareholder litigation that are especially deleterious for corporations and their investors: multiforum litigation and federal securities law class actions. Multiforum litigation occurs when multiple shareholders file identical claims against a corporation in various jurisdictions.¹³ In addition to forcing the corporation to defend the duplicative claims simultaneously, multiforum litigation can potentially result in conflicting court judgments, creating a no-win situation for the defendant-corporation. Federal securities law class actions are private shareholder claims under federal securities law, and they are brought against a corporation or its managers and directors as a class rather than as individuals.¹⁴ Private shareholder litigation under federal securities law has failed to meet its deterrent and compensatory goals, resulting in burdensome costs to corporations and their shareholders. The greatest beneficiaries of these federal securities law class actions are the shareholder-plaintiffs' counsel, who receive hefty attorneys' fees from the corporations and their insurance companies.¹⁵

The research on these issues is well developed. Many commentators have explored the driving forces underlying these phenomena, performed empirical studies to describe their impact on corporations and their shareholders, and recommended solutions to mitigate the harm.¹⁶ Some have argued that corporations should adopt provisions in their corporate governance documents requiring that shareholder claims be brought in a single jurisdiction.¹⁷ Others have contended that corporations are best off if shareholder claims are arbitrated rather than litigated.¹⁸ And still others have argued for preserving the status quo.¹⁹

Many of the commentators' previous positions on multiforum litigation and federal securities law class actions are either too broad or too narrow.

Settlement, 82 VA. L. REV. 1051 (1996); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55 (1991).

13. See *infra* Section I.A.

14. See *infra* Section I.B.

15. See *infra* Part I.

16. See, e.g., Choi, *supra* note 12; Fisch, *supra* note 12; Joseph A. Grundfest & Kristen Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325 (2013); Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused This Problem and Can It Be Fixed?*, 37 DEL. J. CORP. L. 1 (2012); Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1187 (2013); Weitzel, *supra* note 5.

17. See, e.g., Grundfest & Savelle, *supra* note 16; Brian JM Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137 (2011).

18. See, e.g., Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055 (1999); Scott & Silverman, *supra* note 16.

19. See, e.g., James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 ARIZ. L. REV. 497 (1997); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57 (2009).

The overly broad positions argue that all shareholder claims should be subject to a single solution, without distinguishing between the state corporate law and federal securities law claims and tailoring more appropriate solutions for each.²⁰ By contrast, the overly narrow positions only provide recommendations for shareholder claims under either state corporate law or federal securities law, ignoring the other class of shareholder claims.²¹ This Note takes a unique approach: it contends that different solutions should be adopted for state corporate law and federal securities law claims, and it explains what makes each solution either proper or improper for each claim.

This Note argues that corporations can maximize shareholder value by unilaterally adopting both forum selection and mandatory shareholder arbitration bylaw provisions to control shareholder lawsuits under state corporate and federal securities law, respectively.²² Part I describes the current state of shareholder litigation, including the costs associated with multiforum litigation and federal securities law class actions. Part II demonstrates that, despite their controversial nature, forum selection and mandatory arbitration provisions should be—and are likely to be—enforceable in a Delaware corporation’s charter or bylaws. Finally, Part III argues that, in order to maximize long-term shareholder value, corporations’ boards of directors should unilaterally enact forum selection bylaws to ensure that all state corporate law claims are litigated only in the Delaware Court of Chancery and mandatory arbitration bylaws to compel the arbitration of all shareholder claims brought under the federal securities laws.

I. MULTIFORUM LITIGATION AND FEDERAL SECURITIES LAW CLASS ACTIONS ARE COSTLY FOR CORPORATIONS AND THEIR SHAREHOLDERS

While all litigation imposes costs on the parties involved, shareholder litigation can take two especially problematic forms: multiforum litigation and federal securities law class actions. Section I.A describes the multiforum litigation phenomenon, explaining its negative impacts on corporations and their shareholders. Section I.B provides a similar analysis of securities class actions. Both Sections explain why corporations and their shareholders are the ultimate losers in these actions, and how the plaintiffs’ attorneys, the driving forces behind these suits, are the ultimate winners.

20. See, e.g., Micheletti & Parker, *supra* note 16; Weitzel, *supra* note 5.

21. See, e.g., Grundfest & Savelle, *supra* note 16; Scott & Silverman, *supra* note 16; Emily Farinacci, Note, *In a Bind: Mandatory Arbitration Clauses in the Corporate Derivative Context*, 28 OHIO ST. J. ON DISP. RESOL. 737 (2013).

22. As the corporation’s residual claimants, shareholders are entitled “to whatever remains after the [corporation] has met its explicit obligations and paid its fixed claims.” Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1193 (2002). Thus, by minimizing the costs imposed on a corporation and maximizing the corporation’s bottom-line profits, boards of directors maximize shareholder value as well, as each “marginal dollar of profit or loss falls on them.” Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 913.

A. *Multiforum Litigation Does Not Produce Benefits Proportionate to Its Costs for Corporations and Their Shareholders*

Multiforum litigation occurs when shareholders simultaneously challenge a single corporate action in multiple venues.²³ Although multiforum litigation can theoretically benefit individual shareholder-plaintiffs, the pervasive view is that this litigation results primarily from the agency problem between shareholders and the plaintiffs' firms that represent them.²⁴ Further, any benefit that does accrue to individual shareholders as a result of multiforum litigation is arguably offset by the costs that this litigation imposes on corporations and their shareholders—costs that result in a net loss to shareholders as a whole.²⁵

When a corporation engages in a large transaction, that transaction is likely to be the subject of multiple shareholder suits.²⁶ This acquisition-related litigation mainly involves shareholder derivative suits and direct class action claims under state corporate law.²⁷ If these suits are all brought in the same trial court, the defendant-corporation can easily have them consolidated into a single action.²⁸ If the suits are brought in different jurisdictions, however, the corporation faces a conundrum: “there is no mechanism to consolidate suits brought in the courts of different states or to consolidate state and federal actions.”²⁹ The corporation's only default legal options are either to file a motion “to stay one court's actions in favor of another”³⁰ or to defend the suits simultaneously in the various courts. Since such a motion is rarely granted,³¹ corporations are regularly forced to defend the separate suits simultaneously, resulting in multiforum litigation.

23. See *infra* notes 26–31 and accompanying text.

24. See *infra* notes 37–41, 44 and accompanying text. It is doubtful whether even the *plaintiffs themselves* in these actions are representative of the corporations' long-term shareholders. Deemed “professional plaintiffs,” these parties are intended to give plaintiffs' firms the legal standing to sue corporations by “(1) using the same shareholders in multiple lawsuits; (2) using plaintiffs' lawyers or their family members as plaintiffs; (3) using questionable entities as plaintiffs; and (4) using . . . dead plaintiffs and plaintiffs who may not know they are plaintiffs.” Jessica Erickson, *The New Professional Plaintiffs in Shareholder Litigation*, 65 FLA. L. REV. 1089, 1104 (2013).

25. See *infra* notes 42–45 and accompanying text.

26. See DAINES & KOUMRIAN, *supra* note 2, at 1 (showing that in 2012 shareholders brought lawsuits against 93% of the acquisitions of U.S. public companies valued at or over \$100 million, and that on average 4.8 lawsuits were filed).

27. See Erickson, *supra* note 24, at 1103.

28. Wachtell, Lipton, Rosen & Katz, *Exclusive Forum Bylaw Memorandum 2–3*, <http://www.wlrk.com/docs/ForumSelectionBylawBODmemo.pdf> (last visited May 21, 2014).

29. *Id.* at 3.

30. *Id.*

31. *Id.* For theories on why motions to stay are rarely granted, as well as a general critique of judicial solutions to the multiforum litigation problem, see Grundfest & Savelle, *supra* note 16, at 347–51.

The traditionally dominant view relied on the internal affairs doctrine³² in concluding that any intracorporate dispute involving a Delaware corporation would be resolved in the Delaware courts.³³ In the last decade, however, that view has proved less applicable, and filing lawsuits in foreign jurisdictions has become the norm.³⁴ In 2012, plaintiffs challenged 84% of the acquisitions involving Delaware corporations in foreign jurisdictions.³⁵ Furthermore, 77% of these acquisitions resulted in multiform litigation, because the foreign filings were accompanied by actions filed in the Delaware Court of Chancery.³⁶ What do shareholders gain by filing in a foreign jurisdiction, or by filing additional claims after another shareholder has already challenged a specific transaction? The answer is that the plaintiffs' attorneys, rather than the shareholder-plaintiffs themselves, are driving this trend.

