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Investing in Corporate Procedure

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ABSTRACT

Corporate litigation is in crisis. At the state level, shareholder lawsuits challenging mergers and other corporate decisions are ubiquitous but rarely end with meaningful relief for shareholders. At the federal level, securities class actions are rife with ethical challenges and low-value settlements. Over the last several decades, multiple groups—including judges, legislatures, and corporate boards—have tried to solve this problem, but all have come up short. This Article argues that the solution lies in rewriting the procedural rules that govern corporate lawsuits. New standing requirements would lead to better screening of these claims. Discovery limits and heightened pleading requirements would give defendants better tools to fight frivolous claims. All of these new procedures, if incorporated into corporate bylaws, would apply wherever the corporation is sued to address forum shopping, a common feature in these suits. Just as importantly, institutional investors should take the lead in crafting these procedures. They stand on both sides of these lawsuits and are therefore financially invested in ensuring that corporate lawsuits live up to their potential. It is their money on the line if corporate managers breach their fiduciary duties, but also their money on the line if corporations have to pay to defend against meritless litigation. The time has come for shareholders to invest in procedure to solve the enduring problems in corporate litigation.

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INTRODUCTION

Corporate litigation is in crisis. Once a key pillar of the law's efforts to control agency costs, corporate litigation is now roundly derided as a failed experiment.[1] In merger litigation, shareholder plaintiffs challenge nearly every significant merger and acquisition but too often settle these claims for nonmonetary consideration that offers little benefit to the shareholder class.[2] In derivative litigation a similar phenomenon exists, with shareholders frequently settling for modest relief that does not benefit plaintiff corporations.[3] And in securities class actions, a persistent crop of cases settles for nuisance amounts, while other suits raise complex ethical questions about the recruitment of shareholder clients.[4] There are bright spots—meritorious suits that return real value to shareholders—but overall, the outlook is bleak.

Shareholder litigation suffers from these problems because it differs from other forms of litigation in two important ways.[5] First, these suits have far

[1] *See* Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 852 (2016) (stating that the problems in shareholder litigation have reached "crisis proportions"); John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110 COLUM. L. REV. 288, 292 (2010) (discussing how problems in shareholder litigation "remain intractable despite repeated efforts by Congress and the courts to curb highly visible abuses"); James D. Cox, *How Understanding the Nature of Corporate Norms Can Prevent Their Destruction by Settlements*, 66 DUKE L.J. 501, 503 (2016) (stating that shareholder litigation "is very much a part of, if not now central to, the litigation-explosion debate").

[2] *See* Dias v. Purches, No. 7199VCG, 2012 WL 4503174, at *5 (Del. Ch. Oct. 1, 2012) (stating that after merger announcement, litigation "typically follow[s] like mushrooms follow the rain" and disclosure-only settlements "create a risk of excessive merger litigation, where the costs to stockholders exceed the benefits"); Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 559 (2015) ("Although deal litigation is pervasive, these lawsuits rarely result in a monetary recovery for the plaintiff class.").

[3] *See* Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1830 (2010) ("Mounting empirical evidence reveals that the vast majority of shareholder derivative suits do not benefit the corporations on whose behalf the suits are brought."); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 63 (1991) (presenting empirical evidence that parties often settled derivative suits in exchange for "cosmetic" corporate governance reforms and concluding that "[a] likely explanation" for these settlements "is the need to paper a record to justify an award of attorneys' fees to courts").

[4] *See* LAARNI T. BULAN, ELLEN M. RYAN & LAURA E. SIMMONS, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2016 REVIEW AND ANALYSIS 1, 4 (2016), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2016-Review-and-Analysis [https://perma.cc/XKC4-QWDH].

[5] Other forms of aggregate litigation, such as consumer class actions, can also suffer from these problems. *See, e.g.*, AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 336-37 (2011) (alleging each individual plaintiff's harm was roughly thirty dollars in class action brought against AT&T). In shareholder litigation, however, defendants can exit the litigation in a less

greater agency costs. In most lawsuits, the plaintiff directly controls his or her attorney. In shareholder litigation, however, most shareholder plaintiffs do not have sufficient economic incentives to closely monitor their attorneys.[6] As a result, these attorneys effectively control the litigation, allowing them to make litigation decisions that benefit themselves at the expense of their shareholder clients.[7] Second, shareholder litigation suffers from cost asymmetries.[8] In most cases, contrary to conventional wisdom, the parties' litigation costs are roughly equivalent.[9] In shareholder litigation, however, defendants' costs far exceed plaintiffs' costs.[10] As a result, plaintiffs' attorneys have strong incentives to file meritless suits, and the defendants have equally strong incentives to settle.

The legal system has long tried to solve these problems. In the 1990s, Congress overhauled the rules governing securities class actions,[11] but its efforts did too little to preserve meritorious cases and not enough to stamp out meritless ones.[12] More recently, states deputized corporate directors to adopt new procedural rules to govern these lawsuits,[13] but directors are typically among the

costly manner by offering nonmonetary consideration in exchange for a settlement. As discussed below, this option, which is not available in most types of class actions, exacerbates the problems in shareholder litigation.

[6] *See* Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 19 (1991) (arguing high agency costs in class action and derivative litigation primarily are due to the inability of the class to effectively monitor attorneys).

[7] *See* James D. Cox & Randall S. Thomas, *Corporate Darwinism: Disciplining Managers in a World with Weak Shareholder Litigation*, 95 N.C. L. REV. 19, 22 (2016) ("[T]he benefits created by [shareholder litigation] are qualified by the litigation agency costs that surround them.").

[8] *See* Jessica Erickson, *Heightened Procedure*, 102 IOWA L. REV. 61, 71 (2016) ("Meritorious or not, however, these cases are profitable for plaintiffs' lawyers for at least two reasons, both having to do with cost asymmetries.").

[9] The data does not support the oft-repeated claim that discovery costs are out of control across the board. For example, in 2009, the Federal Judicial Center found that most attorneys in the study stated that they thought the amount and costs of discovery in their cases was "just the right amount." *See* CASE EMERY G. LEE, III & THOMAS E. WILLGING, FED. JUDICIAL CTR., CASE-BASED CIVIL RULES SURVEY: PRELIMINARY REPORT TO THE JUDICIAL CONFERENCE ADVISORY COMMITTEE ON CIVIL RULES 1-2, 28 (2009), https://www.fjc.gov/sites/default/files/materials/08/CivilRulesSurvey2009.pdf [https://perma.cc/XZC4-FR6Y] (providing costs of litigation statistics for plaintiffs and defendants).

[10] *See* Erickson, *supra* note 8, at 71 ("[A]lmost all discovery [in shareholder litigation] is in the hands of the defendants.").

[11] *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.).

[12] *See* Section I.A (describing shortcomings of shareholder litigation).

[13] *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014) (validating authority of corporations to adopt fee-shifting provisions in bylaws for unsuccessful plaintiffs in intracorporate litigation); *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (discussing Delaware statute authorizing corporations to enact limits on powers of

defendants in shareholder lawsuits, and therefore they drafted procedural rules that reflect this bias.[14] And more recently, Delaware judges tried to take back control over these cases by more closely scrutinizing low-value settlements,[15] but their efforts only emboldened plaintiffs' attorneys to file their cases in other jurisdictions.[16] In sum, various groups have tried to fix the problems in shareholder litigation, but their efforts have all come up short.

This Article argues that the solution lies in rewriting the procedural rules that govern shareholder litigation. Procedure is typically transsubstantive, which means that the same rules apply in all civil cases.[17] Yet, in practice, civil litigation is not one size fits all, and other types of cases do not suffer from the problems that wreak such havoc in shareholder litigation.[18] Given these unique problems, it makes sense to have unique procedural rules for this subset of cases.

Corporate law has experimented with procedural reform in modest ways,[19] but it has not taken advantage of the full panoply of available options. The field

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shareholders that are not contrary to Delaware law).

[14] *See, e.g.*, Mark Lebovitch & Jeroen van Kwawegen, *Of Babies and Bathwater: Deterring Frivolous Stockholder Suits Without Closing the Courthouse Doors to Legitimate Claims*, 40 DEL. J. CORP. L. 491, 515-16 (2016) (discussing negative implications for shareholders resulting from director-imposed fee shifting provisions in shareholder litigation).

[15] *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 896 (Del. Ch. 2016) ("Given the rapid proliferation and current ubiquity of deal litigation, the mounting evidence that supplemental disclosures rarely yield genuine benefits for stockholders, the risk of stockholders losing potentially valuable claims that have not been investigated with rigor, and the challenges of assessing disclosure claims in a nonadversarial settlement process, the Court's historical predisposition toward approving disclosure settlements needs to be reexamined.").

[16] *See, e.g.*, Sean J. Griffith, *Private Ordering Post-*Trulia*: Why No Pay Provisions Can Fix the Deal Tax and Forum Selection Provisions Can't*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES 292, 293 (Steven Davidoff Solomon & Randall S. Thomas eds., 2017) ("The stampede of filings to alternative jurisdictions can plausibly be explained by the plaintiffs' bar's reaction to *Trulia* and to the cases leading up to it.").

[17] *See* FED. R. CIV. P. 1 ("These rules govern the procedure in all civil actions and proceedings in the United States district courts, except as stated in Rule 81."); *see also* Paul D. Carrington, *Making Rules to Dispose of Manifestly Unfounded Assertions: An Exorcism of the Bogy of Non-Trans-Substantive Rules of Civil Procedure*, 137 U. PA. L. REV. 2067, 2080-81 (1989) ("Generalism in civil procedure is, in the Anglo-American tradition, about a century older than the Federal Rules . . . .").

[18] *Cf.* Erickson, *supra* note 8, at 63 (explaining that "[t]he challenges of prisoner litigation are different from the challenges of securities class actions, which are different still from the challenges of medical malpractice and patent cases").

[19] Specifically, a significant number of companies have experimented with two types of procedural private ordering: forum selection provisions and fee-shifting provisions. A handful have tried a few other types, including minimum ownership requirements and arbitration provisions. Other types, such as customized pleading standards or discovery rules, have been largely absent from corporate governing documents. *See, e.g.*, Jonathan G. Rohr, *Corporate Governance, Collective Action and Contractual Freedom: Justifying Delaware's New Restrictions on Private Ordering*, 41 DEL. J. CORP. L. 803, 805 (2017) (describing how "some

of civil procedure offers specific solutions to the problems of agency costs and cost asymmetries seen in shareholder litigation. When it comes to agency costs, forum selection clauses can keep these cases under the eyes of watchful judges, especially if they are not waivable by corporate boards. Similarly, new standing requirements can ensure that the shareholders who bring these cases have a real financial interest in their outcome. When it comes to cost asymmetries, heightened pleading requirements can require shareholders to put their cards on the table before proceeding to discovery, while cost shifting can provide a more equitable distribution of litigation expenses.

Identifying the right procedural solutions, however, is only one piece of the puzzle. It is equally important to identify *who* will push for these reforms, given the long history of failed reform efforts in this area. This history reveals that most groups are unlikely to advocate for the right procedural reforms. This void presents an opportunity for a new group—institutional investors—to take the lead by amending corporate bylaws to include new procedures that would govern these cases. Institutional investors have the right financial incentives to adopt these procedures because they stand on both sides of shareholder lawsuits. It is their money on the line if corporate managers breach their fiduciary duties, but also their money on the line if corporations have to pay to defend against meritless litigation.[20] Many are also involved in activism efforts and understand the value of litigation in controlling managerial behavior. In short, they stand alone in having the right financial incentives and organizational structure to tackle these problems.

Advocating for procedural reform would be a new form of activism for institutional investors, but they would not need to embark on it alone. Indeed, although shareholders can technically amend corporate bylaws on their own,[21] the dispersed ownership at most public companies makes doing so extremely difficult.[22] Instead, institutional investors should partner with corporate boards and other relevant stakeholders to draft procedural rules that are then incorporated into a corporation's bylaws. This approach circumvents many of

Delaware corporations began to experiment with so-called 'private-ordering solutions' to escape the[] abusive practices" in shareholder litigation, including specifically forum selection bylaws and fee-shifting bylaws).

[20] *See, e.g.*, Verity Winship, *Shareholder Litigation by Contract*, 96 B.U. L. REV. 485, 494 (2016) ("What is special about shareholder litigation—and differentiates it from consumer litigation—is that in some sense, shareholders are always on both sides of the litigation. . . . One consequence of this feature is that shareholders may benefit from some limitations on shareholder litigation.").

[21] DEL. CODE ANN. tit. 8, § 109(b) (2019) ("After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.").

[22] *See, e.g.*, Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CAL. L. REV. 373, 377 (2018) ("Within the context of the New Governance, the board's power to adopt and amend bylaw provisions may, for a variety of reasons, be greater than the shareholders' power to do so.").

the practical difficulties of a shareholder-led approach, while also addressing the potential biases of other constituencies. In short, institutional investors are uniquely positioned to be thought leaders in this area, investing in a new approach to corporate procedure.

This path to reform would help solve the problems in shareholder litigation, but it does raise complex legal questions regarding the authority of shareholders and corporate boards. This authority likely depends on whether the lawsuit is filed under state or federal law. Under state law, which governs nearly all shareholder derivative suits and many merger class actions, corporations likely have broad power to rewrite procedural rules. Delaware, in particular, is quite accommodating of private ordering in this area.[23] Under federal law, which governs securities class actions, however, there is less flexibility to change these rules.[24] This Article is thus intended as a thought experiment, exploring the possibilities of procedural private ordering, while recognizing that, under current state and federal law, corporations may not have the freedom to adopt every variant of these rules.

This Article proceeds in three parts. Part I describes the current crisis in shareholder litigation as well as the problems that gave rise to this crisis. Part II explains how procedure can address these problems, describing both why procedural reform is the right approach and exploring specific procedural solutions. Part III explores why institutional investors are the right group to take the lead in developing these new procedures. The time has come for institutional investors to bring their stake in corporate America to bear in rewriting corporate procedure.

I. THE FAILURE OF SHAREHOLDER LITIGATION

Shareholder litigation is a key weapon in the law's arsenal to control managerial agency costs. Corporate law has traditionally given shareholders only three avenues to control agency costs: they can vote on select corporate decisions, sell their stock, and sue the corporation and its managers for legal violations.[25] While the first two rights remain relatively strong,[26] the right to sue

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[23] *See infra* Section III.C.

[24] *See infra* Section III.C.

[25] *See* Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 LAW & CONTEMP. PROBS. 215, 216 (1999) ("Shareholders have only a limited role: They can vote, sell, or sue.").

[26] This does not mean that the right to vote and the right to sell are perfect, however, as many scholars have noted. *See, e.g.*, David F. Larcker, Allan L. McCall & Gaizka Ormazabal, *Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J.L. & ECON. 173, 174 (2015) ("Like many instances of voting by a dispersed base, shareholder voting is subject to free-rider problems because any individual shareholder receives only a small fraction of the benefit from casting a correct vote, but it bears the full cost of researching matters subject to vote."); Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 384 (2004) (explaining that while "opportunistic behavior in public corporations may be

has come under increasing criticism. This Part first explains the widespread problems with shareholder litigation before turning to the economic and institutional incentives that explain these problems.

A. *How It Failed*

The world of shareholder litigation is diverse, offering an array of options to hold corporations and their managers accountable for misdeeds. The focus here is on the three main litigation options under state and federal law. First, under state law, shareholders can file a class action in connection with a merger or acquisition if they believe that the merger price was too low or the merger disclosures were inadequate.[27] Second, also under state law,[28] shareholders can file a derivative suit if the corporation was directly hurt by its directors' or officers' breach of fiduciary duty.[29] Finally, under federal law, shareholders can file a securities class action to challenge a corporation's misstatements to the market.[30] As this Section explains, these three types of lawsuits have each experienced a high proportion of low-value settlements, although these settlements look different in the three different areas.

1. Merger Class Actions

By almost any measure, merger class actions are in disarray. Over the last ten years, the number of suits challenging mergers and acquisitions skyrocketed. In 2007, shareholders challenged forty-four percent of large mergers and acquisitions in court.[31] By 2014, the percentage had increased to ninety-three

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constrained by the market; by definition, close corporations lack a market, and therefore lack this monitor" (footnote omitted)).

[27] *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 891 (Del. Ch. 2016) ("Today, the public announcement of virtually every transaction involving the acquisition of a public corporation provokes a flurry of class action lawsuits alleging that the target's directors breached their fiduciary duties by agreeing to sell the corporation for an unfair price.").

[28] In rare instances, shareholders can bring federal claims derivatively, but derivative suits more commonly include state claims. *See* Erickson, *supra* note 3, at 1774 ("[M]ore than 30 percent of the derivative complaints filed on behalf of public companies alleged a claim under the federal securities laws, under either section 10(b) or 14(a) of the Securities Exchange Act of 1934.").

[29] *See* Agostino v. Hicks, 845 A.2d 1110, 1116 (Del. Ch. 2004) ("Recognizing, however, that directors and officers of a corporation may not hold themselves accountable to the corporation for their own wrongdoing, courts of equity have created an ingenious device to police the activities of corporate fiduciaries: the shareholder's derivative suit.").

[30] *See* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2401 (2014) (holding that investors can recover damages in a private securities class action "if they prove that they relied on the defendant's misrepresentation in deciding to buy or sell a company's stock").

[31] *See* RAVI SINHA, CORNERSTONE RESEARCH, SHAREHOLDER LITIGATION INVOLVING ACQUISITIONS OF PUBLIC COMPANIES: REVIEW OF 2015 AND 1H 2016 M&A LITIGATION 1 (2016), https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involvin

percent.[32] Whatever one may think of corporate directors, it is hard to imagine that they breach their fiduciary duties in nearly every significant merger and acquisition.

This influx of litigation has harmed shareholders. Nearly all of these cases are dismissed or settle,[33] and shareholders almost never receive any monetary consideration in these settlements. Instead, in eighty percent of these settlements, the primary consideration was additional disclosures about the merger.[34] Although such disclosures could theoretically be beneficial, empirical research shows that they almost never change the outcome of the shareholder vote on the merger.[35] If the information disclosed is truly material in informing shareholders about previously undisclosed problems with the merger, it should result in a smaller percentage of shareholders voting in favor of the merger.[36] The fact that this new information does not impact how shareholders vote strongly suggests that these settlements do not benefit shareholders.[37]

As a result, these suits have faced a storm of criticism from nearly all of the players involved. The Delaware Court of Chancery acknowledged that "far too often such litigation serves no useful purpose for stockholders, . . . serv[ing] only to generate fees for certain lawyers."[38] Prominent plaintiffs' attorneys Mark Lebovitch and Jeron van Kwawegen publicly acknowledged that the "real problem" results from "the percentage of these stockholder lawsuits that achieve little, if anything, for stockholders, while giving away overbroad liability releases for corporate defendants and paying both plaintiffs' and defendants'

g-Acquisitions-2016.pdf [https://perma.cc/6ET4-YPDU] (showing percentage of mergers and acquisition deals challenged by shareholders).

