Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws

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Table of Contents

Introduction 584

I. Arbitration Provisions in Charters and Bylaws as Contractual Agreements 589

A. The Contractual View of the Corporation 589

B. Contracts to Arbitrate Under the FAA 591

C. The Contractual Approach to Litigation-Limiting Bylaws 595

II. The Scope of the "Contract": Corporate Constitutive Documents Extend Only to Intracorporate Disputes 596

III. Are Corporate Charters and Bylaws Contractual Under the FAA? 600

A. The Unique Features of the Corporate "Contract" 601

B. Corporate Governance Is Not Structured Around Shareholder Assent 603

1. Within the Corporate Structure, Shareholders Are Positioned as Wards, Not Counterparties 605

2. With Shareholder Disempowerment Comes Fiduciary Duties and State Oversight 611

C. In Corporate Law, Pricing Substitutes for Assent 616

1. Corporate Law Substitutes Form for Assent 619

2. Corporate Law Contains No Duty to Read 620

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IV. THE FUNDAMENTAL INCOMPATIBILITY OF THE FAA AND CORPORATE GOVERNANCE DISPUTES 626

A. CORPORATE GOVERNANCE DISPUTES CALL FOR A TYPE OF DECISION MAKING AT ODDS WITH FAA ANALYSIS 626

B. THE STRUCTURE OF INTRACORPORATE LITIGATION IS AT ODDS WITH THE SUPREME COURT'S VISION OF ARBITRATION 632

C. ARBITRATION UNDER FAA RULES IS INCOMPATIBLE WITH A LEGAL SYSTEM DOMINATED BY COMMON LAW RULEMAKING 637

D. FAA ARBITRATION IS INCOMPATIBLE WITH THE SUBSTANTIVE REGULATORY ROLE OF CIVIL PROCEDURE IN THE CORPORATE GOVERNANCE CONTEXT 638

CONCLUSION 640

INTRODUCTION

CommonWealth was a publicly traded real-estate investment trust (REIT) organized under the laws of Maryland.[1] It was founded by Barry Portnoy and a partner in 1986. By 2006, Portnoy and his son, Adam Portnoy, occupied two of the five seats of CommonWealth's board of trustees, while two of the remaining seats were held by associates of the Portnoys, who also sat on the boards of other Portnoy REITs.[2] The Portnoys also owned and controlled a company called RMR, which CommonWealth's board hired to manage CommonWealth's assets.

According to a series of lawsuits later filed by CommonWealth stockholders, in 2009, CommonWealth's trustees allowed RMR to churn CommonWealth's assets in order to generate fees to RMR.[3] That campaign, and other allegedly self-interested moves by RMR, led to a sharp drop in CommonWealth's stock price.[4] One analyst deemed CommonWealth (and other Portnoy REITs) to be "un-investable" due to the unconstrained conflicts of interest inherent in their relationship with RMR.[5]

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1. A REIT is essentially a mutual fund that holds real estate instead of securities. The Common-Wealth REIT has since been renamed Equity CommonWealth.

2. In a trust company, the board of trustees occupies a position akin to a board of directors.

3. "Churning" is the practice of buying and selling securities regardless of investment strategy for the purpose of generating commissions for the agent conducting the sales.

4. Complaint ¶¶ 45–46, Katz v. CommonWealth REIT, No. 24-C-13-001299 (Cir. Ct. Balt. City Aug. 31, 2015) [hereinafter Katz Complaint]; Complaint ¶ 27, Corvex Mgmt. LP v. CommonWealth REIT, No. 24-C-13-001111, 2013 WL 1915769 (Cir. Ct. Balt. City May 8, 2013) [hereinafter Corvex Complaint].

5. Vito J. Racanelli, *Whose CommonWealth Is It Anyway?*, BARRON'S (Apr. 20, 2013), http://www.barrons.com/articles/SB50001424052748703318404578426652885493618. The Investment Company Act of 1940 was passed to mitigate conflicts of interest between managers of investment funds and the funds' shareholders, but that Act does not apply to investments in real estate. *See* 15 U.S.C. § 80a-3 (2012).

When two activist shareholders began to accumulate CommonWealth's stock in an attempt to gain control of the company, CommonWealth's trustees adopted defensive tactics that outside observers described as value-destroying, such as commencing a dilutive equity offering that further eroded CommonWealth's stock price.[6] As a result, in 2013, the activists, along with two other groups of stockholders, sued the company and its board of trustees in a series of three cases.[7] The claims were brought both directly and derivatively, alleging that CommonWealth's trustees had violated their fiduciary duties to CommonWealth and its stockholders. But unfortunately for the plaintiffs, a few months after RMR began its allegedly self-interested manipulation of CommonWealth's assets in 2009, CommonWealth's trustees had unilaterally passed a bylaw requiring that all CommonWealth stockholder disputes be submitted to binding arbitration.[8]

A Maryland state court and a Massachusetts federal court concluded that the bylaw represented a "contract" within the meaning of the Federal Arbitration Act (FAA).[9] Because the FAA requires that contractual arbitration clauses be "enforced according to their terms,"[10] the courts dismissed the claims of all stockholders—including those who had purchased their shares before the bylaw change—and directed them to arbitrate their disputes.[11]

Over the years, numerous commenters have argued that publicly traded entities might include binding arbitration provisions in their governing documents,[12] and prior to the *CommonWealth* cases, companies had made a few

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6. Corvex Complaint, *supra* note 4, ¶¶ 40–45; *see* Dane Bowler, *CommonWealth's Questionable Stock Offering Sparks Controversy*, SEEKING ALPHA (Mar. 1, 2013, 9:54 AM), http://seekingalpha.com/article/1239121-CommonWealths-questionable-stock-offering-sparks-controversy.

7. *See* Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 WL 1271528 (D. Mass. Mar. 26, 2014); Katz v. CommonWealth REIT, No. 24-C-13-001299 (Cir. Ct. Balt. City Aug. 31, 2015); Corvex Mgmt. LP v. CommonWealth REIT, No. 24-C-13-001111, 2013 WL 1915769 (Cir. Ct. Balt. City May 8, 2013).

8. *See* HRPT Props. Trust, Quarterly Report (Form 10-Q), Ex. 3.2., Art. XVI (Nov. 6, 2009), https://perma.cc/48QV-CLEK.

9. 9 U.S.C. § 2 (2012); *see Portnoy*, 2014 WL 1271528, at *9–15 (D. Mass. Mar. 26, 2014); *Katz*, slip op. at 29; *Corvex Mgmt.*, 2013 WL 1915769, at 18.

10. Volt Info. Scis., Inc. v. Bd. of Trs., 489 U.S. 468, 479 (1989).

11. *See Portnoy*, 2014 WL 1271528, at *16; *Katz*, slip op. at 44–45; *Corvex Mgmt.*, 2013 WL 1915769, at 27. In so holding, the Maryland decisions also relied on the Maryland Uniform Arbitration Act, which itself is interpreted similarly to the FAA. *See Katz*, slip op. at 10–11.

12. *See, e.g.*, MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP 21, 103 (2007), http://www.nyc.gov/html/om/pdf/ny_report_final.pdf; COMM. ON CAPITAL MKTS., INTERIM REPORT 72, 74–84 (2006), http://capmktsreg.org/app/uploads/2014/08/Committees-November-2006-Interim-Report.pdf; Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751 (2015); John C. Coffee, Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919 (1988); Christos Ravanides, *Arbitration Clauses in Public Company Charters: An Expansion of the ADR Elysian Fields or a Descent into Hades?*, 18 AM. REV. INT'L ARB. 371 (2007); Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1187 (2013); G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517 (1989); Paul Weitzel, *The End of Shareholder Litigation? Allowing*

unsuccessful attempts to do so.[13] The *CommonWealth* cases represent the first time a publicly traded company actually both included an arbitration provision in its governing documents, and persuaded a court to enforce it. The cases therefore raise important questions about whether the FAA should be applied to corporate governance documents in the same way that it applies to "ordinary" contracts,[14] and the suitability of arbitration as a forum for resolving shareholder disputes.

As I argue below, the *CommonWealth* decisions demonstrate that there has been a dangerous blurring of the lines between contract law and the law governing the corporate form that obscures the very different doctrinal underpinnings of the two fields. The nub of the problem is that, although the formal requirements for contract formation and modification—namely, direct notice and affirmative consent to terms—are different from the requirements imposed under corporate law for the adoption and amendment of charter provisions and bylaws, courts have expanded the permissible means of satisfying the contractual requirements to the point where they have become largely meaningless, resembling an empty ritual more than any concrete indication of a bargain between the parties.[15] The more the formalities of contract law decay, the more contract law comes to superficially resemble corporate governance arrangements, causing doctrinal confusion and, ultimately, fundamental misconceptions

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Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws, 2013 BYU L. REV. 65.

13. In the past, the U.S. Securities and Exchange Commission (SEC) has blocked some attempts by companies going public to include arbitration clauses in their constitutive documents. *See, e.g.*, Carl W. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate*, INSIGHTS, May 1990, at 21; Miles Weiss, Jesse Hamilton & Cristina Alesci, *Carlyle Drops Class-Action Lawsuit Ban as Opposition Mounts*, BLOOMBERG (Feb. 3, 2012, 5:57 PM), http://www.bloomberg.com/news/articles/2012-02-03/carlyle-drops-class-action-lawsuit-ban.html. In January 2012, in the face of SEC objections, the Portnoys dropped a proposed arbitration clause they planned to include in the governing documents of a new REIT that it spun off from CommonWealth. *See* Letter from Margaret R. Cohen to U.S. Sec. & Exch. Comm'n (Jan. 26, 2012), http://www.sec.gov/Archives/edgar/data/1537667/000110465912004302/filename1.htm. After the offering was completed, the trustees unilaterally adopted a bylaw restoring the arbitration clause, now explicitly limited to state law claims. *See* Select Income REIT, Current Report (Form 8-K), Ex. 3.2, Amended and Restated Bylaws (May 13, 2013), http://www.sec.gov/Archives/edgar/data/1537667/000110465913042496/a13-9630_5ex3d2.htm.

In addition, certain shareholders of publicly traded corporations have sought to include proposals on corporate proxy statements to amend corporate bylaws to require the arbitration of all shareholder claims—including those brought under state law and those brought under the federal securities laws—on an individualized basis. Thus far, most targeted companies have sought and obtained permission from the SEC to exclude the proposals on the ground they may violate the federal securities laws. *See, e.g.*, Pfizer Inc., SEC No-Action Letter, 2012 WL 587597 (Feb. 22, 2012). In 2012, the proposals were included in the proxy materials of two companies, Google and Frontier Communications, but they were rejected by the shareholders. *See* Google Inc., Current Report (Form 8-K) (June 21, 2012); Frontier Commc'ns Corp., Current Report (Form 8-K) (May 9, 2012).

14. I define an ordinary contract to be one governed by the principles in the *Restatement (Second) of Contracts*. These include the requirements of offer, acceptance, and consideration, and the reliance on objective manifestations of the parties' intentions to determine whether offer and acceptance exist.

15. Margaret Jane Radin, Commentary, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223, 1231 (2006).

regarding the relationship between a corporation's management and its shareholders.

In fact, corporate governance arrangements are not contractual. Contract law is organized around a theory of consent, whereby the application of state coercive force is justified on the presumption that the parties, acting at arms' length, agreed to terms that they deemed to be mutually beneficial at the time. The consent requirement protects individuals from exploitation by empowering them to decide when they will relinquish their entitlements; it serves as the moral underpinning that justifies the state in forcibly transferring an entitlement from one contracting partner to another.[16] Corporations, by contrast, are organized around principles more akin to trust law, whereby inexpert and often dispersed shareholders are presumed to be incapable of bargaining on their own behalf, making it necessary to entrust decisions regarding their welfare to corporate directors.[17] In this model, protection against shareholder exploitation is not predicated on consent, but on fiduciary duties and court oversight, which is why corporate law does not have, even as a formality, the same requirements of notice and consent that exist in contract law. These differences render the FAA—which is predicated on principles of contract law, not trust law—unsuited for application to corporate governance documents.

This is not to say that corporate law claims cannot be arbitrated, or that states may not choose to allow arbitration as an alternative to judicial resolution of corporate disputes. Even if the FAA is interpreted, as I argue, not to apply to arbitration clauses in corporate charters and bylaws, states can choose to enforce such provisions.[18] In this scenario, states might mandate certain procedures, or only allow arbitration for certain types of disputes, or require de novo review of certain arbitral decisions. These potential choices by a state are not the subject of my inquiry. The purpose of my inquiry is more limited: it is whether the FAA takes the choice to allow arbitration of corporate disputes out of state hands by commanding that states enforce arbitration clauses in corporate charters and bylaws and by preempting any attempt states might make to regulate their use.

These issues are particularly critical because corporate governance is primarily regulated via state-based common law. Legislative codes play only a mini-

16. This is precisely why the degradation in what legally constitutes consent has inspired such alarm in commenters. *See, e.g.*, MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW 33–34 (2013); David Horton, *Flipping the Script:* Contra Proferentem *and Standard Form Contracts*, 80 U. COLO. L. REV. 431, 434–35 (2009); Juliet M. Moringiello, *Signals, Assent and Internet Contracting*, 57 RUTGERS L. REV. 1307, 1312–14 (2005).

17. *See* discussion *infra* Section III.B.1.

18. In such a circumstance, arbitration would not be "contractual" and therefore would not be predicated on the shareholders' consent. Therefore, the scheme would have to be sufficiently regulated to protect the shareholders' due process rights. *See* Christopher R. Drahozal, *FAA Preemption After* Concepcion, 35 BERKELEY J. EMP. & LAB. L. 153, 168 (2014); *see also* Alan Scott Rau, *The Culture of American Arbitration and the Lessons of ADR*, 40 TEX. INT'L L.J. 449, 478–83 (2005) (discussing state-imposed, noncontractual forms of arbitration).

mal role, there is no enforcement by any state or federal agency, and the law is advanced almost entirely in the context of judicial decisions reached on private claims. The FAA, however, preempts any state law or policy that would interfere with the enforcement of contractual arbitration clauses. Thus, if corporate governance arrangements are deemed "contractual" for FAA purposes[19] and corporate directors can funnel claims into arbitration by amending corporate bylaws without shareholder input, it could represent an existential threat to an entire substantive field of law, and states—particularly Delaware, which dominates in this area[20]—would be powerless to do anything about it. For example, Delaware recently amended its General Corporation Law to ban the use of exclusive arbitration provisions in corporate charters and bylaws[21]—but if the FAA applies, that legislation is likely preempted.[22]

This Article proceeds in four Parts. In Part I, I explore the legal framework supporting the argument that corporate governance documents should be subject to the FAA. In Part II, I discuss the potential scope of the corporate "contract." In Part III, I analyze the legal relationship between shareholders and managers and conclude that it is very different from the legal relationship between contracting counterparties, as articulated in the Supreme Court's FAA jurisprudence. In particular, corporate law doctrinally starts from the presumption that stockholders—particularly those in publicly traded corporations—are incapable of identifying, reconciling, or bargaining for their interests; contract law, by contrast, doctrinally starts from the assumption that the parties can both recognize and protect their interests. These differences in the premises of each field imply different roles for courts. Finally, in Part IV, I demonstrate that the differences between corporate law and contract law render the Supreme Court's FAA jurisprudence poorly suited for application in the corporate context.

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19. The FAA only applies to contracts evidencing transactions "involving commerce," 9 U.S.C. § 2 (2012), a phrase that has been interpreted to extend as far as Congress's commerce clause power, *see* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 273–75 (1995). It therefore likely extends to corporate governance disputes, which the Supreme Court has acknowledged "necessarily affect certain aspects of interstate commerce." CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89–90 (1987).

20. Delaware is the chartering state of the majority of publicly traded corporations. *See* William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 U. ILL. L. REV. 95, 99. When a corporation plans to effect a large-scale transaction that is likely to be the subject of shareholder litigation, it often reincorporates in Delaware to ensure that the transaction is evaluated under Delaware law. *See* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 226 (1985). Other states typically follow Delaware when determining the content of their own law. *See* Chandler & Rickey, *supra*, at 113–16.

21. *See* Act of June 24, 2015, 2015 Del. Laws 40 § 5. The legislation forbids any provision that would bar access to Delaware courts, including exclusive forum selection clauses that designate non-Delaware fora.

22. *See* Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) ("Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions.").

I. ARBITRATION PROVISIONS IN CHARTERS AND BYLAWS AS CONTRACTUAL AGREEMENTS

A. THE CONTRACTUAL VIEW OF THE CORPORATION

There is a long history of courts referring to a corporation's constitutive documents as contractual in nature.[23] These documents include the corporate charter, or certificate of incorporation, which constitutes the corporation's "constitution," setting forth such basic matters as the powers of the board of directors and the classes of stock authorized to be issued. They also include corporate bylaws, which are akin to the corporate "statutes," and dictate how the business of the corporation will be conducted.

The initial charter is drafted by the corporation's founders, and the corporation is created when the charter is filed with the secretary of state in the relevant jurisdiction. Once the corporation accepts payment for shares of its stock, amendments to the charter may only be made upon a proposal of the corporate directors, with the approval of its shareholders.[24] By contrast, usually both shareholders and directors independently have the power to enact bylaws.[25] Although the demarcating line between matters fit only for inclusion in the charter and matters that may be governed by bylaws is not at all clear,[26] what is true is that the certificate trumps the bylaws, such that any bylaw inconsistent with the certificate is ineffective.[27] When disputes arise regarding the interpretation of charter provisions and bylaws, courts commonly resort to canons of contractual construction,[28] and these provisions—like any ordinary contract—are subject to the duty of good faith and fair dealing.[29]

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23. *See, e.g.*, Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010); Mobile Press Register, Inc. v. McGowin, 124 So. 2d 812, 822 (Ala. 1960); Rogers v. Knolls Prop. Owners Ass'n, 2 CA-CV 2005-0189, 2006 Ariz. App. Unpub. LEXIS 158, at *5 (Ariz. Ct. App. July 27, 2006); State v. Atlantic City & S.R. Co., 72 A. 111, 116–17 (N.J. 1909); Child v. Idaho Hewer Mines, 284 P. 80, 84 (Wash. 1930).

24. DEL. CODE ANN. tit. 8, § 242 (2014).

25. Jurisdictions vary regarding how bylaw power is allocated between shareholders and directors. In some states, directors have the power to enact bylaws by default. MODEL BUS. CORP. ACT § 10.20 (2003). Under Delaware law, directors do not have such power by default, but the certificate may confer the power to enact bylaws on corporate directors. DEL. CODE ANN. tit. 8, § 109 (2015). Universally, publicly traded corporations grant directors such powers from their inception; the rule is so entrenched that Delaware has construed the power of directors to enact bylaws as *more* expansive than the power of shareholders to do so, despite the Delaware General Corporation Law default rule withholding the bylaw power from directors entirely. *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232 (Del. 2008); *see also* D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 150 (2011).

26. *See generally* Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1 (2011); Smith et al., *supra* note 25, at 140–41.

27. DEL. CODE ANN. tit. 8, § 109(b) (2015).

28. *See, e.g.*, Matulich v. Aegis Commc'ns Grp., Inc., 942 A.2d 596, 600 (Del. 2008); Hibbert v. Hollywood Park, Inc., 457 A.2d 339, 342–43 (Del. 1983).

29. *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG, 2012 WL 729232, at *17 (Del. Ch. Mar. 6, 2012).

In the 1970s, academics popularized the notion of the corporation as a "nexus of contracts," thus bolstering and extending the contractual language that had long peppered judicial opinions.[30] Theorists who advocate for a nexus-of-contracts model contend that as both a normative and descriptive matter, corporate internal governance arrangements are matters of private ordering, and that (as with ordinary contracts) investors and managers can be trusted to arrange their affairs more efficiently than can state officials.[31] It is this conception of charters and bylaws as contracts among private parties that animates the argument in favor of permitting corporations to mandate arbitration through their governing documents.[32] Because private parties may contract to arbitrate their disputes, the argument goes, so too may shareholders agree, via bylaws and charters, to arbitrate shareholder disputes.[33] Therefore, if the corporate constitutive documents contain an arbitration clause, that clause is binding, in contractual fashion, on all stockholders. Thus, over the years, there have been various proposals from scholars and commentators to move shareholder disputes into arbitration by inserting arbitration clauses in the governing documents.[34]

There are many examples of states enforcing predispute arbitration agreements in close corporations and membership associations (sometimes, though not always, on the basis of arbitration clauses contained in the charter or bylaws).[35] In these disputes, however, there has always been privity of contract between the member and the corporation. The member may have personally signed an agreement promising to abide by the bylaws, or may have entered into a stock purchase agreement containing the relevant provisions, or at least has entered into some kind of direct agreement to be associated with the firm. Enforcement of arbitration clauses in such cases depends not solely on status as a stockholder, but on the personal and autonomous agreements of the parties.[36]

The proposals described above go further: they would rely neither on privity between the stockholder and the corporation, nor on the personal agreement of the stockholder, to create a binding contract to arbitrate. Instead, the proposals

30. Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383, 386–87 (2007).

31. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1442 (1989).

32. *See, e.g.*, Ravanides, *supra* note 12, at 416–17; Hal Scott & Leslie Silverman, *SEC's Silent Opposition to Arbitration Bylaws Is Speaking Volumes*, 35 NAT'L L.J. 39 (2013); Weitzel, *supra* note 12, at 90, 118.

33. Allen, *supra* note 12, at 753; Coffee, *supra* note 12, at 953–54; Shell, *supra* note 12, at 543–44.

34. *See supra* note 12 and accompanying text.