The main incentive for plaintiffs' attorneys to file in multiple jurisdictions is their own bottom line.³⁷ Submitting multiple filings in foreign jurisdictions can benefit plaintiffs' attorneys in two ways. First, attorneys' fees are generally awarded only to the lead counsel in a case.³⁸ If a given firm does not become the lead counsel in an action in one jurisdiction, the firm has an incentive to file an identical action in another jurisdiction in an effort to become the lead counsel in that case.³⁹ Second, in terms of the general trend of foreign filing, the Delaware Court of Chancery has taken a skeptical view of awarding lavish attorneys' fees in quick, disclosure-based settlements.⁴⁰ The court's stance has motivated plaintiffs' firms to "look elsewhere for a more receptive forum of a million-dollar-plus fee payday for disclosure-based settlements."⁴¹

32. The internal affairs doctrine is a widely accepted and respected choice-of-law principle in U.S. corporations law. See MODEL BUS. CORP. ACT § 15.05(c) (2011); RESTATEMENT (SECOND) OF CONFLICTS OF LAW §§ 301–310 (1971); Stevelman, *supra* note 19, at 60. Under the doctrine, the laws of the state of incorporation govern the internal affairs of each corporation. Stevelman, *supra* note 19, at 60. Delaware law, then, is applied in any controversy involving a Delaware corporation or its managers, directors, and shareholders. See *id.* Although it is a choice-of-law principle, the internal affairs doctrine is not a choice-of-forum principle, which means that shareholders can bring claims in any court that has jurisdiction over the parties. See *id.* at 80; Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 2–3.

33. See Grundfest & Savelle, *supra* note 16, at 334.

34. *Id.* at 334–35.

35. See DAINES & KOUMRIAN, *supra* note 2, at 3.

36. See *id.*

37. See Transcript of Oral Argument at 34, *In re Burlington N. Santa Fe S'holder Litig.*, No. 5043-VCL (Del. Ch. Oct. 28, 2010), 2010 WL 9044719 [hereinafter Burlington Northern Transcript] (“[I]t’s rational for plaintiffs’ lawyers to file [in] multiple jurisdictions to get a seat at the table, to get a piece of the action.”); see also Micheletti & Parker, *supra* note 16, at 8.

38. Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 2.

39. *Id.*

40. Micheletti & Parker, *supra* note 16, at 8–10.

41. *Id.* at 11. “A disclosure-based settlement is one in which a deal litigation is resolved through the issuance of corrective or supplemental disclosures.” *Id.* at 8 n.27.

Making multiple filings in foreign jurisdictions may benefit plaintiffs' firms, but it harms every other party involved in the litigation. The Delaware Court of Chancery itself has recognized how problematic multiforum litigation can be:

Defense counsel is forced to litigate the same case—often identical claims—in multiple courts. Judicial resources are wasted as judges in two or more jurisdictions review the same documents and at times are asked to decide the exact same motions. Worse still, if a case does not settle or consolidate in one forum, there is the possibility that two judges would apply the law differently or otherwise reach different outcomes, which would then leave the law in a confused state and pose full faith and credit problems for all involved.⁴²

These duplicative suits even harm the plaintiffs themselves. Because the shareholder-plaintiffs are the owners of the defendant-corporations, they ultimately bear the costs of defending multiple suits, dealing with conflicting judgments, and paying the higher attorneys' fee awards.⁴³ In these ways, multiforum litigation does not yield proportionate benefits to shareholders,⁴⁴ making this type of litigation inimical to their long-term interests.⁴⁵

B. *Federal Securities Law Class Actions Do Not Produce Benefits Proportionate to Their Costs for Corporations and Their Shareholders*

The academic literature on federal securities law class actions indicates that the deterrence and compensatory goals remain largely unfulfilled.⁴⁶ In addition, as with multiforum litigation, federal securities law class actions implicate an agency problem between shareholders and their attorneys: plaintiffs' firms, because they stand to earn large contingency fees from these

42. *In re Allion Healthcare Inc. S'holder Litig.*, No. 5022-CC, 2011 WL 1135016, at *4 (Del. Ch. Mar. 29, 2011).

43. *See Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 943–44 (Del. Ch. 2013).

44. The theoretical benefits of foreign filings for individual shareholder-plaintiffs include the following: adjudication by courts more receptive to shareholder claims; access to jury trials; and improved odds of receiving punitive damages. *See Micheletti & Parker, supra* note 16, at 7. Note, however, that “[t]he dominant view in the academic literature is that the foreign forum phenomenon is driven by incentives of plaintiffs’ attorneys that are adverse to stockholder interests.” Grundfest & Savelle, *supra* note 16, at 339; *see also* John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 680 (1986); Micheletti & Parker, *supra* note 16, at 8; Quinn, *supra* note 17, at 149; Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)Shapes Shareholder Class Actions*, 57 VAND. L. REV. 1797, 1853–56 (2004).

45. *See Boilermakers*, 73 A.3d at 943–44.

46. *See infra* notes 52–64 and accompanying text.

actions, are the principal drivers of them.⁴⁷ The net result is that, while individual groups of shareholder-plaintiffs can profit from a large federal securities law judgment or settlement in the short run, other shareholders are saddled with a high cost of stock ownership, without a corresponding benefit, in the long run.⁴⁸

Shareholders' private rights of action under the federal securities laws typically arise under either the Securities Act or the Exchange Act.⁴⁹ Under Federal Rule of Civil Procedure 23 and the Private Securities Litigation Reform Act, these claims, usually for securities fraud under section 10(b) of the Exchange Act,⁵⁰ can be brought as class actions against the corporate issuers of those securities and their managers and directors.⁵¹

These securities class actions have two traditional goals: compensation and deterrence.⁵² The compensatory goal seeks to reimburse shareholders for the damages caused by the fraudulent acts of the corporation and its management, and the deterrence goal aims to provide disincentives for those corporations and managers to repeat the fraudulent behavior. Commentators are largely skeptical of whether securities class actions meet either of these goals.

Regarding the compensatory goal, many commentators argue that "securities class actions are a poor method of compensating stockholders for losses due to securities fraud."⁵³ The vast majority of securities class actions result in settlements or dismissals,⁵⁴ and the cases that settle only recover a small fraction of the shareholders' true damages. One study found that the median settlement for securities class actions in 2012 amounted to only

47. See *infra* notes 65–68 and accompanying text.

48. See *infra* notes 69–75 and accompanying text.

49. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2013 YEAR IN REVIEW 7 fig.6 (2014), available at <http://www.cornerstone.com/getattachment/d88bd527-25b5-4c54-8d40-2b13da0d0779/Securities-Class-Action-Filings%E2%80%94942013-Year-in-Review.aspx> (showing that 89% of the securities class actions filed by private parties in 2013 alleged violations of either sections 11 or 12(2) of the Securities Act or Rule 10b-5 under the Exchange Act).

50. See *id.*

51. Scott & Silverman, *supra* note 16, at 1188, 1197.

52. *Id.* at 1189; John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation* 8 (Columbia Law Sch. Ctr. for Law & Econ. Studies, Working Paper No. 293, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=893833.

53. Scott & Silverman, *supra* note 16, at 1192; see also Coffee, *supra* note 52, at 16; Lawrence E. Mitchell, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 WIS. L. REV. 243, 246 & n.9.

54. See RENZO COMOLLI ET AL., RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2012 FULL-YEAR REVIEW 23 (2013), available at http://www.nera.com/nera-files/PUB_Year_End_Trends_2012_1113.pdf (noting that of the 153 securities class actions resolved in 2012, 93 resulted in settlements, 60 were dismissed, and none produced a verdict).

1.8% of the estimated damages suffered by shareholders.⁵⁵ The compensatory goal also remains unfulfilled because of the “circularity problem” of securities class actions.⁵⁶ Put simply, when shareholders recover damages in securities class actions, the corporation pays those damages, not the misbehaving managers.⁵⁷ Thus, as the owners of the residual interest in the corporation, shareholders essentially pay themselves damages and finance the costs of the litigation. These costs, including “plaintiffs’ attorneys’ fees and expenses, defense counsels’ fees and expenses, [directors and officers (“D&O”)] insurance premiums, and the possible costs of disruption, stigma, and adverse publicity—all of which inevitably . . . fall on the corporation’s shareholders,” can sometimes exceed even the total settlement amount, depriving shareholders of any net recovery.⁵⁸

The case for the deterrence goal’s being met is also widely considered weak.⁵⁹ This failure can again be attributed to the circularity problem, as the corporation, rather than the managers who perpetrated the alleged securities fraud, pays the litigation and settlement costs in the vast majority of cases.⁶⁰ More specifically, because the corporation’s senior managers “are highly likely to be named as co-defendants in any securities litigation,”⁶¹ the corporation’s D&O insurer typically covers all of the settlement and litigation costs, up to the policy limits.⁶² The corporation and its shareholders still

55. ELLEN M. RYAN & LAURA E. SIMMONS, SECURITIES CLASS ACTION SETTLEMENTS: 2012 REVIEW AND ANALYSIS 8 (2013), available at http://www.cornerstone.com/files/upload/Cornerstone_Research_2012_Settlements.pdf.