32 *See id.*

33 *See id.* at 4 ("Unlike prior years, settlements in 2015 accounted for less than half of all litigation outcomes.").

34 *See* Olga Koumrian, Cornerstone Research, Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2014 M&A Litigation 1 (2015), https://www.cornerstone.com/Shareholder-Litigation-Involving-Acquisitions-2014-Review [https://perma.cc/HF8Y-PRWP] ("Similar to prior years, almost 80 percent of settlements reached in 2014 provided only additional disclosures. Just six settlements [out of 78] involved payments to shareholders.").

35 *See* Fisch, Griffith & Solomon, *supra* note 2, at 561 ("[D]isclosure-only settlements do not appear to affect shareholder voting in any way.").

36 *See id.* at 575-76 ("[I]t seems clear that for supplemental disclosures to be meaningful, they must have a negative impact on shareholder voting in favor of the merger.").

37 Despite this finding, however, disclosure-only settlements are still profitable for plaintiffs' attorneys, with median fees of $500,000 in 2013. *See* Olga Koumrian, Cornerstone Research, Settlements of Shareholder Litigation Involving Mergers and Acquisitions: Review of 2013 M&A Litigation 3 (2014), https://www.cornerstone.com/Publications/Reports/Settlements-of-M-and-A-Shareholder-Litigation [https://perma.cc/X3D3-9BBZ].

38 *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 892 (Del. Ch. 2016).

lawyers."[39] Other commentators stated that these suits represent a "transaction tax,"[40] "clogging the courts and increasing transaction costs for no reason."[41] Far from being an effective tool for constraining managerial agency costs, merger class actions serve as an example of a litigation failure.

2. Derivative Suits

While the problems in merger litigation have increased exponentially over the past several years, similar problems have plagued derivative suits for decades.[42] The earliest study of derivative suits was conducted in New York in 1944.[43] This study concluded that the "great preponderance" of derivative suits were "unfounded and speculative."[44] More recent studies have reached similar conclusions, with one calling derivative suits a "weak, if not ineffective, instrument of corporate governance"[45] and another noting the "problematic role that these suits continue to play in corporate law."[46]

The reason for this criticism is nearly identical to the reason for the criticism of merger litigation—both types of suits rarely end with monetary settlements. While disclosure-only settlements are common in merger cases, derivative suits frequently end with the plaintiff corporation agreeing to make changes to its corporate governance practices in exchange for dismissal of the suit.[47] In theory, like the disclosure-only settlements in merger litigation, these settlements could be valuable for corporations and their shareholders, but the reality is much more bleak. Corporations frequently agree to very modest reforms that bear little connection to the allegations in the complaint and are unlikely to enhance shareholder value.[48] Although there are bright spots among this criticism,[49] the

[39] Lebovitch & van Kwawegen, *supra* note 14, at 494.

[40] Browning Jeffries, *The Plaintiffs' Lawyer's Transaction Tax: The New Cost of Doing Business in Public Company Deals*, 11 BERKELEY BUS. L.J. 55, 56-59 (2014).

[41] Fisch, Griffith & Solomon, *supra* note 2, at 591.

[42] *See* Jessica Erickson, *The (Un)Changing Derivative Suit*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 58, 66 (Sean Griffith et al. eds., 2018) ("[T]he more fundamental problem of derivative suits ending with low-value settlements that do not benefit corporations or their shareholders has been a persistent problem for many decades.").

[43] *See* FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS (1944).

[44] *Id.* at 9.

[45] *See* Romano, *supra* note 3, at 84.

[46] *See* Erickson, *supra* note 3, at 1755.

[47] *See id.* at 1754 ("[S]hareholder derivative suits more commonly end with the parties agreeing to corporate governance settlements.").

[48] *See id.* at 1755 ("[C]orporate governance settlements often fail to live up to their potential because they include reforms that are unlikely to benefit corporations or their shareholders.").

[49] *See id.* at 1758-59 (explaining how derivative suits filed in connection with backdating of stock options end with more favorable settlements for plaintiff corporations than derivative

empirical record demonstrates that derivative suits share many of the same problems that plague merger litigation.

These suits also reward attorneys in much the same way. As with merger litigation, plaintiffs' attorneys are entitled to fees from the corporation if the case confers a benefit on the represented parties, even if the relief is non-monetary.[50] Again, in theory, this rule makes sense—if the case confers a benefit on the corporation, the attorneys should be compensated, regardless of the precise nature of the relief. In practice, however, courts do little to ensure that the relief is in fact meaningful to the corporation or the class.[51] As one commentator has stated, the ultimate result is that "attorneys now churn a mass of filings and settlements," resulting in "overcompensation of attorneys (on both sides) and systematic under-compensation of the plaintiff class."[52]

3. Securities Class Actions

On their face, securities class actions look quite different from merger class actions and derivative suits. First, and perhaps most notably, securities class actions rarely end with nonmonetary settlements.[53] In fact, in 2017 the median settlement in securities class actions was $5 million, and it is not unusual for settlements to exceed $100 million.[54] Second, unlike both merger class actions and derivative suits, securities class actions have received their fair share of major legislative attention. In 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA"), overhauling the law governing securities

suits with other types of allegations); Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747, 1749, 1762 (2004) (reviewing derivative suits filed in the Delaware Court of Chancery and concluding that "[c]ontrary to earlier studies, we do not find evidence that these cases are 'strike suits' yielding little benefit").

[50] *See* Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees*, 56 B.C. L. REV. 1, 22-23 (2015) (discussing corporate benefit doctrine's requirements).

[51] *See id.* at 5 ("This analysis reveals courts' current application of the corporate benefit doctrine as the principal enabler of the systemic overcompensation of lawyers and under-compensation of plaintiffs.").

[52] *See id.* at 2.

[53] This trend may be changing. The recent crackdown on merger litigation in state court has prompted many plaintiffs' attorneys to repackage their claims as securities class actions with the hope that the nonmonetary settlements rejected in state court will pass muster in federal court. *See, e.g.*, Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV 603, 633 (2018) ("Many of the same plaintiffs' law firms that file deal litigation also are major players in bringing derivative lawsuits and federal securities class actions.").

[54] *See* LAARNI T. BULAN, ELLEN M. RYAN & LAURA E. SIMMONS, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2017 REVIEW AND ANALYSIS 5 (2017), http://securities.stanford.edu/research-reports/1996-2017/Settlements-Through-12-2017-Review.pdf [https://perma.cc/C2XG-ABV2].

class actions.[55] The PSLRA imposed new procedural hurdles and made the substantive law more stringent in a variety of ways. As a result, it is now far more difficult for plaintiffs to prevail in these suits.

Digging into the data, however, the PSLRA did not solve all of the problems in securities class actions. First, the PSLRA did not eliminate nuisance suits. More than a quarter of the settlements in securities class actions are for less than two million dollars—one commonly used cutoff for nuisance settlements in this area.[56] Second, there is a longstanding concern among scholars that the PSLRA may bar many meritorious claims. The PSLRA includes heightened pleading standards that require courts to dismiss any complaint that does not allege facts creating a "strong inference" that the defendant acted with an intent to defraud.[57] This standard is extremely difficult to meet without prior hard evidence of fraud, such as a restatement or Securities and Exchange Commission ("SEC") investigation.[58] As a result, the PSLRA made it harder for shareholders to file both meritorious and nonmeritorious claims alike.

Additionally, the PSLRA led to an array of new ethical challenges. It created a presumption that the lead plaintiff should be the shareholder applicant with the largest financial stake in the litigation.[59] Congress added this presumption to enhance the role of institutional investors in these suits, with the hope that these investors would both better screen cases and negotiate lower fees with class counsel.[60] In practice, however, the institutional investors who serve as lead plaintiffs are often public pension funds, which are typically controlled by political officials.[61] As a result, the PSLRA's lead plaintiff provisions created an incentive for law firms to make campaign contributions to these officials to

[55] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.).

[56] BULAN, RYAN & SIMMONS, *supra* note 4, at 5.

[57] 15 U.S.C. § 78u–4(b)(2)(A) (2012).

[58] *See, e.g.*, Stephen J. Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, 23 J.L. ECON. & ORG. 598, 601 (2007) (discussing PSLRA's high pleading standard).

[59] 15 U.S.C. § 78u–4(a)(3)(B)(iii)(l)(bb) ("[T]he court shall adopt a presumption that the most adequate plaintiff in any private action arising under this chapter is the person or group of persons that . . . in the determination of the court, has the largest financial interest in the relief sought by the class . . . .").

[60] *See* Elliott J. Weiss, *The Lead Plaintiff Provisions of the PSLRA After a Decade, or "Look What's Happened to My Baby,"* 61 VAND. L. REV. 543, 547, 552-53 (2008) ("[I]nstitutional investors that have sought appointment as lead plaintiff generally have negotiated fee arrangements with the law firms . . . for percentage fees far lower than had been the norm prior to passage of the PSLRA. Many institutional lead plaintiffs also have actively monitored class actions in which they have served as lead plaintiff . . . ." (footnote omitted)).

[61] *See id.* at 552 (stating most lead plaintiff institutional investors are public or union pension funds).

secure their appointment as class counsel.[62] Empirical studies demonstrate that the firms that make these contributions receive higher attorneys' fees, suggesting that pension funds may negotiate less over fees if campaign contributions are on the line.[63]

Stepping back, the data reveals that all three types of shareholder lawsuits—merger litigation, derivative suits, and securities class actions—frequently end with low-value settlements that offer little benefit to shareholders. As a result of Congress's efforts to crack down on meritless claims in the PSLRA, securities class actions perform slightly better than their state law counterparts, but these efforts led to new, unanticipated problems. In the end, if shareholder litigation is supposed to be the cornerstone of the law's efforts to constrain corporate misconduct, it is falling far short of this goal.

B. *Why It Failed*

At first glance, this state of affairs is perplexing. Why do shareholders bother to file lawsuits that they are willing to settle for so little? And, if these claims do not have merit, why are defendants so willing to settle them? The answer lies in the unique incentives of shareholder litigation. As this Section explains, these suits suffer from significant agency costs because many shareholder plaintiffs do not have a large enough financial stake in the litigation to closely monitor their attorney. Additionally, the costs of these suits fall disproportionately on defendants, which makes them willing to settle even those claims they think they can win. These dynamics explain the seemingly counterintuitive litigation decisions that plague this area.

1. Agency Costs

A foundational principle of the American litigation system is that clients, not their attorneys, should make major litigation decisions.[64] Shareholder litigation is an exception to this principle because these lawsuits are not controlled by the real parties in interest. Instead, these suits are controlled by a shareholder

[62] *See* Stephen J. Choi, Drew T. Johnson-Skinner & A. C. Pritchard, *The Price of Pay to Play in Securities Class Actions*, 8 J. EMPIRICAL LEGAL STUD. 650, 651 (2011) ("The political influence over these funds raises the question of whether law firms are making campaign contributions to politicians to enhance their chances of being selected to represent the funds.").

[63] *See id.* ("State pension funds whose managers have received campaign contributions . . . appear to be less vigorous in negotiating attorney fees."); *see also* Drew T. Johnson-Skinner, *Paying-to-Play in Securities Class Actions: A Look at Lawyers' Campaign Contributions*, 84 N.Y.U. L. REV. 1725, 1750 (2009) ("[D]ata confirms that plaintiff's law firms are contributing to the pension funds that select them as counsel.").

[64] *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 677 (1986) ("In theory, a fundamental premise of American legal ethics is that clients, not their attorneys, should define litigation objectives.").

representative, who acts on behalf of the shareholder class in merger and securities class actions and on behalf of the plaintiff corporation in a derivative suit.[65] The representative nature of these suits means that the real parties in interest are not directly involved in the litigation and are therefore limited in their ability to monitor it.

Corporate law attempts to solve this problem by entrusting shareholder plaintiffs to monitor the lawsuits on behalf of the larger shareholder class.[66] Yet these shareholders often do not own a large enough stake in the corporation to justify the costs of closely monitoring the litigation.[67] A shareholder with only one hundred dollars at stake in the litigation will not take the time to delve into the details to ensure that the attorneys are acting in the best interests of the class.

This reduced monitoring impacts shareholder lawsuits in two related ways. First, on the front end, attorneys can file lawsuits that may not be in their clients' best interests.[68] These lawsuits may be financially lucrative for the plaintiffs' attorneys, even though they do not ultimately benefit the shareholders or the plaintiff corporation. Second, on the back end, if shareholders are not monitoring the litigation, it opens the door for attorneys to seek a higher fee.[69] Plaintiffs' attorneys may be able to structure a settlement that maximizes their return, even if it does not maximize the return to shareholders.

These agency costs explain many of the problems described above, starting with the prevalence of nonmonetary settlements in merger and derivative suits. Shareholders receive little benefit from these settlements, as empirical studies have documented,[70] yet they are remarkably lucrative for plaintiffs' attorneys,

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[65] *In re* Citigroup, Inc. S'holder Derivative Litig., 964 A.2d 106, 117 (Del. Ch. 2009) ("A shareholder plaintiff in a derivative suit alleges claims in the right of the corporation rather than directly . . . ."); *In re* Countrywide Corp. S'holder Litig., C.A. No. 3464-VCN, 2009 WL 846019, at *13-15 (Del. Ch. Mar. 31, 2009) (presenting framework to ensure that the shareholder plaintiff is an adequate representative of shareholder class in a merger class action).

[66] *See* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5, 49 (1985).

[67] *See id.*

[68] *See* Macey & Miller, *supra* note 6, at 20-21.

[69] Tim Oliver Brandi, *The Strike Suit: A Common Problem of the Derivative Suit and Shareholder Class Action*, 98 DICK. L. REV. 355, 389 (1994) (arguing that interests of shareholder plaintiffs and their attorneys "may conflict since the fee award comes out of the damage recovery so that any increase in the fee award necessarily leads to a decrease in plaintiffs' recovery").

[70] *See* Erickson, *supra* note 3, at 1830 ("As my study reveals, . . . shareholders agree to settle shareholder derivative suits in exchange for corporate governance reforms that are often untested and/or patently unhelpful for both the corporations and their sharholders."); Romano, *supra* note 3, at 63 ("While it is impossible to value the benefits from structural settlements with any precision, the gains seem inconsequential.").

with six-figure fee awards as the norm.[71] The financial incentives favor these types of settlements because plaintiffs' attorneys profit from them and shareholder plaintiffs do not have enough of a financial stake in the litigation to make it worth their while to protest.

Agency costs also help explain the pervasiveness of other types of nuisance settlements. Low-dollar settlements, which are seen in a sizable minority of securities class actions, benefit plaintiffs' attorneys, often at the expense of their shareholder clients. As many scholars have explained, shareholders are harmed by nuisance settlements because they often remain an investor in the target corporation. As a result, any money they receive in the settlement comes out of their investment in the corporation, creating a circularity problem that has been well documented in corporate scholarship.[72] If these suits deter future misconduct by corporate managers, the suits may benefit shareholders despite this circularity, but meritless claims have little, if any, deterrent effect.[73] As a result, suits that are filed for their nuisance value benefit attorneys, but they are unlikely to benefit shareholders. As Professor John Coffee, Jr. stated, the dynamic of "high agency costs make plaintiff's attorneys independent entrepreneurs."[74]

Agency costs, however, are only one piece of the puzzle. They explain why shareholder representatives do not closely monitor these cases, but not why defendants agree to settle them. As we will see, cost asymmetries fill in this part of the story.

2. Cost Asymmetries

The legal system provides multiple opportunities for defendants to contest meritless claims, from motions to dismiss, to summary judgment, and to trial.[75] These opportunities only work, however, if the parties face the right economic

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[71] *See* KOUMRIAN, *supra* note 37, at 3 (reporting average fee request of $500,000 in merger cases in 2013 ending in disclosure-only settlements); Erickson, *supra* note 3, at 1806 (finding $460,000 is median fee award in derivative suits ending with corporate governance settlement).

[72] *See, e.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1534 (2006) (describing "a basic circularity underlying the securities class action: When damages are imposed on the corporation, they essentially fall on diversified shareholders, thereby producing mainly pocket-shifting wealth transfers among shareholders"); Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 334 (describing circularity problem as "private securities litigation [being] socially wasteful because it merely transfers funds from one set of shareholders to another").

[73] *See* Coffee, Jr., *supra* note 72, at 1535-36 ("As presently constituted, securities class actions produce wealth transfers among shareholders that neither compensate nor deter.").

[74] *See* Coffee, Jr., *supra* note 64, at 724.

[75] *See* FED. R. CIV. P. 12(b)(6), 56 (permitting defendant to submit motion to dismiss and motion for summary judgment in civil proceedings).

incentives. In the typical civil lawsuit, the parties face roughly equivalent costs and therefore roughly equivalent incentives to litigate.[76] In shareholder litigation, however, the defendants' costs are typically far greater than the plaintiffs' costs, creating a cost asymmetry between the two sides of the litigation.[77] It costs relatively little for attorneys to file many of these cases. The complaints tend to be fairly similar, and they are often filed within hours of the merger announcement.[78] Additionally, almost all discovery material is in the hands of the defendants.[79]

Given that each side pays its own discovery costs, this disparity means that the corporation's costs are significantly higher than the plaintiffs' costs. As a result, even if a corporation does not think that the suit has merit, it will rationally pay to settle the case rather than incur the high costs of discovery. Indeed, as one New York judge recently stated, "No one, not even plaintiffs, disputes this reality [that] [t]he defendant corporation's cost-benefit calculus almost always leads the company to settle."[80]

Reinforcing these incentives is the fact that many of these cases pose significant downside risks to defendants that are not commensurate with the risks felt by plaintiffs. In merger litigation, for example, the plaintiff will often seek to enjoin the merger, which would create significant costs for the defendant corporation.[81] Potential damages in securities class actions can easily rise to hundreds of millions of dollars, which means that these suits can become "bet

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[76] *See* LEE & WILLGING, *supra* note 9, at 1-2 ("For the closed cases included in the sample, the median cost, including attorney fees, was $15,000 for plaintiffs and $20,000 for defendants.").