35. *See, e.g.*, Shell, *supra* note 12, at 525–28, 544; *see also* Rushing v. Gold Kist, Inc., 567 S.E.2d 384, 387 (Ga. Ct. App. 2002).

36. In *Kirleis v. Dickie, McCamey & Chilcote, P.C.*, 560 F.3d 156, 161–62 (3d Cir. 2009), the Third Circuit refused to enforce an arbitration bylaw against a shareholder-director of a close corporation on the ground that the ordinary requirements for contract formation (that is, notice of the term) had not been provided to her. The court refused to impute notice solely due to her status as a shareholder and a director. *Id*. at 162–63.

would rely solely on the status of bylaws and charters as defining the corporate "contract." Under these proposals, the arbitration provision would be binding on all stockholders—even those who purchased their shares on the open market and had no personal dealings with the firm, and even if the provision was added after the stock was purchased. Advocates of such provisions defend their enforceability by relying on the Supreme Court's FAA jurisprudence,[37] suggesting that corporate constitutive documents are indistinguishable from ordinary contracts for FAA purposes. If that interpretation is correct, an arbitration provision contained within such documents is beyond the power of states to regulate.

B. CONTRACTS TO ARBITRATE UNDER THE FAA

Passed in 1925, the FAA requires that written contracts to settle disputes by arbitration "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[38] The statute provides that arbitral awards are subject to review and vacatur only on extremely narrow grounds, such as fraud or corruption.[39] Because arbitrators are only bound to follow procedures specified in the contract,[40] many arbitration awards contain little or no reasoning (unless the parties request otherwise), which inhibits a court's ability to conduct even this limited review.[41]

After laying somewhat dormant for years, the FAA has recently undergone a judicial reconstruction. The Supreme Court has declared that the FAA represents a substantive expression of federal policy, applicable in both state and federal court, to "assure those who desired arbitration . . . that their expectations would not be undermined by federal judges, or . . . by state courts or legislatures."[42] The Court has interpreted the statute to invalidate any state legislative

37. *E.g.*, M. Todd Henderson & Adam C. Pritchard, *From* Basic *to* Halliburton*: Judges Made the Securities Class Action Mess, but Who Can Clean It Up?*, REG., Winter 2014–2015, at 20, 26, http://object.cato.org/sites/cato.org/files/serials/files/regulation/2014/12/regulation-v37n4-4.pdf; Ravanides, *supra* note 12, at 408; Scott & Silverman, *supra* note 32.

38. 9 U.S.C. § 2 (2012).

39. 9 U.S.C. § 10 (2012). There is currently disagreement among the courts whether arbitral awards can be overturned for "manifest disregard of the law," *see* Wachovia Sec., LLC v. Brand, 671 F.3d 472, 480–81 & n.6 (4th Cir. 2012), although, as Alan Rau notes, the disagreement may be academic given the rarity with which courts overturn awards on such grounds, *see* Alan Scott Rau, Hall Street Associates v. Mattel—*Fear of Freedom*, 17 AM. REV. INT'L ARB. 469, 496 (2006).

40. Procedurally, parties can select the form of the arbitral panel and the identity of its members, Rau, *supra* note 18, at 458, the location and cost of the forum, Bradley v. Harris Research, 275 F.3d 884, 890 (9th Cir. 2001), the amount of discovery available, Edward Brunet, *The Core Values of Arbitration*, *in* ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 3, 3–4 (Edward Brunet et al. eds., 2006), the rules of evidence that arbitrators will employ, Joshua P. Davis, *Arbitration: Trial by Other Means or Settlement by Other Means?*, 38 U.S.F. L. REV. 7, 8 (2003), and the amount of detail and reasoning in the final arbitral award, Brunet, *supra*, at 4; Alan Scott Rau, *Integrity in Private Judging*, 38 S. TEX. L. REV. 485, 536 (1997).

41. Rau, *supra* note 18, at 512.

42. Southland Corp. v. Keating, 465 U.S. 1, 13 (1984) (citations omitted).

or judicial scheme that evinces distrust of the arbitral forum,[43] including state policies that would limit the use of contracts to arbitrate; if other contractual terms would be enforceable under the circumstances, an arbitration clause must receive the same treatment.[44] According to the Court, the FAA "ensure[s] that private agreements to arbitrate are enforced according to their terms,"[45] and "give[s] effect to the contractual rights and expectations of the parties."[46] The Court's FAA jurisprudence thus "evince[s] a strong commitment to values such as party autonomy, freedom of choice, and self-governance free of interference by the state."[47]

That said, the Supreme Court's conception of party autonomy is modulated by a substantive vision of arbitration's virtues that makes it superior to litigation, and which the Court believes Congress sought to promote via the FAA. These include arbitration's lack of "procedural rigor," its privacy, and its "lower costs, greater efficiency and speed."[48] These policy goals operate to limit parties' freedom of contract and whatever regulatory powers might have been left to states. In *Hall St. Associates, L.L.C. v. Mattel, Inc.*,[49] the Court refused to allow parties to contract to expand judicial review of an arbitral award, as this would interfere with the "need[] to maintain arbitration's essential virtue of resolving disputes straightaway."[50] And in *AT&T Mobility LLC v. Concepcion*,[51] the Court held that the FAA preempted a state law rule forbidding waivers of

43. *See* Perry v. Thomas, 482 U.S. 483, 489–90 (1987).

44. *See id.* at 492 n.9. The FAA has a similar, though not identical, effect on contractual agreements to arbitrate federal statutory claims. Though "preemption" is not at issue, agreements to arbitrate federal claims must be enforced according to their terms *unless* the federal statute that forms the basis of the claim evinces a clear congressional intent to prohibit predispute waivers of access to a judicial forum. *See, e.g.*, Compucredit Corp. v. Greenwood, 132 S. Ct. 665, 672 (2012). The Court has yet to identify such a statute, enforcing predispute arbitration clauses in the context of antitrust claims, Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304 (2013), securities claims, Shearson/Am. Express v. McMahon, 482 U.S. 220 (1987), and employment discrimination claims, Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991), among others.

45. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 559 U.S. 662, 682 (2010); *see* Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 585 (2008) ("[T]he FAA is motivated, first and foremost, by a congressional desire to enforce agreements into which parties ha[ve] entered." (alteration in original)); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985) ("The preeminent concern of Congress . . . was to enforce private agreements into which parties had entered . . . .").

46. Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 458 (2003).

47. Hiro N. Aragaki, *The Federal Arbitration Act as Procedural Reform*, 89 N.Y.U. L. REV. 1939, 1946 (2014); *see* Thomas E. Carbonneau, *The Exercise of Contract Freedom in the Making of Arbitration Agreements*, 36 VAND. J. TRANSNAT'L L. 1189, 1192–93 (2003) ("Freedom of contract, therefore, is at the very core of how the law regulates arbitration. What the contracting parties provide in their agreement generally becomes the controlling law."); Richard C. Reuben, *Personal Autonomy and Vacatur After* Hall Street, 113 PENN ST. L. REV. 1103, 1134 (2009) ("[P]arty autonomy remains a coveted value of the arbitration process and dispute resolution in general . . . ."); Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 U. ILL. L. REV. 1, 36 ("The autonomy of contracting parties has always been conceptually intertwined with arbitration law and practice.").

48. *Stolt-Nielsen*, 559 U.S. at 685.

49. 552 U.S. 576 (2008).

50. *Id.* at 588.

51. 563 U.S. 333, 352 (2011).

the class action device in consumer adhesion contracts. Although the state rule was facially nondiscriminatory (in the sense that it applied in both judicial and arbitral fora), the Court held that it functionally undermined the FAA's goals. Companies seeking arbitration were forced to risk classwide arbitration proceedings,[52] which threatened to change the process in ways that "sacrifice[d] the principal advantage of arbitration,"[53] namely, its speed, low cost, procedural informality, confidentiality, and low-stakes claims. As the Court put it, "[t]he overarching purpose of the FAA, . . . is to ensure the enforcement of arbitration agreements according to their terms *so as to facilitate streamlined proceedings*."[54] Thus, according to the Court, the FAA embodies two distinct, but related goals: (1) enabling parties' freedom of contract in designing tailored arbitral procedures *with a view toward* (2) encouraging streamlined, informal, and speedy methods of dispute resolution that, presumably, operate more quickly and cheaply than their judicial counterparts.[55]

Yet there is a deep tension between the Supreme Court's arbitration jurisprudence that justifies enforcement of arbitration on the consent of the parties, and the reality that, in many cases, there has been no meaningful consent at all.[56] Despite the Court's repeated invocations of consent and agreement in its FAA cases, the Court has acknowledged that consumer contracts—to which it is willing to apply the FAA—are almost universally contracts of adhesion,[57] imposed on unsophisticated parties who usually have not read the terms and would not understand them if they did.[58] The tension has prompted Richard Frankel to remark that "what truly interferes with the fundamental attributes of

52. Some arbitration companies have developed rules for classwide proceedings, should parties choose them. *See, e.g.*, *Supplementary Rules for Class Arbitration*, AM. ARBITRATION ASS'N (October 8, 2003), https://www.adr.org/aaa/ShowPDF?url=/cs/groups/commercial/documents/document/dgdf/mda0/edisp/adrstg_004129.pdf.

53. *Concepcion*, 563 U.S. at 348.

54. *Id.* at 1748 (emphasis added); *see also id.* at 1749 ("The point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute."); THOMAS E. CARBONNEAU, THE LAW AND PRACTICE OF ARBITRATION xiv (4th ed. 2012) ("Arbitration agreements are the vehicles for implementing a judicial policy imperative. Given the cumbersome and inefficient operation of judicial litigation, arbitral adjudication supplies American society with a workable trial process."); Rau, *supra* note 39, at 479.

55. *See* Rau, *supra* note 39, at 479–80.

56. RADIN, *supra* note 16, at 12–15, 30–31; Jean R. Sternlight, *Consumer Arbitration*, in ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 143 (Cambridge Univ. Press 2006).

57. *Concepcion*, 563 U.S. at 346–47.

58. There is a rich literature devoted to the myriad ways in which boilerplate adhesion contracts, especially in the consumer context, are unlikely to be read or understood by consumers. *See, e.g.*, Jeff Sovern et al., *"Whimsy Little Contracts" with Unexpected Consequences: An Empirical Analysis of Consumer Understanding of Arbitration Agreements*, 75 MD. L. REV. 1, 15–24 (2015). One study found that even after reading arbitration clauses, consumers do not understand their legal significance. *See id.* at 48–51; *see also* CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(A) 11 (2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf (finding that the vast majority of credit card consumers do not know whether their agreements include an arbitration clause, and do not understand that they may be barred from bringing claims in court).

arbitration is the lack of free and fair negotiation—i.e. adhesion."[59]

In fact, this is a problem not limited to FAA jurisprudence, but one that extends to contract law generally. Contract law justifies the imposition of state coercive force on a theory of consent or voluntariness[60]—or at least on an "objective manifestation" of voluntariness, which is taken as evidence of the underlying reality of assent.[61] The basic assumption of contract law is that individual choices ought to be respected, either because choice—autonomy—is a good in and of itself, or because individuals are best able to gauge their own interests and the arrangements they choose for themselves will therefore maximize welfare across contracting parties.[62] Absent consent, there is no autonomy, and no basis on which to assume that the parties have protected their interests.

The critical role played by consent is evident throughout contract doctrine. For example, ambiguous terms are interpreted in light of a theory of consent,[63] such as the parties' reasonable expectations. Contract defenses, such as duress, mistake, and misrepresentation, go to defects in consent, by vitiating "the actual voluntariness of rights transfer."[64] Even unconscionability, which courts could employ as a purely substantive evaluation of contract terms, is instead deployed via a consent framework. The resisting party is required to show the existence of "procedural unconscionability," defined to mean "a situation where a term is so difficult to find, read, or understand that the plaintiff cannot fairly be said to have been aware he was agreeing to it."[65] Consent has thus been described as "the master concept that defines the law of contracts in the United States,"[66] and a "major" (though not exclusive) requirement for enforceability.[67]

Contract doctrine, however, has never been able to reconcile its focus on consent with transactions that have the standard objective hallmarks of consent and yet nonetheless are known to be ones where consent is lacking, such as

59. Richard Frankel, *State Court Authority Regarding Forced Arbitration After* Concepcion, *in* FORCED ARBITRATIONS AND THE FATE OF THE 7TH AMENDMENT: THE CORE OF AMERICA'S LEGAL SYSTEM AT STAKE? 55, 57 (Pound Civ. Just. Inst. 2014), http://www.poundinstitute.org/sites/default/files/2014PoundReport.pdf.

60. Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 270 (1986) ("Consent is the moral component that distinguishes valid from invalid transfers of alienable rights."); Chunlin Leonhard, *The Unbearable Lightness of Consent in Contract Law*, 63 CASE W. RES. L. REV. 57 (2012); RADIN, *supra* note 16, at 14.

61. Barnett, *supra* note 60, at 304; Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943); Leonhard, *supra* note 60, at 70–71; Moringiello, *supra* note 16, at 1316.

62. RADIN, *supra* note 16, at 58–66.

63. Leonhard, *supra* note 60, at 75–76.

64. Barnett, *supra* note 60, at 318.

65. Jackson v. Payday Fin., LLC, 764 F.3d 765, 777 (7th Cir. 2014). Usually, procedural unconscionability is a necessary precondition to a conclusion that a contract term is unconscionable and unenforceable. *See* Eastham v. Chesapeake Appalachia, L.L.C., 754 F.3d 356, 365 (6th Cir. 2014); *see also* David Horton, *Unconscionability Wars*, 106 NW. U. L. REV. 387, 393 (2012) (noting that unconscionability is a means to identify terms that are lacking in assent).

66. Peter H. Schuck, *Rethinking Informed Consent*, 103 YALE L.J. 899, 900 (1994).

67. RADIN, *supra* note 16, at 19.

consumer contracts of adhesion involving extensive boilerplate.[68] Courts typically recognize these as contracts and enforce them based on the same consent theories under which they enforce negotiated contracts, leading to "an increasing disconnect between consent in contract law and consent in reality."[69]

Perhaps because the Supreme Court now uses consent in the arbitration context as a tool to unlock the *substantive* features of arbitration that the Court favors, the Court has refused to confront this tension;[70] instead, the Court has held that so long as the arbitration clause is embedded in a document that would otherwise be enforced as contractual, the clause must placed on "the same footing as . . . [the] contract's other terms."[71]

C. THE CONTRACTUAL APPROACH TO LITIGATION-LIMITING BYLAWS

Two recent developments, in addition to the *CommonWealth* cases, have led to a new urgency in calls for arbitration of shareholder disputes. The first is the Supreme Court's FAA jurisprudence, and in particular decisions like *Concepcion*. These cases imply that if charters and bylaws are contractual, the FAA requires courts to enforce corporate bylaws requiring arbitration of shareholder disputes—even if those bylaws are unilaterally adopted by corporate directors, and even if they prohibit class claims—regardless of whether state law would deem such bylaws invalid and unenforceable.

The second development concerns a pair of decisions to emerge from Delaware regarding the ability of corporations to use their bylaws to limit shareholder litigation. In *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, the Delaware Court of Chancery upheld bylaws, unilaterally adopted by the directors of Chevron and FedEx, which required that all corporate governance claims be litigated within the state of Delaware.[72] The *Boilermakers* decision emphasized the contractual nature of corporate bylaws and argued that, in many respects, a forum selection clause in a bylaw would be analyzed in the same manner as one contained in an ordinary contract.[73] In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court cited *Boilermakers* when it held that

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68. *See* Karl Llewellyn, *What Price Contract—An Essay in Perspective*, 40 YALE L.J. 704 (1931); Kessler, *supra* note 61, at 632.

69. Leonhard, *supra* note 60, at 78. The RESTATEMENT (SECOND) OF CONTRACTS § 211(3) cmt. f (1981) attempts to mitigate this problem by deeming consent to be lacking where the drafting party "has reason to believe that the [consumer] . . . would not have accepted the agreement if he had known that the agreement contained the particular term." However, this section is rarely cited, except in the insurance context. *See* James J. White, *Form Contracts Under Revised Article 2*, 75 WASH. U. L.Q. 315, 324–25 (1997).

70. According to Lawrence Cunningham, the Supreme Court's policy preferences in favor of arbitration are so strong that it regularly overrides contract doctrine—including doctrines that have been developed to effectuate the parties' intentions. *See* Lawrence A. Cunningham, *Rhetoric Versus Reality in Arbitration Jurisprudence: How the Supreme Court Flaunts and Flunks Contracts*, 75 LAW & CONTEMP. PROBS. 129 (2012).

71. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 275 (1995).

72. 73 A.3d 934, 939 (Del. Ch. 2013).

73. *Id*. at 957–58.

directors of nonstock corporations may unilaterally adopt bylaws that require a losing plaintiff to reimburse the defendants' attorneys' fees.[74] Using reasoning that appeared to be equally applicable to stock corporations, the court emphasized the contractual nature of corporate bylaws.[75]

These decisions have added fuel to the argument that corporate governance documents are just like any other kind of contract, and therefore are equally governed by the FAA.[76] Indeed, the Supreme Court has described arbitration clauses as simply a specialized kind of forum-selection clause,[77] rendering it a short leap from *Boilermakers* to the enforcement of arbitration provisions (which is precisely what the most recent commentary has argued).[78] For this reason, one of the *CommonWealth* courts relied heavily on *Boilermakers* when enforcing the arbitration bylaws at issue in that case.[79]

In response to these decisions, Delaware recently amended its laws to prohibit corporations from adopting bylaws and charter provisions that bar access to Delaware courts.[80] If the FAA applies to charters and bylaws, however, these amendments are likely preempted by federal law.[81]

II. THE SCOPE OF THE "CONTRACT": CORPORATE CONSTITUTIVE DOCUMENTS EXTEND ONLY TO INTRACORPORATE DISPUTES

The FAA only applies to "controvers[ies]" that "aris[e] out of" the contract containing the arbitration clause.[82] Therefore, any analysis of the FAA's application to corporate constitutive documents necessitates an inquiry into the scope of issues that can be said to "aris[e] out" of them. Many commentators have advocated using charters and bylaws to restrict securities claims (state and federal) *and* state law corporate governance claims, as a mechanism for curbing

74. 91 A.3d 554, 560 n.38 (Del. 2014).

75. *Id.* at 558.

76. *See, e.g.*, Allen, *supra* note 12, at 757–66; Scott & Silverman, *supra* note 32.

77. Scherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974); Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 717 (1999).

78. Allen, *supra* note 12, at 770–71.

79. *See* Katz v. CommonWealth REIT, No. 24-C-13-001299, slip. op. at 23–29 (Cir. Ct. Balt. City Aug. 31, 2015).

80. S.B. 75, 148th Gen. Assemb., Reg. Sess. (Del. 2015). The amendments also bar fee-shifting provisions. *Id*. The amendments do not affect the FAA analysis, however, because they do not challenge the courts' holdings that bylaws constitute a contract. Instead, the amendments are more akin to any state's limitations on particular contractual terms, such as prohibitions on contracts to sell body parts or to charge usurious interest rates. Such substantive constraints on the terms the parties may select does not affect the analysis as to whether the agreement is itself an FAA contract. *See* Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 449 (2006).

81. *See* Hiro N. Aragaki, *Equal Opportunity for Arbitration*, 58 UCLA L. REV. 1189, 1204 (2011) (discussing FAA preemption of state limitations on forum selection clauses); Brian T. Fitzpatrick, *The End of Class Actions?*, 57 ARIZ. L. REV. 161, 177–81 (2015) (concluding that corporate charters and bylaws are subject to FAA analysis).

82. 9 U.S.C. § 2 (2012).

frivolous litigation, without distinguishing between the two.[83] But securities regulation differs from state corporate governance regulation in a crucial respect—namely, that securities regulation treats shareholders as external to the corporation. Corporate governance, by contrast, treats investors as a part of the corporation itself, a constituency to whom duties are owed and who possess certain rights of control. Corporate constitutive documents do not bind stockholders in any capacity except as internal corporate constituents; therefore, litigation-limiting clauses contained in such documents can only apply to state law governance claims. Or, as Barbara Black posed the question, "[W]ould anyone seriously argue that a public corporation's charter provision could prohibit public shareholders from owning stock in a competitor?"[84]

American law draws a distinction between regulation of a corporation's governance mechanisms and other forms of corporate regulation, such as state and federal securities laws. Corporate governance regulation concerns the balance of power between its shareholders, its officers, and its directors, and commonly falls within the rubric understood as the corporation's "internal affairs."[85] Matters within this category—such as the scope of directors' fiduciary duties, permissible charter and bylaw terms, and shareholder voting rights—are controlled by the law of the state of incorporation, regardless of whether the corporation has any real economic ties to that location.[86]

Other forms of regulation are generally understood to be external to the corporation, such as antitrust regulation, governing how the corporation conducts itself in relation to its competitors, and labor and employment law, governing how a corporation relates to its employees. Securities regulation—the terms on which the corporation may seek financing in connection with sales of financial instruments—also falls into this latter category.[87] Because securities regulation treats shareholders as external to the corporation, securities laws are

83. Stephen Bainbridge, *The Case for Allowing Fee Shifting Bylaws as a Privately Ordered Solution to the Shareholder Litigation Epidemic*, PROFESSORBAINBRIDGE (Nov. 17, 2014), http://www.professorbainbridge.com/professorbainbridgecom/2014/11/the-case-for-allowing-fee-shifting-bylaws-as-a-privately-ordered-solution-to-the-shareholder-litigat.html; Henderson & Pritchard, *supra* note 37, at 4; A.C. Pritchard, Halliburton II: *A Loser's History*, 10 DUKE J. CONST. L. & PUB. POL'Y 27 (2015); Scott & Silverman, *supra* note 32. As described above, *see supra* note 44, though the FAA does not "preempt" federal law, the Supreme Court has held that agreements to arbitrate federal claims—including securities claims—are enforceable, often using reasoning similar to that used in the context of state law preemption.

84. Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 838 n.172.

85. *See generally* Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985); Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661.

86. *See* Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074, 1081–82 (Del. 2011).

87. Ribstein & O'Hara, *supra* note 85, at 694.

often described as a form of consumer protection.[88]

It is well established that securities claims fall outside the realm known as corporate internal affairs.[89] Unlike corporate governance (and to the extent not preempted by federal law), states regulate the offers, sales, and purchases of securities on a territorial basis.[90] State antifraud statutes, in particular, extend to any security offered or purchased within the state.[91] State courts do not look to the terms of the corporate charter or the law of the state of incorporation to resolve state law securities claims; instead, they look to the state or states that have a territorial nexus to the transaction.[92]

What this demonstrates is that American law distinguishes between the contract that governs the transfer of a security between buyer and seller, and the contract that forms the corporation and allocates power between its managers and shareholders. When an investor purchases a security from a seller other than the corporation itself, the corporation has no contractual relationship with the investor in her capacity as a purchaser. Even assuming that charters and bylaws are contractual, the corporation's contractual relationship with an investor begins only after the purchase, and concerns only the purchaser's rights as a holder of corporate stock and a constituent of the corporate entity. Securities fraud claims concern the investor as purchaser or seller, and for the typical claim—a purchase from someone other than the issuer, caused by false information—there is no contractual relationship with the corporation at the time the harm is inflicted, the moment of purchase. Thus, there is no reason to believe that corporate governance documents, regulated by the law of the state of incorporation, can dictate mechanisms for bringing claims that do not concern corporate internal affairs, such as claims alleging fraud in connection with a securities sale.[93]

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88. *See, e.g.*, Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1741 (2012).

89. *See* Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Bottom/Top*, 23 YALE L. & POL'Y REV. 381, 422–23 (2005); Ribstein & O'Hara, *supra* note 85, at 694. To be sure, the lines between corporate governance and securities regulation can be blurry. In one area where the two overlap, most states, as part of their governance regulation, allow corporations to issue "restricted" securities that can only be transferred from one holder to another with a right of first refusal held by the corporation or other shareholders. But these securities are, by definition, not offered to the public for resale on the secondary market. Moreover, the purpose of permitting such restrictions is closely tied to the regulation of corporate governance, namely, to allow corporations to maintain control over who can participate in management. *See* Tu-Vu Drive-In Corp. v. Ashkins, 391 P.2d 828, 830 (Cal. 1964).

90. Lintz v. Carey Manor, Ltd., 613 F. Supp. 543, 549–50 (W.D. Va. 1985); 12A JOSEPH C. LONG, BLUE SKY LAW § 9:39 (2015).

91. *See* 12A JOSEPH C. LONG, BLUE SKY LAW §§ 9:1, 9:39 (2015).

92. *See* Simms Inv. Co. v. E.F. Hutton & Co., 699 F. Supp. 543, 545 (M.D.N.C. 1988); Friese v. Superior Court, 36 Cal. Rptr. 3d 558, 563–65 (Ct. App. 2005).

93. *See* Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 370 (2013). The court in *In re Activision Blizzard, Inc. Stockholder Litig.* recognized this distinction, describing securities claims as "personal" to the stockholder, akin to a tort claim, rather than a corporate claim

This is not to say a corporation cannot contract to sell its securities on whatever terms it likes, including requiring arbitration of disputes arising from the sale. In such a case, however, the arbitration clause would be included in the contract for sale, and would govern the relationship between the corporation and the purchaser in their respective capacities as buyers and sellers (and be subject to choice-of-law principles outside the internal-affairs doctrine). This is a far cry from the corporation dictating the terms on which its securities are resold in interstate markets merely by amending its charter or bylaws under the laws of the state of incorporation, subject to that state's determinations as to the permissible scope of such amendments.

The Delaware courts have acknowledged as much. In *Boilermakers*, the court recognized that matters outside of internal affairs are not appropriate subjects for corporate bylaws, and thus limited its holding to forum-selection clauses concerning "intra-corporate" litigation, defined to mean litigation governed by the internal-affairs doctrine.[94] *ATP Tour* likewise limited its discussion of fee-shifting bylaws only to claims concerning intra-corporate litigation[95] (an oddity, to be sure, because the bylaw at issue purported to extend to *any* claim brought by a member,[96] and the case was certified to the Delaware Supreme Court out of concern for the bylaw's application to the antitrust laws).[97] Justice Ridgely, a member of the Delaware Supreme Court at the time of *ATP*, even delivered an address affirming that *ATP*'s holding was confined to internal-affairs claims.[98]

The recent amendments to Delaware's corporate law demonstrate a similar understanding, and only concern bylaws and charter provisions that would limit

associated with the shares themselves. *See* No. 8885-VCL, 2015 Del. Ch. LEXIS 140, at *77–78 (Del. Ch. May 20, 2015). In the *CommonWealth* cases, the parties assumed that the arbitration clause could be applied to securities claims, and no argument was raised that securities claims are outside the scope of a corporation's constitutive documents. *See supra* Introduction.

94. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 952 & n.78, 960 n.129 (Del. Ch. 2013). Significantly, in support of its holding, the court cited a passage of Grundfest and Savelle's article that also suggested that litigation-limiting bylaws would have no application to securities claims. *See id.* at 952 n.78 (quoting Grundfest & Savelle, *supra* note 93, at 369–70 (noting that forum-selection bylaws likely apply only to intra-corporate litigation because outside that context, "the provision would not be seeking to regulate the stockholder's rights as a stockholder and would be extended beyond the contract that defines and governs the stockholders' rights")).

95. *See* ATP Tour, Inc., v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014). Notably, Chief Justice Strine—the author of the *Boilermakers* opinion that explicitly limited the bylaw power to matters concerning internal affairs—was among the Justices who decided *ATP Tour*. *Id*. at 555.

96. *Id*. at 556.

97. Deutscher Tennis Bund v. ATP Tour, Inc., 480 F. App'x 124 (3d Cir. 2012).

98. *See* Henry duPont Ridgely, Justice, The Supreme Court of Del., Keynote Address at the Southern Methodist University Dedman School of Law Corporate Counsel Symposium: The Emerging Role of Bylaws in Corporate Governance 16 (Oct. 31, 2014) (transcript available at http://www.delawarelitigation.com/files/2014/11/The_Emerging_Role_of_Bylaws_in_Corporate_Governance-copy.pdf) ("In *ATP Tour*, we were asked whether Delaware law allowed a board of a Delaware non-stock corporation to adopt a bylaw provision shifting all litigation fees, costs, and expenses to a plaintiff in an unsuccessful intra-corporate suit."). Justice Ridgely's address also characterized *Boilermakers* as limited solely to claims concerning internal affairs and matters involving Delaware's corporate law statute. *See id.* at 10.

litigation brought under Delaware's corporate law.[99] This is appropriate because Delaware is not positioned to make policy judgments regarding a corporation's powers to limit securities claims, which are not brought under Delaware law, do not concern Delaware-imposed duties, and usually have no territorial nexus to Delaware.[100]

In sum, to the extent corporate constitutive documents are a contract, that contract only extends as far as the realm of internal affairs. As the charter and bylaws are not part of the contract of sale for secondary-market purchasers, and rarely, if ever, form the basis of a securities fraud claim—it would be a rare Section 10(b) or Section 11 case, for example, that even cited such documents—there is no reason to believe such claims "arise out of" these documents, unless arising out of occurs simply by the but-for causation that if the corporation did not exist, it would have no securities to sell.[101] It can thus be inferred that the FAA is not implicated by charters and bylaws that attempt to mandate arbitration of claims outside the realm of internal affairs.

III. ARE CORPORATE CHARTERS AND BYLAWS CONTRACTUAL UNDER THE FAA?

As the discussion in Part II demonstrates, corporate-governance documents only regulate the rights of stockholders as internal constituents of the corporate entity. To determine whether the FAA applies to such documents, then, we must examine whether stockholders, as members of the corporate polity, can be analogized to contracting counterparties. As I demonstrate below, they cannot. Contract doctrine is predicated on the expectation that contracting counterparties act as autonomous individuals capable of recognizing and bargaining for their interests. Corporate doctrine, by contrast, presumes that stockholders rarely have the skill or the incentives to direct the corporation's destiny. This understanding is inscribed into the corporate form, which legally disables stockholders from effectuating their preferences, and concentrates power in the board of directors, which is presumed better able to make choices on the stockholders' behalf.

To be sure, the portrait of shareholder incompetence drawn by corporate doctrine may not accurately describe today's investor—the rise of the institutional shareholder challenges many of the presumptions on which corporate law

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99. *See* S.B. 75, 148th Gen. Assemb., Reg. Sess. (Del. 2015).

100. In other words, any decisions Delaware makes about the propriety of litigation-limiting governance provisions involve a host of other choices, including whether such provisions must appear in the charter or bylaws, *see infra* Part IV, the degree of shareholder input into their adoption, *see* Verity Winship, *Shareholder Litigation by Contract* (Univ. of Ill. College of Law Legal Studies Research Paper No. 15–14, 2015), http://ssrn.com/ abstract=2575668, and the duties of directors when choosing to invoke them, *see infra* Part IV. But Delaware has no authority to make these judgments when the claims involve a transaction with no nexus to Delaware, brought under another jurisdiction's laws.

101. *See, e.g.*, Coors Brewing Co. v. Molson Breweries, 51 F.3d 1511, 1515–16 (10th Cir. 1995) (holding that an antitrust claim does not arise out of a contract containing an arbitration clause where claims do not concern the interpretation and performance of the contract itself).

rests[102]—but the framework remains intact, at least for now. So long as corporate doctrine rests on the presumption that shareholders are incapable of making substantively meritorious choices on behalf of the corporation—and then hobbles them from attempting to do so—corporate law will remain noncontractual for FAA purposes.

A. THE UNIQUE FEATURES OF THE CORPORATE "CONTRACT"

The corporate form was originally conceived not as a private arrangement, but as a quasi-governmental institution. Charters were granted sparingly via individual acts of state legislatures, and tailored to permit each corporation to perform specific public functions, such as operating public works.[103] States were thus heavily involved in corporate management; these earlier corporations were financed with state funds and controlled by state appointees who sat on their boards.[104] Over time, states loosened their standards for the granting of charters. They allowed corporations to serve private business interests and, correspondingly, ceased to exercise such tight control over their operations. Yet, despite this shift, corporations continue to be "entities whose very existence and attributes are a product of state law."[105] In many formulations, the state is understood to be a party to the corporate "contract," either explicitly or implicitly.[106] This is because the states are heavily intertwined with corporations as a definitional matter.

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102. *See infra* Section III.C.2.

103. Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 IOWA J. CORP. L. 33, 50–51 (2006).

104. *See id.* at 51–54.

105. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 89 (1987). At the most basic level, a corporation cannot be created without state permission: "The fact that this permission is readily granted (as long as fees and taxes are paid) does not change the fact that permission is required." Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of "Nexus of Contracts" Theory*, 109 MICH. L. REV. 1127, 1130; *see also* William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 445 (1989) ("If the corporation really 'is' contract, as the new economic theory tells us, then the last doctrinal vestiges of state interference should have withered away by now . . . . But the sovereign presence persists.").

106. *See, e.g.*, Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518 (1819); STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1136 (Del. 1991) ("A corporate charter is both a contract between the State and the corporation, and the corporation and its shareholders. . . . The charter is also a contract among the shareholders themselves."); Schroeter v. Bartlett Syndicate Bldg. Corp., 8 Cal. 2d 12, 14 (1936) ("The relation existing between a corporation and its stockholders, is one of contract in which the charter, articles of incorporation, by-laws of the corporation and pertinent statutes of the state are embodied."); Roberta Romano, *The Market for Corporate Law Redux* 52 (Eur. Corp. Governance Inst. Law Working Paper No. 270, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2514650.

To the extent the state is viewed as a party to the corporate contract, that might be sufficient to prevent the application of the FAA, because a contracting party can select its own contract terms, including the decision *not* to arbitrate. *See* St. Mary's Med. Ctr., Inc. v. Disco Aluminum Prods. Co., 969 F.2d 585 (7th Cir. 1992). Thus, the state might require that, as a condition of corporate status, the corporation either not adopt arbitration clauses at all, or only adopt them under state-specified conditions. *Cf.* Bldg. & Constr. Trades Council v. Associated Builders & Contractors, 507 U.S. 218, 227 (1993) (holding that a state acting as a proprietor rather than regulator may manage its own property without being preempted by the National Labor Relations Act); Hughes v. Alexandria Scrap

For example, shareholders are not liable for the debts of the corporation, including debts owed as a result of tortious conduct. This is not a result that private parties could achieve by promise alone; it is only possible because the state confers a set of rights and entitlements—including entity status—on the corporation.[107] The internal-affairs doctrine, as well, is a remnant of the time when corporations' status as state actors gave their home states exclusive authority to regulate their management.[108] No other contract is subject to such an unusual choice-of-law rule; even contractual choice-of-law clauses typically require some connection to the selected jurisdiction.[109]

In fact, viewed in ordinary contract terms, the entire corporate enterprise is an odd creature because of the lack of obligations on either side. Most shareholders—especially those who buy on the secondary market—owe no duties to the corporation and have offered no consideration to it. The corporation, in turn, owes no concrete benefits to its shareholders.[110] Though the common stockholders are often described as holding residual rights, those rights are meaningless until the corporation ceases to be a going concern.[111] Whatever value those rights have, they are subject to change: managers can issue debt that will burden those rights, and they often have expansive discretion to issue new stock that will dilute the economic interest and even the voting power of existing shareholders. At best, directors may be viewed as having a contractual obligation to maximize shareholder returns. Yet not only is the existence of that obligation contested as a legal matter,[112] but the concept of wealth maximization is so vague and confers so much discretion on directors as to be largely undefinable in most contexts.[113] If these arrangements were viewed in traditional contract terms, a court might conclude that the contract failed for

Corp., 426 U.S. 794, 808 (1976) (finding that a state acting as a market participant rather than a regulator does not run afoul of the Commerce Clause even if its behavior favors in-state activity over out-of-state activity).

107. Greenwood, *supra* note 89, at 418.

108. *See* Tung, *supra* note 3, at 54–56.

109. Ribstein & O'Hara, *supra* note 85, at 662.

110. Directors have no obligations to issue dividends or make other distributions to shareholders. *See* Pa. Co. for Ins. on Lives & Granting Annuities v. Cox, 199 A. 671, 673 (Del. 1938); Lynn A. Stout, *Lecture and Commentary on the Social Responsibility of Corporate Entities: Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1194 (2002); *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 91 (1991).

111. Stout, *supra* note 110, at 1194. Moreover, once the corporation becomes insolvent, the residual rights are held by its creditors. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007).

112. There is an enormous debate among theorists as to whether shareholder wealth maximization either *is*, or *should be*, the ultimate goal of corporate directors. *See, e.g.*, CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER 46–47 (2013); Stout, *supra* note 110, at 1195–99. Many states have enacted "constituency" statutes that permit corporate directors to consider the interests other than stakeholders, although directors rarely rely on these statutes when taking action, because their scope and legal effect are uncertain. *See* Brett H. McDonnell, *Committed to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19 (2014).

113. *See infra* Part III.C.

indefiniteness or lack of consideration. This state of affairs has led one commenter to remark, "[w]hen courts speak of the charter as a contract . . . they do so within a frame of reference restricted to corporate law."[114]

That said, neither consideration, nor choice of law, nor limited liability are critical features on which the FAA analysis turns. Rather, in the Supreme Court's view, the factor that justifies enforcement of an arbitration clause is the parties' consent (as constructed via contract law).[115] The question we must ask, then, is whether an arbitration provision in a corporate charter or bylaw rests on the stockholders' consent.

B. CORPORATE GOVERNANCE IS NOT STRUCTURED AROUND SHAREHOLDER ASSENT

Contract law's expansion of the types of actions that are recognized as manifestations of consent undermines many attempts to apply contract concepts to the corporate form. For example, relying on the premise of actual consent, corporate scholars often argue that corporate law is not contractual because shareholders' consent to managerial action is often coerced or ignorant.[116] Yet in today's world of boilerplate contracts of adhesion, it is difficult to say that consumers' consent is any different.[117] Therefore, viewing the two fields solely through the lens of actual consent does not yield useful distinctions.

Similarly, contracts will only be enforced if the parties have received notice of the terms[118] because notice is a prerequisite of consent.[119] No similar requirement inheres within corporations; shareholders, as matter of law, are deemed to be on notice that the corporate charter and bylaws may contain, or be modified to contain, any legal provision.[120] This distinction has led some commenters to contend that bylaws are not enforceable as contracts.[121] But in contract law, as boilerplate has proliferated—such as thirty-two feet of text for a ninety-nine cent transaction—courts have found the requisite notice to exist even for the most unreadable of documents,[122] often received after the transaction is complete.[123] Because the notice requirements of contract law are, in some sense, vestigial, the differences between ordinary contracts and corporate constitutive documents seem trivial.

114. Shell, *supra* note 12, at 545.

115. *See supra* Part I.B.

116. *See, e.g.*, Melvin A. Eisenberg, *The Conception That the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999).

117. RADIN, *supra* note 16, at 7–14.

118. Moringiello, *supra* note 16, at 1314.

119. Rodman v. Safeway Inc., No. 11-cv-03003-JST, 2015 WL 604985, at *10 (N.D. Cal. Feb. 12, 2015).

120. Boilermakers Local 154 Retirement Fund v. Chevron Corp., 73 A.3d 934, 955–56 (Del. Ch. 2013).

121. Barbara Black, *Arbitration of Investors' Claims Against Issuers: An Idea Whose Time Has Come?*, 75 LAW & CONTEMP. PROBS. 107, 114–15 (2012).

122. *See* OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 7–11, 24 (2014).

123. *See* Robert A. Hillman, *Rolling Contracts*, 71 FORDHAM L. REV. 743, 754 (2002).

Scholars have also distinguished ordinary contracts from the corporate form on the ground that while charter provisions may be modified without the consent of any particular shareholder—and bylaws may be modified without the consent of any shareholders at all—contract law does not allow one party to unilaterally change the terms of the deal.[124] But despite this formal difference in doctrine, consumer contracts are often amended through bill-stuffers and other fine print notices that few people read, with the consumer's failure to object taken as consent.[125] Under such circumstances, the distinction between a lack of an assent requirement, and an assent requirement that can be satisfied with such empty formalism, seems devoid of any substantive content.[126]

The bottom line is, in a world where clicking "I agree" at the bottom of unreadable pages of fine print text is deemed a manifestation of assent,[127] what counts as a "manifestation" has little to do with subjective intent and is instead dictated by state fiat (typically as effected through a judicial determination, and occasionally as mandated by a legislature). In such a world, it is difficult to identify a functional reason why stockholders are not deemed to assent to charter and bylaw terms by virtue of their general awareness that such terms exist and, in the context of a publicly traded corporation, are available at the SEC website.[128] Or, more simply, once tests for manifestation are divorced from the subjective intent they were intended to signify (as has occurred in contract law), there is no external constraint on designating stock ownership as a manifestation of intent as well; manifestation is, ultimately, what the state says

124. *See* Shell, *supra* note 12, at 546.

125. Oren Bar-Gill and Kevin Davis, *Empty Promises*, 84 S. CAL. L. REV. 1, 9 (2010); David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. REV. 605, 636 (2010). Most of these contracts involve continuing relationships, like a credit card or a cell phone contract, such that the consumers do more than simply fail to object; they are deemed to manifest assent by continuing to avail themselves of the contract. Some companies, however, have made unilateral changes to transactions that may be characterized as "single shot," such as Amazon Kindle unilaterally revoking a text-to-speech feature in its Kindle 2. *See* Bar-Gill & Davis, *supra*, at 16.

126. Arguably contract modifications are different from corporate modifications because a wealth-destroying change to the corporate contract immediately lowers the value of the shareholders' stock, and therefore the shareholders have no ability to refuse assent (by selling) while maintaining their wealth. *See* Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1841 (1989). However, as David Horton points out, this is equally true in modern contract law; in many cases, contracts are expensive to terminate, thus rules that permit companies to make unilateral changes to adhesion contracts may inflict costs on consumers who exit rather than assent. *See* Horton, *supra* note 125, at 650–51.

127. Even Supreme Court Chief Justice Roberts, who has taken a hardline contractualist view of the FAA, has conceded that he does not and cannot read the boilerplate terms in consumer contracts. *See* Debra Cassens Weiss, *Chief Justice Roberts Admits He Doesn't Read the Computer Fine Print*, ABA JOURNAL (Oct. 20, 2010, 12:17 PM), http://www.abajournal.com/news/article/chief_Justice_roberts_admits_he_doesnt_read_the_computer_fine_print.

128. Though state law does not necessarily require that charter and bylaw terms be communicated to shareholders, *infra* note 232, the SEC requires that charter and bylaw amendments be filed on Form 8-K. The *CommonWealth* courts thus treated bylaws as ordinary contracts because their public nature was deemed to be sufficient "notice" of terms. *See* Katz v. CommonWealth REIT, No. 24-C-13-001299, slip op. at 18–28 (Cir. Ct. Balt. City Aug. 30, 2015); Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 WL 1271528, at *12 (D. Mass. Mar. 26, 2014).

it is. The search for a "true" external signifier of intent will not get us anywhere; determining whether corporations are contractual in the FAA sense requires a deeper analysis.