56. Coffee, *supra* note 52, at 4–7 & 4 n.5; Mitchell, *supra* note 53, at 245–47.

57. Mitchell, *supra* note 53, at 245.

58. Coffee, *supra* note 52, at 17. Professor Coffee further elaborates as follows on the interaction between defense costs and the insurance coverage that corporations provide to their directors and officers:

The primary reason for the high level of defense costs in securities litigation is that [D&O insurance], which all public corporations carry, is unique D&O insurance gives no control over the defense to the insurer, but simply reimburses the policyholders’ defense costs up to the dollar limit of the policy As a result, D&O insurers have little ability to control defense costs. Indeed, one recent study reports a case in which defense counsel billed “\$75 million in the course of 18 months.”

Id. at 18.

59. Mitchell, *supra* note 53, at 247; see also Scott & Silverman, *supra* note 16, at 1197–1202; Coffee, *supra* note 52, at 5. But see Stephen J. Choi & Adam C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* 17–38 (Univ. of Mich. Law Sch. Law & Econ. Research Paper Series, Paper No. 12-022, 2012; N.Y. Univ. Sch. of Law Ctr. for Law, Econ. & Org., Paper No. 12-38, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109739, for an argument that private enforcement of federal securities law provides at least as much deterrent value as public enforcement, based partially on the fact that the stock drop for a corporation facing a securities class action lawsuit exceeds the stock drop for a corporation facing an SEC investigation. Scott and Silverman respond by pointing out that those stock drops only damage shareholders and do not actually deter individual wrongdoing by managers and directors. Scott & Silverman, *supra* note 16, at 1200.

60. See Mitchell, *supra* note 53, at 247; Scott & Silverman, *supra* note 16, at 1197.

61. Coffee, *supra* note 52, at 21.

62. *Id.* at 27.

ultimately bear these costs, however, as the D&O insurers inevitably adjust premium levels and shift those costs back to the innocent parties.⁶³ In addition, the expressive value of securities class actions in deterring managerial misbehavior is questionable, given the fact that directors generally do not suffer a loss of reputation following securities class actions, other than “in cases in the top quartile of settlement amounts” or those in which the SEC is involved.⁶⁴

Considering that both of securities class actions’ main objectives appear to be failing, one might assume that shareholders rarely bring them. This is not the case. Similar to multiforum litigation, securities class actions are largely driven by the plaintiffs’ attorneys.⁶⁵ Because attorneys’ fees can reach up to 35% of the settlement value,⁶⁶ plaintiffs’ firms have the incentive to bring securities class actions regardless of whether the compensatory or deterrent goal will be met. In 2004, there were 2,480 securities class actions pending in the federal courts.⁶⁷ To put this figure in perspective, those securities cases made up 47.9% of the total number of class actions in federal courts.⁶⁸

The costs that these actions impose on corporations are similarly staggering. According to one study, \$68.1 billion in settlements have been paid since 2000.⁶⁹ These settlement figures do not include the costs of defending the lawsuit, which “can rise to 50% to 100% of the settlement [amount].”⁷⁰ Because D&O insurers pay a significant portion of these amounts,⁷¹ insurance rates are “six times higher in the [United States] than in Europe.”⁷²

Securities class actions not only impose costs by transferring wealth to plaintiffs, their attorneys, and the D&O insurers, but they also exact costs that destroy a corporation’s wealth without transferring that wealth to another party.⁷³ In a study of 482 corporations, “\$24.7 billion in shareholder wealth was wiped out” solely due to the transaction costs of securities class

63. *Id.*

64. Eric Helland, *Reputational Penalties and the Merits of Class-Action Securities Litigation*, 49 J.L. & ECON. 365, 366 (2006).

65. Coffee, *supra* note 52, at 62.

66. Scott & Silverman, *supra* note 16, at 1226.

67. STATISTICS DIV., ADMIN. OFFICE OF THE U.S. COURTS, 2004 JUDICIAL BUSINESS OF THE UNITED STATES COURTS 400 tbl.X-4 (2004) [hereinafter 2004 JUDICIAL BUSINESS]. Note that 2004 numbers are used because 2004 was the last year that the report included the number and types of class actions pending in federal courts. Because the rate of securities class action filings has remained about steady during the last decade, this number is likely still representative. See COMOLLI ET AL., *supra* note 54, at 3 fig.1.

68. See 2004 JUDICIAL BUSINESS, *supra* note 67, at 400 tbl.X-4.

69. See COMOLLI ET AL., *supra* note 54, at 31 fig.28.

70. Scott & Silverman, *supra* note 16, at 1202.

71. Coffee, *supra* note 52, at 27.

72. LUIGI ZINGALES ET AL., INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 11 (2006).

73. See ANJAN V. THAKOR, THE UNINTENDED CONSEQUENCES OF SECURITIES LITIGATION 6 (2005).

action litigation.⁷⁴ These data indicate that securities class actions are not zero-sum games and that they can inflict financial distress on corporations that creates significant deadweight loss.⁷⁵ As a result, “[t]he wealth destroyed for defendants far exceeds the wealth gained by plaintiffs.”⁷⁶

II. FORUM SELECTION AND MANDATORY ARBITRATION PROVISIONS ARE ENFORCEABLE UNDER DELAWARE CORPORATE LAW

This Part presents corporations’ two options under Delaware law to respond to the costs of shareholder litigation described in Part I: forum selection provisions and mandatory arbitration provisions. Section II.A describes the legal history of forum selection provisions and briefly explains how they can be used to reduce the costs of multiforum litigation. In particular, Section II.A focuses on a recent decision by the Delaware Court of Chancery that held enforceable forum selection bylaws that a corporation’s board of directors unilaterally enacted. Section II.B then discusses mandatory arbitration provisions and argues that, based on the legal precedent set by the Court of Chancery’s ruling on forum selection bylaws, mandatory arbitration bylaws should be enforceable under Delaware law as well.

A. *Enforceability of Forum Selection Provisions Under Delaware Law*

Many companies enact forum selection provisions in their charter or bylaws to combat the multiforum litigation problem.⁷⁷ These provisions dictate the exclusive jurisdiction in which shareholders must bring certain claims. Typically, the provisions designate the Delaware Court of Chancery as the exclusive forum for the following types of suits: any derivative lawsuits; actions asserting breach of fiduciary duty; actions arising pursuant to a provision in the DGCL; and actions asserting shareholder claims governed by the internal affairs doctrine⁷⁸ (collectively, “state corporate law claims”). Since 2010, in response to the recent increase in multiforum litigation,⁷⁹ over

74. *Id.* at 5–6. “[I]nformation-disclosure-related litigation destroys on average approximately 3.5 percent of the equity value of a company.” *Id.* at 14.

75. *See id.* at 6.

76. *Id.* at 14.

77. *See supra* Section I.A.

78. MARC A. ALPERT & PATRICK J. NARVAEZ, CONTINUING CHALLENGES TO EXCLUSIVE FORUM BYLAW PROVISIONS 1 (2012), available at http://www.chadbourn.com/files/Publication/d9847614-a7b3-4164-9cf9-973e92ab2299/Presentation/PublicationAttachment/0baecf9c-db50-4f90-89bf-c6a17e3d215c/ContinuingChallengestoExclusiveForumBylawProvisions_Alpert_DealLawyers.pdf. Forum selection provisions in a corporation’s charter or bylaws must only regulate internal claims brought by a plaintiff as a stockholder. *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 952 (Del. Ch. 2013). This excludes “tort claim[s] against the company based on a personal injury [a shareholder] suffered that occurred on the company’s premises or a contract claim based on a commercial contract with the corporation.” *Id.*

79. *See supra* Section I.A.

250 publicly traded corporations have adopted forum selection provisions.⁸⁰ Many corporations' boards of directors adopted these provisions unilaterally, without shareholders' approval.⁸¹

It is easy to see why a corporation would want to adopt forum selection provisions. Channeling shareholder litigation into a single jurisdiction eliminates costly and inefficient parallel litigation: claims by multiple shareholders can be consolidated into a single case, and the troubling potential for inconsistent decisions by multiple courts regarding a single transaction disappears.⁸² Forum selection provisions can also give companies the benefit of having their disputes litigated in the Delaware Court of Chancery. This "help[s] provide greater certainty with respect to the outcome of disputes as Delaware courts have substantial expertise in matters of corporate law and a well-developed body of caselaw."⁸³

While many corporations view forum selection provisions as a boon to shareholders, the provisions remain controversial. Professor Stevelman argues that the ability to bring suit in various jurisdictions serves as an important bulwark against Delaware law's perceived bias in favor of corporate management.⁸⁴ Since much of Delaware's revenue is generated through incorporation fees, Stevelman argues, Delaware corporate law may favor corporate management against shareholders as a way to encourage continued incorporation in the state.⁸⁵ As such, allowing shareholders to bring suits in other states might "exert[] a salutary, equilibrating effect on Delaware corporate law."⁸⁶

Foreign filings, however, are unlikely to have any impact on the balance of power between management and shareholders in Delaware corporate law. Because foreign filings are primarily motivated by plaintiffs' attorneys' desire for an increased payout⁸⁷—rather than by their desire to champion the interests of shareholders—the rate of foreign filings would likely remain the same even if Delaware corporate law became more proshareholder. The Delaware courts' explicit recognition that increased attorneys' fees serve as the main impetus for foreign filings supports this rationale.⁸⁸ In other words,

80. Grundfest & Savelle, *supra* note 16, at 325.

81. See Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 1. Corporations' boards of directors can unilaterally adopt forum selection provisions in a corporation's charter in situations where a shareholder vote is not required for an amendment ("e.g., in connection with an IPO, a spin-off, bankruptcy reorganization, or reincorporation in Delaware"). *Id.* The board of directors can also adopt the provisions in the corporation's bylaws if the charter gives the board the power unilaterally to amend the bylaws. *Id.* at 1, 6.