[77] *See, e.g.*, Erickson, *supra* note 8, at 71-72, 75-76 (discussing cost asymmetries in merger and securities class actions); Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597, 602-03 (2017) (explaining that "the one-sided threat of unchecked discovery costs becomes a source of leverage for extracting settlement payments without regard to the merits of the litigation" (footnote omitted)).

[78] *See, e.g.*, Brian JM Quinn, *Shareholder Lawsuits, Status Quo Bias, and Adoption of the Exclusive Forum Provision*, 45 U.C. DAVIS L. REV. 137, 155 (2011) (discussing how plaintiffs' attorneys "quickly file cookie-cutter complaints").

[79] *See, e.g.*, Erickson, *supra* note 8, at 71-72, 75-76 ("[W]hile the plaintiff may only have to locate a few pages from his investment records, the defendant will have to spend millions of dollars to conduct a sweeping search of its own documents.").

[80] *See* City Trading Fund v. Nye, No. 651668/2014, 2015 WL 93894, at *14 (N.Y. Sup. Ct. Jan. 7, 2015), *rev'd,* 43 N.Y.S.3d 21 (2016).

[81] *See* William Savitt, *Leave Merger Disclosure Litigation Where It Belongs*, 93 TEX. L. REV. *SEE ALSO* 173, 177 (2015) ("Disclosure claims thus offer shareholder plaintiffs a route to seek expedited discovery and a preliminary injunction to block the deal, both of which can in turn create leverage to force a settlement."); *see also In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 892 (Del. Ch. 2016) ("In [merger] lawsuits, plaintiffs' leverage is the threat of an injunction to prevent a transaction from closing. Faced with that threat, defendants are incentivized to settle quickly in order to mitigate the considerable expense of litigation and the distraction it entails . . . .").

the company" lawsuits.[82] In such low-probability suits involving the potential for large verdicts, defendants are often risk-averse.[83] As a result, they are often willing to settle meritless claims to avoid delaying an important transaction or risking the company's financial stability.[84]

Nonmonetary settlements are an easy way for defendants to avoid these financial risks. Most settlements outside of corporate law are zero-sum[85]—every dollar that the plaintiff recovers comes out of the defendant's pocket.[86] As a result, defendants have an incentive to fight claims they think they can win. Nonmonetary settlements change this analysis. If the defendant can get rid of the case by offering nonmonetary relief, such as additional disclosures about a merger or modest corporate governance reforms, then it has a reduced incentive to fight meritless claims.[87] The same calculus exists in securities class actions, albeit in a slightly different way. In these cases, defendants often do not have the option of nonmonetary settlements, but they can still enter into a monetary settlement at a fairly low cost. Across the board, therefore, defendants make the rational cost-benefit calculation that it is cheaper to settle the case and pay the plaintiff's fees than go through discovery and then get the case dismissed.

Defendants are not necessarily victims in this narrative. In shareholder lawsuits, defendants walk away with a release from liability at a bargain price. Settlements are a negotiation in which plaintiffs get money or other consideration and defendants get a binding promise that they will not face liability in a related suit in the future. In settlements involving nonmonetary or

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[82] *See* Charles Yablon, *A Dangerous Supplement? Longshot Claims and Private Securities Litigation*, 94 NW. U. L. REV. 567, 588 (2000) ("When it comes to securities class action litigation, there are substantial reasons to believe that defendants are strongly risk-averse, pessimistic, and have asymmetric stakes. It should not be surprising, therefore, that they will seek to settle even cases that they view as having only a small chance of success."); *see also* Blair v. Equifax Check Servs., Inc., 181 F.3d 832, 834 (7th Cir. 1999) ("Many corporate executives are unwilling to bet their company that they are in the right in big-stakes litigation, and a grant of class status can propel the stakes of a case into the stratosphere.").

[83] *See, e.g.*, Chris Guthrie, *Framing Frivolous Litigation: A Psychological Theory*, 67 U. CHI. L. REV. 163, 168 (2000) (explaining theory that defendants will be risk-averse with respect to low probability losses, while plaintiffs will be risk-seeking in same context); Mark Moller, *Procedure's Ambiguity*, 86 IND. L.J. 645, 696-97 (2011) (stating that "many claim defendants are more risk averse than plaintiffs, particularly in low probability suits" and "[i]f true, even the small threat of a very large jury verdict, particularly in class cases, may lead defendants to settle weak class claims for more than they are objectively worth").

[84] *See* Moller, *supra* note 83, at 697.

[85] Congress has eliminated non-monetary settlements in many other areas of law. *See, e.g.*, 28 U.S.C. § 1712 (2012) (eliminating coupon settlements).

[86] *See* Melvin A. Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rulemaking*, 89 HARV. L. REV. 637, 652 (1976) ("Furthermore, when the purpose of negotiation is dispute-settlement, the process tends to be a zero-sum game (that is, a contest in which the winner's gains are exactly balanced by the loser's losses).").

[87] *See, e.g.*, Coffee, Jr., *supra* note 66, at 25 ("Normally, in litigation, the winning side's recovery equals the losing side's losses, much as in poker. But in [a non-monetary settlement], an absent third party, the corporation, bears the expenses of both sides.").

other inconsequential relief, the defendants' release from liability may be far more valuable than anything they agree to give the plaintiffs. As a result, the typical pattern in these suits—a hastily-filed complaint, minimal investigation by the plaintiff's attorney, and a nonmonetary settlement—benefits the lawyers on both sides of the suit, as well as the defendants. The only group that does not benefit is shareholders, who both pay for the litigation and give up any later right to sue if they discover a problem with the underlying transaction or disclosures in the future.

Together, these points present a bleak image of shareholder litigation. Merger and derivative suits rarely return meaningful value to shareholders. Securities class actions have a better batting average, but the PSLRA has created a substantial risk that many good cases are never filed, while some meritless cases still escape scrutiny. These outcomes are a direct result of agency costs and cost asymmetries. Shareholder plaintiffs are supposed to monitor their attorneys to ensure that these cases are litigated in the best interests of shareholders, but they often own too little stock to perform this monitoring function effectively. And corporations and their managers, who should be defending against these claims, find it cheaper to enter into low-value settlements and get broad releases. As a result, these suits do not perform a critical role in policing corporate managers.

II. THE PROMISE OF PROCEDURE

The field of civil procedure offers a solution to the longstanding problems in shareholder litigation. This Part first explores why procedure is the right solution, before discussing specific procedures to address the problems introduced in Part I. As discussed below, together these procedures have the potential to revive the promise of shareholder litigation. This analysis sets the stage for an examination in Part III as to why institutional shareholders are the right group to take the lead in adopting these new procedural reforms.

A. *Why Procedure?*

When it comes to litigation reform, lawmakers have different tools at their disposal. They can reform the substantive law, the procedures that govern this substantive law, or the remedies available to plaintiffs. This Section addresses why procedural reform is the right solution to the specific problems in corporate litigation. It then addresses how including new procedures in corporate bylaws or charters would have the unappreciated benefit of making these procedures portable, which would help address the multijurisdictional challenges in these suits.

1. Procedure Versus Substance

It is not immediately obvious why corporations should turn to procedure. Maybe instead of focusing on procedural reform, investors should rewrite the substantive rules that apply in these cases. They could, for example, make the business judgment rule even more stringent. Or they could make it more difficult for shareholders to prevail in claims alleging waste or lack of oversight.

The problem with this approach is that the substantive law already makes it extremely difficult to bring fiduciary duty and securities claims. It is nearly impossible to rebut the presumption of the business judgment rule—the bedrock of substantive fiduciary duty law.[88] It is harder still to prove a claim that the board did not exercise proper oversight over the corporation or engage in corporate waste.[89] Even self-dealing claims, which are typically reviewed under the more stringent entire fairness standard, rarely succeed.

The problem in corporate law, in other words, is not that the substantive law is too lax. The problem is that these claims are profitable even though they are unlikely to succeed.[90] Changing the substantive law will not solve these problems. Most defendants would win under the existing substantive law, if they chose to fight the claims. Nevertheless, they choose to settle, rather than take these cases to trial, because agency costs and cost asymmetries make it unprofitable to defend against these claims, even if they believe they would win. Making the law more stringent would not change this calculus. Instead of tougher substantive laws, the legal system needs a better way to sort the good cases from the bad. Such sorting is exactly what procedural rules are supposed to do.[91] Procedure sorts cases at all stages of the litigation process, from motions to dismiss to motions for class certification and summary judgment.

Yet traditional procedural rules are inadequate for the unique problems in shareholder litigation. Procedure is typically transsubstantive, which means that the same procedural rules apply in all civil cases.[92] Most cases, however, do not suffer from the agency costs and cost asymmetries that cause such problems in shareholder litigation. In a typical civil case, the plaintiff receives the lion's share of any recovery, which gives the plaintiff a strong economic interest to monitor her attorney. In addition, most cases involve discovery costs that are

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[88] *Cf.* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (describing business judgment rule as "powerful presumption in favor of actions taken by the directors").

[89] *Cf. In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (describing an oversight claim as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment").

[90] *See supra* Section I.B (discussing economics of claims that are unlikely to actually prevail but nonetheless lead to monetary settlement).

[91] *See* Robert G. Bone, *Modeling Frivolous Suits*, 145 U. PA. L. REV. 519, 577 (1997) ("The goal of any regulatory scheme, whether it involves strict pleading, penalties or judicial screening, is, loosely stated, to minimize the problems of frivolous litigation without creating too many new problems along the way."); Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73, 74 (1990) (discussing "screening function" of summary judgment rules).

[92] *See* FED. R. CIV. P. 1; William B. Rubenstein, *The Concept of Equality in Civil Procedure*, 23 CARDOZO L. REV. 1865, 1888 (2002) (describing transsubstantive procedural rules as "deliberate design choices that lie at the core of the achievement of the Federal Rules of Civil Procedure").

relatively minor and fall equally on both sides.[93] In other words, transsubstantive procedural rules do little to address agency costs and cost asymmetries because these problems are not present in any significant way in most civil cases. Shareholder litigation is different, for all of the reasons set out in Part I. As a result, it makes sense to have special procedural rules that apply in this special category of cases.

Finally, it is important to acknowledge that procedure is not an entirely new solution to the problems in shareholder litigation. Prior reform efforts by states and legal reform groups have also proposed procedural changes. In shareholder derivative suits in particular, states impose a demand requirement on shareholders prior to filing suit,[94] and they have created a complex set of rules permitting plaintiff corporations to form a special litigation committee that can move to dismiss a derivative suit.[95] Some states also impose a bond requirement on shareholders seeking to file a derivative suit.[96] The American Law Institute similarly spent years debating the appropriate procedural rules to apply in these cases, ultimately recommending a universal demand requirement along with other procedural hurdles.[97]

These procedures, however, were not designed to address the specific problems—agency costs and cost asymmetries—in shareholder litigation. Instead, they were primarily designed to give corporate boards more influence over these suits. For the reasons discussed below in Part III, this approach has been unsuccessful as a screening mechanism because corporate boards have a structural bias that prevents them from impartially reviewing such claims.[98] Bond requirements are similarly undesirable because they make it more difficult for all plaintiffs to file these claims, regardless of the underlying merits of the

[93] Multiple studies have found that the cost of discovery in most cases is fairly minimal. For example, a study by the Federal Judicial Center found that the median discovery costs for plaintiffs were $15,000, while the median discovery costs for defendants in these same cases were $20,000. These costs are far lower than the lore that dominates policy debates would suggest. *See* LEE & WILLGING, *supra* note 9, at 1-2.

[94] *See* FED. R. CIV. P. 23.1(b)(3)(A); Aronson v. Lewis, 473 A.2d 805, 808 (Del. Ch. 1984) ("[D]emand can only be excused where facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the business judgment rule.").

[95] *See* 3 MODEL BUS. CORP. ACT ANN. § 8:25 (AM. BAR FOUND. Supp. 2002).

[96] *See, e.g.*, N.Y. BUS. CORP. LAW § 627 (McKinney 2011).

[97] *See* Carol B. Swanson, *Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The Ali Drops the Ball*, 77 MINN. L. REV. 1339, 1341-42 (1993) ("Since 1978, the Corporate Governance Project of the American Law Institute ('ALI')—sometimes called the most elite group of lawyers in the United States—has labored over finding the appropriate balance between management and shareholder rights in derivative suits.").

[98] *See infra* Section II.B.3; *see also* 2 PRINCIPLES OF CORPORATE GOVERNANCE § 7.02(c) (AM. LAW INST. 1994) (emphasizing that there is a consistent pattern among special litigation committees of dismissing the action as to all defendants).

claims.[99] The legal system cannot indiscriminately throw new procedures at the specific problems in this area of law. Instead, legal reformers must step back and analyze the suite of procedural options more systematically to identify those that can more effectively address the specific challenges of shareholder lawsuits. Before doing so, however, it is necessary first to analyze where these new procedures will be included, a point that will impact the effectiveness of any new procedures.

2. The Benefits of Portable Procedure

When thinking about procedural reform, one may typically think about new rules adopted by legislatures or judges. Yet plenty of procedural reform happens through private ordering. The rise of arbitration, for example, occurred because contracting parties included arbitration clauses in their agreements. Contracting parties also routinely agree to change how they will pay for any future litigation expenses. And they can agree to waive their right to appeal,[100] their right to a jury trial,[101] and their right to file a class action.[102] In other words, the procedural rules in the *Federal Rules of Civil Procedure* are often only default rules that parties are free to change through private agreement.

Procedural private ordering, however, has been slow to come to corporate law. In 2010, the Delaware Court of Chancery first opened the door, albeit in a limited way. The court invited corporations that were concerned about litigating in multiple jurisdictions to include a forum selection provision in their governing documents.[103] Following this invitation, several hundred companies adopted

[99] *See* George S. Geis, *Shareholder Derivative Litigation and the Preclusion Problem*, 100 VA. L. REV. 261, 311 n.244 (2014) ("This bonding requirement is much less common today—as judges came to believe that it would smother derivative claims. The cost of posting the bond, even before it is combined with the risk that the money might be lost, can be greater than the expected recovery to a small shareholder-claimant.").

[100] *See* 2 AM. JUR. APPEAL AND ERROR § 204 (2010) ("Though there are a few cases to the contrary, the rule prevailing in the great majority of the jurisdictions is that an [appellate waiver] is valid and binding, and, when properly pleaded, will constitute a bar to proceedings taken in violation of the agreement.").

[101] *See, e.g.*, RDO Fin. Servs. Co. v. Powell, 191 F. Supp. 2d 811, 813 (N.D. Tex. 2002) ("Although the right of trial by jury in civil actions is protected by the Seventh Amendment to the Constitution, that right, like other constitutional rights, may be waived by prior written agreement of the parties.").

[102] *See, e.g.*, DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463, 471 (2015) (holding that the Federal Arbitration Act does not permit states to prohibit class action waivers in arbitration contracts).

[103] *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

forum selection provisions in their bylaws.[104] A smaller number of corporations adopted other procedural rules, but this trend is limited. It does show, however, that procedural reform in the corporate arena does not have to happen through formal, legislative action. Instead, it can occur on a company-by-company basis through amendments to corporate charters or bylaws.[105]

This point matters because including new procedures in corporate charters or bylaws has the unappreciated benefit of making these procedures portable. To understand this point, one must understand the multijurisdictional nature of shareholder litigation. In January 2016, the Delaware Court of Chancery stated that it would look far more closely at disclosure-only settlements, rejecting those that do not involve "plainly material" disclosures.[106] Over the following year, the total number of merger cases across the country fell slightly,[107] but a sizable percentage of the remaining cases moved outside of Delaware. In 2016, thirty-four percent of merger cases were filed in Delaware; in 2017, that percentage dropped to nine percent.[108] In short, Delaware tried to crack down on these cases, but as a result, it lost most of them.[109] Past reform efforts have shown the portable nature of these claims to be one of the biggest challenges in reforming shareholder litigation.

This observation reveals the drawbacks of including new procedures in the *Federal Rules of Civil Procedure* or the state equivalents. Under the internal affairs doctrine,[110] if a state adopts new substantive reforms to the law governing shareholder litigation, these reforms apply to all cases involving corporations incorporated in that state, regardless of where the case is filed.[111] If, however, a state adopts new procedural reforms, such as greater scrutiny of settlements or heightened pleading requirements, these reforms do not apply in cases filed

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[104] *See* Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, 14 J. EMPIRICAL LEGAL STUD. 31, 33 (2015) (finding that, as of August 2014, 746 public companies had adopted these provisions).

[105] *See infra* notes 140-141.

[106] *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 898 (Del. Ch. 2016).

[107] *See* Cain et al., *supra* note 53, at 608 ("In 2013, 91% of all completed deals were challenged in at least one lawsuit. That number declined to 73% in 2016 but rose to 85% in 2017.").

[108] *See id.*

[109] *See, e.g.*, Randall S. Thomas, *What Should We Do About Multijurisdictional Litigation in M&A Deals?*, 66 VAND. L. REV. 1925, 1939 (2013) ("Weaker cases, however, are more likely to go elsewhere [outside of Delaware], in an effort to find a more hospitable home.").

[110] *See* Edgar v. MITE Corp., 457 U.S. 624, 645-46 (1982) (discussing modern internal affairs doctrine).

[111] *See, e.g.*, Jack B. Jacobs, *The Reach of State Corporate Law Beyond State Borders: Reflections Upon Federalism*, 84 N.Y.U. L. REV. 1149, 1159 (2009) ("Extraterritoriality is an unavoidable consequence of the internal affairs doctrine."); Verity Winship, *Aligning Law and Forum: The Home Court Advantage*, 81 TENN. L. REV. 1, 14, 22-23 (2013) (arguing that *Erie* "unbundles" state law and state forum and "dictates the use of substantive state law in diversity cases").

outside the jurisdiction.[112] In other words, fiduciary duties travel outside the state's boundaries, while settlement rules and pleading requirements do not.

As a result, although Delaware has announced that it will review disclosure-only settlements more stringently, courts in other states are free to apply their own standards, even if the case involves corporations incorporated in Delaware.[113] State choice-of-law rules accordingly allow plaintiffs' attorneys to forum shop for more favorable procedural rules,[114] seeking out courts that will use less scrutiny in reviewing their proposed settlements. These doctrines, however, do not apply to procedures included in corporate charters and bylaws. Parties are generally free to agree that different rules will govern their dispute,[115] and by and large, these agreements will trump a jurisdiction's own procedural rules.[116] When shareholders or board members adopt new rules to govern their disputes, these rules become the law in any future shareholder lawsuit.[117] In sum, by including procedural rules in their charters or bylaws, corporations can make procedure portable.