As it turns out, corporate regulation does not rest on principles of contract, but to look at such signifiers as notice and manifestation of assent is to get the relationships backwards. The proper question is not whether stock ownership may be taken as a manifestation of assent; the proper question is why corporate law does not require notice and manifestation of assent in the first place, even as a formality. The answer is that corporate law does not rely upon shareholder consent to justify directorial action. Instead, directors' power to act is conferred by the state as a part of the corporate form, and that power is constrained by state rules and state-imposed obligations. As described below, this framework is predicated on the doctrinal presumption that corporate shareholders—and especially shareholders of publicly traded corporations—are incapable of acting in their own best interests or of making substantively correct choices regarding the corporation's fate.

1. Within the Corporate Structure, Shareholders Are Positioned as Wards, Not Counterparties

As explained above, the corporate form is defined and limited by state law,[129] with most states taking their cues from Delaware.[130] Thus, it is a well-recognized truism that within a corporation, directorial power to act comes not from shareholders, but is instead "original and undelegated," having been "received from the state in the act of incorporation."[131] As the *Restatement (Third) of Agency* describes it, "the directors are neither the shareholders' nor the corporation's agents . . . given the treatment of directors within contemporary corporation law in the United States. Directors' powers originate as the legal consequence of their election and are not conferred or delegated by shareholders."[132]

Because corporations are created via the state, incorporators and shareholders have only limited freedom to control the structure of organization. Though the matter has been the subject of extensive debate, "most state statutes remain mandatory on at least a number of important points."[133] And even nonmandatory aspects of the corporate form are often subject to sticky default rules that

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129. Hayden & Bodie, *supra* note 5, at 1130.

130. *See supra* note 20 and accompanying text.

131. Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918); *see* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 560 (2003); Greenwood, *supra* note 89, at 435 (describing the principle as "blackletter law"); Julian Velasco, *Fiduciary Duties and Fiduciary Outs*, 21 GEO. MASON L. REV. 157, 164 (2013).

132. RESTATEMENT (THIRD) OF AGENCY §1.01 cmt. f(2) (2006); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981) (noting that "[d]irectors of Delaware corporations derive their managerial decision making power" from Delaware statutory law conferring such power).

133. Coffee, *supra* note 12, at 939–40.

make alteration so difficult as a practical matter that they become mandatory.[134]

The existence of these mandatory rules does not by itself answer the question whether corporate relationships are contractual, although many nexus-of-contracts theorists draw a line from flexibility to contract.[135] Ordinary contracts are subject to a number of restrictions, both specific and general (prohibitions on racially restrictive covenants, inalienability of body parts, unconscionability, and so forth), with only minimal damage to the underlying concept of the contractual relationship as voluntary and predicated on consent to terms.[136]

But the types of mandatory rules inherent in the corporate form are geared in a specific direction—concentrating directorial power and minimizing the ability of shareholders to express their preferences.[137] The charter and bylaws of a corporation do not represent a bilateral arrangement between two parties. Instead, they constitute a "suite of governance relationships"[138] whereby power is conferred on directors and withdrawn from shareholders. As Stephen Bainbridge puts it:

> In general, shareholders of public corporations have neither the legal right, the practical ability, nor the desire to exercise the kind of control necessary for meaningful monitoring of the corporation's agents . . . . In fact, shareholder control rights are so weak that they scarcely qualify as part of corporate governance.[139]

For example, a ground rule of the corporation is that all management authority must be vested in a board of directors subject to shareholder election.[140] Except for certain privately held corporations,[141] this rule cannot be modified, even if the shareholders so desire.[142] Major transactions, such as mergers, charter amendments, sales of all assets, dissolution, and reincorporation in a different jurisdiction, are subject to a shareholder vote, but they must first be independently initiated by the directors,[143] using their judgment, that the transaction is in the corporation's best interests—which may or may not com-

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134. McDonnell, *supra* note 30, at 393–94.

135. *See, e.g.*, Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1599 (1989); Bernard Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 551 (1990).

136. Eisenberg, *supra* note 116, at 823.

137. Bainbridge, *supra* note 131, at 568–69.

138. Deborah A. DeMott, *Forum-Selected Bylaws Refracted Through an Agency Lens*, 57 ARIZ. L. REV. 269, 291 (2015).

139. Bainbridge, *supra* note 131, at 568–69.

140. BRUNER, *supra* note 112, at 38 (recognizing the power structure within the corporation as an "architectural choice" within the law itself) (quoting Deborah A. DeMott, *Corporate Litigation in the US and UK*, 51 AM. J. COMP. L. 229, 233 (2003)); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 856 (2005); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1404 (1985).

141. *E.g.*, DEL CODE ANN. tit. 8, § 351 (2014); MODEL BUS. CORP. ACT §7.32 (2008).

142. BRUNER, *supra* note 112, at 40.

143. *Id.* at 39; Bebchuk, *supra* note 140, at 846–47.

port with shareholders' actual preferences.[144] Less dramatic decisions, such as when to initiate distributions of assets, require no shareholder input at all.[145]

Rather than express their preferences via interference with management decisions, shareholders express their preferences by voting.[146] Even shareholder voting, however, "is embedded in an intentional governance structure that usually trusts directors to make corporate decisions, subject to a bevy of interlocking constraints . . . . [S]hareholder voting is not the fount from which all corporate authority flows."[147] In voting for directors, for example, the law places a thumb on the scales in favor of incumbents by permitting them to use the corporate treasury to fund their campaigns while leaving insurgents to fend for themselves.[148]

Shareholders nominally have the right to vote for bylaws without director approval, but they are legally hobbled in doing so. To the extent shareholders have access to the corporate proxy, it is generally through limited and idiosyncratic SEC rules.[149] Without proxy access, shareholders can only call for a vote on a bylaw at great personal expense. Even then, directors have expansive ability to thwart shareholder action by refusing to call a special meeting, adopting onerous notice requirements, imposing supermajority voting requirements, and placing limits on shareholder ability to act by written consent,

144. Greenwood, *supra* note 89, at 391 n.28; *see* Bebchuk, *supra* note 140, at 847 (noting that the board can abandon a transaction that has received prior shareholder approval).

145. Bainbridge, *supra* note 131, at 574 ("[T]he vast majority of corporate decisions are assigned to the board of directors or their subordinates acting alone. Shareholders essentially have no power to initiate corporate action and are entitled to approve or disapprove only a very few board actions."); Bebchuk, *supra* note 140, at 847.

146. Shareholders may also express their preferences by exit, that is, by selling their shares. But if they do so after directors take a wealth-destroying action, they are still "bound" by that action, in that they will obtain a lower price for their shares. *See* Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1396 (1989).

147. Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 130, 137 (2009); *see* Stephen M. Bainbridge, *An Abridged Case for Director Primacy*, 62 UCLA L. REV. DISC. 69 (2014); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1750 (2006) [hereinafter Bainbridge, *Director Primacy*]; Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 141.

148. Bebchuk, *supra* note 140, at 856. Delaware recently changed its laws to permit shareholders to adopt bylaws that would reimburse challengers for their proxy campaigns, DEL. CODE ANN. tit. 8, § 113 (2015); thus far, however, shareholders have generally focused more on allowing insurgents access to management's proxy, via nonbinding requests that management allow it. Moreover, they have only sought the opportunity to nominate a minority of directors. *See 2015 New York City Pension Funds Proxy Access Shareowner Proposal*, N.Y.C. COMPTROLLER, http://comptroller.nyc.gov/boardroom-accountability/bap-proxy-access-proposal (last visited Oct. 28, 2015). It is thus not clear that the change in Delaware law significantly levels the playing field. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs and Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863, 893 (2013).

149. Smith et al., *supra* note 25, at 185–87. Among other things, stockholders may not usurp management authority to govern the corporation by proposing bylaws concerning ordinary business operations. 17 C.F.R. § 240.14a-8(i)(7) (2014).

among other things.[150] In the absence of legislative authorization, shareholder power to enact bylaws is more limited than the power of directors, and is perhaps limited only to matters on which shareholders are permitted to act, such as voting for directors.[151] Within this narrow category, shareholder-enacted bylaws may not actually constrain director action; that is, they must continue to grant directors discretion to act in accordance with their own judgment as to the best interests of the corporation. As a result, the power of shareholders to counter directorial action through their own bylaws is, by law, sharply limited.[152]

The legal framework for the corporation therefore does not resemble anything like the legal framework for contracting parties, which allows each side to bargain for its own interests. Instead, corporate law is structured to concentrate discretionary power in the board of directors and to minimize the ability of shareholders to influence director action.[153] Or, as one Delaware decision put it, "[d]irector primacy remains the centerpiece of Delaware law."[154]

This intentional disabling of shareholders reflects two fundamental principles of corporate doctrine. The first is that shareholders do not have the skills necessary to make educated decisions about corporate activity, and therefore informed, expert directors must substitute their judgment for that of shareholders.[155] As one Delaware court put it: "Stockholders may have idiosyncratic reasons for preferring decisions that misallocate capital. Directors . . . need not

150. *See* BRUNER, *supra* note 112, at 50–51; McDonnell, *supra* note 30, at 395; Ribstein, *supra* note 147, at 140–42; *see generally* Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?*, 73 TUL. L. REV. 409 (1998); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325 (2013); Randall S. Thomas, *What Should We Do About Multijurisdictional Litigation in M&A Deals?*, 66 VAND. L. REV. 1925 (2013).

151. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 232, 237 (Del. 2008); Gorman v. Salamone, C.A. No. 10183–VCN, 2015 WL 4719681, at *11–12 (Del. Ch. July 31, 2015).

152. Delaware law is currently unsettled as to whether directors can repeal or alter a shareholder-enacted bylaw (except in specific circumstances, *see* DEL CODE ANN. tit. 8, § 216 (2014)), but the Model Business Corporation Act allows shareholders to prevent directors from altering shareholder-passed bylaws, *see* MODEL BUS. CORP. ACT § 10.20 (2003). As a result, when directors use their discretion to pass bylaws that empower shareholders, it is often defensive; by passing their own bylaw, the directors preempt any attempt by shareholders to do so, and the directors are left free to withdraw the bylaw as it suits them. *See* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1299 (2009). For example, when Rupert Murdoch announced that Fox would make an unsolicited tender offer for Time Warner, Time Warner's board revoked a director-enacted bylaw that permitted shareholders to call special meetings. *See* Crayton Harrison and Edmund Lee, *Time Warner Moves to Thwart Fox Bid by Changing Bylaws*, BLOOMBERG (July 22, 2014, 4:28 PM), http://www.bloomberg.com/news/2014-07-21/time-warner-blocks-shareholders-from-calling-special-meetings.html.

153. Smith et al., *supra* note 25, at 128 ("[T]his one-size-fits-all governance structure—typified by almost complete reliance on centralized decision making by directors and officers—is not merely an expression of market preferences, but a result of the hard wiring of corporate law.").

154. *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 415 (Del. Ch. 2010); *see also* Leo E. Strine, Jr., *Response to Increasing Shareholder Power: Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1763 (2006) (describing "empowerment of centralized management" as "the core element of the Delaware way").

155. *See* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 659–60 (2010); James P. Holdcroft, Jr. & Jonathan R. Macey, *Flexibility in*

cater to stockholder whim."[156] This principle is especially salient in the context of the publicly traded corporation, where shareholders' rational apathy, informational deficits, and collective action problems are both explicitly recognized in law and serve as the doctrinal foundation for deference to director decisionmaking.[157]

This conception of shareholder (in)competence is at its apex in the business judgment rule: actions taken by the board of directors are conclusively presumed to be valid and proper exercises of their authority absent evidence that they either labored under a conflict of interest or behaved with gross negligence. "[T]he 'business judgment' rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power."[158]

The law regarding takeover defenses also rests on the assumption that shareholders are not well-positioned to gauge the best interests of the firm. Boards of directors are legally empowered to block shareholders from selling their shares—even on terms that the shareholders judge favorable—because directors are presumed to have more knowledge of corporate worth than stockholders,[159] and ignorant stockholders "may mistakenly tender into an inadequately priced offer."[160] As then-Vice Chancellor Strine described it,

Determining the Role of the Board of Directors in the Age of Information, 19 CARDOZO L. REV. 291, 291 (1997).

156. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013).

157. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 30–31 (Del. Ch. 2010) (recognizing that courts have deferred to certain management decisions particularly in the context of publicly traded corporations); Bird v. Lida, Inc., 681 A.2d 399, 402 (Del. Ch. 1996) ("A fundamental condition of the corporate form when stockholders are widely dispersed, as typically occurs in public corporations, is that individual shareholders have little incentive to bear the costs associated with activities that monitor board of director (or management) performance. Of course, a fundamental advantage that the corporate form offers to owners of capital is the utility that an investor gains through centralized management. Centralized management allows passive (low cost) ownership and promotes investor diversification.").

158. Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981); *see also In re* InfoUSA, Inc. S'holders Litig., 953 A.2d 963, 984 (Del. Ch. 2007) ("The value of assets bought and sold in the marketplace, including the personal services of executives and directors, is a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by shareholders precisely for their skill at making such evaluations."). The SEC also restricts shareholder access to the corporate proxy because there are certain matters "that shareholders, as a group, would not be qualified to make an informed judgment on, due to their lack of business expertise and lack of intimate knowledge of the [company's] business." Amendments to Rules on Shareholder Proposals, 62 Fed. Reg. 50,682 (Sept. 26, 1997) (to be codified at 17 C.F.R. pt. 240) (alteration in original).

159. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

160. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 57 (Del. Ch. 2011). Directors are also empowered to block tender offers because "shareholders might elect to tender . . . in ignorance or a mistaken belief of the strategic benefit" of the directors' own future plans for the company. Paramount Commc'n, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1989); *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1385 (Del. 1995). This is why directors may not simply present merger proposals to shareholders and leave the matter in their hands; directors are presumed to be more knowledgeable and have greater expertise in gauging the benefits of an offer, and they are charged with protecting shareholders from their own ignorance. *See* Smith v. Van Gorkum, 488 A.2d 858, 873 (Del. 1985) ("[A] director has a duty . . . to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders. Certainly in the

"Delaware law has seen directors as well-positioned to understand the value of the target company, ... Relatedly, dispersed stockholders have been viewed as poorly positioned to protect and, yes, sometimes, even to think for themselves."[161]

The second principle of corporate law is that shareholders cannot coordinate among themselves to advance a single, coherent business strategy; thus, corporate directors serve a critical harmonizing function by choosing among shareholder preferences and prioritizing those that the directors believe to be in the firm's best interests.[162] This principle, as well, can be seen in the context of takeover defenses. Directors are permitted to block tender offers because shareholders have heterogeneous preferences that directors, by law, are charged with reconciling; directors may do so by favoring the interests of some shareholders—long-term holders, for example—over the interests of others—short-term speculators or shareholders who would adopt different corporate goals.[163] Similarly, federal proxy rules burden shareholders seeking to amass large block positions or to coordinate with other shareholders precisely because of concerns that a few shareholders will, due to the dispersed nature of stockholding in a publicly traded corporation, exploit the others.[164]

To be sure, shareholders retain certain minimal powers within the corporate governance structure in what some have described as an "error-correcting" role.[165] By law, directors must hold annual meetings; directors can only act pursuant to statutorily prescribed quorums; mergers may be proposed by directors but must be approved by shareholders, and so forth.[166] But the voting rights left to shareholders are so weak, as a formal matter, that scholars have written entire articles devoted to the puzzle of why they exist at all.[167] Corporate law fundamentally disables shareholders because it does not trust them to manage

merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement."); *see also* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 722 (2009) ("[T]he board's duty to take a position on a merger is one of the hooks on which the structure of fiduciary duties is hung.").

161. *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 441 (Del. Ch. 2002).

162. *See* Strine, *supra* note 154, at 1765; *see also* Bainbridge, *Director Primacy*, *supra* note 147, at 1745; Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 4 (2010) (warning against allowing management actions to be dictated by "stockholder plebiscite[s]" who have "no long-term commitment to remaining as stockholders").

163. *See, e.g.*, Unitrin, Inc., 651 A.2d at 1386; Third Point LLC v. Ruprecht, C.A. No. 9469-VCP, C.A. No. 9597-VCP, C.A. No. 9508-VCP, 2014 WL 1922029, at *1, *26 (Del. Ch. May 2, 2014); *cf.* Air Prods. & Chems., Inc., 16 A.3d at 48.

164. Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 909 (quoting Bainbridge, *supra* note 131, at 569–70).

165. Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 127, 152 (2009); Bainbridge, *Director Primacy*, *supra* note 147, at 1750.

166. DEL. CODE ANN. tit. 8, §§ 211, 141, 251 (2015).

167. *See, e.g.*, Thompson & Edelman, *supra* note 165, at 130; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 616 (2006).

their own interests.[168] Instead, "the board [is] charged with ultimate responsibility for deciding the best interests of the shareholders."[169] In Robert Thompson's words, Delaware "provide[s] a predictable governance structure whose central tenet is to 'trust directors.'"[170]

2. With Shareholder Disempowerment Comes Fiduciary Duties and State Oversight

There is a flipside to this expansive grant of powers to the directors, however, and that is the imposition of mandatory, unwaivable fiduciary duties that constrain directorial discretion. These fiduciary duties—the duty of loyalty and the duty of care[171]—"are themselves a reflection of the agency problem created when shareholders choose to be represented by directors whose interests may not be identical to those of their principals."[172] These fiduciary duties are fundamental to the corporate form precisely because shareholders are legally disabled from contracting for other limits on managerial discretion.[173] As a result, under corporate law, the mere fact that an action is formally authorized either by law or by the corporate-governance documents does not, standing alone, justify directors in taking that action. Instead, directors must exercise the authority granted to them in a manner consistent with their fiduciary duties. As the Delaware Supreme Court stated, "[I]nequitable action does not become permissible simply because it is legally possible."[174]

But with fiduciary limits on directorial discretion necessarily comes a policing mechanism: the ongoing oversight of the judiciary, as invoked through

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168. In some accounts of corporate law, shareholders are disempowered less because they are incapable of protecting their interests than because the directors' job is to mediate among multiple constituencies, with the shareholders being but one of several stakeholders. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 253 (1999). Even under this view, however, shareholders are, by design, legally disempowered from bargaining for their interests precisely because they cannot be trusted to reach substantively beneficial results.

169. *In re* IXC Commc'ns S'holders Litig. v. Cincinnati Bell, Inc., No. C.A. 17324, C.A. 17334, 1999 WL 1009174, at *6 (Del. Ch. Oct. 27, 1999); *see also* Hollinger Inc. v. Hollinger Int'l, Inc., 858 A.2d 342, 387 (Del. Ch. 2004).

170. Robert B. Thompson, *Delaware's Disclosure: Moving the Line of Federal-State Corporate Regulation*, 2009 U. ILL. L. REV. 167, 178.

171. Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV 595, 599 (1997). Though some have challenged whether the duty of care is truly mandatory because corporate charters may provide that damages are unavailable for care breaches, *see* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 69 (2010), as the recent case of *In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54, 86 (Del. Ch. 2014), *aff'd sub nom. RBC Capital Mkts., LLC v. Jervis*, No. 140, 2015, 2015 Del. LEXIS 629 (Del. Nov. 30, 2015), demonstrates, the duty itself remains as a legal obligation that can be enforced even if it is not a source of damages against the directors specifically. *See also In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 836 (Del. Ch. 2011) (issuing a preliminary injunction based on violations of the duty of care); Lyman Johnson, *Delaware's Non-waivable Duties*, 91 B.U. L. REV. 701, 705 (2011).

172. Chandler & Rickey, *supra* note 20, at 101.

173. Ribstein, *supra* note 147, at 133, 142.

174. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

shareholder lawsuits.[175] The judicial role is more than simply that of enforcer; instead, the judiciary constructs, on a case-by-case basis, the exact nature of the directors' obligations in any given scenario.[176] The judiciary's role in policing corporate governance reflects that corporations are ultimately state creations; the state still reserves the right to continually reexamine directors' exercise of their powers for compliance with state-imposed norms of appropriate behavior. Or, as Henry Hansmann describes it, "The provisions of corporate law are essentially contract terms that can be repeatedly reformed by a third party—the state—to adapt them to changing circumstances."[177] For this reason, John Coffee argues that, for all of the theoretical battles among commenters as to whether corporations should be described as artificial entities, real entities, or a nexus of contracts, the one immutable constant is "the institution of judicial oversight."[178] Larry Ribstein puts it in political economy terms: "The corporate form represents a quid pro quo: big firms get corporate features, and government gets an opportunity to regulate governance, ..."[179]

Contract law, by contrast, approaches matters differently. When disputes arise, judges evaluate terms to ascertain parties' intentions at the time of contracting. Though contract doctrine rests not on actual intentions, but on manifestation of intention, the theoretical basis for this approach is that manifestations can generally be trusted to reflect actual intentions.[180] This is why contracts are read in light of a number of specific circumstances that may be unique to the industry or to the contracting parties.[181]

In the corporate context, however, courts do not evaluate whether managers behaved in accordance with shareholders' intentions, but rather whether they behaved in accordance with state-imposed duties of conduct. This results in a flexible, complex body of common law delineating state-imposed directorial

175. *See* Thompson, *supra* note 170, at 178 ("To constrain possible self-dealing or entrenchment action by directors, Delaware provides for shareholder self-help via voting and for judicial oversight via fiduciary duty litigation."); Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215, 217–18 (1999) ("[A] shareholder's ability to sue serves as a constraint on the actions of managers and is a regular part of the governance matrix.").