82. *Id.* at 2.

83. ALPERT & NARVAEZ, *supra* note 78, at 1.

84. See Stevelman, *supra* note 19, at 64.

85. See *id.* at 64–65.

86. *Id.* at 65.

87. See *supra* Section I.A.

88. See Burlington Northern Transcript, *supra* note 37; Transcript of Motion to Consolidate and Organize Counsel and the Court's Ruling at 34, *In re Compellent Techs., Inc. S'holder Litig.*, No. 6084-VCL (Del. Ch. Jan. 13, 2011), available at <http://www.delawarelitigation.com/>

because the Delaware courts view multiform litigation as primarily driven by plaintiffs' firms' interests rather than as a response to a perceived bias in Delaware corporate law, multiform litigation does not provide any incentive for the Delaware courts to alter their adjudication to remedy any actual bias. In addition, when a Delaware corporation is sued in a foreign jurisdiction, any managerial bias in the DGCL still harms shareholders, as foreign courts must apply the law of the state of incorporation.⁸⁹ Although foreign courts could theoretically apply Delaware law in a more shareholder-friendly manner than the Delaware courts, it is not clear whether Delaware corporate law actually has a proshareholder or promanagement bias.⁹⁰

Shareholders have also challenged the legal enforceability of forum selection provisions that boards of directors unilaterally adopted. In February 2012, shareholders sued twelve public Delaware corporations in the Court of Chancery to invalidate their unilaterally adopted forum selection bylaws.⁹¹ In response to the suits, ten of the twelve companies repealed the provisions.⁹² The remaining two actions were consolidated into one case, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*,⁹³ which neatly summarizes the legal arguments for and against enforcing unilaterally adopted forum selection bylaws.

The defendant-corporations in *Boilermakers*, Chevron and FedEx, were both Delaware corporations with bylaw provisions stating that, unless the corporation consents in writing to another forum, all state corporate law claims must be brought in the Delaware Court of Chancery.⁹⁴ Both corporations' boards of directors were empowered by provisions in their charters to adopt bylaws unilaterally⁹⁵—as permitted by the DGCL⁹⁶—and the boards

uploads/file/int76(2).pdf; Transcript of Courtroom Status Conference at 18–19, Scully v. NightHawk Radiology Holdings, Inc., No. 5890-VCL (Del. Ch. Dec. 17, 2010), available at [http://www.rlf.com/files/Scully%20v.%20Nighthawk%20Radiology%20Holdings%20\(Del.%20Ch.%20Dec.%202017,%20202010\)%20\(00162924-2\)_OCR.pdf](http://www.rlf.com/files/Scully%20v.%20Nighthawk%20Radiology%20Holdings%20(Del.%20Ch.%20Dec.%202017,%20202010)%20(00162924-2)_OCR.pdf).

89. See *supra* note 32 (discussing the internal affairs doctrine).

90. Compare William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 672 (1974), and Stevelman, *supra* note 19, at 64–65, with Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 92 (1990), and Claire Hill & Brett McDonnell, *Executive Compensation and the Optimal Penumbra of Delaware Corporation Law*, 4 VA. L. & BUS. REV. 333, 358 (2009). For a more direct critique of Stevelman's argument, see Grundfest & Savelle, *supra* note 16, at 343 (“The problem with this argument is that it is, at best, speculative, incomplete, and fails to consider the costs imposed by the current regime . . . [It] presents no example of Delaware's courts engaging in ‘excessive partisanship’ and fails to address recent Delaware decisions favoring shareholder-plaintiffs . . .”).

91. Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 3.

92. *Id.*

93. 73 A.3d 934 (Del. Ch. 2013).

94. *Boilermakers*, 73 A.3d at 942.

95. *Id.* at 941.

96. DEL. CODE ANN. tit. 8, § 109(a) (2011) (“[A]ny corporation may, in its [charter], confer the power to adopt, amend or repeal bylaws upon the directors . . .”).

consequently adopted these bylaws without a shareholder vote.⁹⁷ The defendants stated that the forum selection bylaws were adopted as a response to multiform litigation, which, they argued, damages the corporations and their shareholders by imposing “needless costs” that are “not justified by rational benefits” for shareholders.⁹⁸

The shareholder-plaintiffs claimed that the bylaws were invalid and unenforceable under two theories. First, the plaintiffs claimed that the bylaws were statutorily invalid because adopting the bylaws was beyond the boards’ authority under the DGCL.⁹⁹ Second, they claimed that the provisions were contractually invalid under the U.S. Supreme Court’s test in *The Bremen v. Zapata Off-Shore Co.*¹⁰⁰ The plaintiffs also “conjured up an array of purely hypothetical situations in which they [said] that the bylaws of Chevron and FedEx might operate unreasonably.”¹⁰¹

Then-Chancellor Strine (now the Chief Justice of the Delaware Supreme Court)¹⁰² ruled in favor of the defendants, holding the bylaw provisions both statutorily and contractually valid.¹⁰³ Regarding the statutory validity of the provisions, Chancellor Strine pointed to section 109(b) of the DGCL,¹⁰⁴ which provides that the bylaws of a corporation “may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”¹⁰⁵ The challenged bylaw provisions “easily” met the requirements of section 109(b) because they governed the internal affairs of the corporation and were not inconsistent with Delaware or federal law, both of which respect and enforce forum selection clauses in contracts.¹⁰⁶

Regarding the contractual validity of the provisions, Chancellor Strine noted that “the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers, and stockholders formed within the statutory framework of the DGCL.”¹⁰⁷ When Chevron’s and FedEx’s shareholders bought stock in the companies, they were aware that

97. *Boilermakers*, 73 A.3d at 941–42.

98. *Id.* at 943–44.

99. *Id.* at 938.

100. *See id.*; *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12–15 (1972) (holding that a contractual forum selection clause “unaffected by fraud, undue influence, or overweening bargaining power” is enforceable unless it is shown to be “unreasonable and unjust”).

101. *Boilermakers*, 73 A.3d at 940.

102. Tom Hals, *Leo Strine Confirmed as Chief Justice of Delaware’s Supreme Court*, REUTERS (Jan. 29, 2014, 7:05 PM), <http://www.reuters.com/article/2014/01/30/delaware-court-strine-idUSL2N0L32MZ20140130>.

103. *See Boilermakers*, 73 A.3d at 939.

104. *Id.*

105. DEL. CODE ANN. tit. 8, § 109(b) (2011).

106. *Boilermakers*, 73 A.3d at 939.

107. *Id.*

the charters gave the boards of directors authority unilaterally to adopt by-law provisions and that these provisions would be binding on them as long as the provisions complied with section 109(b).¹⁰⁸ As such, by investing in Chevron and FedEx, the shareholders assented to any bylaws compliant with section 109(b) that the board might unilaterally adopt.¹⁰⁹

Although forum selection bylaws are generally valid under Delaware corporate law after *Boilermakers*, the controversy surrounding these provisions persists. The validity of unilaterally adopted forum selection bylaws is before the Delaware Supreme Court,¹¹⁰ although commentators believe that Chancellor Strine's "well-reasoned" decision should be upheld.¹¹¹ The bigger question is whether courts outside of Delaware will enforce the provisions.¹¹² When claims are brought in non-Delaware forums against Delaware corporations with forum selection provisions in their bylaws, the defendant-corporations must move to dismiss, using the forum selection bylaw as a jurisdictional defense. Despite the fact that the Court of Chancery's decision is presumably entitled to full faith and credit by the other courts,¹¹³ the forum selection bylaws are still vulnerable to a finding that the provision would operate inequitably in a specific as-applied challenge by a court using a *Bremen*-style reasonableness test.¹¹⁴ As the court in *Boilermakers* explained, "*Bremen* . . . requires courts to give as much effect as is possible to forum selection clauses and only deny enforcement of them to the limited extent necessary to avoid some fundamentally inequitable result or a result contrary to positive law."¹¹⁵ A finding of inequity is even less likely in the context of a corporate bylaw than in other contracting environments due to shareholders' ability to modify corporations' bylaws and elect directors.¹¹⁶

B. *Enforceability of Mandatory Arbitration Provisions Under Delaware Law*

Mandatory arbitration provisions, both in corporate governance documents and in other contractual settings, are even more controversial than forum selection provisions. In its most extreme form, a mandatory arbitration provision would require all shareholder claims against a corporation to

108. *Id.* at 940.