This portability could prove pivotal in the struggle over shareholder litigation. By including new procedural rules in their governing documents, corporations can prevent plaintiffs' attorneys from forum shopping for more favorable procedures. Given that the substantive law in fiduciary duty cases is almost always the law of the state of incorporation, plaintiffs' attorneys would face the

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[112] *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. d (AM. LAW INST. 1971) ("[A] court under traditional and prevailing practice will apply its own state's rules involving process, pleadings, joinder of parties, and the administration of the trial . . . .").

[113] Several courts have declined to follow *Trulia*, applying their own state-specific standards for reviewing proposed settlements. *See, e.g.*, Murphy v. Synergetics USA Inc., No. 1511-CC00778 (Mo. Cir. Ct. July 29, 2016) (approving disclosure-only settlement); *In re* Sigma-Aldrich Corp. S'holder Litig., No. 1422-CC09684 (Mo. Cir. Ct. Aug. 19, 2015) (same); Gordon v. Verizon Commc'ns, Inc., 46 N.Y.S.3d 557, 566 (App. Div. 2017) (holding that New York courts will apply New York law to review settlements in merger class actions, rather than *Trulia* standard from Delaware).

[114] When it comes to choice-of-law rules regarding substantive law, the internal affairs doctrine dictates that courts should apply the law of the state of incorporation. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. g (AM. LAW INST. 1971) ("[T]he local law of the state of incorporation should be applied except in the extremely rare situation where a contrary result is required by the overriding interest of another state in having its rule applied.").

[115] *See, e.g.*, Stewart E. Sterk, *The Marginal Relevance of Choice of Law Theory*, 142 U. PA. L. REV. 949, 951 (1994) ("Widespread approval by courts of party autonomy rules has made it more possible for commercial parties to avoid choice of law confusion.").

[116] *See* Kevin M. Clermont, *Governing Law on Forum-Selection Agreements*, 66 HASTINGS L.J. 643, 672 (2015) ("Many of the normal rules of procedure thus become no more than default contractual rules, which the parties can extensively modify through negotiation.").

[117] As discussed in Section III.C, *infra*, the law is not entirely clear regarding the limits of procedural innovations in charters and bylaws. Yet the likely interpretation of the law is that shareholders have tremendous flexibility to craft their own procedural rules just like they can create their own substantive rules.

same substantive *and* procedural rules regardless of where they file. This consistency would reduce the incentives for plaintiffs' attorneys to forum shop, thus providing more effective means for corporations to address the agency costs and cost asymmetries in these cases.

B. *A New Procedural Toolkit*

There is no single procedure that will solve all of the problems with shareholder litigation. The field of civil procedure, however, does offer specific tools designed to reduce agency costs and cost asymmetries. This Section outlines procedural changes in shareholder litigation that could target both problems. Viewed as a whole, these proposals aim to help sort the good cases from the bad, ensuring that meritless cases are dismissed while meritorious cases continue.

1. Tools to Control Agency Costs

As discussed in Part I, many of the problems in shareholder litigation are caused by agency costs. Shareholders' interests are not aligned with the interests of their attorneys, and most shareholder plaintiffs do not have a large enough stake in the case to ensure that the attorneys are putting the shareholders' interests above their own. As a result, plaintiffs' attorneys can file cases and enter into settlements that do not benefit their shareholder clients. This Section discusses three procedural tools that can help address these agency costs: nonwaivable forum selection clauses, bans on nonmonetary settlements, and enhanced standing requirements.

a. *Nonwaivable Forum Selection Clauses*

Shareholders should consider incorporating forum selection clauses into corporate bylaws, specifying the forum in which future shareholder lawsuits must be litigated.[118] These clauses help address agency costs in two ways. First, they curb multijurisdictional litigation and the problems that go along with it. As noted above, over the last several years, plaintiffs' law firms have increasingly filed parallel claims in multiple jurisdictions.[119] These multijurisdictional suits allow defendants to hold a reverse auction among the various plaintiffs' attorneys to get the cheapest settlement price.[120] Defense

[118] Delaware specifically amended its corporate code to permit these clauses, as long as the forum is Delaware. *See* DEL. CODE ANN. tit. 8, § 115 (2019) ("The certificate of incorporation or the bylaws may require . . . that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State . . . .").

[119] *See, e.g.*, Griffith, *supra* note 16, at 5 ("Merger claims can be brought in three places: in the state of incorporation, in the headquarters state, or in federal court.").

[120] *See* Minor Myers, *Fixing Multi-Forum Shareholder Litigation*, 2014 U. ILL. L. REV. 467, 507 ("The most threatening consequence of multi-forum shareholder litigation is that it inhibits the ability of any plaintiff's attorney to press for a tough bargain in settlement.");

counsel can offer low settlement terms to an attorney in one jurisdiction with the implicit threat that if the attorney does not accept the terms, the defendant will settle with another attorney who will.[121] Even if the first attorney thinks that the case is worth more than the settlement offer, it may well accept the settlement to avoid losing the lion's share of the attorneys' fees, which typically go to the firm that oversees the settlement. The defendant can then use the settlement as res judicata to dismiss parallel cases pending in other jurisdictions.[122] Forum selection clauses have the potential to halt these efforts by bringing all litigation into a single forum.[123]

Second, if shareholders choose the right forum, forum selection clauses should funnel the claims into a forum such as Delaware that is likely to provide greater oversight over these claims. As corporations experienced, as soon as one jurisdiction starts to crack down on shareholder suits, these suits move to a different jurisdiction where the judges are less likely to closely monitor them.[124] Forum selection clauses prohibit this type of forum shopping, allowing courts that want to crack down on litigation abuses to do so without worrying about driving the cases away.

Unlike many of the other procedural reforms suggested in this Article, forum selection clauses are already on their way to becoming a procedural staple in corporate law. First proposed by the Delaware Court of Chancery in 2010, they are now commonplace, especially among corporations announcing a large merger or acquisition. These clauses, however, are typically adopted by boards of directors and give boards broad discretion to waive the clause.[125] In theory, this discretion makes sense. While a corporation may generally want its shareholders' suits to be litigated in a given jurisdiction, there may be times when it makes more sense for these suits to be litigated elsewhere.

In practice, however, the mere possibility of waiver undercuts the effectiveness of these clauses. Once a company is sued, it has to decide whether to enforce the forum selection clause and fight the claims in its chosen forum (likely Delaware, where the claims will be closely scrutinized by the court) or simply enter into a cheap settlement and get rid of the claims. A rational company could easily decide that it is cheaper to go with the latter option, and

Morris A. Ratner, *Class Conflicts*, 92 WASH. L. REV. 785, 799 (2017) ("Reverse auctions occurred when defendants pitted competing camps of plaintiffs' counsel against each other, awarding the role of settlement class counsel to the lowest bidder.").

121 *See* Thomas, *supra* note 109, at 1936 ("Defendants may run a reverse auction, in which competing plaintiffs' counsel offer to settle their suits at the lowest price.").

122 *See* Myers, *supra* note 120, at 507 ("[A] settlement with the plaintiff's attorney in one forum generally precludes the claims asserted in another forum.").

123 *See* Ratner, *supra* note 120, at 854-55 (explaining how "the likelihood of reverse auctions in mass torts has been substantially reduced" as a result of procedures bringing these cases into a single jurisdiction with a clear leadership structure).

124 *See supra* Section II.A.2.

125 *See* Romano & Sanga, *supra* note 104, at 35.

plaintiffs' firms deciding whether to sue know this. As a result, the possibility of waiver revives the incentives to file meritless claims. Shareholders crafting these clauses should therefore consider eliminating the broad discretion that boards currently have to waive these clauses.

Even with this change, however, forum selection clauses cannot solve the problems in shareholder litigation on their own. These clauses only prevent forum shopping in shareholder lawsuits filed under state law. They cannot control shareholder lawsuits filed under federal law because federal law provides that federal courts have exclusive jurisdiction over these suits. Increasingly, as state courts have cracked down on merger cases, law firms have started to package their allegations as securities class actions instead, avoiding state courts altogether.[126] As a result, forum selection clauses are an important tool in the procedural toolbox, but they cannot fix the problems in these suits by themselves.

b. *Bans on Nonmonetary Settlements*

An additional option to control agency costs in shareholder litigation is to ban nonmonetary settlements. As discussed in Part I, both derivative suits and merger suits frequently end with settlements in which the shareholders and/or the plaintiff corporation receive no money or other financial consideration. Instead, in derivative suits, the plaintiff corporation often agrees to make minor changes to its corporate governance practices, while in merger cases, the defendant corporation agrees to make additional disclosures about the merger. Empirical evidence suggests that such nonmonetary consideration offers little benefit for shareholders.[127]

One option then is for shareholders to prohibit corporations from entering into these settlements. Similarly, as Professor Sean Griffith recently suggested, shareholders could prohibit the corporation from paying the plaintiffs' attorneys fees in these settlements.[128] As Griffith notes, a corporation faces different incentives before and after it is sued.[129] After a corporation is sued, it makes economic sense for the corporation to agree to a nonmonetary settlement. These

126 CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2017 MIDYEAR ASSESSMENT 3 (2017), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-Midyear-Assessment [https://perma.cc/2P46-4ZDC] ("The Delaware Court of Chancery's rejection of a disclosure-only settlement in *Trulia* in January 2016 seems to have caused a shift of merger objection lawsuits from state to federal court.").

127 *See* Erickson, *supra* note 3, at 1755 ("[C]orporate governance settlements often fail to live up to their potential because they include reforms that are unlikely to benefit corporations or their shareholders."); Fisch, Griffith & Solomon, *supra* note 2, at 561 (finding that "disclosure-only settlements do not appear to affect shareholder voting in any way").

128 *See* Griffith, *supra* note 16, at 1 (detailing benefits of "No Pay" provisions in corporations' charters or bylaws).

129 *Id.* at 14 (describing "disconnect in defense side incentives *ex ante* and *ex post*" in context of forum selection provisions).

settlements are cheap for the corporation, at least compared to defending against the claims. Before the corporation has been sued, however, a corporation is better off surrendering this settlement option, because doing so will reduce the likelihood that the corporation will be sued in the first place.[130]

The ex post incentives make corporations easy targets because plaintiffs' attorneys know that it is cheaper for them to settle the claims with non-monetary settlements than to litigate the claims. If this option is off the table, and the corporation has to pay actual money to settle the suit, it may well decide to fight instead, reducing the incentives for plaintiffs' attorneys to sue the company in the first instance. In short, ex post corporations want to enter into nonmonetary settlements, but ex ante, the same corporations may well rationally surrender their right to do so.

Although Griffith's proposal focuses on merger litigation, shareholders could extend it to derivative suits as well. Just as in merger suits, corporations agree to nonmonetary settlements in derivative suits because these settlements are a relatively inexpensive way to get rid of individual suits. If this option were off the table, however, corporations would have to decide whether to demand money from the defendants or go to trial. To the extent that some corporations would choose to fight frivolous claims rather than settle them, it should reduce the incentive to file these claims.

As with forum selection clauses, this proposal is unlikely to completely solve the agency cost problems in shareholder litigation. Nonmonetary settlements are not common in securities class actions,[131] and yet there are still nuisance settlements in these cases. As discussed in Part I, nearly twenty percent of settlements in securities class actions are for less than two million dollars, a commonly used cutoff for nuisance settlements in this area.[132] A similar outcome is possible in derivative and merger suits if corporations collectively refuse to enter into non-monetary settlements. Although these cases are cheaper to litigate than securities class actions, the litigation costs will likely still exceed a million dollars, and many corporations would therefore be willing to pay less than this amount to settle the claims. Even without nonmonetary settlement options, in other words, parties could likely still find ways to settle nuisance claims relatively cheaply. As a result, banning nonmonetary settlements is best viewed as part of a larger shareholder effort to reform shareholder litigation.

130 *See id.* ("But *ex post*, once the corporation has become a defendant in merger litigation, that corporation has a strong incentive to buy the broad, cheap releases that disclosure settlements provide.").

131 LAARNI T. BULAN, ELLEN M. RYAN & LAURA E. SIMMONS, SECURITIES CLASS ACTION SETTLEMENTS: 2016 REVIEW AND ANALYSIS 1 (2017), http://securities.stanford.edu/research-reports/1996-2016/Settlements-Through-12-2016-Review.pdf [https://perma.cc/E6AN-KV2W] (showing that from 1996 to 2016, the minimum settlement in securites class action case was approximately $100,000).

132 *See* BULAN, RYAN & SIMMONS, *supra* note 54, at 5.

c. *New Standing Requirements*

As a more radical option, shareholders could adopt enhanced standing requirements to reduce the agency costs in shareholder litigation. The legal system currently imposes minimal standing requirements on shareholders seeking to file representative lawsuits. In shareholder derivative suits, representative shareholders must own stock at the time of the alleged misconduct[133] and hold this stock throughout the litigation.[134] In securities class actions, the plaintiff must have purchased or sold the corporation's securities during the class period.[135] And in all shareholder lawsuits, the lead plaintiff must be an "adequate" representative,[136] although this standard typically requires very little.[137]

What the law does not require, however, is that the representative shareholder own a minimum amount of the corporation's stock. At least in theory, a shareholder who owns just a single share of stock in the target corporation can challenge a merger or take a corporation to court for allegedly lying to its investors.[138] This permissive approach to standing exacerbates the agency costs outlined above. The less of a stake that a shareholder has in the target company, the less time and expense the shareholder will be willing to invest in monitoring his or her attorney.

Investors could change the standing rules in shareholder lawsuits. Rather than allowing any shareholder to embroil the company in litigation, no matter how small the shareholder's holdings or how little the shareholder's damages, a

[133] *See* DEL. CODE ANN. tit. 8, § 327 (2019).

[134] *See* Lewis v. Anderson, 477 A.2d 1040, 1050 (Del. 1984) ("A plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit.").

[135] *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754 (1975) (holding that plaintiffs lacked standing because they were neither "'purchasers' nor 'sellers'").

[136] *See* FED. R. CIV. P. 23(a)(4) (requiring that "representative parties will fairly and adequately protect the interests of the class").

[137] *See* Jay Tidmarsh, *Rethinking Adequacy of Representation*, 87 TEX. L. REV. 1137, 1176 (2009) (stating that the adequacy requirement "is fairly minimal—a modest and elementary principle of justice rather than an extraordinary and heroic burden").

[138] This does not mean that the amount of stock a shareholder owns is irrelevant in the litigation. The PSLRA includes a rebuttable presumption that the shareholder applicant with the largest financial interest should be the lead plaintiff in the suit. 15 U.S.C. § 78u–4(a)(3)(B)(iii)(I)(bb) (2012). State law also makes a shareholder's holdings an important factor in choosing a lead plaintiff. *See* Hirt v. U.S. Timberlands Serv. Co., LLC, No. 19575, 2002 WL 1558342, at *3 (Del. Ch. July 3, 2002) (identifying as a factor in determining the lead plaintiff "the relative economic stakes of the competing litigants in the outcome of the lawsuit (to be accorded 'great weight')"). Under either approach, however, the amount of the plaintiff's stock holdings is only a factor when it comes to choosing among those shareholders vying to be lead plaintiff. There is no amount of stock that a shareholder is required to own to file the lawsuit, and if there are no other shareholders seeking to serve as lead plaintiff, the sole applicant is typically appointed automatically.

company's bylaws could provide for minimum ownership and/or damage requirements. A handful of companies have already made this change. For example, Emergent Capital, Inc. amended its bylaws to prohibit shareholders from filing a class action or derivative suit against the corporation, its directors, or its officers unless the shareholder owns at least three percent of the corporation's stock.[139] This bylaw was approved by both Emergent's board and its shareholders.[140] In adopting the bylaw, Emergent's Chairman stated that "we strongly believe this is a very good bylaw that deters such suits without unduly impeding meritorious representative lawsuits."[141]

The three percent requirement is likely higher than most companies would want, although the optimal level of holdings or damages will vary depending on the size of the corporation and its concentration of ownership. In smaller corporations with relatively concentrated stock holdings, shareholders might choose to allow only those who own more than one or two percent of the corporation's stock to file suit. In larger corporations with less concentrated stock ownership, it might make more sense to use a monetary threshold (i.e., one hundred thousand dollars) because there might not be many shareholders who own a significant percentage of the corporation's stock. With either type of company, the objective should be to set the requirements high enough that only shareholders with the financial incentives to monitor the case can serve as representative plaintiffs, while still ensuring that there is an ample supply of potential plaintiffs among the corporation's shareholders.[142]

The adoption of minimum ownership requirements in shareholder litigation would be consistent with the approach used in other areas of corporate and securities law. Individual shareholders with only a single share of stock have little power to act on their own. To submit a shareholder proposal, for example, a shareholder must own at least two thousand dollars worth of stock in the corporation or one percent of the corporation's outstanding stock.[143] In addition,

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[139] *See* Michael P. Matthews et al., *Shareholder Suit Challenging Groundbreaking Minimum-Support-to-Sue Bylaw Dismissed*, FOLEY & LARDNER LLP (Oct. 19, 2015), https://www.foley.com/shareholder-suit-challenging-groundbreaking-minimum-support-to-sue-bylaw-dismissed-10-19-2015/.

[140] *Id.*

[141] *Id.*

[142] For this reason, standing requirements should not permit the aggregation of claims. If aggregation was permitted, a corporation with a minimum standing requirement of one hundred thousand dollars could be sued by a collection of one hundred shareholders each owning one hundred dollars worth of stock in the corporation. As scholars note in the securities class action context, such bundling undercuts the goal of having individual investors with the financial incentive to monitor their attorney. *See, e.g.*, Jill E. Fisch, *Aggregation, Auctions, and Other Developments in the Selection of Lead Counsel Under the PSLRA*, 64 LAW & CONTEMP. PROBS. 53, 54 (2001) (noting concerns regarding use of aggregation to unite large numbers of unrelated investors into a lead plaintiff group).

[143] 17 C.F.R. § 240.14a–8(b)(1) (2018). The Financial CHOICE Act would dramatically increase this ownership threshold, prohibiting shareholders from making shareholder

in many corporations, shareholders cannot call a special meeting unless they own a substantial stake in the company.[144] These ownership requirements are not universal—small shareholders can, for example, request to inspect a corporation's books and records[145]—but they are far from uncommon.

Minimum ownership requirements are also consistent with the broader belief in corporate law that ownership stakes matter. Individual shareholders have very few rights in corporate law. Unless they own a majority of the company's stock, they cannot elect or remove directors, amend bylaws, force a merger, or stop corporate transactions. Instead, these powers all rest with the shareholders as a whole. In short, shareholder litigation is one of the only areas in which a single shareholder owning a single share of stock can act on behalf of the corporation or other shareholders. Given the agency costs in shareholder litigation, shareholders would be justified in adopting new standing requirements that bring shareholder litigation more in line with the norms in other parts of corporate law.