176. Easterbrook & Fischel, *supra* note 31, at 1445.

177. Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006); *see also* Bainbridge, *supra* note 131, at 586 ("Under the contractarian model, fiduciary duties are gapfillers by which courts resolve disputes arising out of cracks in incomplete contracts.").

178. John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1621 (1989).

179. RIBSTEIN, *supra* note 171, at 66.

180. *See* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1186 (1983).

181. *See supra* Part I.B; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 202 (1981); Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 498 (2004) (characterizing contract interpretation proceeds along an "all-things-considered analysis of what the parties may have meant in the individual case").

obligations.[182] Even though it might be theoretically possible to reduce the state's role by building more specific constraints into the corporate charter, in practice, corporate charters tend to be very sparse documents with nearly uniform provisions that grant directors a great deal of power and mostly rely on the default rules of the state of incorporation to govern the corporate relationship.[183] Michael Klausner and Henry Hansmann argue that incorporators and shareholders thus voluntarily opt into a system whereby the state—rather than themselves—will construct the terms of the corporate contract on an ongoing basis[184] because (given the indefinite life of the corporate entity) the law can respond more completely and rapidly to changes necessitated by business exigencies than can the corporate-governance documents.[185] Under this view, the corporate form, continually tinkered with by the state, is preferable to a system in which parties privately contract for terms.

Even advocates of the nexus-of-contracts view understand the corporation in these terms. That view posits that, because corporations have an indefinite lifespan and "people cannot see the future well enough to resolve all contingencies ahead of time," the corporate governance contract is necessarily incomplete.[186] Fiduciary duties function as a substitute for the missing terms.[187] As Stephen Bainbridge put it, fiduciary duties are a cure for shareholders' "bounded rationality" when entering into the corporate governance "contract" (which is another way of recognizing that shareholders are not legally recognized in corporate law as capable of bargaining on their own behalf).[188] Thus, although there is scholarly disagreement as to whether the murky, uncertain nature of the common law of corporate fiduciary duties should be deemed a feature[189] or a bug,[190] at its most basic level, it may simply be inherent in the corporate form

182. *See* Sean J. Griffith & Myron T. Steele, *On Corporate Law Federalism: Threatening the Thaumatrope*, 61 BUS. LAW. 1, 9 (2005) ("State 'regulation' of corporate governance is a function performed primarily by judges, and the judiciary's basic tool for regulatory intervention is the background principle of fiduciary duty."); Shell, *supra* note 12, at 537–38 ("Virtually the only source of cases that give operational meaning to these fiduciary standards are judicial opinions rendered in response to shareholder lawsuits against management.").

183. *See* Klausner, *supra* note 150, at 1329–30; *see also* Hansmann, *supra* note 177, at 4.

184. Hansmann, *supra* note 177, at 2, 9; *see also* Klausner, *supra* note 150, at 1330.

185. Hansmann, *supra* note 177, at 6–7.

186. EASTERBROOK & FISCHEL, *supra* note 110, at 90.

187. *Id.* at 91 ("[Equity investors] receive few explicit promises. Instead they get the right to vote and the protection of fiduciary principles."); Klausner, *supra* note 150, at 1330 (discussing that, in the context of fiduciary duties, the terms of the corporate contract are left unspecified; instead "the content of the term is provided through judicial interpretation in particular contexts").

188. Bainbridge, *supra* note 131, at 586.

189. *See* Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1082–85 (2000).

190. *See* William J. Carney & George B. Sheperd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1; *see also* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 273 (2009) ("If we appreciate the Delaware courts as the actual negotiators of the corporate contract that set the standards and guide the enforcement of all corporate governance provisions, then we begin to see litigation as a very costly way of specifying contract terms . . . .").

as a result of the impracticality of having shareholders specify directors' contractual duties in advance.[191]

Courts' ability to substantively police the terms of the corporate "contract" is made possible by their disregard of actual shareholder interests in favor of what Daniel Greenwood calls "fictional shareholders"—a constructed form of shareholder whose goal is wealth maximization on an uncertain timeline.[192] Even if stockholders indicate by affirmative vote that their preferences lie elsewhere, or even that they conceive of profit on a different timeframe than managers do, the managers owe no duties to these actual preferences and may be barred from considering them.[193] By rationalizing shareholder interests in this manner, courts can police the terms of the corporate charters and bylaws in a way that would be impossible for ordinary contracts, where the heterogeneous expectations of individual contracting parties would have to be construed. Whereas courts shy away from imposing substantive terms on ordinary contracts,[194] in the corporate-governance realm, such a role is integral to the corporate form.[195]

Delaware's "entire-fairness review" of corporate transactions demonstrates how the state, in its oversight role, reserves to itself the right to substantively construct the terms of the corporate contract. When entire-fairness review is triggered, the court will scrutinize both the process by which a particular deal was reached and its substantive outcome to determine whether the transaction

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191. Even scholars who argue that Delaware law is excessively indeterminate often acknowledge that corporate law in general demands a high degree of flexibility. *See, e.g.*, Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1908 (1998).

192. *See* Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996); Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445 (2008). In a particularly striking—and controversial—example of this phenomenon, the D.C. Circuit invalidated an SEC regulation that would have permitted shareholders access to corporate proxies to nominate directors of their choice. *See* Bus. Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011). Among other flaws in the SEC's rule, the D.C. Circuit concluded that the SEC had not properly weighed the costs that would be imposed by allowing nominations by shareholders, such as employee pension funds, who had preferences other than the long-term maximization of corporate wealth. *Id.* at 1149–50.

193. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1140 (Del. 1989); *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 655 (Del. Ch. 2008) ("Directors are not thermometers, existing to register the ever-changing sentiments of stockholders. . . . [D]irectors may take good faith actions that they believe will benefit stockholders, even if they realize that the stockholders do not agree with them."); Greenwood, *supra* note 89, at 390 n.28, 436–37.

194. Ian Ayres & Alan Schwartz, *The No-Reading Problem in Consumer Contract Law*, 66 STAN. L. REV. 545, 557–60 (2014).

195. Fiduciary duties are not the equivalent of the contractual covenant of good faith and fair dealing. Compliance with the duty of good faith is determined by looking to the parties' intentions at the time of contracting, whereas fiduciary duties are constructed based on new obligations that arise as the situation warrants. *See* Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400, 418–19 (Del. 2013); *see also* Scott FitzGibbon, *Fiduciary Relationships Are Not Contracts*, 82 MARQ. L. REV. 303, 324–25 (1999) (distinguishing good faith from fiduciary duty). Compliance with fiduciary duties also depends not simply on the final action taken by the fiduciary, but also on the fairness of the process that led to the action. *See* Stephen R. Galoob & Ethan J. Leib, *Intentions, Compliance, and Fiduciary Obligations*, 20 LEGAL THEORY 106 (2014); *see also In re* Nine Sys. Corp. S'holders Litig., Consol C.A. No. 3940-VCN, 2014 WL 4383127 (Del. Ch. Sept. 4, 2014).

was fair to shareholders.[196] Critically, entire-fairness review may be warranted even when the deal was approved by shareholders upon full disclosure of the terms.[197] In other words, because corporate doctrine distrusts shareholders' ability to bargain on their own behalf, the court retains the right to scuttle a deal that shareholders have accepted.

The relationship between common stockholders and the corporation may be distinguished from other corporate relationships. For example, preferred stockholders and bondholders have specific, concrete claims on the corporation, set forth in separate documents governing the security issuance. As a result, directors do not owe fiduciary duties to bondholders, nor do they owe duties to preferred stockholders above those owed to the common stockholders. When courts adjudicate disputes concerning the rights of preferred stockholders and bondholders, they contrast the truly contractual nature of these instruments with the less contractual nature of the obligations owed by the corporation to the common stockholders.[198] Similarly, other organizational forms—such as the partnership and the limited liability company—are legally deemed to be truly contractual, as compared to the less contractual corporation, allowing the parties to waive fiduciary duties and to specify their obligations in more detail than they can in the corporate form.[199] In the law of business organizations, then, there are contracts and there are *contracts*, and the charter and bylaws of a corporation fall into the former category.[200]

What this means is that actions taken by directors in their capacity as directors—including passing bylaws, proposing charter amendments, and invoking bylaw and charter power to authorize actions on the corporation's behalf—do not, even doctrinally, rest on a theory of voluntary choice of the shareholders.

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196. Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

197. *See In re* Zhongpin Inc. Stockholders Litig., C.A. No. 7393-VCN, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds*, *In re* Cornerstone Theraputics, Inc., 115 A.3d 1173 (Del. 2015).

198. *See, e.g.*, *In re* Trados Inc. S'holder Litig., Inc., 73 A.3d 17, 39–42 (Del. Ch. 2013) (distinguishing director duties to "residual claimants," the common stockholders, from duties to "contractual claimants," such as bondholders); *In re* Appraisal of Ford Holdings, Inc. Preferred Stock, 698 A.2d 973, 977 (Del. Ch. 1997) (discussing the contractual nature of preferred stock as compared to ordinary equity).

199. *See* Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286 (Del. 1999); Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146 (Del. Ch. 2006); Sonet v. Timber Co., 722 A.2d 319, 324 n.14 (Del. Ch. 1998); Ribstein, *supra* note 147, at 143–46, 152. *But see* Mark J. Loewenstein, *Freedom of Contract for Alternative Entities in Delaware: Myth or Reality?*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS (Robert W. Hillman & Mark J. Loewenstein eds., 2015) (arguing that Delaware judges are already seeking to "backdoor" fiduciary duties into LLCs and partnerships via the duty of good faith and fair dealing); Joan MacLeod Heminway, *The Ties That Bind: LLC Operating Agreements as Binding Commitments*, 68 SMU L. REV. 811 (2015) (arguing that LLCs often do not operate in the same way as "common law" contracts).

200. The REIT at issue in the *CommonWealth* cases was not a corporation and thus was potentially subject to a different analysis of fiduciary obligations than a corporation would have been. However, most courts have treated the forms similarly, *see, e.g.*, Realty Acquisition Corp. v. Prop. Tr. of Am., No. JH-89-2503, 1989 WL 1779973 (D. Md. Oct. 27, 1989); Terrydale Liquidating Tr. v. Barness, 611 F. Supp. 1006 (S.D.N.Y. 1984), and the courts in the *CommonWealth* cases did not draw any distinctions between REIT trusts and corporations.

To the contrary, the corporate arrangement is structured so as to incapacitate shareholders from making choices on the assumption that they are substantively incapable of doing so. Instead, the terms of the corporate contract are imposed by the directors and the state itself as a substitute for shareholders' voluntary consent. Or, to put it another way, whatever agreement among shareholders there may be, it resides in the shareholders' initial decision to enter into a relationship designated as corporate, with all of the legal trappings the corporate form entails. Once within the corporate form, both shareholders and directors can only take actions within the constraints imposed by state law, and those constraints themselves are predicated on the view that shareholders are substantively incapable of directing corporate activities themselves, such that directors must act in their stead.

Critically, this framework means that any actions taken by directors in their capacity as directors—including passing corporate bylaws and exercising their authority as directors to invoke bylaws that already exist—are dramatically at odds with the doctrinal basis of the FAA. The FAA, and the contractual doctrine on which it rests, start from the presumption that contracts to arbitrate represent the choices of autonomous persons who are better positioned than the state to bargain for their interests.[201] The law therefore requires affirmative evidence—often rather extreme evidence, such as fraud or unconscionability—before that assumption will be disturbed. In the corporate context, however, the law starts with the presumption that, having become constituents of a corporation, shareholders cannot identify or bargain for their interests. The law then proceeds to disable shareholders from doing so, at least until they prove their competence by surmounting the various obstacles to action thrown in their path. This fundamental distinction renders actions of directors taken pursuant to their governance powers noncontractual for FAA purposes.

C. IN CORPORATE LAW, PRICING SUBSTITUTES FOR ASSENT

Advocates of the nexus-of-contracts conception of the firm typically argue that the terms of the corporate contract are reflected in its pricing. Though only a small number of shareholders may attend to the details of corporate governance, their trading patterns will be reflected in the price of the common stock such that all shareholders buy at a fair price as gauged by the market as a whole. Corporations that have unfavorable terms in their charters and bylaws will be punished with lower stock prices; therefore, shareholders get the benefit of a cheaper price in exchange for the burden of less favorable governance terms.[202]

Markets may price terms for the benefit of investors who are unaware of them; however, that does not transform into assent to terms on the part of the

201. *See supra* Part I.B.

202. Bainbridge, *Director Primacy*, *supra* note 147, at 1736; Easterbrook & Fischel, *supra* note 31, at 1430.

investor—at best, it simply marks the transaction as a fair one.[203] A market-price-based system is one in which the government determines whether and when to employ coercive power by delegating authority to a small number of individuals whose voluntary choices act as proxies for the greater universe of shareholders. For the remaining shareholders, this is not a legal system based on voluntariness or consent.

The inherent uncertainties and imperfections in any pricing system render it particularly difficult to see pricing as the equivalent of assent. A single price is the result of the multitude of goals, preferences, judgments, and time horizons of different investors,[204] and therefore conceals very different views of the worth of a stock. Moreover, in many cases, the effect of corporate-governance terms is simply unknowable and cannot be priced. As John Coffee explains, corporate governance terms are unlike the fixed qualities of a consumer product because the terms themselves will influence future managerial behavior in unpredictable ways.[205] Under such circumstances, "an 'accurate' price may simply reflect the range of uncertainty as to the likely amount of managerial misappropriation of corporate returns to which shareholders are legally entitled."[206]

Even Easterbrook and Fischel, champions of pricing as the lynchpin of the nexus-of-contracts model, concede that the detrimental effect of various governance "terms" will only be revealed in the long-run, at which time the "market" will price them.[207] As Thomas Joo argues, "Under this analysis, . . . [t]he pricing is 'eventually' efficient with respect to all investors as an undifferentiated class that stretches across time. Such a 'contract' can only be metaphorical, not literal."[208] Moreover, to the extent that directors have extraordinary freedom to add or subtract terms via their bylaw power and their control over the corporation, all corporations must be priced to reflect the uncertainty not only over existing terms, but also over terms that may exist in the future.[209]

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203. Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779, 793 (2002) ("Even if markets efficiently priced all terms, this would mean only that the buyer received fair value for her money. This may be a good argument for the fairness of enforcing the term against the buyer, but it does not mean they actually consented to the term.").

204. *Id.* at 793–94; Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 646 (2003).

205. Coffee, *supra* note 12, at 935.

206. *Id.* at 942; *see also* Coffee, *supra* note 178, at 1668; *cf.* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628 (arguing that investors cannot contract to allow insider trading because a lack of specificity makes it impossible to assess benefits and harms).

207. EASTERBROOK & FISCHEL, *supra* note 110, at 20–21.

208. Joo, *supra* note 3, at 794.

209. Klausner, *supra* note 150, at 1351 (explaining that the existence or absence of a poison pill is a "nonevent" in pricing terms because it can be added at will). Even Roberta Romano, a contractualist, concedes that terms added to the corporate contract—via charter amendments—after public trading begins cannot be viewed via the same framework as terms that exist at conception, and offers policy prescriptions to counteract the possibility that management will offer opportunistic (value-decreasing) amendments. *See* Romano, *supra* 135, at 1613–16.

Even if price perfectly captures the economic value of the governance terms, it still would only equal consent, rather than act as a substitute for it, if one assumes that the only thing shareholders value is wealth maximization—precisely as courts presume in order to police directors' behavior.[210] That is, to equate price with consent is to assume that the only value the corporation has to shareholders concerns the economic returns it offers; therefore, if the price is accurate, it necessarily incorporates all the information investors need for assent. Leaving aside the reality that wealth maximization may have different meaning to different shareholders depending on their risk tolerance and investment horizons, it is empirically true that shareholders often have goals and desires independent of wealth maximization.[211] This fact is reflected in both the "socially responsible investing" movement, whereby investors select stocks in part to advance broader ethical, environmental, or human rights goals,[212] and the growing popularity of "corporate social responsibility" shareholder proxy proposals.[213] Though it has been argued that these preferences are not reflected in stock prices,[214] they are undoubtedly real to the stockholders who champion them. The framework that substitutes pricing for assent necessarily ignores these actual preferences of individual stockholders in favor of constructed preferences, in the same way that corporate doctrine does.

Pricing therefore bears little resemblance to the Supreme Court's vision of contract as predicated on party autonomy because it—at best—only reflects an average viewpoint, without regard to the real, but idiosyncratic, preferences of various stockholder constituencies.[215] Yet pricing does play a critical role in the regulatory system for purchases and sales of common stock, which consistently evinces an expectation that public information is reflected in pricing and that the

210. *See supra* note 192 and accompanying text; *see also* Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 961 (1984) (arguing that corporate directors must pursue profit maximization because it "is the only goal for which we can at least theoretically posit shareholder unanimity").

211. It is precisely because some investors have goals other than corporate wealth-maximization that commenters frequently argue against increasing shareholder power over the corporation. *See, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 589–90 (2006); Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764–65 (2006) (arguing that the "dangers of direct shareholder control" include the fact that "[t]hose institutions most inclined to be activist investors are associated with state governments and labor unions, and often appear to be driven by concerns other than a desire to increase the economic performance of the companies in which they invest").

212. *See* Anna Prior, *Investing with a Mission*, WALL ST. J., July 18, 2015, at B7.

213. *See* Amy Goodman & John Olson, *Shareholder Proposal Developments During the 2014 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 2, 2014), http://blogs.law.harvard.edu/corpgov/2014/07/02/shareholder-proposal-developments-during-the-2014-proxy-season/.

214. *See* Ian B. Lee, *Corporate Law, Profit Maximization, and the "Responsible" Shareholder*, 10 STAN. J.L. BUS. & FIN. 31, 61 (2005).

215. *But cf.* Carnival Cruise Lines v. Shute, 499 U.S. 585, 594 (1991) (holding that a cruise-ticket forum selection clause was reasonable and enforceable because "it stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued").

law must facilitate the ability of stock prices to reflect information.[216] However, information can only be incorporated into price where markets are deep and liquid enough to ensure that a range of preferences is adequately reflected. Such markets can only exist where transaction costs are minimized. Reading, comprehension, and assent are themselves transaction costs. Thus, the law itself is structured to facilitate buying and selling in the absence of knowledge in a manner antithetical to contract law. The fact that corporate law is designed to minimize transaction costs and allow price to substitute for investor knowledge only highlights its fundamental, noncontractarian nature.

1. Corporate Law Substitutes Form for Assent

One critical way that corporate law both encourages accurate pricing and makes shareholder assent unnecessary is through its use of form—the unvarying, sticky, mandatory (or nearly mandatory) rules that govern the corporation. State law confines all business organizations to a few recognizable structures—the corporation, the limited liability company, the trust, and the like—governed by standardized rules, thus sparing investors the need to investigate terms and eliminating the costs associated with such investigation. The reduced transaction costs facilitate the development of deep, liquid markets and allow investors to value businesses based on their substantive operations without the noise of structure.[217]

These state-imposed strictures more closely resemble property law than contract law.[218] As Thomas Merrill and Henry Smith point out, property law is governed by the "numerus clausus" principle: property rights can only take a few specified forms, and even explicit contracts for other forms will not be enforced.[219] Thus, there are limits on the kinds of tenancies that the law will recognize; idiosyncratic tenancy forms will be reinterpreted to meet one of the standardized forms.[220] Merrill and Smith argue these limitations on property rights minimize "network confusion," the costs that would result if third parties were forced to investigate each new property interest at the time of purchase in

216. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 123 (Del. Ch. 2007) (expressing doubt that a widely traded and publicly followed stock could be dramatically underpriced); 65 Fed. Reg. 51,716 (Aug. 24, 2000) (describing the promulgation of SEC Regulation FD, designed to ensure that market prices reflect material information); 47 Fed. Reg. 11,380, 11,382, 11,384 (Mar. 16, 1983) (noting that SEC disclosure requirements rest on the assumption that public information will be reflected in market price and therefore need not be repeated in subsequent disclosures).

217. Coffee, *supra* note 178, at 1677–78 (noting that because charters are essentially unvarying, "both investors and securities analysts can virtually ignore the corporate charter and focus exclusively on disclosures that relate to cash flow and breakup value").

218. The internal-affairs doctrine is difficult to explain in terms of contract law, but it fits neatly into property law, where the law that governs a res depends on the res's location. *See generally* James Y. Stern, *Property Exclusivity and Jurisdiction*, 100 VA. L. REV. 111 (2014).

219. *See* Thomas W. Merrill and Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 3–4 (2000).

220. *See id.* at 11–12.

order to determine the exact scope of the available rights.[221]

When it comes to business organizations, where liquidity and ease of trading are particularly important, these principles have special force.[222] Shareholder assent, to the extent it exists, is based not on awareness of particular bylaws or charter provisions, but on investors' general knowledge of the legal regime governing the organization, such as the knowledge that directors have the power to adopt any bylaw consistent with law and with their fiduciary duties. As the *Boilermakers* court puts it, "Such a change [in bylaws] . . . is the kind of change that the overarching statutory and contractual regime the stockholders buy into explicitly allows the board to make on its own."[223] Assent to any particular term is irrelevant; directorial fiat, subject to fiduciary constraints, is an inherent aspect of the corporate structure itself, and thus is a part of any stock purchase as a feature of the product. The certainty provided by the legal rule substitutes for individualized consent to the idiosyncratic choices made by particular directors at a particular time.