109. *See id.*

110. *See* Brian JM Quinn, *Chevron Seeks to Certify Question*, M&A LAW PROF BLOG (Feb. 4, 2014), <http://lawprofessors.typepad.com/mergers/2014/02/chevron-seeks-to-certify-question.html>.

111. Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 4; *see also* Quinn, *supra* note 110.

112. For an indication that foreign courts are likely to respect a Delaware corporation's forum selection bylaw, see *Hemg Inc. v. Aspen Univ.*, No. 650457/13, slip op. at 1, 3–5 (N.Y. Sup. Ct. Nov. 4, 2013), in which a New York state court respected a Delaware corporation's forum selection bylaw and dismissed the claims that were subject to the bylaw.

113. U.S. CONST. art. IV, § 1.

114. *See supra* note 100; *Boilermakers*, 73 A.3d at 941; Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 4.

115. *Boilermakers*, 73 A.3d at 949.

116. *See id.* at 956–58.

be arbitrated rather than brought in court. Advocates laud arbitration on the grounds that it is cheaper and faster than litigation.¹¹⁷ Arbitration clauses can also give the contracting parties the ability to choose the arbitrator.¹¹⁸ For complex cases, such as those involving federal securities law claims, this flexibility allows the parties to choose an arbitrator with relevant expertise, leading to more reasonable decisions than would result in less experienced courts.¹¹⁹

In addition to giving corporations the ability to prevent multiforum litigation by consolidating multiple claims into a single arbitration, arbitration clauses can also eliminate class action lawsuits by requiring all claims to be arbitrated on an individual basis rather than as a class.¹²⁰ While in theory this process creates additional costs by forcing corporations to arbitrate multiple claims rather than one single claim, in practice it prevents many shareholder claims from being brought in the first place.¹²¹ The ability to prevent class actions makes arbitration potentially attractive for public corporations but extremely controversial among commentators and shareholders. Some of the greatest costs that shareholder litigation imposes on corporations stem from class action litigation.¹²² On the other hand, critics argue that, without the ability to litigate as a class, shareholders with meritorious claims against corporations would never bring them because individual cases are often prohibitively expensive for any single shareholder.¹²³

The Supreme Court addressed this argument in the customer context in *American Express Co. v. Italian Colors Restaurant*.¹²⁴ In that case, the district court granted American Express's motion to compel arbitration pursuant to the mandatory arbitration clause in the company's customer contracts and dismissed the customer-plaintiffs' claims.¹²⁵ The plaintiffs, who had contractually agreed to class arbitration waivers, appealed on the grounds that individual arbitration would be inequitable because each plaintiff's cost of individually arbitrating his or her claim exceeded the potential recovery.¹²⁶ Justice Kagan, in her dissent, summarized the majority's response to the plaintiffs' argument as follows: "[t]oo darn bad."¹²⁷ The Court ruled in favor

117. *E.g.*, Scott & Silverman, *supra* note 16, at 1209–12; Weitzel, *supra* note 5, at 83.

118. SECTION OF DISPUTE RESOLUTION, AM. BAR ASSOC., BENEFITS OF ARBITRATION FOR COMMERCIAL DISPUTES 5 (n.d.), available at http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf.

119. *Id.*

120. Scott & Silverman, *supra* note 16, at 1209–12.

121. *See id.* at 1218–19. *See also infra* Sections III.A and III.B for an explanation of why this feature of mandatory arbitration provisions makes the provisions appropriate for shareholder claims under federal securities law but not for shareholder claims under state corporate law.

122. *See supra* Section I.B.

123. Scott & Silverman, *supra* note 16, at 1218–19.

124. 133 S. Ct. 2304 (2013).

125. *Italian Colors Restaurant*, 133 S. Ct. at 2308.

126. *Id.*

127. *Id.* at 2313 (Kagan, J., dissenting).

of American Express, holding that the Federal Arbitration Act (the “FAA”) required enforcing the contractual waivers of class arbitration.¹²⁸ More specifically, the Court held that the FAA’s overarching principle is that arbitration is a matter of contract.¹²⁹ As such, unless a contrary congressional command has overridden the FAA’s mandate, “courts must rigorously enforce arbitration agreements according to their terms.”¹³⁰

In the context of mandatory shareholder arbitration bylaws, most of the opponents’ arguments are policy based. A case in the Maryland state courts, *Corvex Management LP v. Commonwealth REIT*,¹³¹ represents a microcosm of that opposition. The shareholders in that case sued to invalidate a public company’s unilaterally adopted mandatory arbitration bylaw.¹³² In support of the plaintiffs’ argument that the bylaw should be invalidated as a matter of public policy, a group of securities law professors filed an affidavit arguing that, “[a]bsent the transparency and visibility provided by legal proceedings in an open courtroom, and the possibility of a rebuke by a judge, fiduciaries would be much less deterred from violating their duties to shareholders.”¹³³ Still, the court granted the defendant’s motion to compel arbitration, in part due to a finding that federal, Maryland, and Delaware law all “have expressed public policy’s strong preference for arbitration.”¹³⁴

The arbitration provision at issue in *Corvex* was also challenged in a federal district court in Massachusetts. In that case, *Delaware County Employees Retirement Fund v. Portnoy*,¹³⁵ the court evaluated the merits of the bylaw under Maryland and federal law.¹³⁶ Similar to the Court of Chancery’s reasoning in *Boilermakers*,¹³⁷ the court’s reasoning in this case led it to conclude that, because the shareholders knew when they originally invested in the company that the board could unilaterally adopt any legal bylaw provision, the shareholders had constructive knowledge of the mandatory arbitration bylaw, regardless of when it was adopted.¹³⁸ The court also rejected the contention that the bylaw violates the Exchange Act, noting that mandatory arbitration does not “preclude shareholders from asserting Exchange Act

128. *Id.* at 2308–12 (majority opinion).

129. *Id.* at 2309.

130. *Id.* (internal quotation marks omitted).

131. No. 24-C-13-001111, 2013 WL 1915769 (Md. Cir. Ct. May 8, 2013).

132. *Corvex*, 2013 WL 1915769, at *3–4.

133. Alison Frankel, *Law Profs, Ex-SEC Chair Protest Commonwealth Arbitration Bylaw*, REUTERS (June 12, 2013), <http://blogs.reuters.com/alison-frankel/2013/06/12/law-profs-ex-sec-chair-protest-commonwealth-arbitration-bylaw/>.

134. *Corvex*, 2013 WL 1915769, at *7–10.

135. No. 13-10405-DJC, 2014 WL 1271528 (D. Mass. Mar. 26, 2014).

136. *Portnoy*, 2014 WL 1271528, at *13–14.

137. See *supra* text accompanying notes 107–109.

138. *Portnoy*, 2014 WL 1271528, at *11.

claims but merely specifies a forum for them.”¹³⁹ Although it ultimately refused to invalidate the bylaw on *res judicata* grounds, the court concluded in dicta that the shareholders had failed to prove that the bylaw was unenforceable.¹⁴⁰

Although no Delaware case has yet addressed the issue, if a unilaterally adopted mandatory shareholder arbitration bylaw is challenged in the Court of Chancery, it should be, and is likely to be, found enforceable. Under Delaware corporate law, “[t]he 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.”¹⁴¹ Applying the court’s reasoning in *Boilermakers*, if a corporation’s charter has granted its board of directors the power unilaterally to adopt bylaw provisions under section 109(a) of the DGCL, then any provision compliant with section 109(b) that the board of directors unilaterally adopts would be statutorily valid.¹⁴²

Mandatory shareholder arbitration provisions are appropriate bylaws under section 109(b) because, similar to forum selection provisions, they regulate the rights of shareholders. Mandatory arbitration bylaws are also like forum selection bylaws in that they are process oriented, regulating *where* and *how* shareholders bring their claims against a corporation, not *whether* a shareholder may bring suit or the kind of remedy that a shareholder may obtain.¹⁴³ As long as the claims subject to arbitration are brought by shareholders in their capacity as shareholders, then the bylaws are process oriented and are tantamount to forum selection bylaws.¹⁴⁴ In fact, arbitration and forum selection provisions are so similar that the Supreme Court has described arbitration as a type of forum selection provision.¹⁴⁵ As such, mandatory arbitration bylaws plainly fall within the scope of section 109(b) and are hence statutorily valid.

Mandatory arbitration bylaws should also be found contractually valid. Because shareholders invest knowing that section 109(a) of the DGCL permits a board of directors unilaterally to adopt any bylaw compliant with section 109(b), they implicitly assent to and are contractually bound by a subsequently adopted mandatory arbitration bylaw.¹⁴⁶ The Supreme Court’s holding in *AT&T Mobility LLC v. Concepcion*¹⁴⁷ provides additional support for the contractual validity of mandatory arbitration bylaws. In that case, the

139. Alison Frankel, *Shareholders Beware: Federal Judge OKs Corporate Arbitration Clause*, REUTERS (Mar. 27, 2014), <http://blogs.reuters.com/alison-frankel/2014/03/27/shareholders-beware-federal-judge-oks-corporate-arbitration-clause/>.