2. Tools to Control Cost Asymmetries

Just as procedure offers tools to reduce agency costs, it also includes tools to control cost asymmetries. As described in Part I, the litigation costs in most shareholder lawsuits fall disproportionately on defendants. As a result, defendants often make the rational cost-benefit calculation that it is cheaper to settle and pay the plaintiffs' fees than go through discovery and then try to get the case dismissed. Each of the procedural tools described in the prior Section could also help control cost asymmetries. Forum selection clauses, for example, can funnel shareholder litigation into forums in which judges keep a more watchful eye on discovery expenses, while enhanced standing requirements can ensure that the representative shareholder has enough of a financial stake in the corporation that it does not want to pressure the corporation into a nuisance settlement. This Section explores additional procedural tools that have the potential to address cost asymmetries, including heightened pleading requirements, discovery limitations, and fee and cost shifting.

a. *Heightened Pleading Requirements*

Institutional investors could adopt heightened pleading requirements to address the cost asymmetries in shareholder lawsuits. In general, shareholder lawsuits filed under state law are subject to traditional notice pleading rules. These pleading rules are quite minimal, requiring only that the plaintiff set forth "a short and plain statement of the claim showing that the pleader is entitled to

proposals unless they own at least one percent of the relevant company's stock. *See* H.R. 10, 115th Cong. § 844 (2017).

[144] *See, e.g.*, DEL. CODE ANN. tit. 8, § 211 (2019).

[145] *See id.* § 220 (allowing any stockholder to inspect various corporate records).

relief."[146] In contrast, shareholder lawsuits filed under federal law are subject to heightened pleading requirements. The PSLRA imposes heightened pleading requirements for two of the most crucial elements in a securities fraud claim—whether the defendants made a false or misleading statement and whether they acted with the required state of mind.[147] It also prohibits plaintiffs from obtaining any discovery until after they survive a motion to dismiss.[148]

The heightened pleading requirements of the PSLRA have faced a significant amount of criticism, and for good reason. These pleading requirements did help address the cost asymmetry between the parties. They also, however, exacerbated an information asymmetry between the parties. As discussed in Part I,[149] defendants bear a disproportionate share of the discovery costs in these cases and thus have an economic incentive to settle even meritless cases.[150] At the same time, however, plaintiffs in these cases often lack the information they need to evaluate the merits of their claims prior to discovery.[151] This is especially true when it comes to the element of scienter, which requires plaintiffs to allege that the defendants knew what they were saying was false at the time they said it.

The results were predictable. The PSLRA succeeded in reducing the number of nuisance suits—exactly the result that Congress wanted. Yet it also eliminated non-frivolous claims, as several empirical studies demonstrated.[152] In short, the heightened pleading requirements in the PSLRA made it harder for shareholders to file both meritorious and nonmeritorious claims alike.

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146 FED. R. CIV. P. 8.

147 15 U.S.C. § 78u–4(b)(1), (2) (2012).

148 *See id.* § 78u–4(b)(3)(B).

149 *See supra* Section I.B.2.

150 *See* Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 38 n.2 (Del. 1996) ("It is a fact evident to all of those who are familiar with shareholder litigation that surviving a motion to dismiss means, as a practical matter, that economical rational defendants (who are usually not apt to be repeat players in these kinds of cases) will settle such claims, often for a peppercorn and a fee.").

151 *See, e.g.*, Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN L. REV. 497, 549 (1991) ("Since discovery in securities class actions is almost completely one-sided, plaintiffs [or their attorneys] control the discovery agenda.").

152 *See* Stephen J. Choi, Karen K. Nelson & A. C. Pritchard, *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. EMPIRICAL LEGAL STUD. 35, 64-67 (2009) ("There is evidence . . . that pre-PSLRA nonnuisance claims would be less likely to be filed under the PSLRA regime."); Eric Talley & Gudrun Johnsen, *Corporate Governance, Executive Compensation and Securities Litigation* (U.S.C. Gould Sch. of Law, Olin Research Paper No. 04-7, 2004), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=536963 (presenting data "that even if the PSLRA reduced frivolous litigation (as its proponents claim), it likely deterred meritorious litigation as well, and in such proportions as to swamp the deterring effects on non–meritorious suits").

What would better heightened pleading requirements look like? First, they would focus on specific elements of the claims in question. The U.S. Supreme Court's interpretation of Federal Rule of Civil Procedure 8 in *Bell Atlantic Corp. v. Twombly*[153] has been criticized for raising pleading standards across the board, without regard to the difficulties of pleading facts that plaintiffs cannot obtain prior to discovery.[154] While any interpretation of Rule 8 inevitably applies to a wide swath of claims with different elements and different fact-finding challenges, heightened pleading requirements in corporate bylaws can be more targeted.[155]

In derivative and merger litigation, heightened pleading requirements should focus on facts supporting the claim that the directors and officers breached their fiduciary duty. Fiduciary duty claims resemble tort claims,[156] which involve four elements: duty, breach of duty, causation, and damages.[157] Any heightened pleading requirements in this area should focus only on the second element—breach of duty. Plaintiffs should have to allege facts with particularity showing that the directors and officers breached their fiduciary duty. With respect to all other elements of these claims, normal pleading rules should apply. These targeted pleading requirements would require plaintiffs to put their cards on the table early for the elements most central to the case, while allowing them to wait longer for elements such as causation and damages that may be harder to support with specific facts prior to the discovery process.

Second, new pleading requirements could include an exception for information that the plaintiff cannot reasonably obtain. Such exceptions are common in statutes imposing heightened pleading requirements, although the PSLRA itself does not include one. For example, in proposed legislation related to patent litigation, plaintiffs would have been required to plead certain specified facts about their patent claim "unless the information is not reasonably accessible."[158] The Act further stated that "if information required to be

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[153] 550 U.S. 544 (2007).

[154] *See, e.g.*, Alexander Reinert, *Pleading as Information-Forcing*, 75 LAW & CONTEMP. PROBS. 1, 29 (2012) ("Where the informational asymmetry favors the responding party . . . there is little justification for applying an information-forcing principle to the pleader."); Paul Stancil, *Balancing the Pleading Question*, 61 BAYLOR L. REV. 90, 114 (2009) ("If the operative pleading standard required plaintiff to allege facts that she cannot reasonably be expected to know at the case's inception, this informational asymmetry would in turn prevent proper functioning of the litigation market.").

[155] *See* Erickson, *supra* note 8, at 89.

[156] *See* J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 71 (2010) ("We conclude that a breach of a fiduciary duty is in fact a tort, although a unique species historically called an 'equitable tort.'"). *But see* MCG Capital Corp. v. Maginn, No. 4521-CC, 2010 WL 1782271, at *12 (Del. Ch. May 5, 2010) ("Fiduciary duties exist independent of tort obligations.").

[157] Preston v. Preston, No. 6049, 1981 WL 15086, at *3 (Del. Ch. Apr. 16, 1981).

[158] Innovation Act, H.R. 3309, 114th Cong. § 3 (2015).

disclosed under [the Act's heightened pleading requirements] is not readily accessible to a party after an inquiry reasonable under the circumstances, as required by Federal Rule of Civil Procedure 11, that information may instead be generally described."[159] Under these circumstances, however, the plaintiff must also include "an explanation of why such undisclosed information was not readily accessible, and of any efforts made by such party to access such information."[160] Such detailed requirements make it difficult for plaintiffs to generically claim that the required facts are not reasonably accessible.

Finally, institutional investors can take steps to ensure that plaintiffs continue to have access to pre-suit discovery. Heightened pleading requirements are often criticized because plaintiffs have few ways to uncover the facts needed to support their claims prior to discovery. Shareholder lawsuits, however, are different. Many states, including Delaware, have laws that allow shareholders to obtain copies of a company's books and records as long as they have a proper purpose for requesting this information.[161] Courts have held that investigating wrongdoing by the corporation's managers is a "proper purpose" within the scope of these statutes.[162] These provisions are crucial to enabling plaintiffs to obtain the facts necessary to comply with any new heightened pleading requirements. Institutional investors should therefore ensure that companies are complying with their requirements under these state law provisions.[163]

Thus far, the discussion has focused on new heightened pleading requirements for state law claims. Institutional investors, however, could also use this opportunity to revisit the heightened pleading requirements imposed by the PSLRA on federal securities claims. Institutional investors could include an exception to these requirements if the underlying facts needed to support certain elements are not reasonably accessible, similar to the proposed exception described above in fiduciary duty claims. Alternatively, investors could eliminate the heightened pleading requirements that govern scienter entirely. The PSLRA's heightened pleading requirement regarding scienter has been criticized extensively because it requires plaintiffs to allege facts regarding the defendants' intent without access to discovery.[164] Heightened pleading

159 *Id.*

160 *Id.*

161 *See, e.g.*, DEL. CODE ANN. tit. 8, § 220(b) (2019); Melzer v. CNet Networks, Inc., 934 A.2d 912, 917 (Del. Ch. 2007) ("Before shareholders may inspect books and records, they must demonstrate . . . a proper purpose for seeking inspection.").

162 Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 121 (Del. 2006) ("It is well established that a stockholder's desire to investigate wrongdoing or mismanagement is a 'proper purpose.'").

163 In states that do not give shareholders the right to inspect a corporation's books and records, shareholders could include such a right in the corporation's bylaws.

164 *See, e.g.*, Choi, *supra* note 58, at 600 ("Without discovery until after the motion to dismiss . . . plaintiffs face a difficult time in gathering facts related to the state of mind of particular defendants in engaging in fraud.").

requirements are difficult enough to satisfy without requiring plaintiffs to allege what was going on in the defendants' heads at a specific moment in time. At the time of the PSLRA, such heightened pleading requirements may have made more sense because the default standards under Rule 9 were so lax.[165] Post-*Twombly*, however, plaintiffs now have to plead specific facts supporting all of their claims,[166] so the current default standards may suffice to solve any concerns about lax pleading in this area.

As discussed further in Part III, it is not entirely clear whether such company-specific overrides would be permissible. It is an open question whether companies can modify—or even bypass altogether—the procedural requirements imposed by statute. Are the PSLRA or state corporate governance statutes merely a set of default rules that apply if and until companies choose to change them? Or are they a mandatory set of requirements that apply even if companies and their shareholders would prefer a different set of procedural rules? As explored in Part III, the limits of private ordering in this area have never been clearly delineated, but current law provides grounds for optimism that shareholders can experiment in this area.[167]

b. *Cost and Fee Shifting*

Shareholders should also consider provisions that allow fee and cost shifting in shareholder litigation. Such provisions would reverse the presumption that each side pays its own attorney's fees and discovery costs. Under the right circumstances, such reforms could help address the cost asymmetries in shareholder lawsuits. The problem in cost asymmetric cases is that the plaintiff has far less on the line than the defendant. They typically have less discovery material because most shareholder plaintiffs have few relevant documents and know relatively little about the case. Accordingly, their discovery costs (and the accompanying attorneys' fees to locate and produce this discovery) are typically far lower than the defendants' costs. As a result, the plaintiff has little to lose by filing a meritless lawsuit.

Fee and cost shifting rules change this calculus, albeit in slightly different ways. With fee shifting, plaintiffs who know that they will have to pay their opponents' legal fees if they lose will be far more reluctant to file a meritless case. Additionally, defendants who know that they will be able to recover their legal fees if they prevail will no longer see these fees as sunk costs. Along similar lines, with cost shifting, plaintiffs would no longer be able to serve sweeping requests on defendants and use the costs of responding as a lever in settlement discussions. Instead, both sides would have an incentive to tailor their discovery

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[165] Federal Rule of Civil Procedure 9 includes heightened pleading requirements for fraud claims generally, but "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally." *See* FED. R. CIV. P. 9(b).

[166] *See* Bell Atl. Corp. v. Twombly, 550 U.S. 544, 554-57 (2007).

[167] *See infra* Section III.C (addressing legal hurdles that institutional investors may face in implementing customized procedural rules).

requests to the specific needs of the litigation. Unlike fee-shifting rules, which only require losing parties to contribute to their opponents' attorneys' fees, cost-shifting rules require each side to share the costs of litigation, regardless of which side ultimately prevails.

Although fee and cost shifting would both address the cost asymmetries in litigation, fee-shifting rules stand on shakier legal ground than any of the other procedural reforms suggested in this Part. In 2015, after intense lobbying by the plaintiffs' bar, the Delaware General Assembly banned fee shifting, stating that "the bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim."[168] Delaware was right to be concerned about corporations adopting fee-shifting provisions. Shareholder plaintiffs have little to gain by serving in this role—receiving a pro rata share of any recovery, plus a small incentive payment if approved by the court. If the class action is not successful, however, the class representative would be liable for the entire fee award, which could amount to millions of dollars. Faced with this imbalance, few class representatives would agree to lend their name to a lawsuit.

Yet such concerns do not mean that these provisions always place shareholder litigation in peril. There are ways to implement fee-shifting rules that would not discourage class representatives from participating in suits, while also complying with Delaware's new limitations. Instead of making class representatives liable for the defendants' costs, for example, shareholders could require class counsel to pay the defendant's legal fees if the lawsuit is unsuccessful. This rule would not violate Delaware's statutory prohibition against fee shifting, which only bars provisions that impose liability "on a stockholder."[169] Attorneys are not stockholders, at least in the typical suit, so they are not covered by the statute.[170]

Standing alone, applying fee-shifting rules to attorneys would not address Delaware's concerns, even if it would be outside the scope of the state's

[168] DEL. CODE ANN. tit. 8, § 109(b) (2019).

[169] *Id.*

[170] Opponents could argue that the legal system is not perfect and thus firms could be penalized if they file a meritorious suit that is nonetheless unsuccessful. The market, however, could provide a solution to this concern. In England, for example, a robust after-the-event ("ATE") insurance market allows a party who is nervous about the consequences of losing at trial to purchase insurance to cover his opponent's legal fees in event of a loss. *See, e.g.*, Jonathan T. Molot, *Fee Shifting and The Free Market*, 66 VAND. L. REV. 1807, 1820-21 (2013) ("Claimants able to purchase ATE insurance can proceed with meritorious claims without fear of bearing their opponents' costs."). A similar market could theoretically protect law firms that would otherwise personally bear the cost of unsuccessful claims. The actuarial nature of insurance markets could incentivize law firms to screen their cases carefully, while also providing a safety net if the legal system disagrees with a firm on the merits of a particular claim.

legislation as presently worded. Instead, it would simply discourage a different group from participating in these cases, if these attorneys stand to lose more than they might gain. Accordingly, shareholders should couple any fee-shifting rules with a related provision awarding prevailing class counsel higher fees than they currently receive. This approach would increase both the risk and reward of shareholder lawsuits, creating even greater incentives for plaintiffs' attorneys to choose wisely when deciding which cases to file.[171]

Even with these modifications, however, shareholders should exercise caution when adopting fee- and cost-shifting rules. These rules radically change the economic structure of representative litigation, and it is easy to imagine the rules having unanticipated consequences, especially since the U.S. legal system has little experience with these procedural tools. For example, shareholders would not want to implement rules that create costly satellite litigation over the exact amount of discovery costs or attorneys' fees to be billed to the other side. Nor would they want to give defendants an incentive to drive up their discovery costs to give them leverage in settlement negotiations. There are ways to ameliorate these concerns—courts can manage the discovery process more closely or the parties can agree on their discovery plans up front[172]—but these solutions are unlikely to completely eliminate concerns about satellite litigation and perverse incentives.

In addition, fee and cost shifting could inhibit shareholders' access to justice. Larger plaintiffs' firms could likely absorb the costs of discovery, as well as their opponents' attorneys' fees, if they lose. Smaller firms, however, may be in a more financially precarious position, unable to absorb a multi-million dollar award of fees or costs to the defendants. For these firms, even if they think their claims are meritorious, the mere possibility of bankrupting their firm may steer them away from claims shareholders would like them to bring. One way to reduce this risk is to cap the fees. For example, these provisions could make firms liable for the first one million dollrs of the company's legal fees, or the

[171] One concern with this approach is that it could create a conflict of interest between class counsel and members of the class. There could be situations in which class counsel would be better off with a lower settlement rather than risk having to pay their opponents' legal fees if the case continues, even if the class itself, facing no such risk of loss, would rather roll the dice on a judgment at trial. These conflicts already exist to some extent in any class action, given that class counsel often advances the costs of the lawsuit and, through the contingency fee, may stand to gain more than any individual class member. Nonetheless, if shareholder plaintiffs have sizable stakes in the case (as anticipated by the minimum ownership and damage rules described above), plaintiffs should be able to mediate these concerns with their counsel. *See supra* note 140 and accompanying text (discussing methods such as minimum ownership to prevent abusive shareholder litigation practices).

[172] *See, e.g.*, Jay Tidmarsh, *The Litigation Budget*, 68 VAND. L. REV. 855, 859 (2015) (proposing model by which parties develop litigation budget at start of case and present it for court approval, following similar proposal adopted in United Kingdom).

first five hundred thousand of the company's discovery costs.[173] Alternatively, this cap could depend on the size of the target company or the amount of claimed damages, expressly allowing smaller law firms to incur less risk by suing smaller firms or bringing claims with lower potential damages.

Even with these accommodations in mind, the concerns suggest that shareholders might want to try the other procedural tools suggested in this Part before adopting fee or cost shifting provisions. The field of civil procedure offers a variety of tools for addressing agency costs and cost asymmetries, but each comes with its own risks and challenges. With heightened pleading, plaintiffs risk dismissal of their claims.[174] With fee or cost shifting, however, plaintiffs (or their attorneys) risk financial ruin. As a result, fee and cost shifting could discourage borderline claims that shareholders and their attorneys think could have merit, even if they are not legal slam dunks. Companies may want to stagger adoption of these procedures to see if more modest measures, such as heightened pleading or minimum ownership requirements, will solve the problems in these cases before adopting more sweeping procedures, such as fee or cost shifting.

c. *Arbitration*

No review of procedural alternatives would be complete without a discussion of arbitration. The procedures outlined above would all apply within the traditional legal system. Yet parties can opt out of this system altogether by sending their dispute to arbitration. Each arbitration body has its own set of procedural rules,[175] which are often considerably different than the procedural rules that apply in a court.

Although shareholders may have the legal right to arbitrate their claims,[176] that does not mean that it is in their best interest to do so. Arbitration is often thought to be cheaper and faster than traditional litigation, in large part because discovery is much more limited.[177] Yet limited discovery in arbitration is not a

[173] The insurance markets described above, *see supra* note 170, could similarly help defray these potential risks.