2. Corporate Law Contains No Duty to Read

A corollary to the principle that shareholders are encouraged to rely on the corporate *form*, and not the specific "terms" enacted by corporate directors, is the fact that shareholders are under no duty to read the terms of their corporate contract. That is, when making an investment or voting decision, common stockholders are under no obligation to investigate the company charter and bylaws, or—in many cases—any other aspect of the corporation. This is a major difference between the corporate form and the ordinary contract that marks their distinct doctrinal underpinnings.

As described above, contract law is predicated on the notion of voluntary assent to terms. Yet the reality is that many contracts go unread and thus lack assent. To justify enforcing such contracts, courts impose a duty to read on contracting parties. Parties who fail to read assume the risk of onerous or

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221. *See id.* at 47.

222. *See id.* The case law explicitly recognizes this fact. *See* Sonet v. Timber Co., 722 A.2d 319, 323 (Del. Ch. 1998) (markets may have more difficulty pricing partnerships than corporations because the more contractual nature of the partnership form allows for greater variation); *see also* Leo E. Strine & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2481039 (arguing that contractual freedom in non-corporate entities inhibits investors' ability to price terms).

223. Boilermakers Local 154 Ret. Fun v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013). Of course, Delaware does not permit directors to make bylaw changes on their own by default; to have that power, directors must be granted it in the charter. Then-Chancellor Strine's treatment of such power as essentially a rule of law demonstrates the degree to which charters of publicly traded companies are unvarying, even when the law would permit variation. This is also what Merrill and Smith predict; they point out that once the corporate form is established, incorporators do not vary individual companies even when permitted to do so, happy to take advantage of the benefits associated with standardization. *See* Merrill & Smith, *supra* note 219, at 47; Klausner, *supra* note 150, at 1330 (explaining the same principle).

unfavorable terms (within the limits of certain extremes, like unconscionability).[224] Despite objections that, in the consumer context, the duty to read imposes unreasonable burdens, it remains because of the fear that the lack of such duty will allow unscrupulous counterparties to avoid contractual terms by simply not reading them.[225] Were that to occur, it would interject courts too far into constructing what the terms of the contract should be, instead of enforcing the terms as written, which is antithetical to the notion of a voluntary agreement.[226] The duty to read is thus contract law's answer to the problem of a system that relies on "voluntary" assent when contrasted with the reality that many counterparties are rarely even aware of the terms of the contracts they sign.

As a result of the duty to read, an enormous body of precedent has been generated on the principle that contract drafters must give their counterparties a fighting chance at apprising themselves of contract terms. Contracting parties must be directly and clearly supplied with a copy of the contract, and key language may not be "hidden."[227] Though contract drafters may be permitted to change the terms of the contract, the change must be communicated directly to the counterparty.[228] Consumers generally must also demonstrate assent to the new terms, even if the actions that constitute "assent" are an ever-growing category.[229] Unquestionably, the duty to read is as much of a fiction when it comes to contracts of adhesion as is the original concept of voluntary agreement; the duty remains entirely disconnected from consumers' actual experiences, as scholars have lamented for decades.[230] Nonetheless, the doctrinal requirement of reading—and thus contractual voluntariness—remains.

Corporate law, however, does not impose a duty to read, at least with respect to publicly traded stock. That lack is evident throughout the system of regulation. In contract law, terms must be directly communicated to the counterparty; posting in a publicly accessible location is not sufficient.[231] In corporate law, by

224. *See* Ayres & Schwartz, *supra* note 194, at 549; Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627, 636 (2002).

225. *See* Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1269 (2003).

226. *See* Ayres & Schwartz, *supra* note 194, at 558–60; Kessler, *supra* note 61, at 633, 636; Moringiello, *supra* note 16, at 1314.

227. *See* Ayres & Schwartz, *supra* note 194, at 549; Korobkin, *supra* note 225, at 1271–72.

228. Douglas v. U.S. Dist. Court for the Cent. Dist. of Cal., 495 F.3d 1062 (9th Cir. 2007); Black, *supra* note 121, at 114.

229. Assent might be inferred, for example, from continuing to perform one's job in the at-will employment setting, or from continuing to make charges on a credit card. Bar-Gill & Davis, *supra* note 125, at 9–10.

230. *See* BEN-SHAHAR & SCHNEIDER, *supra* note 122, at 43–47, 79–106; RADIN, *supra* note 16, at 15–17; Kessler, *supra* note 61, at 632; Arthur Allen Leff, *Contract as Thing*, 19 AM. U. L. REV. 131 (1970); Llewellyn, *supra* note 68, at 731–32.

231. Though there are some situations where publicly posted terms are deemed to be part of a contract—*see* RESTATEMENT (SECOND) OF CONTRACTS § 28 (1981) (addressing auctions)—in most situations, terms must be directly communicated to the counterparty, if only via a hyperlink or other reference to where additional terms may be located. *See* Black, *supra* note 121, at 114. Moreover, a

contrast, there is no requirement that terms, in the form of charters and bylaws, be directly communicated to shareholders, either at the time of purchase or when subsequently amended. For example, Delaware has no requirement that bylaw amendments be communicated to stockholders at all, and charter amendments need only be filed with the secretary of state.[232] Federal law requires that amendments to charters and bylaws be publicly filed with the SEC,[233] a form of notice that would be insufficient under law governing ordinary contractual relationships. Because shareholder assent exists as a matter of law with respect to any legal change to the corporate governing documents,[234] it hardly makes sense that shareholders should have any duty to read them at all.

Public posting, rather than direct communication, is deemed sufficient in the corporate context because it is not expected that each stockholder will make informed decisions; instead, it is presumed that a small number of stockholders will concern themselves with the details of corporation-specific information. This is not deemed a failing of stockholders; to the contrary, stockholder ignorance is encouraged via numerous causes of action available to investors who claim that disclosures were false or inadequate, none of which require that investors demonstrate that they (or any particular individual) actually read and relied upon the information.[235] Instead, shareholders' injuries are measured by the potential impact of disclosures on other stockholders. Corporate law, recognizing that stock ownership reflects shared interest in a common enterprise, treats harms as collective. That someone theoretically read the information and relied on it, thus affecting stock prices or a shareholder vote, is sufficient to

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contracting party is under no duty to continually revisit posted terms to determine if there has been any change. *See Douglas*, 495 F.3d at 1066.

232. DeMott, *supra* note 138, at 282. Under Delaware law, corporate fiduciary duties require disclosures only in connection with specific transactions on which shareholder votes are sought. *See* Thompson, *supra* note 170, at 181–82; *In re* Allergan, Inc. Stockholder Litig., C.A. No. 9609-CB, 2014 WL 5791350, at *10 (Del. Ch. Nov. 7, 2014) ("[T]here is no independent duty of disclosure under Delaware law.").

233. *See* 17 C.F.R. § 240.13a-11 (2014) (requiring filing of Form 8-K); SEC. AND EXCH. COMM'N, FORM 8K, ITEM 5.03, http://www.sec.gov/about/forms/form8-k.pdf (requiring disclosure of amendments).

234. *See supra* Section III.C.1.

235. This is true under the federal securities laws, state securities laws, and state corporate governance law. *See, e.g.*, 15 U.S.C. §§ 77(k)–(l) (2012); Basic Inc. v. Levinson, 485 U.S. 224, 241–48 (1988) (holding that investors alleging fraud under Section 10(b) of the Securities Exchange Act may substitute a showing that a misstatement affected a security's market price for a showing of individualized reliance); Cowin v. Bresler, 741 F.2d 410, 427 (D.C. Cir. 1984) (holding that reliance is not required to bring a claim for a false proxy statement under Section 14 of the Securities Exchange Act); Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998); UNIF. SEC. ACT § 410 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1956). The legislative history of the Securities Act of 1933 demonstrates that Congress believed that most investors would not read corporate documents, but would nonetheless be injured by false statements to the extent that *other* investors relied on the false statements and influenced market prices. *See* APA Excelsior III L.P. v. Premiere Techs., Inc., 476 F.3d 1261, 1273–75 (11th Cir. 2007). As discussed above, securities law and corporate law are separate spheres, *see supra* Part II, but they act in tandem with each other, and states frequently import federal disclosure standards into their own jurisprudence. *See* Thompson, *supra* note 170, at 182 (describing how Delaware relies on federal disclosure standards in its own law).

demonstrate harm to the remaining shareholders.

Contracts, by contrast, are treated as individual transactions, with harms felt only by the counterparty. Contract terms are evaluated by reference to what the parties actually understand and value, as opposed to the presumed (fictionalized) preferences that dominate corporate law. In the context of contracts, materiality may turn, in part, on the idiosyncratic preferences of the contracting party, regardless of whether similarly situated parties would find the representation material.[236] Analogously, in the context of false advertising, misrepresentations that are material to purchasers are prohibited, even if the purchasers' preferences are themselves irrational.[237] But when it comes to corporations, courts evaluate the sufficiency of a disclosure by reference to a hypothetical shareholder who is rational and disregards irrelevant information.[238] This distinction further demonstrates that corporate law is predicated less on shareholders' actual consent and more on ex post judicial declarations regarding corporate directors' state-imposed obligations.

To be sure, there are markets other than securities that depend on swift transactions; consumer markets, for example, would be greatly inhibited if purchasers were granted a serious opportunity to read contract terms.[239] Therefore, some have argued that the concept of efficiency in pricing may be extended even to ordinary contracts—particularly boilerplate consumer contracts—to justify their enforcement as an alternative to theories of voluntary choice.[240] But the cultivation of pricing efficiency does not accurately describe the regulatory regime that governs boilerplate contracts.[241] The concept of procedural unconscionability itself suggests that although rapid transactions may be necessary to modern commerce, courts are deeply uncomfortable about using efficiency justifications to bind consumers to terms they did not have an opportunity to read.

In response to the obvious disconnect between true assent and what contract doctrine will accept as evidence of assent, contracts scholars have proposed a variety of alternative regimes in which courts substantively police contract

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236. *See* RESTATEMENT (SECOND) OF CONTRACTS § 162 cmt. c (1981).

237. *See* FTC v. Algoma Lumber Co., 291 U.S. 67, 78 (1934).

238. David A. Hoffman, *The "Duty" to Be a Rational Shareholder*, 90 MINN. L. REV. 537, 539–41 (2006); *see also* Amgen Inc. v. Conn. Ret. Plans & Tr. Funds, 133 S. Ct. 1184, 1191 (2013) (affirming that, in the securities context, materiality is an objective standard that remains the same across all investors); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985) (importing the materiality standard of federal law into disclosure requirements under state law fiduciary duties).

239. Hillman, *supra* note 123, at 747.

240. *See id.* at 747–48. Theoretically, businesses can compete on terms that only a small number of consumers read, and so long as their choices drive pricing, all consumers will benefit from optimal terms. *See id.*; Tess Wilkinson-Ryan, *A Psychological Account of Consent to Fine Print*, 99 IOWA L. REV. 1745 (2014).

241. Moreover, because courts have weakened constraints on the amendment of contract terms, the terms of consumer contracts are not stable enough to allow pricing signals to develop. Horton, *supra* note 125, at 609. Corporate law deals with this problem by keeping the form stable, with judicial oversight of directors' actions.

terms for reasonableness, fairness, and so forth.[242] As Margaret Radin has recognized, these proposals may represent good policy, but such regimes would no longer be rooted in contract because they would no longer be predicated on assent to terms.[243] Unsurprisingly, then, efforts to regulate contracts as products have been unsuccessful so far, likely because of the great variety of potential contract terms and the idiosyncratic preferences and sophistication levels of counterparties.[244]

By contrast, the terms of the corporate "contract" are regulated by judges on a case-by-case basis for fairness via fiduciary duties, even when doing so overrides the consent of shareholders. In this context, there is no concern for the actual desires, intentions, and differing sophistication levels of real-life shareholders because the fiction of the shareholder preference for wealth maximization, coupled with objective standards regarding what information investors may rationally take into account, homogenize shareholder preferences to the point where they become judicially manageable. In other words, when it comes to corporate law, the contract truly is "the thing"—and it is regulated as such.[245] Ordinary contracts, even in the adhesion context, are not.

These different regimes lay bare the premises described earlier. In contract law, notice is critical because actions taken by one party are authorized by the manifested consent of the other party. Within the corporate form, however, notice has little role because actions taken by directors are not authorized by a fiction of shareholder consent; they are authorized by the powers inherent in the corporate form, conferred by the state, and constrained by shareholder preferences that are also state-mandated. The ultimate organizing principle is that in the context of ordinary contracts, parties are presumed capable of bargaining for their own interests; within a corporation, dispersed shareholders are conceptualized as needing the protection of corporate directors, and ultimately judges and the state, to make proper choices.

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242. *See* KARL N. LLEWELLYN, THE COMMON LAW TRADITION: DECIDING APPEALS 370–71 (1960); RADIN, *supra* note 16, at 198–99, 211–13; Margaret Jane Radin, *Reconsidering Boilerplate: Confronting Normative and Democratic Degradation***,** 40 CAP. U. L. REV. 617, 642–43 (2012); Rakoff, *supra* note 180, at 1176.

243. *See* Radin, *supra* note 242, at 642–43, 646; *see also* Leff, *supra* note 230, at 149; Robert G. Natelson, *Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association*, 51 OHIO ST. L.J. 41 (1990); Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 IND. L.J. 1125, 1156 (2000) ("Courts rewrite the terms of contracts they find unconscionable, sometimes, rather than merely declaring the contract null and void. When they do this, they are implementing something other than a consented-to bargain." (footnote omitted)). A similar argument has been made in the context of corporate law: when terms are imposed as a result of a hypothetical bargain and cannot be altered, they are, by definition, anticontractarian. *See* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-contractarians*, 65 WASH. L. REV. 1, 15–16 (1990).

244. *See* Ayres & Schwartz, *supra* note 194, at 558–60. There do currently exist certain types of quasi-substantive regulations of contract terms—such as warranties—but these are often treated more like extra-contractual remedies than contractual ones. *See* RADIN, *supra* note 16, at 203–04.

245. *See* Leff, *supra* note 230, at 144.

Now, there is a certain irony when contrasting the doctrinal assumptions of contract law with the doctrinal assumptions of corporate law because the theoretical bases for each have strayed far from the empirical reality. Consumer contracts do not involve parties of equal bargaining power, and consumers in many situations do not have the information or expertise to bargain for their interests, despite the doctrinal assumption that they can do so.[246] By contrast, today's stock markets are dominated by institutional investors, many of whom are capable of making judgments about their interests and understanding corporate strategies on a sophisticated level (or who at least have advisors who can guide them in such understandings).[247] These investors also have sufficient power and unity to protect those interests, even within existing legal constraints. Thus, today's investors are far more capable of bargaining on their own behalf than is reflected in the legal regime allocating power within the corporation.[248] Nonetheless, the doctrinal underpinnings of contract law and corporate law remain distinct.

There are signs of change, albeit glacially paced. Delaware recently authorized shareholders to pass bylaws that would enable them to nominate their own director-candidates to be included in corporate proxy materials.[249] Then-Vice Chancellor Strine recognized the prominence of institutional shareholders when setting standards for evaluating the fairness of a takeover bid, and suggested that he was willing to relax some of the doctrinal disdain toward shareholder competence.[250] Myron Steele, former chief justice of the Delaware Supreme Court, has acknowledged that the shift from retail to institutional investors may justify changes in doctrine that would shift power from corporate directors to shareholders.[251] Even as he acknowledged the propriety of a doctrinal shift, however, he continued to adhere to the view that shareholders' interests must be constrained by law and limited to wealth maximization—which suggests that whatever legal changes may be contemplated to allow shareholders to manage their own interests, there remains a ways to go before corporate law is willing to

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246. *See* BEN-SHAHAR & SCHNEIDER, *supra* note 122, at 18–25.

247. *See* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1922 (2013).

248. For example, in response to shareholder pressure, many corporations have voluntarily destaggered their boards, thus defanging a common antitakeover device. *See id*. As a practical matter, though the existing legal regime makes it very difficult for shareholders to wage proxy contests to oust directors whom they oppose, corporate directors often resign in the face of significant minority opposition to their reelection. *See* Velasco, *supra* note 164, at 909.

249. DEL. CODE ANN. tit. 8, § 113 (2009).

250. *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 444 (Del. Ch. 2002) ("[C]orporate law should not be designed on the assumption that diversified investors are infirm but instead should give great deference to transactions approved by them voluntarily and knowledgeably.").

251. *See* Myron T. Steele, former Chief Justice, Delaware Supreme Court, Continuity and Change in Delaware Corporate Law Jurisprudence, The Albert A. DeStefano Lecture on Corporate, Securities, and Financial Law at the Fordham Corporate Law Center, *in* 20 FORDHAM J. CORP. & FIN. L. 352, 361 (2015).

treat stockholders as autonomous actors.[252] As long as corporate law is structured around protecting shareholders from making substantively bad choices, then, regardless of whether shareholders are in fact more capable than the law recognizes, the legal arrangement is noncontractual.[253]

IV. THE FUNDAMENTAL INCOMPATIBILITY OF THE FAA AND CORPORATE GOVERNANCE DISPUTES

A. CORPORATE GOVERNANCE DISPUTES CALL FOR A TYPE OF DECISION MAKING AT ODDS WITH FAA ANALYSIS

The premise of both the Supreme Court's FAA jurisprudence and arbitration as a scheme of dispute resolution is autonomy of the parties to the contract. Yet in the corporate context, actions taken by directors in their capacity as directors are not predicated on shareholder autonomy or the presumptive benefits of bargains struck by arm's-length counterparties; instead, these actions are presumptively worthy of judicial respect because directors possess expertise superior to that possessed by shareholders, and their actions are tempered by state-imposed fiduciary duties. Thus, the validity of these actions—or lack thereof—rests on the content of state fiduciary obligations, and not (as in the FAA context) on the consent of the shareholders. The FAA has nothing to say about the content of state fiduciary obligations; therefore, the corporate model both disrupts, and is incompatible with, the regime envisioned by the FAA.

The differences are evident in Delaware's treatment of litigation-limiting bylaws. After directors unilaterally adopted the fee-shifting bylaw in *ATP*, the Delaware Supreme Court explained that although such bylaws were permissible under Delaware law in the abstract,[254] the circumstances surrounding their adoption and their application in a particular case would be subject to review for compliance with fiduciary obligations.[255] As the Delaware Supreme Court recognized, bylaws that are adopted or enforced for inequitable purposes may be invalidated by a court; identical bylaws, properly adopted and used, may be permissible.[256] Similarly, when directors adopted bylaws requiring that shareholder lawsuits be brought in Delaware in *Boilermakers*, then-Chancellor Strine allowed their adoption in part because he expected that the application of such a

252. *See id.* at 360.

253. It would be possible for a state to adopt a system of corporate law that places shareholders on a much more even footing with directors; if so, a corporation organized in that state would have a greater claim that its constitutive documents represent FAA contracts. North Dakota, for example, recently amended its corporate law to give shareholders far greater power to act unilaterally. *See* BRUNER, *supra* note 112, at 63–64. However, almost no public corporations are organized under North Dakota law; thus, the issue of the proper treatment of a North Dakota arbitration bylaw or charter provision is unlikely to be tested any time soon.

254. A point on which Delaware law has since been legislatively changed. *See* 80 Del. Laws ch. 40 (2015).

255. ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 560 (Del. 2014).

256. *See id.*

bylaw to any particular dispute would include an evaluation of whether the forum-selection clause operated inequitably in violation of the directors' fiduciary duties.[257]

Arbitration clauses should be subject to the same legal regime. A director adopting an arbitration bylaw, and invoking it to dismiss a particular lawsuit, would be acting on the corporation's behalf in his capacity as a fiduciary.[258] These actions should then be subject to review for compliance with fiduciary standards—a type of review that is incompatible with rules set by the FAA. For example, if the directors' actions were subject to review under the business judgment rule, they would be granted a high degree of deference, in recognition of the directors' responsibilities to decide how to manage the corporation. But viewed through the lens of contract, if one party added or invoked a term, no court would automatically "defer" to that party's judgment as having superior rights over the relationship. To the contrary, the core premise of contract law generally, and FAA jurisprudence specifically, is that the parties come before the court as autonomous equals. If anything, contract law would consider whether a clause is unconscionable—and thus unenforceable—in part by reference to whether it was imposed unilaterally, with no opportunity for input from the resisting party.[259] Once again, this is directly contrary to principles of corporate governance, where unilateral action by directors without input from shareholders is the default.

But it is unlikely that an arbitration clause would receive review under the business judgment rule. When directors act under a conflict of interest, scrutiny of a transaction is increased.[260] Because all directors potentially have an interest in deterring litigation, minimizing discovery, and ensuring that proceedings are confidential, the decision to adopt an arbitration bylaw—and the decision to

257. Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 954 (Del. Ch. 2013).

258. Usually, arbitration is something sought by corporate directors, not shareholders. That said, the bylaw in the *CommonWealth* cases and the bylaw proposed by Google and Frontier shareholders would have required directors to arbitrate disputes if a shareholder so demanded. *See* Corvex Mgmt. LP v. CommonWealth REIT, No. 24-C-13-001111, 2013 WL 1915769 (Cir. Ct. Balt. City May 8, 2013); Google Inc., Definitive Proxy Statement (Schedule 14A) (May 9, 2012); Frontier Communications Corporation, Definitive Proxy Statement (Schedule 14A) (March 26, 2012). However, it is unclear whether such a bylaw would be valid under most corporate statutes; ordinarily, a bylaw constraining director action would have to contain a "fiduciary out" to be valid, *see* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227 (Del. 2008), meaning that directors would always have to be left with some degree of discretion to decide whether invoking the bylaw was in the best interests of the corporation (a decision that would be subject to review under fiduciary standards). Even this requirement of corporate law—that shareholders not be permitted to bind directors' exercise of fiduciary duties—presents a poor fit with examination under the FAA.