140. *Portnoy*, 2014 WL 1271528, at *9.

141. *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 407 (Del. 1985).

142. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939–40 (Del. Ch. 2013).

143. *Id.* at 951–52.

144. For background on forum selection bylaws, see *supra* note 78.

145. *Grundfest & Savelle*, *supra* note 16, at 386.

146. *Boilermakers*, 73 A.3d at 939–40.

147. 131 S. Ct. 1740 (2011).

Court held that, under the FAA, arbitration agreements must be placed on equal footing with other contractual provisions.¹⁴⁸ Any finding that an arbitration agreement is unenforceable must be made under generally applicable contract defenses and must not apply only to arbitration agreements.¹⁴⁹ As a result, since forum selection bylaws have already been found enforceable under Delaware law,¹⁵⁰ finding mandatory arbitration bylaws unenforceable would be a prohibited form of discrimination under the FAA. Thus, although opponents will likely argue that mandatory arbitration bylaws are different from forum selection bylaws for policy reasons,¹⁵¹ both should be equally enforceable under Delaware and federal law.

III. CORPORATIONS SHOULD UNILATERALLY ADOPT FORUM SELECTION BYLAWS FOR ALL STATE CORPORATE LAW CLAIMS AND MANDATORY ARBITRATION BYLAWS FOR ALL FEDERAL SECURITIES LAW CLAIMS

Based on the rising costs of shareholder litigation described in Part I and the benefits and likely enforceability of forum selection and mandatory arbitration provisions described in Part II, corporations' boards of directors have a number of options. The real challenge lies in deciding which solution—forum selection or mandatory arbitration—most benefits the corporation and its shareholders.¹⁵² This Part argues that corporate boards of directors should unilaterally adopt forum selection bylaws that require all state corporate law claims to be brought in the Delaware Court of Chancery and mandatory arbitration bylaws that require all federal securities law claims to be subject to arbitration. This blended approach will reduce the costs of shareholder litigation while simultaneously respecting its goals and policy justifications. Section III.A describes forum selection provisions' beneficial impacts on corporations and their shareholders and shows why litigation in the Delaware Court of Chancery is preferable to arbitration for state corporate law claims. Section III.B then argues that arbitration is more beneficial than litigation for private claims arising under federal securities law. Finally, Section III.C recommends that boards of directors unilaterally adopt forum selection and mandatory arbitration provisions through bylaw amendments rather than bilaterally adopting them as charter amendments subject to a shareholder vote.

148. *Concepcion*, 131 S. Ct. at 1757.

149. *Id.* at 1746.

150. *Boilermakers*, 73 A.3d 934.

151. *Grundfest & Savelle*, *supra* note 16, at 386 (“Forum selection provisions cause disputes to be litigated in open court, subject to public scrutiny, in a forum that generates reviewable precedent through procedures that have full due process guarantees. Arbitral proceedings have none of these features.”).

152. Although there are other proposed solutions and reforms to multiform litigation and federal securities class actions, they remain outside the scope of this Note.

A. *Corporations Should Adopt Forum Selection Provisions for All State Corporate Law Claims*

In response to the costs of multiforum litigation, corporations should enact forum selection provisions requiring that all shareholder state corporate law claims¹⁵³ be brought in the Delaware Court of Chancery. As noted in Section I.A, multiforum litigation neither creates value for the corporation nor produces greater compensation for injured shareholders. Instead, it primarily serves as a tool for plaintiffs' firms to extract additional fees, shifting wealth from the corporation and its shareholders to the plaintiffs' attorneys. Corporations not only bear the costs of defending multiple actions simultaneously, but they also risk receiving inconsistent judgments from multiple jurisdictions, forcing them into the "impossible situation of trying to comply with incompatible orders."¹⁵⁴ Adopting effective forum selection bylaw provisions would completely eliminate these costs by allowing a corporation to channel all state corporate law claims into the Court of Chancery, where the claims could be consolidated into a single action. In this scenario, a corporation with a forum selection provision would defend only one action, in only one court, and receive only one judgment.

Furthermore, by designating the Court of Chancery as the sole jurisdiction for all state corporate law claims, corporations and their shareholders get the benefit of the Delaware courts' familiarity with the DGCL. In any dispute about the internal affairs of a Delaware corporation, the DGCL is applied, regardless of where a shareholder brings suit.¹⁵⁵ The Delaware courts, however, often enjoy a comparative advantage in interpreting and applying the law of their state.¹⁵⁶ This comparative advantage is magnified by the fact that judges hear all cases in the Court of Chancery,¹⁵⁷ which mitigates the unpredictability, inconsistency, and unsophistication of jury decisions.¹⁵⁸ The Delaware courts are thus more likely than other courts to apply

153. See *supra* note 78 and accompanying text.

154. Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 2.

155. See *supra* note 32.

156. Grundfest & Savelle, *supra* note 16, at 334.

157. DEL. CONST. art. IV, § 10.

158. See LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 5 (2007). Proponents of jury trials sometimes criticize bench trials on fairness grounds, arguing that shareholder-plaintiffs lose the benefit of their peers' judgment when they litigate in the Court of Chancery. These concerns are mitigated when one considers the intricacy of the subject matter of corporate disputes. In fact, in similarly complex commercial litigation cases, courts sometimes decide against jury trials on the grounds "that when the issues involved are beyond the competence of jurors, a jury trial would violate the litigants' due process rights." Paul Lansing & Nina Miley, *The Right to a Jury Trial in Complex Commercial Litigation: A Comparative Law Perspective*, 14 LOY. L.A. INT'L & COMP. L.J. 121, 121 (1991). In addition, commentators generally count bench trials among the benefits of litigating in the Court of Chancery. See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1077 (2000); Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 704 (1992).

the DGCL correctly, consistently, and predictably. This certainty allows opposing parties to reach reasonable settlements more quickly and enables corporate participants to avoid litigation altogether by structuring their corporate transactions accordingly.¹⁵⁹

The Delaware courts are also renowned for the speed and proficiency with which they decide corporate disputes. Because of the Court of Chancery's unique jurisdictional design, it hears no criminal or tort cases. It therefore processes corporate litigation quickly and efficiently, avoiding criminal and tort cases that "create huge backlogs in other judicial systems."¹⁶⁰ The resulting "high volume of corporate litigation" has created "economies of scale" that "contribute to an efficient and expert court system."¹⁶¹ The Court of Chancery's judges are often lauded for their "familiarity with complex business transactions and insight into the inner workings of corporations."¹⁶² The Delaware Supreme Court, which hears appeals from the Court of Chancery, is also recognized for its sophistication and experience with corporate law, and it has become known for the speed with which it decides appeals.¹⁶³ This efficiency and expertise in the Delaware courts provide litigants with a quicker and more reasonable decision than they might receive from a foreign jurisdiction lacking these qualities.

There are also many reasons for a corporation to choose to battle the costs of multiform litigation with a forum selection rather than a mandatory arbitration provision. First, although arbitration is generally viewed as cheaper and faster than litigation, and although arbitrators are viewed as more expert in complex legal matters than traditional trial courts,¹⁶⁴ these benefits are not as pronounced for corporate litigation in the Court of Chancery. As explained above, the court can process corporate cases more quickly and efficiently than other trial courts. Further, because all trials in the Court of Chancery are heard only by judges,¹⁶⁵ and because the judges are preeminent corporate law experts,¹⁶⁶ the court likely possesses as much expertise in complex corporate law as any arbitrator.

Second, as the plaintiffs in *Corvex*¹⁶⁷ argued, "[a]bsent the transparency and visibility provided by legal proceedings in an open courtroom, and the

159. See BLACK, *supra* note 158, at 6; A.C. Pritchard, *London as Delaware?*, 78 U. CIN. L. REV. 473, 479–81 (2009).

160. BLACK, *supra* note 158, at 6 (quoting former Supreme Court Chief Justice Rehnquist).

161. *Id.*

162. *Id.*; see also, e.g., Pritchard, *supra* note 159, at 479 (citing the high quality of Delaware's judicial system and the Court of Chancery judges as factors that motivate firms to incorporate in the state).

163. See BLACK, *supra* note 158, at 7.

164. See *infra* Section III.B.

165. BLACK, *supra* note 158, at 5.

166. *Id.* at 6; Fisch, *supra* note 158, at 1078; Pritchard, *supra* note 159, at 479; Farinacci, *supra* note 21, at 751.