[174] For further discussion of heightened pleading, see *supra* Section II.B.2.a.

[175] *See infra* note 177 (outlining procedural rules for arbitration).

[176] *But see* DEL. CODE ANN. tit. 8, § 115 (2019) (prohibiting forum selection clauses that send shareholder litigation to any jurisdiction other than Delaware courts). It is an open question whether this law passes muster under the Federal Arbitration Act. *See* 9 U.S.C. § 2 (2012) (prohibiting states from banning arbitration clauses in written contracts).

[177] *See, e.g.*, COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES, INCLUDING PROCEDURES FOR LARGE, COMPLEX COMMERCIAL DISPUTES 19 (AM. ARBITRATION ASS'N 2013) (outling rules for pre-hearing exchange and production); INTERNATIONAL DISPUTE RESOLUTION PROCEDURES 25 (INT'L CTR. FOR DISPUTE RESOLUTION 2014) ("The tribunal may, upon application, require a party to make available to another party documents in that party's possession not otherwise available to the party seeking the documents, that are reasonably believed to exist and to be relevant and material to the outcome of the case.").

sure thing. Indeed, the New York State Bar recently noted that "there has been a trend to inject into arbitration expensive elements that had traditionally been reserved for litigation—interrogatories; requests to admit; dispositive motions; lengthy depositions; and massive requests for documents, including electronic data."[178] Parties now bemoan the fact that discovery in arbitration has "spiraled out of control" as arbitrators make ad hoc decisions about how much discovery should occur in individual cases.[179] It is still true that parties generally get less discovery in arbitration, but it is hardly a sure bet.[180] As a result, agreements to arbitrate shareholder claims do not put to bed concerns about discovery costs.

Moreover, if shareholders want more limited discovery rights, they do not need to go to arbitration to get them. Instead, they can stay in the traditional legal system, but limit the discovery rights that apply in this system. Discovery rules are largely default rules, and parties are free to amend them.[181] For example, corporate bylaws could narrow the scope of discovery or provide that parties are only entitled to a certain number of depositions.[182] They can also provide that the parties are only entitled to discovery specifically approved by a judge.[183] Alternatively, if shareholders are nervous about tying their own hands before they know the details of the dispute, they can instead provide for cost shifting, as suggested above, which forces each side to decide whether the benefits of the requested discovery is worth the costs.[184] In short, discovery costs alone do not justify a retreat to arbitration.

The other purported benefit of arbitration is that it checks the dangers of aggregate litigation. The opt-out nature of most class actions means that class

[178] N.Y. STATE BAR ASS'N, REPORT BY ARBITRATION COMMITTEE OF DISPUTE RESOLUTION SECTION: ARBITRATION DISCOVERY IN DOMESTIC COMMERCIAL CASES 1 (2009), https://www.nysba.org/Sections/Dispute_Resolution/Dispute_Resolution_PDFs/ARBITRATION_DISCOVERY__IN_DOMESTIC_COMMERCIAL_CASES.html [https://perma.cc/69QB-R7EK].

[179] *Id.* ("In some cases, it has spiraled out of control and has reached a point where some users of arbitration feel that there is little difference between arbitration and litigation.").

[180] Nor is arbitration necessarily faster than litigation. *See* Henry S. Noyes, *If You (Re)build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579, 585 (2007) (noting that the average time to resolve a case through arbitration is only slightly shorter that the median time to resolve a case through the litigation system).

[181] *See* FED. R. CIV. P. 29 ("Unless the court orders otherwise, the parties may stipulate that . . . procedures governing or limiting discovery be modified.").

[182] *See* Jessica Erickson, *Bespoke Procedure*, 71 VAND. L. REV. 1873, 1876 (2018) ("To address concerns that discovery is too expensive, parties can agree ex ante to limit the scope of discovery, place caps on the number of depositions or document requests, or enter into binding discovery budgets.").

[183] *See id.* at 1891 ("Parties can also agree that they are only entitled to discovery if their discovery request is specifically approved by a judge or arbitrator.").

[184] *See supra* Section II.B.2.b (detailing concept of cost shifting).

members are joined in the suit unless they affirmatively opt out.[185] As a result, defendants may feel pressured to settle because the potential damages can be so high that the suit threatens the company's financial viability.[186] Many arbitration clauses, however, include class action waivers, allowing injured parties to sue only on their own behalf.[187] These waivers allow defendants to avoid aggregate claims and the dangers that go along with them.[188] In theory, such a limitation might be appealing to those reflecting on the troubled history of shareholder class actions.

Yet prohibiting shareholders from joining together to bring their claims would ultimately hurt many shareholders. Some shareholders, especially large shareholders with positive value claims, would be fine in a regime that does not permit class actions.[189] Smaller shareholders, however, would find it cost prohibitive to bring their claims on an individual basis. As a result, they would be effectively barred from seeking compensation for their claims.[190] Just as importantly, shrinking the number of potential claimants reduces the overall deterrent effects of shareholder litigation, hurting large and small shareholders

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[185] *See* FED. R. CIV. P. 23(b) (stating that class members can be automatically included in suit unless they opt out of class); Scott Dodson, *An Opt-in Option for Class Actions*, 115 MICH. L. REV. 171, 173 (2016) ("The empirical evidence strongly suggests that opt-out classes are much larger than opt-in classes and that individual litigation by excluded class members is rare.").

[186] Randy J. Kozel & David Rosenberg, *Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment*, 90 VA. L. REV. 1849, 1890 (2004) ("[C]ertification increases plaintiffs' opportunities for profit . . . .").

[187] *See, e.g.*, Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 882-84 (2008) (finding that eighty percent of contracts imposed by financial services and telecommunications firms contained class action waivers).

[188] *See* Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 425-27 (2005) (discussing why class action waivers will become more commonly used).

[189] *See* David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201, 233 (2015) (arguing that trustees overseeing institutional investment vehicles have fiduciary duty to bring positive-value claims).

[190] And ironically, even if small shareholders could not sue themselves, they would still have to pay (at least indirectly) the costs of securities class actions because they have a financial stake in the target corporation. In other words, channeling shareholder claims into arbitration would take money from the pockets of smaller shareholders and put it in the pockets of larger shareholders. *See id.* at 259 ("Conversely, many smaller institutional investors and most, if not all, individual investors will have negative-value claims. Consequently, they will have no remedy for their wrong. Yet they may very well remain invested in the defendant company after the fraud.").

alike.[191] If corporate managers think that their potential liability has plummeted, they may be more likely to enrich themselves at shareholders' expense.[192]

This discussion reveals a powerful lesson about the role of procedural rulemaking. In the past, when new procedural rules were incorporated into corporate bylaws, they were almost always pro-defense—i.e., reforms that make it more difficult for shareholders to bring representative claims.[193] Yet, while corporate boards prefer such procedures, their shareholders may well have more nuanced views about the right procedures for these cases because it is not always in their interest to make it more difficult to bring shareholder lawsuits. Sometimes the right procedural tools will curtail shareholders suits, while other times they will make it easier to file these claims.[194] In short, as we will see, it takes the right incentives to push for the right procedures.

III. PROMOTING A NEW MARKET FOR CORPORATE PROCEDURE

The analysis thus far demonstrates that procedural reform can play a pivotal role in addressing the problems that have long plagued shareholder litigation. In a perfect world, the story would end there. Once we know what new procedures to adopt, we could simply adopt them, and the problems would be solved. In the complicated world of shareholder litigation, however, identifying the right reforms is only the first piece of the puzzle. The right actors must also push for their adoption. Corporate law has long relied on three groups to address the

[191] Scholars have long argued that deterrence is the central goal of shareholder litigation. *See, e.g.*, Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors and Officers Insurance and Securities Settlements*, 157 U. PA. L. REV. 755, 762 (2009) ("Scholars customarily treat deterrence as the principal objective of civil damages in corporate and securities litigation."); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b–5*, 108 COLUM. L. REV. 1301, 1314 (2008) ("[M]ost commentators now agree that the prototypical Rule 10b–5 class action (i.e., one brought against a nontrading corporation for its officer's fraud-on-the-market) cannot be defended on compensatory grounds.").

[192] It is possible that the dynamics would play out differently if, for example, the large shareholders who brought individual claims insisted that officer and director defendants personally paid part of the settlement proceeds, rather than relying entirely on their insurance carrier. *See, e.g.*, Webber, *supra* note 189, at 264 ("It is also possible that institutional investors will demand, as a condition for settling an arbitration, that individually culpable defendants make personal payments towards the settlement.").

[193] For a discussion of fee-shifting bylaws, see *supra* note 168 and accompanying text.

[194] While this Part proposes some procedural reforms that shareholders could adopt, it is by no means an exhaustive list. Shareholders might experiment with limitations on discovery or new summary judgment standards, or they might tinker with damage rules. Further still, they might decide to repeal some of the procedural relics that have long been associated with certain types of shareholder litigation, such as the demand requirement or contemporaneous ownership requirement in derivative suits. The point is not that there is a single procedural talisman that will solve all of the problems in shareholder litigation, but rather that companies should experiment to find the right procedural tools for their particular situation.

problems in shareholder litigation: judges, legislatures, and corporate boards. Yet, as explained below, none of these groups have the right incentives to promote the necessary procedural changes.

This Part suggests a new actor to drive these reforms: institutional investors. Institutional investors have the right financial incentives to push for these new reforms because they stand on both sides of these lawsuits. As a result, they are financially invested in both preserving meritorious lawsuits and blocking meritless ones. No other group has these dual incentives. The discussion below first explains why other groups have run into roadblocks in trying to solve the problems in shareholder litigation. It then explains why institutional investors are uniquely situated to push for the procedural reforms laid out in Part II.

A. *Institutional Roadblocks*

Corporate law has traditionally looked to judges, legislatures, and corporate boards to solve the problems in shareholder litigation. This Section explains why none of these groups have the right incentives and/or power to advocate for sweeping procedural reform.

1. Judicial Reform

Judges already use procedure as a key weapon in their effort to monitor shareholder litigation.[195] Under the *Federal Rules of Civil Procedure*, class actions and derivative suits cannot settle without the approval of the presiding judge.[196] In carrying out this responsibility, judges are supposed to ensure that proposed settlements are "fair, reasonable, and adequate" in protecting the interests of represented parties.[197] In theory, therefore, judges already have a procedural tool to address the problems in shareholder litigation.

In practice, however, this tool falls short. Judges cannot easily probe under the surface of most settlements. Unlike motions practice where the parties are on opposite sides and are quick to point out the weaknesses of each other's arguments, settlements are a joint proposal by the parties. The non-adversarial nature of settlement hearings means that it is difficult for judges to discern the problems in proposed settlements. The Delaware Court of Chancery has stated, for example, that it is forced to become a "forensic examiner . . . play[ing] devil's advocate" to determine the value of settlement terms.[198]

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[195] *See, e.g.*, Hillary A. Sale, *Judges Who Settle*, 89 WASH. U. L. REV. 377, 390 (2011) ("Their job is to adjust for and counteract the agency problems and litigation gaps. It is through this process that the judges become settlement gatekeepers.").

[196] FED. R. CIV. P. 23(e), 23.1(c) (outlining procedure for class action settlement and derivative actions).

[197] FED. R. CIV. P. 23(e)(2).

[198] *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 894 (Del. Ch. 2016).

Few judges are willing to play this role. Most judges have busy dockets, and they do not want to go looking for a fight where none exists.[199] Moreover, even if judges decide to inquire more deeply, they may find it difficult to hold onto their cases. Delaware's experience trying to crack down on merger litigation illustrates this point. As discussed in Section II.A, plaintiffs' attorneys took their cases elsewhere when Delaware judges tried to rein in disclosure-only settlements.[200] In other words, there is a clear downside in relying on judges to police nuisance settlements—many judges do not want to play this role, and those who do lack the tools to hold onto their cases.

Nor can judges simply adopt new procedural tools to augment their existing ones. Judges enforce the procedural rules on the books; they do not write the rules themselves. They do have some flexibility to fill in procedural gaps in the existing rules through local rules or standing orders, but they cannot adopt altogether new requirements. As a result, even if judges wanted to adopt the new procedures outlined in Part II, they lack the power to do so.

2. Legislatures

The legislative branch has an easier time making wholesale changes to the law. While individual judges are limited to the cases pending before them, Congress can enact laws that apply to all cases of a given type. In enacting the PSLRA for example, Congress made sweeping changes to the law governing securities class actions, regardless of where these cases were filed.[201] State legislatures are more limited in their reach, but they can still alter the rules in cases governed by their states' law. It is no surprise, therefore, that both federal and state legislators have occasionally tried to fix the problems in shareholder litigation.[202]

Their efforts, however, reveal the downsides of relying on the legislative branch to develop nuanced solutions to complex litigation challenges. Legislators are subject to lobbying by those whose interests may be impacted by new legislation. With the PSLRA, for example, Congress heard extensive testimony from corporate America regarding the problems with securities class

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[199] *See, e.g.*, Sale, *supra* note 195, at 411 ("Of course, if judicial gatekeepers spend more time on settlements, they may increase the amount of time that cases spend on the docket. Busy judges will then face their own personal and professional conflicts with resisting and scrutinizing settlements.").

[200] For further discussion, see *supra* Section II.A.

[201] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.) (outlining investigations and actions).

[202] *See, e.g.*, *id.*; DEL. CODE ANN. tit. 8, § 109(b) (2019) (prohibiting bylaws of Delaware corporations from containing "any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim"); OKLA. STAT. tit. 18, § 1126 (2017) (adopting loser pays rules in derivative suits filed against Oklahoma corporations).

actions.[203] It heard much less from the investors who benefit from these suits. This partisan jockeying left little opportunity for careful consideration of appropriate solutions. As a result, as discussed above,[204] the PSLRA includes many procedural reforms inappropriate for the information asymmetries that plaintiffs in these suits face.[205]

State legislatures are not immune from these challenges. In Delaware, for example, the General Assembly relies on the corporate bar to suggest and draft changes related to corporate law.[206] These lawyers, while certainly knowledgeable, have a vested interest in ensuring that shareholder litigation remains a viable source of income for Delaware lawyers.[207] As a result, they are unlikely to take any broad action that might threaten their monopoly.[208] In other states, legislative action is difficult for different reasons. Few states outside of Delaware see enough shareholder litigation to make legislative action worthwhile, and even those state legislatures that choose to address it are unlikely to have enough expertise in the area to develop nuanced legislative solutions.[209]

3. Corporate Boards

Perhaps recognizing the limitations of judges and legislatures, corporate law recently vested boards of directors with greater power to police shareholder

[203] *See, e.g.*, *Securities Litigation Reform: Hearings Before the Subcomm. on Telecomms. & Fin. of the H. Comm. on Energy & Commerce*, 103d Cong. 217 (1994) (testimony of Stephen F. Smith, Gen. Counsel, Exabyte Corp.) (alleging plaintiffs' attorneys often utilized computer-generated boilerplate complaints).

[204] *See supra* notes 147-152 and accompanying text.

[205] *See* Erickson, *supra* note 8, at 71-72, 113-16.

[206] *See* Guhan Subramanian, *Delaware's Choice*, 39 DEL. J. CORP. L. 1, 48 (2014) ("Council of Corporation Law, a group of 27 well-respected attorneys mostly from prominent Wilmington firms, proposes all amendments to the DGCL. The Council writes the corporate law of Delaware and, by extension, the country.").

[207] *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 472 (1987) ("[R]ules that Delaware supplies often can be viewed as attempts to maximize revenues to the bar, and more particularly to an elite cadre of Wilmington lawyers who practice corporate law in the state.").

[208] *See* Bainbridge, *supra* note 1, at 875 ("[I]f [Delaware] wishes to ensure that future legislation advances both sound public policy and the State's financial interests, the General Assembly needs to free itself from the bar's influence.").

[209] For example, Oklahoma recently adopted a fee-shifting statute pursuant to which losing parties in derivative suits are now required to pay their opponents' expenses, including attorneys' fees. OKLA. STAT. tit. 18, § 1126 (2017). Commentators have reported that this statute was the result of lobbying by a prominent Oklahoma company, Continental Resources, which had faced a fiduciary duty lawsuit. *See* Gary W. Derrick, Recent Developments in Oklahoma Business and Corporate Law 2014, at 11 (2014) (unpublished manuscript), http://derrickandbriggs.com/wp-content/uploads/2015/08/Seminar-paper-recent-developments-2014.docx [https://perma.cc/K944-Y9UE]. The statute itself reflects these pro-defense roots, making it financially perilous for any shareholder to file a derivative suit.

litigation. As discussed above, in 2010, the Delaware Court of Chancery invited corporations concerned about litigating in multiple jurisdictions to include a forum selection provision in their corporate charter.[210] Following this invitation, several hundred companies adopted forum selection provisions.[211] This development paved the way for corporations to consider other types of private ordering, including fee-shifting bylaws,[212] minimum ownership requirements,[213] and arbitration provisions.[214] Scholars have largely cheered on this development, while exploring other ways that corporations can engage in litigation self-help.[215]

The problem is that there is significant reason to question whether corporate directors are the right people to rewrite these rules, at least on their own.[216] Directors are typically among the defendants in these cases.[217] As a result, they draft procedures that will govern suits that may later be filed against them and, in doing so, they will inevitably be influenced by concerns about their own self-interest. For obvious reasons, the legal system does not usually put parties in charge of drafting the procedural rules that will later determine their legal fate.

[210] *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

[211] *See* Romano & Sanga, *supra* note 104, at 3 (finding that, as of August 2014, 754 public companies had adopted these provisions).

[212] The Delaware General Assembly has since prohibited these provisions. *See* DEL. CODE ANN. tit. 8, § 109(b) (2019) ("The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim . . . .").

[213] Soon after the Delaware Supreme Court upheld fee-shifting bylaws, four related companies announced bylaws prohibiting its stockholders from initiating a direct or derivative claim unless the claiming stockholder delivers to the corporate secretary written consent by beneficial stockholders owning at least three percent of the outstanding shares. *See, e.g.*, Imperial Holdings, Inc., Current Report (Form 8-K) (Oct. 30, 2014) ("[C]urrent or prior shareholder or group of shareholders . . . may not initiate a claim in a court of law on behalf of . . . any class of current and/or prior shareholders against the corporation . . . unless the Claiming Shareholder . . . delivers to the Secretary written consents by beneficial shareholders owning at least 3% of the outstanding shares of the corporation . . . .").