259. *See* Brown v. Aimco Cent. Park Townhomes, LLC, 2013 IL App (1st) 121140-U, ¶ 17–19. *But see* Richard Frankel, *The Arbitration Clause as Super Contract*, 91 WASH. U. L. REV. 531, 555 (2014) (arguing that many courts have improperly abandoned the principle of contra proferentem in the context of arbitration clauses).

260. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1374, 1379 (Del. 1995).

invoke it in a particular case—could easily be treated as a conflicted action.[261] Only in highly unusual circumstances would there be a possibility of cleansing the clause by having it adopted or invoked only by disinterested directors; in most cases, there would not be any disinterested directors available.[262]

This type of heightened review of an arbitration provision is exactly the kind of inquiry forbidden by the FAA. Any heightened scrutiny would necessarily involve an examination of the suitability of the arbitral forum, which is an inquiry largely forbidden by current Supreme Court jurisprudence.[263] The Supreme Court has made it clear that, with the possible exception of arbitral fora that charge high fees, the FAA requires the enforcement of arbitration clauses even when they will functionally deny plaintiffs the ability to bring their claims.[264] However, that is exactly the inquiry Delaware courts would ordinarily conduct to determine whether directors have violated their fiduciary duties by enacting or invoking a bylaw.[265] Even singling out arbitration clauses for special scrutiny may be deemed to violate the FAA.[266]

To put it another way, one suspects that directors will only invoke an arbitration clause in a particular case so long as they believe that an arbitrator is

261. Though Delaware is hesitant to say certain kinds of transactions inherently give rise to a conflict of interest among directors, thus creating heightened scrutiny across the board, *see* Gantler v. Stephens, 965 A.2d 695, 713–14 (Del. 2009), it has done so in the context of defensive measures to shield against a takeover, *see* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985); *see also* Calma v. Templeton, 114 A.3d 563, 578 (Del. Ch. 2015) (noting that director self-compensation decisions are inherently interested). The adoption of an arbitration bylaw—even if done on a clear day—could easily fall into this latter category, as its only purpose would be to address accusations of a directors' violation of fiduciary duty, and—as the enacting directors would anticipate—there is little chance it could be invoked by a disinterested director. Even forum selection bylaws are not comparable because it is the unique ability of parties to the action, such as directors, to manipulate arbitral procedures that gives rise to the suspicion of self-interest; public courts are not susceptible to the same manipulation. This is precisely why, under the FAA, arbitration is considered superior to litigation.

262. *Cf.* Zapata Corp. v. Maldonado, 430 A.2d 779, 787–88 (Del. 1981) (recognizing that directors' natural sympathy for each other should inform a court's inquiry into the disinterested process of a board committee recommending dismissal of derivative litigation). Only a bylaw entirely adopted by shareholders would be free of this taint, and even then, the bylaw would have to be invoked by (self-interested) directors in a particular case. Moreover, even though there have been shareholder proposals to adopt arbitration bylaws, it seems far more likely that if arbitration clauses are permissible and enforceable, such clauses will be adopted unilaterally by directors, or perhaps presented to shareholders as a charter amendment. As a charter amendment, directors may have a great deal of freedom to pressure shareholders into accepting the change. *See* Lucian A. Bebchuk & Ehud Kamar, *Bundling and Entrenchment*, 123 HARV. L. REV. 1549 (2010); James D. Cox et al., *Are Companies Impermissibly Bundling Proposals for Shareholders Votes?* (Vanderbilt Law Sch. Law & Econ., Working Paper No. 15-10, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2602827.

263. *See* CARBONNEAU, *supra* note 54, at xv ("[T]he Court's policy on arbitration implies[] the recourse to arbitration is—as a matter of law—in each party's best interest.").

264. *See* Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304 (2013); AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011).

265. *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 936, 958 n.120 (Del. Ch. 2013) (forum selection clause may be inequitable if it would deprive plaintiff of any forum); *cf.* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 662–63 (Del. Ch. 1988) (directors may not take action that would thwart shareholder franchise).

266. *See* Hiro N. Aragaki, *Arbitration's Suspect Status*, 159 U. PA. L. REV. 1233, 1247 & n.73 (2011).

more likely, or at least as likely, to absolve the directors of wrongdoing than a judge. If directors believe that judges are more likely than arbitrators to dismiss plaintiffs' claims, they will not use such clauses.[267] This inherent imbalance almost assures that directors will only choose to adopt and enforce arbitration clauses when they believe such clauses will redound to their personal benefit, which itself may be a violation of their fiduciary duties to shareholders. This is not a problem that can be assessed within the framework imposed by the FAA, partly because Supreme Court jurisprudence does not allow courts to raise suspicions about the substantive adequacy of the arbitral forum,[268] and partly because the FAA assumes the existence of a dispute arising out of a contractual relationship—namely, parties bargaining at arms' length, each of whom is permitted to act in her own self-interest.[269]

Thus, there is a fundamental incompatibility between the FAA, arbitration, and corporate governance. Existing FAA doctrine makes no allowances for scrutiny of actions by interested parties because—by definition—all parties to ordinary contracts act in self-interest. In the corporate context, this is impermissible; directors may not advance their own interests to shareholders' detriment. The FAA has no vocabulary for this kind of assessment; parties in a contractual relationship are under no duty to protect the interests of their counterparty.

This is not to say that claims for breach of fiduciary duty cannot be arbitrated; clearly, they can.[270] But where fiduciary claims have been ordered to arbitration, the parties were acting autonomously when they contracted to arbitrate disputes.[271] When one party invoked the arbitration clause to dismiss the claims of the opposing party, that action was taken in its personal capacity, not in its capacity as a fiduciary to the opposing party. In the corporate context, when directors invoke powers conferred via the charter and bylaws, the directors are acting *as fiduciaries* on behalf of the corporate entity.[272] A director invoking an

267. This is not to say that directors—like any party to a contract—may not have reasons to prefer arbitration for the procedural benefits it may offer, such as speed and informality. It is doubtful, however, that directors would invoke arbitration to obtain such benefits *if they believe* that they are more likely to lose before an arbitrator. In other words, directors would have to first believe that an arbitrator was at least as likely to decide in their favor as a judge.

268. *See* Perry v. Thomas, 482 U.S. 483, 489 (1987).

269. In the context of forum selection bylaws, Delaware has already signaled that it will examine the adequacy of the alternative forum and the reasonableness of the forum as a situs for the resolution of corporate disputes. *See* City of Providence v. First Citizens Bancshares, Inc., 99 A.3d 229, 235, 237 (Del. Ch. 2014). These are not inquiries the FAA permits in any depth because of the "contractual freedom" afforded to the parties to determine their own procedures.

270. *E.g.*, Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 295 (Del. 1999) (enforcing a contractual provision in an LLC agreement requiring the arbitration of disputes, including claims for breach of fiduciary duty).

271. *See, e.g.*, Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 7 F.3d 1110 (3d Cir. 1993); Bird v. Shearson Lehman/Am. Express, Inc., 926 F.2d 116 (2d Cir. 1991); *Jaffari*, 727 A.2d at 288.

272. *Cf.* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 958 (Del. Ch. 2013) (recognizing that a plaintiff may challenge a corporation's invocation of a forum-selection bylaw on the grounds that to do so violates the directors' fiduciary duties). Most proposals for arbitration of shareholder disputes do not explicitly discuss how such bylaws would affect third parties who are also

arbitration clause contained in a director-enacted bylaw might be analogized to a lawyer acting as a client's representative when adding an arbitration clause to the client's retainer agreement, and simultaneously purporting to invoke it on the client's behalf in the event of a professional negligence dispute. The propriety of arbitration in that instance would not be judged by reference to whether the client assented to the clause or its invocation, but by reference to whether the lawyer's behavior was consistent with her duties of representation.

Courts have recognized this principle in disputes over agency. Parties to arbitration agreements often resist their application on the ground that the agent who executed the agreement on the party's behalf was acting outside the scope of its authority. When this occurs, courts routinely hold that the question of the agent's authority to bind the principal—and thus the ultimate arbitrability of the dispute—must be evaluated by the court, outside the scope of the FAA.[273] When it comes to directors either enacting or invoking arbitration bylaws, similar principles should apply: the propriety of the directors' action depends on the content of their fiduciary obligations, which is not an issue to which the FAA speaks.[274]

The decisions rendered in the *CommonWealth* cases demonstrate precisely the problem. There, the trustees unilaterally adopted the arbitration clause, as well as a provision purporting to bar the award of attorneys' fees to prevailing plaintiffs, shortly after they undertook several of the actions that eventually became the subject of the plaintiffs' lawsuits (such as the alleged churning of assets and a bylaw change that made it harder to remove existing trustees).[275]

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named as defendants, such as outside advisors or corporate counterparties who are sued for aiding or inducing the directors' breach of fiduciary duties to the corporation. *See, e.g.*, OTK Assocs. v. Friedman, 85 A.3d 696, 721 (Del. Ch. 2014). If the arbitration clause does not specify that claims against such parties will be arbitrated, there is a serious danger of claim splitting and duplicative actions. Broadly worded arbitration clauses might be interpreted to apply to third parties, however, and if corporate charters and bylaws are contractually binding on shareholders, third parties might be able to insist that claims against them be arbitrated on the theory that they are third-party beneficiaries of such contracts. *Cf.* Shell, *supra* note 12, at 553 n.219; *see also Pritzker*, 7 F.3d at 1113, 1121 (allowing third party to seek arbitration where claims filed against third party were intertwined with claims against signatory to the agreement); Christopher Driskill, Note, *A Dangerous Doctrine: The Case Against Using Concerted-Misconduct Estoppel to Compel Arbitration*, 60 ALA. L. REV. 443, 449–50 (2009).

273. *See, e.g.*, Rice Co. v. Precious Flowers Ltd., 523 F.3d 528, 537–39 (5th Cir. 2008); Sphere Drake Ins. v. All Am. Ins. Co., 256 F.3d 587, 589–91 (7th Cir. 2001).

274. DeMott, *supra* note 138, at 290.

275. Corvex Complaint, *supra* note 4, ¶¶ 36, 37, 72; Katz Complaint, *supra* note 4, ¶¶ 45–46. The clause forbidding the award of attorneys' fees to prevailing plaintiffs (ordinarily a staple of intracorporate litigation) did not necessarily pose an issue for resolution under the FAA. Courts often sever or otherwise invalidate arbitration clauses that are deemed to operate as impermissible waivers of substantive rights, such as damages limitations and fee-shifting provisions. *See, e.g.*, Zaborowski v. MHN Gov't Servs., Inc., 936 F. Supp. 2d 1145, 1154 (N.D. Cal. 2013); Winston v. Academi Training Ctr., Inc., No. 1:12-cv-767, 2013 WL 989999, at *2, *4 (E.D. Va. Mar. 13, 2013); Ajamian v. CantorCO2e, L.P., 137 Cal. Rptr. 3d 773, 799–800 (Cal. Ct. App. 2012); Franks v. Bowers, 116 So. 3d 1240, 1241–42 (Fla. 2013); *see also* Thomas J. Stipanowich, *The Third Arbitration Trilogy:* Stolt-Nielsen*,* Rent-A-Center*,* Concepcion *and the Future of American Arbitration*, 22 AM. REV. INT'L ARB.

Nonetheless, neither of the courts entertaining the plaintiffs' claims even considered whether the trustees had acted in accordance with their fiduciary duties when adopting the bylaw, let alone when invoking it to dismiss the plaintiffs' claims. Instead, they simply declared that corporate governance documents are contractual and analyzed the bylaw within a contractual framework.[276]

The problem could be mitigated, though not entirely eliminated, by a requirement that any arbitration clause be contained in the corporate charter at the company's inception rather than in a unilaterally enacted bylaw. If the clause is placed in the charter prior to the company's IPO, before any shareholders exist to whom directors owe fiduciary duties, then the adoption of the provision would not raise fiduciary concerns.[277] Even then, however, the directors' decision to invoke it in response to a particular lawsuit would still be subject to review for compliance with their obligations as fiduciaries.[278]

But the possibility that arbitration clauses might be restricted to charters—or even charters prior to the beginning of public trading—raises an additional issue: given pervasive state law restrictions on the content of charters and bylaws, and the procedures for their amendment, it would be impossible to determine whether a state law rule places arbitration on the "same footing" with other types of provisions, as the FAA requires.[279] For example, states require that certain types of provisions be included in the charter rather than the bylaws.[280] Would a similar rule for arbitration clauses place arbitration on the same, or different, footing with other contracts? Some changes to the rights of

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323, 394 (2011). Under this line of case law, the validity of the *CommonWealth* attorneys' fees provision would be gauged by reference to Maryland law, irrespective of the FAA. *But see* George Watts & Son, Inc. v. Tiffany & Co., 248 F.3d 577 (7th Cir. 2001) (refusing to disturb arbitral award that failed to provide for fees and costs, in violation of state law).

276. By contrast, in *City of Providence v. First Citizens Bancshares, Inc.*, 99 A.3d 229, 240–41 (Del. Ch. 2014), a Delaware court considered the circumstances surrounding the adoption of a forum-selection bylaw—including its timing relative to a corporate merger that was likely to be the subject of litigation—when gauging whether the bylaw had been adopted and invoked in a manner consistent with the directors' fiduciary duties.

277. Lucian Bebchuk explains that debates regarding the contractual nature of the corporation are actually two debates: one involving provisions that exist in the charter at the moment of the IPO, and one involving provisions added later, because charter amendments raise greater fairness concerns. *See* Bebchuk, *supra* note 146, at 1396; *see also* Coffee, *supra* note 12, at 949; McDonnell, *supra* note 30, at 398. A charter provision added after the IPO, that is, one approved by a vote of the shareholders, would still trigger a fiduciary analysis because the directors would owe an independent duty to shareholders only to propose the amendment after a determination that it would be in the best interests of the company.

278. One could imagine a charter provision that was unwaivable by the directors, but such a provision might be deemed to violate the requirement that all management authority be vested with the board. *See* BRUNER, *supra* note 112, at 39–40. In any event, it is difficult to imagine that directors would want to be constrained to that degree.

279. Southland Corp. v. Keating, 465 U.S. 1, 16 n.11 (1984) (quoting H. R. REP. NO. 96, No. 68-96, at 1 (1924)).

280. Only the charter may contain provisions regarding the authorized classes of stock and damage waivers for breaches of the directors' duty of care. *See* DEL. CODE ANN. tit. 8, § 102 (2014); *see also* McDonnell, *supra* note 30, at 437 (listing the types of provisions that may only be included in charters and not bylaws).

existing stockholders may only be made with the specific agreement of those stockholders;[281] other changes may only be made if those stockholders, as a class, vote in favor of the change;[282] others trigger appraisal rights;[283] and others require no stockholder consent at all.[284] If a state were to require that arbitration clauses receive similar treatment to any of these categories of change, would that amount to a violation of the nondiscrimination principle? Equality of terms is meaningless in a scheme structured by state law; there is simply no baseline from which to measure.[285]

B. THE STRUCTURE OF INTRACORPORATE LITIGATION IS AT ODDS WITH THE SUPREME COURT'S VISION OF ARBITRATION

The Supreme Court has made clear that, although the FAA permits parties to contract for any arbitral procedures they like (including a replication of the Federal Rules of Civil Procedure),[286] federal policy favors arbitration because, by definition, arbitration represents a more streamlined, less formal, and cheaper method of dispute resolution than litigation.[287] These values, in turn, are deemed to be incompatible with class arbitration, which requires more formal procedures to bind absent parties, involves public proceedings, and forces the parties to choose between arbitrators with industry expertise and arbitrators with procedural expertise.[288] Class arbitration also fits poorly within the FAA scheme because its high stakes make procedural informality and lack of appellate review particularly risky.[289]

But these benefits of arbitration cannot be advanced in corporate disputes because corporate law is organized around the principle that the corporation is a collective entity, with directors atop the hierarchy. Intracorporate litigation, concerning the scope of directors' governance powers, necessarily implicates the rights of all stockholders in the corporation. These disputes concern a single res—the corporation—in which all stockholders have stakes, and are thus incompatible with the procedural informality and default confidentiality of arbitral proceedings.

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281. DEL. CODE ANN. tit. 8, § 202.

282. *Id.* § 242(b)(2).

283. *Id.* § 262.

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

285. This is also an issue that plagues the application of the FAA to ordinary contracts. *See* Aragaki, *supra* note 81. But because the corporate form cannot exist spontaneously—it requires the cooperation and definition of the state—the problem is particularly acute.

286. *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011).

287. *See supra* Part I.B; *see also* CARBONNEAU, *supra* note 54, at 3.

288. *See supra* Part I.B. This is not to say that parties cannot contract for class arbitration; they certainly can. *See* Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064 (2013). It is simply that class arbitration does not fulfill the substantive goals that are part of the "liberal federal policy favoring arbitration agreements." Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

289. *Concepcion*, 563 U.S. 333; *see also* Brunet, *supra* note 40, at 8; Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 158 (2002) (discussing the value of arbitral privacy).

Derivative actions in particular illustrate the problem. In these cases, the plaintiff-shareholder forces the corporation to bring a claim it otherwise would have forgone, thus "wrest[ing] governance control from the corporate entity itself in order to prosecute a lawsuit on the firm's behalf."[290] Because the plaintiff-shareholder steps in management's shoes to bring the claim, such actions are tightly controlled by the judiciary to protect the interests of absent stockholders.[291] When the plaintiff alleges that the directors or officers breached their fiduciary duties to the corporation,[292] the court is necessarily adjudicating rights in a property in which all shareholders have an interest and simultaneously evaluating defendants who are legally accountable to the shareholders. Derivative actions therefore are not individual adjudications, which is precisely why courts have struggled with determining the res judicata rules to apply to derivative plaintiffs.[293]

Claims brought directly, rather than derivatively, present similar problems. For example, a claim that a poison pill improperly limits shareholders' voting rights requires consideration of and action upon the rights of all shareholders. A claim of disclosure violations in connection with a proxy vote is meaningless when conducted on an individual basis; the harm to the shareholder comes from the influence of the false proxy materials on other shareholders. Indeed, in the face of a determination—arbitral or otherwise—that a director breached fiduciary duties by agreeing to inadequate merger consideration, it might be a further breach of fiduciary duty for the director to make reparation solely to a

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290. George S. Geis, *Shareholder Derivative Litigation and the Preclusion Problem*, 100 VA. L. REV. 261, 264 (2014).

291. For example, they cannot be settled with notice and judicial approval, in the same way Rule 23(b)(3) governs notice and settlement of federal class actions. *See* Off v. Ross, No. 3468-VCP, 2008 WL 5053448 (Del. Ch. Nov. 26, 2008); Shell, *supra* note 12, at 540. Absent stockholders can object to derivative settlements, and courts may reject them. *See, e.g.*, David S. Hilzenrath, *Fairchild Executives' Settlement Rejected; Judge Says Allegations Call for Better Terms for Investor Plaintiffs*, WASH. POST, May 19, 2005, at E.01.

292. Derivative claims that are not based on the directors' breaches of duty to the corporation are more complex. For example, in *Ernst & Young, LLP v. Tucker ex rel. HealthSouth Corp.*, 940 So. 2d 269 (Ala. 2006), the corporation had agreed to an arbitration clause in its contract with its auditors. Shareholders brought a derivative lawsuit on HealthSouth's behalf, alleging that the auditor had neglected its duties under the contract, and all parties agreed that the shareholders, suing derivatively, were bound by the arbitration clause. Unlike most derivative lawsuits, then, the subject of the litigation was not intracorporate; the directors' fiduciary performance was not the focus of the claim, and therefore absent shareholders had less of an interest in the proceedings. Nonetheless, the derivative form of action gave rise to the problem of shareholder-plaintiff-as-fiduciary. Though none of the parties in the *HealthSouth* case challenged arbitration, the court maintained its role as a protector of shareholder interests by appointing the initial plaintiff-shareholder and allowing the plaintiff to continue the action derivatively even over corporate objections.

293. *See* Geis, *supra* note 290, at 264–65. If courts too easily allow derivative proceedings to bind absent plaintiffs as res judicata, defendants may manipulate the process. *See id.* In the context of arbitration, these concerns are only heightened (assuming privacy and informality—the very aspects of arbitration that, according the Supreme Court, Congress sought to promote in the FAA). *See* Coffee, *supra* note 12, at 965–66.

single shareholder, while leaving the others remediless;[294] any additional payment would be deemed merger consideration and would have to be disclosed to the other shareholders, possibly necessitating a new round of proxy statements and even (in extreme cases) a new vote. The concept of an individual corporate governance claim is a contradiction in terms; as the Delaware Supreme Court put it, "[W]here the shareholder's individual interests are directly and equally implicated, as in proxy contests, the distinction between individual and representative claims may become blurred."[295] This is why, as described above, shareholders may bring claims for corporate misstatements without demonstrating personal reliance—in the corporate context, the fate of the corporation, and the value of its securities, rests in the whole.