167. *Corvex Mgmt. LP v. Commonwealth REIT*, No. 24-C-13-001111, 2013 WL 1915769 (Md. Cir. Ct. May 8, 2013).

possibility of a rebuke by a judge, fiduciaries would be much less deterred from violating their duties to shareholders.¹⁶⁸ While this risk does not provide a compelling reason for a court to find a mandatory arbitration provision legally unenforceable, it does give corporations and their shareholders a basis for preferring that state corporate law claims be brought in open litigation rather than in private arbitration. Even when the Court of Chancery dismisses a claim against directors and managers, the judges sometimes will make a point to condemn publicly directors' and managers' actions, recommending the better course of action for a larger audience of corporate participants.¹⁶⁹ Because individual directors rarely pay monetary damages in shareholder lawsuits, Delaware courts use the attention from the media and academia publicly to shame directors into behaving.¹⁷⁰ This negative publicity acts as a deterrent against weak monitoring and self-serving actions by directors and managers and is arguably a more effective deterrent than large judgments against the corporation from private suits.¹⁷¹ In addition, unlike federal securities law,¹⁷² state corporate law only enforces directors' and managers' duties through shareholder litigation. Thus, if corporations can eliminate state corporate law class actions through a class action waiver in a mandatory arbitration provision, which could render individual claims prohibitively costly, there will be no legal mechanism to enforce state corporate law duties.¹⁷³

Finally, adopting provisions requiring that state corporate law claims be arbitrated could stymie the development and evolution of Delaware corporate law. Because arbitration privately resolves a contract dispute, it creates no reviewable precedent.¹⁷⁴ Although individual shareholders may prove indifferent about this lack of precedent, Delaware corporations and their shareholders as a whole benefit from the constant growth and updating of Delaware corporate law—a positive externality of litigation in the Court of Chancery.¹⁷⁵ The “corporate norms” created as a result of Delaware’s case law have been described as “public good[s]” and used as a justification for

168. Frankel, *supra* note 133.

169. Pritchard, *supra* note 159, at 480–81; Edward B. Rock, *Saints and Sinners: How Does Delaware Corporation Law Work?*, 44 UCLA L. REV. 1009, 1103–04 (1997).

170. Pritchard, *supra* note 159, at 480–81.

171. *See id.*; Rock, *supra* note 169, at 1103–04.

172. *See* discussion of SEC and DOJ enforcement of federal securities laws *infra* Section III.B.

173. Absent the ability to sue, shareholders' only means of redress are their corporate governance (i.e., voting for new directors) and market (i.e., selling their shares) rights. *See* Thompson, *supra* note 1, at 216.

174. Scott & Silverman, *supra* note 16, at 1217; Farinacci, *supra* note 21, at 746–47. For a discussion of why the lack of reviewable precedent is not a concern in the context of federal securities law, *see infra* Section III.B.

175. BLACK, *supra* note 158, at 7–8; Fisch, *supra* note 158, at 1074–81 (arguing that the lawmaking function of the Delaware Court of Chancery is the biggest reason corporations prefer to incorporate in Delaware); Farinacci, *supra* note 21, at 746–47, 751.

shareholder litigation in Delaware, distinct from the two traditional justifications of compensation and deterrence.¹⁷⁶ Thus, to ensure that current and future generations of corporations and their shareholders can benefit from Delaware's vast and well-developed corporate case law,¹⁷⁷ forum selection provisions, rather than mandatory arbitration provisions, should be adopted to combat the costs of multiforum litigation.

B. *Corporations Should Adopt Mandatory Arbitration Provisions for All Federal Securities Law Claims*

To reduce the costs of shareholder litigation under the federal securities laws,¹⁷⁸ corporations should enact provisions mandating that all such claims be subject to arbitration. Arbitration is generally faster and cheaper than litigation, and arbitrators generally have more expertise in complex legal matters than the federal district courts.¹⁷⁹ The concern that arbitrators may lack some of judges' legal interpretation and application skills is mitigated by the fact that nearly all securities class actions are claims for fraud under one rule (Rule 10b-5) of the Exchange Act.¹⁸⁰ Unlike the complex, shifting fiduciary duties under state corporate law,¹⁸¹ the legal obligation not to commit fraud is relatively easy for an arbitrator to evaluate, as it consists of only six clear, well-established elements.¹⁸² A corporation and its shareholders would benefit from arbitration because they would pay less in attorneys' fees (as a result of the shorter and more efficient resolution process) and because they would receive more consistently reasonable decisions made by expert arbitrators rather than by federal district court judges.

There are also many reasons why arbitration is appropriate for shareholders' federal securities law claims but not for their state corporate law claims. First, no trial court matches the Delaware Court of Chancery in its state corporate law expertise in the realm of federal securities law. Perhaps the federal trial court in the Southern District of New York comes closest to rivaling the Court of Chancery in expertise, as more federal securities law class actions are filed there than in any other federal district court. Yet even though 36% of the federal securities law class actions pending in 2004 were in the Southern District of New York (a total of 887 cases), these cases constituted less than 5% of the total number of cases pending in that court (a total of 19,983 civil and criminal cases).¹⁸³ Contrast these numbers with

176. Rock, *supra* note 169, at 1089–90.

177. See BLACK, *supra* note 158, at 7–8; Fisch, *supra* note 158, at 1074–81; Farinacci, *supra* note 21, at 746–47, 751.

178. See *supra* Section I.B.

179. Scott & Silverman, *supra* note 16, at 1210, 1224.

180. Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 498 (2007).

181. See *supra* Section III.A.

182. *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317 (2011).

183. See 2004 JUDICIAL BUSINESS, *supra* note 67, at 144 tbl.C-3A, 230 tbl.D-8, 400 tbl.X-4.

those of the Court of Chancery, which, due to its limited jurisdiction, hears no tort or criminal actions.¹⁸⁴ Arbitration, by contrast, has long been the primary mechanism for resolving many federal securities law disputes.¹⁸⁵ As a result, the benefits of expert, experienced arbitrators are more pronounced for shareholder claims brought under federal securities law than under state corporate law.

Second, unlike for state corporate law duties, separate mechanisms exist to satisfy the goals of federal securities law: SEC and DOJ enforcement actions. If a shareholder doesn't sue under state corporate law, the public will never be informed of a fiduciary-duty violation, and the director will be spared any reputational pressure to modify his wrongful behavior. Under federal securities law, by contrast, even if shareholders do not sue, the threat of an SEC civil action or a DOJ criminal action is likely to motivate the directors and managers to behave.¹⁸⁶ Moreover, in the federal securities law context, "major deterrence from management misdeeds comes from the disclosure of wrongdoing rather than the bringing of class actions."¹⁸⁷ This disclosure usually results from internal and media whistleblowing rather than shareholder lawsuits, which will presumably remain constant regardless of whether shareholders bring claims individually in arbitration or in class action litigation.¹⁸⁸ Thus, even if the class action waivers in mandatory arbitration provisions deter shareholders from bringing their claims, federal securities law will still be enforced.

Finally, case law plays a much less important role for federal securities law than for state corporate law. Delaware's "highly developed body of case law," rather than the DGCL, comprises the bulk of Delaware corporate law.¹⁸⁹ By contrast, the development of federal securities law is largely statutorily driven rather than judge made.¹⁹⁰ As such, the fact that private arbitration will not generate reviewable precedent is less problematic for the federal securities law system.

184. BLACK, *supra* note 158, at 6.

185. Farinacci, *supra* note 21, at 761.

186. See Ronald W. Breaux & Daniel H. Gold, *Criminal Enforcement of the U.S. Securities Laws*, HAYNES & BOONE LLP 1 (Mar. 5, 2008), available at <http://www.haynesboone.com/files/Publication/ed770586-b5e6-4af7-83d7-3e45f44886b1/Presentation/PublicationAttachment/5b204bc3-e71a-41f7-8e6b-3f851b2eb010/Criminal%20Enforcement%20of%20the%20US%20Securities%20Laws.pdf>; Scott & Silverman, *supra* note 16, at 1189.

187. Scott & Silverman, *supra* note 16, at 1190.

188. See Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2214 (2010).

189. BLACK, *supra* note 158, at 7.

190. See, e.g., Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77(a)–(aa) (2012)); Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78(a)–(pp) (2012)); Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376-2223 (2010) (codified as amended in scattered sections of 7, 12, and 15 U.S.C.); Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.).

Mandatory arbitration provisions are particularly appealing because they enable corporations to include class arbitration waivers requiring all claims to be individually arbitrated. For corporations, class actions impose the largest costs under federal securities law.¹⁹¹ Because the current regime of securities class actions is clearly leaving unfulfilled the two most commonly stated goals of federal securities law—compensation and deterrence—the costs of securities class actions are not offset by equal benefits.¹⁹²

The SEC and DOJ may prove the more effective agents for ensuring that federal securities law achieves its deterrent and compensatory goals.¹⁹³ The SEC's ability to bring civil claims directly against an individual manager or director and to strip him of his insurance and indemnification serves as a strong deterrent against violating the federal securities law.¹⁹⁴ And a DOJ threat of criminal prosecution for fraud acts as an even stronger deterrent.¹⁹⁵ SEC and DOJ securities law enforcement actions also have serious consequences beyond formal penalties. Of the 2,206 individuals against whom the SEC and DOJ brought enforcement actions for securities law violations between 1978 and 2006, 93% lost their jobs by the end of the regulatory enforcement period.¹⁹⁶ As a result, the costs of federal securities law violations are shifted from the corporation and its insurance companies—the parties that bear the costs in private securities litigation—to the individual directors and managers, a shift that incentivizes these directors and managers to obey the law.