[214] *See* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 587 (2016) (arguing that Federal Arbitration Act does not require states to uphold corporate bylaw or charter provisions mandating that shareholder claims be arbitrated).

[215] *See, e.g.*, Griffith, *supra* note 16, at 3 (promoting "No Pay" provisions).

[216] *See infra* Section III.B (discussing merit to having corporate boards play role in development of procedural bylaws, but also risk of having boards do so without significant input or oversight from other corporate constituencies).

[217] *See* Bainbridge, *supra* note 1, at 852 n.1 (using term shareholder litigation to encompass suits by "shareholders under state corporate law against any combination of the corporate entity and its officers and directors").

The perils of this approach are far from theoretical. As discussed in Part II, after the Delaware Court of Chancery invited boards to take procedure into their own hands, many boards amended their bylaws to include fee-shifting provisions.[218] Representative shareholders only receive their pro rata share of the recovery if the suit is successful, but these provisions made them liable for 100% of the costs if it is not successful.[219] This combination of high risks and low rewards makes it financially perilous for any shareholder to serve as a lead plaintiff, threatening the entire shareholder litigation franchise. As a result, if the goal of these boards was to eliminate all shareholder litigation, these bylaw provisions were a good start.

So far, courts have been relatively unconcerned about these potential conflicts of interests. In *ATP Tour, Inc. v. Deutscher Tennis Bund*[220] the Delaware Supreme Court held that litigation-limiting charter and bylaw provisions are facially valid.[221] The court retained the right to review these provisions on an as-applied basis to determine whether they are "adopted by the appropriate corporate procedures and for a proper corporate purpose."[222] This standard, for example, might prohibit a board from adopting protective procedures after its members have been sued. It does not, however, account for the more pervasive structural biases that exist when boards adopt procedures that may later govern litigation filed against them.[223]

Courts are not the only bodies that can try to guard against these structural biases. Directors ultimately answer to shareholders in elections that take place every one to three years.[224] If directors put procedures in place that insulate them from shareholder litigation, and shareholders oppose the move, in theory they can vote the directors out of office at the next election. Shareholders can also sell their stock, choosing to invest in companies that offer shareholders greater opportunities to constrain managerial agency costs. If enough shareholders sell their shares, the stock price will fall, financially penalizing the corporation. Or

[218] *See id.* at 858 (noting that "over fifty Delaware corporations adopted fee-shifting bylaws by April 2015").

[219] *See, e.g.*, Lebovitch & van Kwawegen, *supra* note 14, at 515-16 ("[I]t will be difficult for even the largest institutional investors to take the risk of paying millions, or tens of millions, of dollars in defense attorneys' fees to correct corporate misconduct when their individual, pro rata share of the potential benefit or recovery created by the litigation will only be a fraction of the total benefit sought . . . .").

[220] 91 A.3d 554 (Del. 2014).

[221] *Id.* at 560 ("Under Delaware law, a fee-shifting by-law is not invalid *per se* . . . .").

[222] *Id.* at 554.

[223] Michael J. Kaufman & John M. Wunderlich, *Paving the Delaware Way: Legislative and Equitable Limits on Bylaws After ATP*, 93 WASH. U. L. REV. 335, 357-60 (2015) (proposing that courts use enhanced scrutiny in reviewing litigation-limiting bylaw provisions).

[224] *See* DEL. CODE ANN. tit. 8, § 141(d) (2019) ("[A]t each annual election held after such classification becomes effective, directors shall be chosen for a full term . . . .").

shareholders can simply overrule directors, amending the bylaws on their own to delete or amend the procedures put in place by the board. In theory, therefore, shareholders can constrain procedural rulemaking by directors.

In practice, however, shareholders are limited in their ability to control directors. Shareholder voting has long been criticized for its inability to serve as an effective check on director power.[225] At many corporations' annual elections, there is only a single slate of directors. Shareholders unhappy with their performance can withhold their vote, but the slate will likely still be elected. Shareholders can put up their own slate, but this process is extremely expensive and time-consuming.[226] Similar hurdles apply when shareholders try to amend corporate bylaws on their own.[227]

This analysis is not meant to cast aspersions on corporate boards. Corporate law vests significant power in corporate boards,[228] and for good reason.[229] At the same time, however, the law has long recognized that boards have conflicts of interests that sometimes require greater judicial scrutiny and that the market is constrained in its ability to monitor.[230] These conflicts are fully present when boards insert litigation-limiting provisions into corporations' governing documents. Accordingly, corporate boards should not be the primary drivers of procedural reform.

B. *The Unique Potential of Institutional Investors*

Corporate law was on the right track when it invited corporations to include procedural innovations in their governing documents. Procedure is designed to sort the good cases from the bad, and, if done right, it can reduce the incentives to enter into nuisance settlements. To date, however, corporate boards have been the primary drafters of new procedural rules to govern shareholder lawsuits, creating a structural bias when they draft procedures that may later be used against them. Institutional investors, on the other hand, have far better economic

[225] *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676 (2007) ("[S]hareholder franchise does not provide the solid foundation for the legitimacy of directorial power that it is supposed to supply.").

[226] *See id.* at 688 (stating that "even when shareholder dissatisfaction with board actions and decisions is substantial, challengers face considerable impediments to replacing boards").

[227] *See, e.g.*, Fisch, *supra* note 22, at 377 ("[T]he board's power to adopt and amend bylaw provisions may, for a variety of reasons, be greater than the shareholders' corresponding power to do so.").

[228] *See* DEL. CODE ANN. tit. 8, § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

[229] *See* Stephen Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 6-9 (2002) (explaining rationale behind director power in corporate law).

[230] *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (using enhanced scrutiny to review board's adoption of defensive mechanisms); Zapata Corp. v. Maldonado, 430 A.2d 779, 788 (Del. 1981) (using enhanced scrutiny to review board's rejection of shareholder demand in derivative suit).

and organizational incentives to draft these new procedures. This Section first explores why institutional investors are better positioned than other potential actors to draft these rules, before turning to the legal hurdles that may stand in their way.

1. The Right Financial Incentives

Institutional investors have a direct financial stake in ensuring that shareholder lawsuits work effectively. It is their money on the line if corporate managers breach their fiduciary duties or other legal obligations. It is also their money on the line if corporations have to pay to defend against and settle frivolous lawsuits. This Section first examines the economic benefits of new procedural rules for shareholders as a whole and then explores whether individual shareholders have sufficient incentives to promote these new rules.

a. *Aggregate Financial Incentives*

New procedural rules could increase the net return for shareholders because shareholders stand on both sides of most shareholder lawsuits. On one hand, shareholders are the beneficiaries of any judgments in these cases. In merger and securities class actions, shareholders receive their pro rata share of the settlement fund directly.[231] In derivative suits, the recovery goes to the corporation, but still indirectly benefits shareholders by increasing the overall value of the company.[232] On the other hand, shareholders also pay the costs of these cases, at least indirectly. When a corporation, its directors, and its officers are sued, the corporation typically pays its own attorneys' fees and the fees of its directors and officers.[233] If the case settles, the court often orders the defendant corporations to pay the plaintiffs' attorneys' fees as well.[234] These amounts ultimately come out of the shareholders' pockets.

The amount of money at stake can be significant. One study found that public pension funds reported receiving an average of $6.75 million in the prior fiscal

[231] *See* Webber, *supra* note 189, at 223 (stating that many investors "passively participate in class actions by collecting their pro rata share of settlement").

[232] *See* Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 81 (2008) ("Any recovery in a derivative suit is returned to the corporation. As a result, shareholders may receive an indirect benefit from a derivative suit because of their share of ownership in the corporation, but they do not receive any direct financial benefit.").

[233] *See, e.g.*, DEL. CODE ANN. tit. 8, § 145 (providing for indemnification of corporate officers and directors).

[234] *See* Griffith, *supra* note 50, at 10 ("The plaintiffs' lawyers, nevertheless, are entitled to recover their fees from the defendant corporation on the basis of the settlement's therapeutic benefit."). Even if these amounts are covered by directors and officers insurance, shareholders still pay through higher premiums.

year in recoveries from litigation.[235] The potential gains in individual cases can be even greater, with another study finding that public pension funds seeking to serve as lead plaintiffs have an average claimed loss of $9.2 million.[236] These figures suggest that improvements in how these suits function could directly impact investors' bottom lines.

Beyond these direct recoveries, new procedural rules could also increase the deterrent impact of shareholder litigation more broadly. Shareholder litigation has two goals: to compensate shareholders that have been injured financially by violations of the law and to deter future breaches of fiduciary duty, both by the managers of the targeted company and by managers at other companies.[237] If managers see that their counterparts at other companies are being held accountable for their bad acts, these managers may decide to be more careful about their own behavior. As a result, in addition to their recovery in specific cases, shareholders may benefit from the policing effect on managers at the other companies in which they invest.

The deterrent value of these suits will likely increase if the number of meritless claims is reduced. Shareholders lose financially when shareholder litigation becomes overrun with frivolous cases. If managers believe that they will be sued no matter what decisions they make—as is currently the case in merger litigation and, to a lesser extent, derivative litigation and securities class actions—shareholder litigation will not have the same impact on managerial behavior. Similarly, if managers know that they can get a case dismissed by offering relatively inconsequential disclosures or corporate governance reforms, they will have less fear of personal liability. Shareholder litigation is one of the primary means for shareholders to control managerial agency costs,[238] and anything that compromises the effectiveness of these suits ultimately hurts shareholders. As a result, addressing the problems in these lawsuits would benefit investors as a whole, but only if the solution is also nuanced enough to protect meritorious suits.

[235] Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 333 (2008) ("We find that funds in our sample reported recovering an average of $6.75 million in the prior fiscal year . . . .").

[236] James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1621 n.130, 1622 n.134 (2006).

[237] *See* Darian M. Ibrahim, *Individual or Collective Liability for Corporate Directors?*, 93 IOWA L. REV. 929, 951 (2008) ("First, fiduciary duty litigation is intended to deter fiduciary duty breaches ex ante; second, it is intended to compensate for the losses those breaches cause ex post.").

[238] *See* Kaufman & Wunderlich, *supra* note 223, at 363 ("[B]y enabling equitable review of managers' actions, shareholder litigation gives shareholders a powerful tool to protect their welfare and, as the Delaware Way recognizes, constrain the broad legal authority Delaware law invests in managers.").

This point reflects a broader point about procedural rulemaking. The best procedural rules are written by those who do not know which side of the case they will eventually be on.[239] Similar to the Rawlsian veil of ignorance,[240] if drafters write procedures without knowing whether they will be the plaintiff or the defendant, they are much more likely to write procedural rules that aim to be fair and neutral. Shareholders are in exactly this position. They may be the plaintiffs in a future case if a corporate board engages in self-dealing or other egregious conduct, but they could also find themselves standing with the corporate defendants opposing a meritless lawsuit. Without a crystal ball, they simply cannot predict which side they will be on in any particular case. As a result, they want procedural rules that will accurately sort the cases with merit from those without.

This observation sets shareholders apart from the other groups that could help address the problems in shareholder litigation. Shareholders are the only group with the right financial incentives when it comes to procedural rulemaking. Corporate directors, even if they are not actively facing a lawsuit, know that they could be defendants in these suits at some point in the future, creating a legitimate concern that their proposals will reflect this bias. The attorneys on both sides of these suits have a financial interest in making sure that these suits continue unabated. And judges do not have any financial skin in the game, which means that they often lack an incentive to come up with systemic solutions, especially if their caseload includes only a few shareholder suits. In short, although many groups may want to solve the problems in shareholder litigation, only shareholders are financially invested in ensuring that any solution is balanced enough to let the meritorious suits proceed while screening out the meritless ones. And, unlike judges, shareholders have the power to address these problems through their ability to amend corporate bylaws.

b. *Incentives for Individual Investors*

Even if shareholders as a whole have the right financial incentives to engage in balanced procedural rulemaking, can they overcome the collective action problems necessary to push these reforms? In other words, do *individual*

[239] *See, e.g.*, Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485, 540 (2003) ("Each agent knows that after the veil of ignorance is lifted she will be better off with an option that lets her use the information she has to contract for alternative procedures that improve her prospects."); Bruce L. Hay, *Procedural Justice–Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1847 (1997) ("To the extent that impartiality is considered a central or fundamental value by the procedure community, it may be that this community's own commitments require it to employ something like the Rawlsian procedure when designing procedure.").

[240] *See generally* JOHN RAWLS, A THEORY OF JUSTICE (1971).

institutional investors have enough money on the line to take the lead in these efforts?[241]

These questions reflect the fact that procedural rulemaking is a form of shareholder activism, and such activism has always suffered from a free rider problem.[242] Although all of a corporation's shareholders may benefit from activism, the costs of activism are borne almost entirely by the activists themselves. Even if, for example, all shareholders of a given company agreed that heightened pleading is necessary to screen shareholder lawsuits, it may not be cost-effective for any single shareholder to take the lead in proposing this new rule. These efforts are further complicated by the fact that institutional investors are competing against each other to attract customers.[243] As a result, an effort by one institution to promote firm-specific reforms may raise their individual costs relative to their competitors and accordingly cause them to lose customers.[244] The key question is whether this reluctance will doom any procedural rulemaking efforts.

The experience of the PSLRA provides a reason for optimism. The PSLRA created a rebuttable presumption that the lead plaintiff in a securities class action should be the shareholder applicant with the greatest financial stake in the litigation.[245] When this statute was enacted in 1995, there was concern that few institutional investors would take Congress up on its invitation to lead these suits.[246] Just like procedural rulemaking, it costs money to serve as a lead plaintiff in a securities class action, and an institution may find it difficult to recoup these costs given that the benefits of a securities class action are spread among all shareholders. Slowly, however, institutions got involved, and today institutions serve as lead plaintiffs in nearly half of all securities class actions.[247]

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[241] *See* Romano, *supra* note 3, at 55 ("The efficacy of shareholder litigation as a governance mechanism is hampered by collective action problems because the cost of bringing a lawsuit, while less than the shareholders' aggregate gain, is typically greater than a shareholder–plaintiff's pro rata benefit.").

[242] *See* Stephen M. Bainbridge, *The Politics of Corporate Governance*, 18 HARV. J.L. & PUB. POL'Y 671, 699 (1995) (describing "institutional activism" as "classic example of a situation in which free riding is highly likely").

[243] *See* Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359, 1392 (2014) ("From the fund's perspective, any monies spent on voting may reduce marginally the firm's relative performance compared to its competitors.").

[244] *See* Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 300 (2008) ("Many institutions were reluctant to incur the expenses of engaging in monitoring activities because this could depress portfolio returns, whereas any benefits would be shared with their competitors.").

[245] *See* 15 U.S.C. § 78u (2012).

[246] *See, e.g.*, Cox & Thomas, *supra* note 236, at 1602 (stating in 2006 that "institutional investors have been slow to answer the call to become lead plaintiffs").

[247] *See id.* at 1597-602.

Why are institutional investors willing to participate in these suits, despite the collective action problems? The institutions that most commonly serve as lead plaintiffs are not hedge funds or private equity funds—institutions with a single-minded focus on their short-term financial returns. Instead, more often than not, the institutions that have stepped up to serve as plaintiffs in these suits are public pension or labor funds.[248] As other scholars have documented, these funds are "not motivated by purely economic interests in deciding to take part in litigation."[249] Instead, "[i]n addition to believing that they can improve settlements to their own benefit, lead plaintiff applicants may be motivated to serve by a sense of moral and civic duty to act in the face of fraud."[250] Their participation benefits securities litigation, as suits filed by public pension or labor funds are associated with greater recoveries and lower attorneys' fees than suits filed by other types of plaintiffs.[251] One could imagine these same institutions being the first movers in procedural rulemaking.

Other types of institutions are also focused on broader issues of governance and accountability as a way to enhance the value of their investment portfolios. Vanguard, for example, has four pillars of corporate governance that guide its investments. In its pillar of governance structure, Vanguard states, "We believe that shareholders should be able to hold directors accountable as needed through certain governance and bylaw provisions."[252] Similarly, BlackRock recently stated that its "philosophy on corporate governance" included the core idea that "[c]ompanies and their boards should be accountable to shareholders and structured with appropriate checks and balances to ensure that they operate in shareholders' interests."[253] In other words, these institutions think that board accountability is so crucial to their financial strategy that they have put it front and center in their investment plans. Procedural rulemaking is entirely consistent with this investment strategy because it enhances one of the primary means of holding board members accountable.

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[248] James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 369-70 (2008).

[249] David H. Webber, *The Plight of the Individual Investor in Securities Class Actions*, 106 NW. U. L. REV. 157, 174 (2012).

[250] *Id.*

[251] *Id.* at 159 (noting improved outcomes for shareholders when public pension or labor funds take lead plaintiff position).

[252] *Investment Stewardship Pillars*, VANGUARD, https://about.vanguard.com/investment-stewardship/investment-stewardship-pillars/ [https://perma.cc/LK78-F9H2] (last visited Apr. 6, 2019).

[253] BLACKROCK, INVESTMENT STEWARDSHIP: GLOBAL CORPORATE GOVERNANCE & ENGAGEMENT PRINCIPLES 2 (2017), https://www.blackrock.com/corporate/en-br/literature/fact-sheet/blk-responsible-investment-1engprinciples-global-122011.pdf [https://perma.cc/4FEQ-2X9Z].

These institutions could also take steps to reduce the costs of procedural rulemaking. A number of different companies could use a single set of procedural rules. Institutional investors could draft—or hire procedural experts to draft—a common set of proposed rules, and then work to get these rules adopted at a number of the companies in which they invest. In this way, the costs of drafting these rules would be divided among the different companies in their investment portfolio. Institutional investors could also work together to draft these rules, further lowering their individual costs.[254] Or, as discussed in greater detail below, proxy advisory services, such as Institutional Shareholder Services, could draft a common set of proposed rules that its member companies could then propose to the companies in which they invest, thereby spreading the costs across many investors.[255] Any of these options would allow investors to spread the costs of procedural rulemaking across their portfolio. In short, collective action could solve the collective action problem.

Putting all of this together, institutional investors stand on both sides of shareholder lawsuits, receiving any financial benefits but also paying the costs. As a result, as a group, these investors have the greatest financial incentive to fix the problems in these suits. The challenge comes in encouraging individual institutions to overcome the free rider problem to promote new procedural rules. Public pension and labor funds, or other like-minded institutional investors, are best suited to take the lead in these reforms because they are committed to corporate governance more broadly and thus are more willing to incur the costs of implementing these rules.