These claims are therefore quite different from claims against a business that enters into separate contracts with different customers. In those cases, each contract represents an individual transaction, even if the contracts are identical. Although doctrines like nonmutual offensive estoppel might allow later plaintiffs to take advantage of earlier unfavorable rulings against a single defendant, adjudication on a one-to-one basis usually does not directly implicate the rights of other persons who signed a distinct (albeit indistinguishable) contract.[296]

This is not true of corporate disputes, as the *CommonWealth* cases make clear. Three separate groups of shareholders brought direct and derivative claims against CommonWealth and its trustees, challenging, among other things, the validity of CommonWealth's arbitration bylaw. After a Baltimore court ordered the first two groups into arbitration, a federal court in Massachusetts ruled that the validity of the arbitration bylaw was res judicata as to the third group of plaintiffs because "as shareholders of the Company seeking the same judicial remedy" they stood in privity with the earlier litigants, even as to claims

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294. *See In re* Sea-Land Corp. S'holders Litig., 642 A.2d 792, 799 n.10 (Del. Ch. 1993) ("[A]bsent an express agreement or statute to the contrary, all shares of stock are equal. Flowing from that premise is the rule that all shares of the same class or series are equally entitled to share in the profits of the corporation and in the distribution of its assets on liquidation." (citations omitted)). Individual *shareholders* may be treated differently—if they own a controlling block, for example, or launch a hostile takeover bid, *see id.*—but the shares themselves should receive equal treatment.

295. Tandycrafts, Inc. v. Initio Partners, 562 A.2d 1162, 1166 (Del. 1989). For this reason, a prevailing shareholder in a corporate governance dispute may be entitled to an award of attorneys' fees even if the claim was brought individually rather than as a class because the remedy for the claim necessarily confers a benefit on all shareholders. *See id.* at 1167. Proposals for arbitration of investor disputes typically go hand in hand with prohibitions on class actions. *See, e.g.*, The Carlyle Grp. L.P., Common Units Representing Limited Partner Interests (Form S-1) (Jan. 10, 2012); Google Inc., Proxy Statement (Schedule 14A) (May 9, 2012); Frontier Commc'n Corp., Proxy Statement (Schedule 14A) (Mar. 26, 2012); Allen, *supra* note 12, at 753. To the extent these proposals apply to intracorporate disputes, they are a contradiction in terms.

296. Among other things, there might be variations among consumers with respect to actual knowledge of the disputed terms, conditions under which the contracts were signed, expectations of the consumers, and the like. *Cf.* Ayres & Schwartz, *supra* note 194, at 550–51 (recognizing that consumers often have actual knowledge of boilerplate terms, obtained not by reading the contract, but by rumor, seller reputation, and other sources of information).

brought directly rather than derivatively.[297] Though the court did not address whether an arbitral award, as well, would be subsequently binding on all shareholders, the court's reasoning—that the shareholders stood in privity with each other and were equally bound by a single judicial decision—suggests it would, or at least should, which only highlights the necessity that such arbitrations be conducted publicly and with procedural protections to ensure that absent shareholders' interests are represented.

Even without res judicata, a purely private proceeding would hobble the interests of the remaining shareholders. They would be left without valuable information about the scope of the duties of the managers of their own corporation, thus adding additional uncertainty to attempts to price the terms of the governance contract.[298] Multiple lawsuits would not only damage the entity, in which all shareholders have an interest, with duplicative litigation, but would also potentially subject the corporation to conflicting mandates. In other words, it is meaningless to speak of disputes over a common governance structure as bilateral.

In this respect, intracorporate litigation might be usefully compared to Federal Rule of Civil Procedure 19, which requires joinder of parties where a "person's absence may as a practical matter impair or impede the person's ability to protect" his interest in the subject of the litigation,[299] or Federal Rule of Civil Procedure 23(b)(2), which creates a mandatory class action where "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole."[300] Though not all intracorporate cases require joinder of all stockholders as literal parties to the action, all cases do concern the rights that stockholders have in relation to a single res. Thus, adjudication requires attention to those absent interests, both in formality of procedure and publicity of proceedings, precisely as the Supreme Court has held to be fundamentally antithetical to arbitration.

Professors Coffee and Shell have previously advocated for the use of arbitration in derivative proceedings specifically, arguing that its lower costs, flexibil-

297. Del. Cnty. Emps. Ret. Fund v. Portnoy, No. 13-10405-DJC, 2014 WL 1271528, at *7 (D. Mass. Mar. 26, 2014). The direct claims in the second and third complaints were both brought as putative class actions, but the classes were never certified. Ordinarily there is no res judicata as to absent members of a class prior to class certification. *See* Smith v. Bayer Corp., 131 S. Ct. 2368 (2011).

298. *Cf.* Coffee, *supra* note 178, at 1667–68.

299. FED. R. CIV. P. 19.

300. FED. R. CIV. P. 23(b)(2). Intracorporate class actions are frequently certified under Delaware's equivalent of Rule 23(b)(2). *See In re* Celera Corp. S'holder Litig., 59 A.3d 418, 432–33 (Del. 2012). Intracorporate direct claims might also be compared to Federal Rule of Civil Procedure 23(b)(1), which also does not allow for individual opt-outs and was designed for situations where the defendant "is obliged by law to treat the members of the class alike." Benjamin Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356, 388 (1967).

ity, and speed would be beneficial to litigants.[301] Yet both have also recognized the necessity for states to provide protections to ensure procedural fairness, especially given the collective nature of corporate disputes.[302] This is, of course, precisely what the FAA would not permit.

Professor Shell also contends that the private nature of arbitration is not inconsistent with derivative claims because the fact that arbitration occurred, as well as its outcome, would be public knowledge, communicating information about fiduciary duties in the context of the dispute.[303] But even if this were sufficient to develop the law generally—a point discussed below[304]—it would hardly be sufficient to inform the real parties in interest—the shareholders themselves—of their rights under the corporate contract. Moreover, Professor Shell does not attempt to reconcile his argument that courts can develop procedural protections appropriate for the class context and conduct substantive review of arbitral proceedings and settlements to protect shareholders with his simultaneous recognition that arbitration is typically a private affair.[305] It is difficult to conceive of proceedings just public enough to allow the court to serve this role while still preserving the privacy that is valued in arbitration. Such a proceeding would certainly require regulation to accomplish,[306] yet the FAA places substantive limits on courts' abilities to review arbitral awards that do not take into account issues posed by representative arbitration and the need to protect absent parties. Thus, Professor Shell's argument illustrates the problem of attempting to graft the FAA, and its assumptions about arbitration and its benefits, onto corporate disputes.[307]

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301. *See* Coffee, *supra* note 12, at 957; Shell, *supra* note 12, at 565–70. Both Professors Coffee and Shell assumed that arbitration clauses would be contained only in corporate charters, where shareholders would at least have input or warning into their adoption. As discussed above, *see supra* Part IV.A, and as the *CommonWealth* cases demonstrate, the FAA may not allow for even that kind of restriction. At the very least, the FAA does not have a framework for that kind of analysis.

302. *See, e.g.*, Coffee, *supra* note 12, at 967 ("[T]he simple truth is that existing arbitration mechanisms were never designed to substitute for collective proceedings, such as the class or derivative action, in which the interests of numerous persons are aggregated."); Shell, *supra* note 12, at 559–60, 563. Hal Scott and Leslie Silverman have also advocated for arbitration clauses in corporate governance documents so long as they adhere to the rules of the American Arbitration Association. Scott & Silverman, *supra* note 12, at 1224. Once again, to the extent the FAA governs, there is no assurance that any particular rules would be used.

303. Shell, *supra* note 12, at 564.

304. *See infra* Part IV.C.

305. Professor Shell also lamented that state legislatures had only recently amended their codes to provide special treatment for close corporations as compared to public corporations—while simultaneously recognizing that close corporations have arbitrated disputes for decades. *See* Shell, *supra* note 12, at 527. One cannot help but suspect that the latter had something to do with the former. In other words, it is possible that the popularity of arbitration in close corporations prevented legislatures from recognizing the need for special rules applicable to the form.

306. *Cf.* Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377 (2011) (discussing how judges must probe the facts of a proposed settlement to determine fairness to shareholders).

307. Labor arbitration, like corporate disputes, involves adjudication in the context of a commonly shared resource (namely, a single collective bargaining agreement). It is likely for this reason that labor arbitration has more robust publication practices than other areas of law. *See* W. Mark C. Weidemaier,

C. ARBITRATION UNDER FAA RULES IS INCOMPATIBLE WITH A LEGAL SYSTEM DOMINATED BY COMMON LAW RULEMAKING

The corporate "contract" is not simply a private affair; it is one in which the state controls the terms via the judiciary.[308] When it comes to common law rulemaking, the law does not exist until announced by a court; it is a court's act of adjudicating a particular case that creates the law on the issue. Arbitrators cannot replicate this process even conceptually, because an arbitrator is not empowered by the state to create the law that will govern the corporate relationship.[309] To apply the FAA in this context is to require states to hand over lawmaking functions to private actors.

This is not to say that arbitration is categorically inappropriate for use in connection with corporate disputes. States might easily decide that a scheme of arbitration, properly regulated and coordinated with other mechanisms of decision making, is suitable for use in the corporate context. New York allows for the arbitration of disputes in close corporations[310] and Delaware allows for arbitration of disputes in LLCs—a form in which fiduciary duties are both waivable[311] and defined in large part by contract.[312] But if corporate governance documents are deemed contractual in the FAA sense, it would eliminate state flexibility on the issue.

To apply the FAA in this context also risks completely preempting and displacing states' ability to determine and develop their own law. Corporate common law depends on a steady stream of cases and scenarios being presented to the courts so that they can develop new approaches in response to changing conditions. If a significant number of cases are removed from the system, courts

Judging-Lite: How Arbitrators Use and Create Precedent, 90 N.C. L. REV. 1091, 1101 (2012). But the fact that labor organizations and employers have chosen this mechanism of dispute resolution (under an overarching, heavily regulated statutory regime) does not change the fact that inherently collective disputes are at odds with the private, low-stakes, procedurally informal values that the Supreme Court has held the FAA embodies.

308. Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1784 (2006) ("[T]he legislative preference [in Delaware corporate law] for flexibility and private ordering is ultimately dependent on what we believe to be a well-founded view that the courts will police overly opportunistic behavior on the part of those in control."); Lyman Johnson, *Dynamic, Virtuous Fiduciary Regulation* (Washington & Lee Legal Studies, Paper No. 2013-14, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2273869 ("In common law, of course, courts play an even more explicit law-making rather than merely a gap-filling, interpretive role. And recalling that fiduciary duties originate from the judicial exercise of equity jurisdiction, the legislative role on this subject is, generally, less significant than that of courts. This is particularly the case in Delaware."); Shell, *supra* note 12, at 537. Though states other than Delaware may appear to give greater power to the legislature to regulate corporate governance, in practice it is not clear that the courts have any less important a role in developing applicable standards. *See* Chandler & Rickey, *supra* note 20, at 111–22.

309. The Supreme Court implicitly recognized this fact in *Stolt-Nielsen*, criticizing the arbitral panel for behaving "as if it had the authority of a common law court to develop what it viewed as the best rule to be applied." 559 U.S. 662, 673–74 (2010).

310. Shell, *supra* 12, at 533.

311. DEL. CODE ANN. tit. 6, § 18-1101 (2015).

312. *See* Douzinas v. Am. Bureau of Shipping, Inc., 888 A.2d 1146, 1149–50 (Del. Ch. 2006).

will be hobbled in their attempts to properly adjudicate remaining disputes.[313] Granted, this is not a new critique; arbitration has often been criticized for interfering with courts' ability to engage in common law rulemaking.[314] In the context of corporate law, however, FAA preemption is particularly dangerous because common law dominates the landscape either by design or by the inherent indeterminacy of corporate fiduciary duties.[315] Indeed, given states' historical responsibility for the creation and regulation of the corporate form,[316] it would be particularly inappropriate to rely solely on the FAA's reference to contract to conclude that Congress intended to preempt states' main regulatory tool, namely, the private lawsuit.[317]

To be sure, many corporations might not choose arbitration, and institutional investors might exert enough pressure to prevent directors from adopting policies with which they disagree.[318] However, the CommonWealth example demonstrates that if directors can unilaterally adopt arbitration provisions at any time, directors who believe that arbitration would be more favorable to their interests may be willing to risk investor condemnation by hastily enacting such bylaws in order to gain an advantage in an anticipated lawsuit. It is impossible to know ex ante which way the axe will fall.

D. FAA ARBITRATION IS INCOMPATIBLE WITH THE SUBSTANTIVE REGULATORY ROLE OF CIVIL PROCEDURE IN THE CORPORATE GOVERNANCE CONTEXT

The indeterminate and flexible nature of corporate fiduciary duties gives rise to another phenomenon that is incompatible with FAA jurisprudence: the use of

313. Professor Shell contends that if corporate governance law can tolerate the settlement of claims, which generates no new precedent, it can also tolerate their arbitration. Shell, *supra* note 12, at 565; *see also* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991). But settlement requires the agreement of both sides of the dispute; if arbitration clauses can be inserted unilaterally into corporate bylaws, and invoked at will by the directors, directors will then have sole authority to decide which disputes to withhold from court review. Professor Shell assumed arbitration clauses would be contained in the corporate charter, where shareholders would have more input (or at least warning) as to their existence. *See* Shell, *supra* note 12, at 519. Moreover, even cases that settle often involve extensive litigation that does create precedent, such as opinions on a motion to dismiss, or on a motion for a preliminary injunction.

314. *See, e.g.*, Rex R. Perschbacher & Debra Lyn Bassett, *The End of Law*, 84 B.U. L. REV. 1, 31–33 (2004).

315. In many other areas of law—from ERISA to employment discrimination to consumer fraud—federal and state agencies elucidate parties' obligations either through rulemaking or enforcement actions.

316. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987).

317. *See* Bates v. Dow Agrosciences L.L.C., 544 U.S. 431, 449 (2005) ("In areas of traditional state regulation, we assume that a federal statute has not supplanted state law unless Congress has made such an intention clear and manifest.").

318. *See* Strine, *supra* note 162, at 13–14. Professors Coffee and Shell are skeptical that a significant number of corporations would choose arbitration if given the option; however, both also assumed that arbitration clauses could only be included in charters, where the provisions would have to either exist at inception or be approved by shareholders. Neither contemplated that directors could unilaterally require the arbitration of all disputes, let alone do so in the context of particular disputed transactions.

civil procedure as a tool of substantive regulation, reflecting the judiciary's integral role in constructing the corporate "contract."

Under Delaware law, there are few outright prohibitions or requirements regarding how managers conduct corporate affairs; instead, managers have discretion to structure transactions in a wide variety of ways. At the same time, Delaware encourages directors to adopt certain best practices. The carrot that managers are offered includes judicial deference if the transaction is challenged by shareholders, with an associated stick of expansive judicial review of transactions that appear to be disloyal or otherwise improper. In this manner, Delaware preserves the ability of directors to use their own judgment in determining the best interests of the corporation, while simultaneously providing a disincentive for directors to abuse their positions.

For example, there is no bar to directors or controlling shareholders approving corporate transactions in which they have a personal interest, so long as the transaction is fair to disinterested shareholders. However, when such transactions are challenged, courts conduct an in-depth review of the process by which the deal was arranged, and the price at which the deal was completed, in order to test the transaction's substantive fairness. This review usually cannot be conducted on the pleadings or even at summary judgment; it almost always requires a full record and a trial. Managers can, however, cleanse the transaction of the taint of self-dealing by having only disinterested directors approve the transaction, by requiring that a majority of disinterested shareholders approve it, or both. If the transaction is challenged in court, managers get a shift in the burden of proof, or a more deferential standard of review, which allows for the possibility of a quick dismissal with limited, if any, discovery. Thus, rather than directly regulate interested transactions, Delaware consciously encourages corporations to structure their transactions fairly with the promise of procedural benefits during litigation.[319]

Arbitration is incompatible with this scheme. Depending on the arbitral forum, there may be minimal or no procedures for summary relief[320] And the informality of arbitration, coupled with its idiosyncratic approach to discovery—the very features that the Supreme Court believes Congress intended to promote in the FAA—makes regulation-via-procedure an impossibility. Thus, if the FAA applies to corporate governance disputes, a key regulatory mechanism would be lost.[321]

319. *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014); *In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013).

320. For example, the rules of the International Chamber of Commerce—the rules specified by the Carlyle Group in its partnership agreements—have no such procedures. *See* INT'L CHAMBER OF COMMERCE, INT'L COURT OF ARBITRATION, ARBITRATION RULES, http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Rules-of-arbitration/ICC-Rules-of-Arbitration/.

321. Professors Coffee and Shell also contend that in the context of derivative litigation specifically, the requirement that a shareholder demonstrate that demand is excused—that is, demonstrate that the board is incapable of making an impartial determination whether to pursue the lawsuit on the corporation's behalf—may not translate, a matter that they either view as positive (Coffee) or neutral

The Supreme Court's FAA jurisprudence is built on the premise that arbitration simply represents an alternative procedural mechanism for enforcing the same substantive legal rights that the parties would otherwise have.[322] However, in the context of corporate law, procedure is substance.

CONCLUSION

The Supreme Court's FAA jurisprudence is built on theories of contract that do not accurately describe corporate theory. Contract law assumes that parties come to the bargaining table with the ability to advocate for and protect their own interests; corporate law assumes the opposite, and is fundamentally structured to minimize shareholder power.

This reality has been obscured by the fact that the protections of contract law to ensure true consent between the parties—such as the requirements of notice and affirmative manifestations of assent—have significantly eroded. Because contract law's protections against binding an unwilling party are so weak, many courts and commenters have assumed that the corporate governance arrangement—which does not contain such formal protections at all—must be built on the same foundation. As the above discussion demonstrates, however, in the corporate context, the protections against exploitation of one party—that is, shareholders—are not embodied in notice and assent requirements, but in the fiduciary obligations of directors. The erosion of contract law—while posing a significant problem for contract law theorists—cannot inform the specification of corporate directors' fiduciary duties. And because corporate law is premised on fiduciary obligations, it is, for FAA purposes, noncontractual.

This confusion between the two doctrines also threatens to distort other areas of corporate law as courts manufacture a vision of shareholder consent that validates corporate action divorced from director fiduciary duties. In cases like *Citizens United v. FEC*[323] and *Burwell v. Hobby Lobby Stores*,[324] the Supreme Court adopted a robust view of shareholder consent,[325] imagining that shareholders have both access to information and powers of control over corporate activities,[326] and that they have—and are legally permitted to express—

(Shell). *See* Coffee, *supra* note 12, at 958; Shell, *supra* note 12, at 553–54. In Professor Shell's view, corporations may rationally waive that protection to receive the benefits of arbitration. *See* Shell, *supra* note 12, at 554. But to the extent the demand excusal standards *substantively* encourage corporate directors to independently and fairly evaluate potential lawsuits (a matter open to some debate, *see* Coffee, *supra* note 12), its loss would again work a substantive change in the law.

322. *See* Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987).

323. 558 U.S. 310 (2010).

324. 134 S. Ct. 2751 (2014).

325. *Id*. at 2771.

326. *See* Paul S. Miller, *Shareholder Rights:* Citizens United *and Delaware Corporate Governance Law*, 28 J. L. & POL. 51, 77 (2012) ("[A]ccording to the *Citizens United* majority . . . corporate democracy is as robust as civil democracy and . . . suitable judicial remedies are equally available to dissident shareholders . . . ."); Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?:*

preferences beyond simple wealth maximization.[327] Such misunderstandings distort public policy to the extent policymakers depend on shareholders to exert control over corporate behavior, and justify corporate behavior as representing shareholders' will.

If the Supreme Court ultimately decides that arbitration clauses in corporate-governance documents must be enforced under the FAA, one cannot help but notice that Delaware would have hoisted itself on its own petard. It is generally believed that Delaware is extremely protective of its status as the dominant force in the market for corporate charters, and shapes its law accordingly.[328] By justifying fee-shifting bylaws and forum selection clauses as contractual, Delaware may have triggered an unintended consequence in opening the door to mandatory arbitration—which could then displace its courts as a source of law. In the extreme case, if private litigation is no longer under state control, states might have to develop alternative corporate regulatory systems. Alternatively, the displacement of state control might pave the way for more intrusive, and substantive, federal regulation.

That said, it is worth returning to the story of CommonWealth and the efforts of its trustees to shunt shareholders into an arbitral forum. The activist shareholders, rather than delay their takeover bid through a lengthy appeals process, dropped their lawsuit and submitted their dispute to arbitration as the court ordered. The arbitral panel held the trustees had violated the REIT's declaration of trust by limiting shareholders' ability to elect trustees of their choice, and allowed the activists to conduct a written solicitation of all CommonWealth shareholders to remove the trustees. In a vote that took place in March 2014, the trustees were ousted by an overwhelming 81 percent of the votes cast.[329]

Perhaps the CommonWealth example establishes that whatever concerns may exist about directors' self-interested use of arbitration, there are limits to directors' ability to use arbitration to avoid meritorious shareholder claims. Nonetheless, corporate law has always viewed self-interested decisions by directors with suspicion; there is no reason to treat an arbitration bylaw any differently, and the FAA should not be interpreted to command such a result.

The Tension Between Conservative Corporate Law and Citizens United, 100 CORNELL L. REV. 335, 340 (2015).

327. *See Hobby Lobby*, 134 S. Ct. at 2771.

328. Timothy P. Glynn, *Delaware's* VantagePoint*: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 98 (2008).

329. Robbie Whelan & Eliot Brown, *Challenge to REIT Prevails*, WALL ST. J., Mar. 19, 2014, at C8.