Regarding the compensatory function, the Sarbanes–Oxley Act of 2002 gave the SEC the power to use the proceeds of its administrative and judicial actions to compensate defrauded shareholders.¹⁹⁷ These funds are more beneficial to both shareholders and corporations than proceeds from shareholder litigation because, unlike plaintiffs' attorneys, the SEC does not take a cut of any reparations and can require these payments to come from the individual managers and directors themselves.¹⁹⁸ Thus, SEC and DOJ enforcement measures may be better suited than class actions to deter misconduct and compensate shareholders under federal securities law.

In addition, the compensatory and deterrent functions of federal securities law may be more effectively satisfied under individual arbitration than under class action litigation. From a compensatory standpoint, injured shareholders can expect to receive quicker payment because arbitration is

191. See *supra* Section I.B.

192. See *supra* Section I.B.

193. See Scott & Silverman, *supra* note 16, at 1192–1202; see also Breaux & Gold, *supra* note 186, at 1.

194. See Scott & Silverman, *supra* note 16, at 1195.

195. See *id.* at 1197–1202; Breaux & Gold, *supra* note 186, at 1.

196. Jonathan M. Karpoff et al., *The Consequences to Managers for Financial Misrepresentation*, 88 J. FIN. ECON. 193, 194 (2008).

197. 15 U.S.C. § 7246(a) (2012).

198. Scott & Silverman, *supra* note 16, at 1195.

generally faster than federal securities law class actions.¹⁹⁹ Shareholder-plaintiffs are also likely to be more engaged in the individual proceedings than they would be in class actions, which could result in larger individual settlements.²⁰⁰

Shareholders' increased engagement may also enhance the deterrent force of individual arbitration. Under the current regime, the lead plaintiff in a class action receives most of the decisionmaking responsibility, which often causes the nonlead plaintiffs to become apathetic.²⁰¹ Because individual plaintiffs have the full panoply of decisionmaking options in an individual arbitration, they are likely to be more assertive in pursuing claims they view as meritorious.²⁰² Further, as shareholders become more engaged, increasing numbers of them will necessarily gain familiarity with the facts of the case. If those facts do reveal actual wrongdoing by the corporation's managers and directors, the reputational impact of a federal securities law violation, which is minimal under the current class action regime,²⁰³ could be greater after individual arbitration proceedings, because knowledgeable shareholders may feel more motivated to pressure corporations to punish the guilty individuals.

Finally, individual arbitration may have more expressive value than class actions. The reputational impact of a securities class action is questionable, in part because these actions are "ubiquitous."²⁰⁴ Class action waivers in mandatory arbitration provisions, however, make many shareholder claims cost prohibitive.²⁰⁵ This may result in shareholders' filing fewer frivolous suits in general as well as a higher proportion of total claims brought by financially and legally sophisticated institutional shareholders with large holdings—shareholders for whom individual claims are not cost prohibitive. Under the current class action regime, because "everyone is being sued, being sued no longer signals incompetence."²⁰⁶ If individual shareholders bring claims despite higher marginal litigation costs, however, these claims are more likely to be viewed as meritorious.

That corporations' largest shareholders are likely to bring such claims further supports their expressive value. The circularity problem afflicts shareholders even in the individual arbitration context.²⁰⁷ As such, although individual arbitration is most cost effective for the biggest shareholders, these shareholders are also the largest financiers of the costs of defending the arbitration and the settlement or judgment amount. In other words, they stand to gain *and* lose the most from any claim against the corporation; they

199. *Id.* at 1210.

200. *Id.*

201. *See id.* at 1211.

202. *See id.* at 1210–11.

203. *See supra* text accompanying note 64.

204. Weitzel, *supra* note 5, at 75; *see supra* text accompanying notes 64–68.

205. *See supra* Section II.B.

206. Weitzel, *supra* note 5, at 75.

207. *See supra* Section I.B.

pay their own litigation costs directly, and they pay those of the corporation indirectly. These shareholders, then, must bring only the most meritorious claims. To the extent that corporate stakeholders recognize this, the expressive value of individual arbitration may exceed that of class actions, resulting in a greater reputational impact on management.

C. *Corporations' Boards of Directors Should Unilaterally Adopt Forum Selection and Mandatory Arbitration Bylaws*

The final step in a corporation's decision to adopt forum selection and mandatory arbitration provisions is determining whether to include them in the corporation's charter or in its bylaws. Boards of directors should unilaterally adopt both of these provisions in the corporation's bylaws to avoid the time and expense of a shareholder vote. For charter amendments, with some limited and rare exceptions,²⁰⁸ a shareholder vote is statutorily required.²⁰⁹ Unilateral bylaw amendments, by contrast, are much easier to enact: a board simply needs to be vested with this unilateral right in the corporation's charter.²¹⁰ The ease of this process has traditionally made unilateral bylaw amendments the preferred method for adopting forum selection and mandatory arbitration provisions.²¹¹

While easy for the board of directors to adopt, unilateral bylaw amendments can create a backlash for a corporation. Some courts have indicated that they are less likely to enforce a Delaware corporation's forum selection provision if a board of directors unilaterally adopts it than if it was adopted pursuant to a shareholder vote.²¹² Proxy advisory firms have also been generally skeptical of unilaterally adopted forum selection bylaws, recommending that corporations include shareholders in the decision to adopt these provisions.²¹³ This opposition is partially rooted in the "vested rights" doctrine, which holds that "boards cannot modify bylaws in a manner that arguably

208. See *supra* note 81.

209. See DEL. CODE ANN. tit. 8, § 242(b)(2) (2011) ("The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed [charter] amendment . . .").

210. See *id.* § 109(a).

211. Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 1.

212. See *Galaviz v. Berg*, 763 F. Supp. 2d 1170, 1174–75 (N.D. Cal. 2011) (noting that forum selection provisions are more likely to be enforced if shareholders explicitly assent to them); *In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f 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."). Although both of these opinions appear to run contrary to the holding in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), discussed at length *infra* Section II.A, they were both issued prior to that case and would be bound by the Court of Chancery's decision in *Boilermakers* if decided today.

213. See Wachtell, Lipton, Rosen & Katz, *supra* note 28, at 4–5; ALPERT & NARVAEZ, *supra* note 78, at 3.

diminishes or divests pre-existing shareholder rights absent stockholder consent.”²¹⁴ Delaware corporate law has consistently rejected this doctrine,²¹⁵ however, rendering the objections legally toothless.

The opposition also ignores the fact that a corporation’s shareholders can unilaterally amend or repeal a bylaw provision that a Delaware corporation’s board of directors unilaterally adopted.²¹⁶ This means that, even if a corporation’s board adopts a forum selection or mandatory arbitration bylaw provision without a shareholder vote, the shareholders are still capable of rejecting that provision without a corresponding vote by the board of directors. Including the provisions in the bylaws, as opposed to in the charter, also preserves flexibility for the shareholders in the future. If the shareholders decide, after the forum selection and mandatory arbitration provisions have been adopted, that they want to repeal the provisions, a charter amendment would require approval by both the board of directors and the shareholders.²¹⁷ This process essentially gives the board of directors the ability to veto any shareholder vote, leaving removal of the directors themselves as the shareholders’ only recourse. Furthermore, if the corporation’s shareholders decide to accept the unilaterally adopted bylaw provision, they need not take any further action, and the company has thereby avoided the expense of soliciting shareholder votes to gain the inevitable approval. As such, unilaterally adopting a forum selection or mandatory arbitration bylaw provision benefits corporations by allowing them to avoid the expense of a shareholder vote while preserving the shareholders’ right to dictate the terms by which the corporation is governed.

CONCLUSION

Multiforum litigation and securities class actions are two challenging aspects of shareholder litigation that impose costs on corporations and their shareholders without offering proportionate benefits. Commentators have proposed many solutions to these problems, but none of them represents a comprehensive solution that properly distinguishes between state corporate law claims and federal securities law claims. This Note proposes such a comprehensive solution, arguing that boards of directors should unilaterally adopt forum selection bylaws for state corporate law claims and mandatory arbitration bylaws for federal securities law claims. If corporations take this blended approach, they can avoid the costs of multiforum litigation and securities class actions and mitigate the agency problem between shareholders and their attorneys.

214. Grundfest & Savelle, *supra* note 16, at 376.

215. *Boilermakers*, 73 A.3d at 955 (“Our corporate law has long rejected the so-called ‘vested rights’ doctrine.”).

216. See DEL. CODE ANN. tit. 8, § 109(a) (2011) (“The fact that [the power unilaterally to adopt bylaws] has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.”).

217. *Boilermakers*, 73 A.3d at 955 n.93.