2. The Right Organizational Structure

Institutional investors, including public pension and labor funds, also have the right organizational structure to engage in procedural rulemaking. As this Section discusses, institutional investors are already engaged in a variety of activism efforts, and procedural rulemaking would complement these existing efforts. It would also allow them to have a broader impact on shareholder litigation compared to their current practice of serving as plaintiffs in individual lawsuits. This Section first discusses how procedural rulemaking would fit into the larger sphere of shareholder activism before turning to the specific means by which institutional investors could promote new procedural rules.

a. *A Complementary Form of Activism*

Over the last twenty years, institutional investors have been increasingly active in attempting to influence their portfolio companies. In 2016 alone, investors put forth more than five hundred shareholder proposals at U.S. publicly

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[254] *See, e.g.*, Choi & Fisch, *supra* note 235, at 319 (discussing "coalition-building efforts between more activist and less activist funds" in promoting corporate governance reform).

[255] *See infra* notes 262-264 and accompanying text (detailing actions taken by proxy advisory services).

traded companies, more than half of which related to issues of corporate governance.[256] Activists also launched proxy contests and engaged in other efforts to gain board representation in more than one hundred campaigns in the 2017 proxy season, and these efforts have been increasingly successful.[257] Finally, as discussed above, institutional investors constitute nearly half of the lead plaintiffs in securities class actions, and they file a significant percentage of merger class actions and shareholder derivative suits.[258] Overall, spending on shareholder activism now exceeds forty billion dollars per year,[259] with one leading law firm stating that the rise of shareholder activism over the past decade has caused a "seismic shift" in the relationship between corporations and their shareholders.[260]

As a result, large investors already have staffs and infrastructure devoted to corporate governance efforts.[261] These staffs are often small, but they think systematically about how to improve corporate governance across their portfolio companies.[262] Many investors have also published detailed corporate

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[256] *See* SULLIVAN & CROMWELL LLP, 2017 PROXY SEASON REVIEW 1 (2017), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2017_Proxy_Season_Review.pdf [https://perma.cc/7KR8-LSZ6] (outlining statistics related to shareholder proposals).

[257] *See* J.P. MORGAN CHASE & CO., THE 2017 PROXY SEASON: GLOBALIZATION AND A NEW NORMAL FOR SHAREHOLDER ACTIVISM 11-12 (2017), https://www.jpmorgan.com/jpmpdf/1320739681811.pdf [https://perma.cc/6Z5G-LSQK] (discussing success rate of proxy votes that went to vote).

[258] *See* David H. Webber, *Private Policing of Mergers and Acquisitions: An Empirical Assessment of Institutional Lead Plaintiffs in Transactional Class and Derivative Actions*, 38 DEL. J. CORP. L. 907, 907 (2014) (finding that "institutional investors play as large of a role in these cases as they do in federal securities fraud class actions, leading 41% of them").

[259] *See* Christopher P. Skroupa, *2017 and Beyond—Major Trends Shaping Shareholder Activism*, FORBES (Oct. 31, 2017, 8:43 AM), https://www.forbes.com/sites/christopherskroupa/2017/10/31/2017-and-beyond-major-trends-shaping-shareholder-activism/#171bd68c15e7 [https://perma.cc/DY28-WUEG] ("Activist shareholders have deployed $45 billion in new campaigns year to date, nearly double the amount for all of 2016.").

[260] *See* SULLIVAN & CROMWELL LLP, 2016 U.S. SHAREHOLDER ACTIVISM REVIEW AND ANALYSIS 1 (2016), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2016_U.S._Shareholder_Activism_Review_and_Analysis.pdf [https://perma.cc/734X-585N] ("The past decade has seen a seismic shift in the relations between companies and their shareholders.").

[261] *See* Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 483 (2014) ("[C]ertain institutional investors have staffs who have jobs and influence largely because of the proliferating number of votes that stockholders are asked to cast.").

[262] *See* George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1301 ("Many institutions (especially the larger ones) maintain internal staffs to research proxy issues, and they often reject the advice of a proxy advisor and follow the contrary recommendations of their own staffs.").

governance principles that inform their voting practices.[263] Proxy advisory services support these efforts, providing detailed recommendations to institutional investors on specific issues.[264]

Shareholder litigation has been largely absent from these efforts. Some public pension and labor funds regularly serve as representative plaintiffs in shareholder lawsuits, but otherwise most institutional investors have not paid much attention to what happens in the courtroom. Activist investors are focused on market-based forms of activism, seeking to unseat directors or pushing shareholder proposals to change specific governance practices, rather than filing shareholder lawsuits.[265]

This strategy has drawbacks. Market-based activism aims to create a solid governance foundation within target corporations, ensuring that people with the right skills and incentives are on corporate boards and that these boards are pursuing the right management strategies. These efforts are crucial, but they offer little protection to shareholders if things go wrong. Even the best governance foundation cannot prevent every form of managerial wrongdoing. Indeed, if corporate law teaches us anything, it is that managers are ever-creative when it comes to enriching themselves at the expense of shareholders. Litigation supported by the right procedural rules is therefore an essential complement to existing forms of shareholder activism.

Procedural rulemaking is also a more influential strategy than serving as plaintiffs in individual lawsuits. By serving as representative plaintiffs, institutional investors can influence the individual cases in which they serve, but they cannot stop other shareholders from filing their own meritless suits. Investors can object to settlements in these other cases, but this is also a piecemeal approach to litigation reform because objectors have to appear in individual cases to contest the settlement.[266] In addition, serving as an objector only allows shareholders to object at the final stage of the litigation.[267] It does not allow them to object to other litigation decisions, including whether to file the case in the first place.

Serving as a lead plaintiff also puts heavy demands on an institution's time and resources. One institutional investor, for example, stated that it costs between twenty-five thousand and one hundred thousand dollars of

[263] *See, e.g.*, *supra* notes 252-253 and accompanying text (discussing governance principles of BlackRock and Vanguard).

[264] *See* Edelman, Thomas & Thompson, *supra* note 243, at 1361 ("[T]he birth of proxy advisory firms, including Institutional Shareholder Services ('ISS'), . . . help[ed] address the costs of voting and the collective action problems inherent in coordinated institutional shareholder action.").

[265] *See supra* notes 256-258 and accompanying text (discussing statistics associated with activist investors).

[266] *See, e.g.*, Schultz v. Ginsburg, 965 A.2d 661, 669-71 (Del. 2009) (discussing standards objectors must meet to nullify security class action settlement).

[267] *See id.*

unreimbursed staff time to serve as lead plaintiff.[268] Given the time burdens, this institution stated that it can only serve as lead plaintiff in one or two cases at a time.[269] Some scholars have suggested that it is only worth an institutional investor's time and money to serve as lead plaintiff if the investor has at least one million dollars at stake in the litigation.[270] Even apart from these financial constraints, the PSLRA places a limit on the number of cases in which an institutional investor can serve as lead plaintiff.[271] As a result, there are both economic and legal limitations to how many cases investors can influence by serving as lead plaintiff.

In contrast, procedural rulemaking offers a number of advantages. As noted above, a single set of rules can be used at a number of companies. By investing the time and money to draft a single set of rules, investors can impact litigation practices across their investment portfolio.

Moreover, procedural rulemaking may appeal to a broader group of institutional investors. Prior empirical work revealed that, although many institutional investors care deeply about corporate governance, they do not engage in shareholder activism because they do not want to take a confrontational stance toward corporate management.[272] Trying to unseat a board member or block a deal proposed by the board pits institutional shareholders against management in a way that can have long-term ramifications for an institution's relationship with the company. This is especially true if the institution has other business dealings with the company. Similarly, institutions inevitably come into conflict with management when they agree to serve as representative plaintiffs in shareholder lawsuits. However, the process of adopting new procedural rules does not need to be antagonistic. Rather than a zero-sum negotiation, shareholders can work with corporate boards to craft new procedural rules. Procedural rulemaking can be a more cooperative enterprise than most other forms of shareholder activism.

[268] *See* Cox & Thomas, *supra* note 236, at 1621 n.130 (discussing cost of litigation and burden of litigation on firms).

[269] *See id.* at 1622 n.134 ("One institutional investor has told us that because of staffing limits, it can only take on one or two cases at a time. To focus on the biggest impact cases, its threshold claim for considering a lead plaintiff position is $7 million.").

[270] *See id.* at 1621 ("In any event, this analysis suggests that a minimum claim size of $1 million is necessary for an institution to give serious consideration to becoming a lead plaintiff.").

[271] 15 U.S.C. § 78u–4(a)(3)(B)(iv) (2012) (limiting number of cases in which plaintiff can be a lead plaintiff to five at time unless court permission is received).

[272] *See* Choi & Fisch, *supra* note 235, at 319 (stating that institutional investors attribute their lack of involvement in activist activities in part to "their desire to avoid confrontational behavior").

b. *Two Paths to Procedural Reform*

Institutional investors may be organizationally well-suited to engage in procedural rulemaking, but it would not necessarily be easy for them to get their portfolio companies to adopt these procedures. Institutional investors have two different paths available to them when it comes to adding new procedures to a corporation's bylaws.

First, they could propose the amendments to the bylaws themselves, although this is easier said than done. Delaware corporate law gives shareholders the right to amend corporate bylaws,[273] but it does not make it easy for them to come together to do so. An investor can propose a bylaw amendment to be voted upon by shareholders at a corporation's annual meeting. To do so, however, it would need to solicit the proxies of other shareholders in support of its proposal,[274] a time-intensive and expensive process. Alternatively, it can include its proposal on the corporation's proxy, which is subject to a host of complex requirements under the federal securities laws.[275] Shareholders could also act to amend the bylaws outside of the annual meeting through written consent,[276] but the dispersed ownership at most public corporations makes this option difficult as well. These options are all possible, but the time and expense associated with them would discourage all but the most committed shareholders.

A more feasible option is for institutional investors to work with corporate boards to draft new procedural rules. It is far easier for boards to amend the bylaws because they can do so at a regularly-scheduled board meeting.[277] For all of the reasons discussed above, boards should not have sole control over the rulemaking process, but they could partner with institutional investors to put into place neutral rules that curb the excesses of shareholder litigation without screening out meritorious suits. In this way, institutional investors could provide thought leadership on these issues without incurring the cost of a proxy campaign. This approach is consistent with a growing trend in corporate law of institutions and boards working together to influence corporate governance.[278]

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[273] *See* DEL. CODE ANN. tit. 8, § 109(b) (2019) (outlining requirements for giving proper notice).

[274] *See* Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1, 28 (2011) (arguing that, "as a practical matter," shareholders' ability to amend corporate bylaws "can be operationalized in a typical public company only by aggregating proxies in favor of the proposal from a large number of minority shareholders—a costly endeavor indeed").

[275] As one example, the proposal can only be five hundred words. *See* 17 C.F.R. § 240.14a-8(c), (d) (2018). It would be nearly impossible to craft and defend specific procedural reforms within this small number of words.

[276] *See* DEL. CODE ANN. tit. 8, § 228 (providing for written consent in lieu of meeting).

[277] *See id.* § 109(b) (providing for director vote to amend bylaws).

[278] *See, e.g.*, Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 831 (reviewing evidence that "significant number of investors [have] sought greater engagement with the board" and stating that "shareholders and their advocates have

Studies demonstrate that institutional investors routinely work with boards to achieve their desired reforms. For example, one study found that one-third of public pension and labor funds attempted to influence corporate managers through direct negotiation or letters.[279] Another study examined the activism efforts of the Teachers Insurance and Annuity Association of American-College Retirement Equities Fund ("TIAA-CREF") and found that the companies came to an agreement with the target company before a formal vote more than seventy percent of the time.[280] Across different forms of activism, shareholders are increasingly negotiating for the relief they want, rather than entering into pitched battles with corporate boards.[281] Accordingly, the type of cooperative engagement proposed here is not unusual in the world of shareholder activism.

This engagement would ideally occur when there is no ongoing shareholder litigation at the company at issue and, therefore, the board would not have their own potential liability front and center in their minds. During this process, shareholders will have to be cognizant of directors' structural bias, but they can also benefit from boards' wisdom and experience in participating in these suits. This partnership would address the oft-raised concern that shareholder activism preempts the role of corporate boards in managing corporations,[282] while also addressing the reality that boards have a conflict of interest, meaning they should not have unchecked power to propose new limitations on shareholder litigation.

c. *Explaining the Status Quo*

If there is money to be made and cooperative relationships to be formed from procedural rulemaking, why are shareholders not already exploring this option?

proposed a range of different strategies for increasing their interactions with board members from annual corporate governance calls with directors, to periodic 'investor days' at the corporation spearheaded by directors"); Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171, 171-72 (2009) ("An increasing number of shareholders are demonstrating a preference for negotiations over such traditional forms of activism as shareholder proposals, proxy contests, and litigation.").

279 *See* Choi & Fisch, *supra* note 235, at 329.

280 *See* Willard T. Carleton, James M. Nelson & Michael S. Weisbach, *The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence from TIAA-CREF*, 53 J. FIN. 1335, 1335 (1998).

281 *See, e.g.*, Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 265 (2016) ("The shareholder proposal settlement has become increasingly popular as a tool for negotiating private rules for corporations on matters that are, by long tradition, subjects of public regulation."); Lee Harris, *Corporate Elections and Tactical Settlements*, 39 J. CORP. L. 221, 224 (2014) (describing "elaborate dance" by corporate boards "to avoid a contested corporate election").

282 *See, e.g.*, Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601, 626 (2006) ("Active investor involvement in corporate decisionmaking seems likely to disrupt the very mechanism that makes the public corporation practicable; namely, the centralization of essentially nonreviewable decisionmaking authority in the board of directors.").

In many respects, this is the million-dollar question. Sophisticated investors, after all, do not usually leave money or opportunity on the table. The fact that they have not gotten into the procedural rulemaking business perhaps suggests that they might not be interested in this new form of activism.

There are, however, other explanations for the current state of affairs. First, procedural innovation in corporate charters and bylaws is a fairly new development. The Delaware Court of Chancery did not suggest it as an option until 2010, and even then it was only raised in the context of forum-selection bylaws.[283] Boards led the next round of procedural rulemaking involving fee-shifting bylaws, which were subject to a significant amount of criticism and legal wrangling (and for good reason, as discussed in Part II).[284] Throughout this period, many institutional investors were watching carefully, with Institutional Shareholder Services advising companies to vote against most fee-shifting bylaws.[285] More generally, however, procedural rulemaking may be in a holding pattern of sorts while the financial markets seek to better understand its legal limits.

Second, procedural rulemaking is out of most institutional investors' normal wheelhouse. Institutional investors are experts in judging financial risk and pricing companies, not altering legal rules. And altering legal rules is not child's play. It is difficult to predict the exact impact of raising pleading standards or changing the scope of discovery. It may not occur to financial analysts to tinker with the legal rules governing shareholder lawsuits, and even if it does, they may fear that they will accidentally make the problems in these suits even worse.

Finally, the market is not as efficient or rational as we sometimes think. Investors are skilled at pricing companies, but this expertise does not necessarily translate into other ways of making money. A 2005 study, for example, found that institutional investors rarely submit claims in securities class action settlements, even though these claims could be worth significant amounts of money.[286] The authors tracked one hundred eighteen settlements in securities

[283] *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("If they do, and if boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

[284] *See, e.g.*, Lebovitch & van Kwawegen, *supra* note 14, at 515-16.

[285] *See* INSTITUTIONAL S'HOLDER SERVS., UNITED STATES SUMMARY PROXY VOTING GUIDELINES: 2017 BENCHMARK POLICY RECOMMENDATIONS 26 (2016), https://www.issgovernance.com/file/policy/2017-us-summary-voting-guidelines.pdf [https://perma.cc/DWE7-8T8N] ("Generally vote against bylaws that mandate fee-shifting whenver plaintiffs are not completely successful on the merits . . . .").

[286] *See* James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Their Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 454 (2005) ("[W]e determine that a large majority of institutional investors failed to file claims in securities fraud class action settlements.").

class actions, finding that only twenty eight percent of institutional investors filed claims in these settlements,[287] despite the fact that the average mean loss was approximately eight hundred fifty thousand dollars.[288] Collectively, the authors concluded that institutional investors let "billions slip through their fingers," which they attributed in part to organizational lapses within these institutions.[289] This example illustrates that institutional investors are only human, at least metaphorically speaking. They focus on their strengths—valuing companies and assessing risk—but pay less attention to matters outside their traditional expertise.[290]

Yet the example of the PSLRA demonstrates the possibility of changing the status quo when it comes to investor inaction. It took institutional investors a while to take Congress up on its invitation to serve as lead plaintiff in securities class actions, but eventually they did.[291] The market, in other words, can be sticky but ultimately responsive. It sometimes takes time for investors to recognize economic opportunities, but in the past, they have responded once these opportunities are brought to their attention.

C. *Legal Pathways*

If institutional investors decide that they want to take on this new role, will the law stand in their way? In other words, can institutional investors actually change the procedural rules in the ways suggested here? Contracting parties have long opted out of certain default rules governing how their future disputes will be decided.[292] Parties, for example, can add forum selection clauses to their agreements to direct their disputes to a specific court.[293] They can also adopt

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[287] *See id.* at 420-25.

[288] *See id.* at 424 ("We find that the average loss is roughly $275,000, which is substantially lower than the almost $850,000 average value reported.").

[289] *See id.* at 425-32 (outlining four reasons for failure of institutional investors to join class actions: (1) "[f]inancial service providers try not to align themselves with protagonists of their clientele"; (2) class actions are slow and institutional investors may not have time; (3) negative perceptions of class action returns, despite evidence to the contrary; and (4) communication issues between broker and the corporation).

[290] *See id.*

[291] *See, e.g.*, Cox & Thomas, *supra* note 236, at 1602 ("Despite this impressive list of benefits, investors have been slow to answer the call to become lead plaintiffs.").

[292] *See, e.g.*, Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507, 512 (2011) (describing "widespread perception that customized procedure is an increasingly important feature of contracting practice among U.S. firms"); Judith Resnik, *Procedure As Contract*, 80 NOTRE DAME L. REV. 593, 597 (2005) ("[M]ini-codes of civil procedure are being created by courts, agencies, and a multitude of private providers. The aspiration for a trans-substantive procedural regime embedded in the Federal Rules has been supplanted by an array of contextualized processes.").

[293] *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 593 (1991) (upholding forum selection clause on back of cruise ship ticket).

arbitration clauses to opt out of the judicial system altogether,[294] and agree on how they will allocate the costs of litigation.[295] The procedures suggested in this Article, however, go well beyond the dispute resolution provisions typically included in commercial contracts.[296] This Section addresses the legal hurdles that institutional investors may face in implementing customized procedural rules. It first explores possible restrictions under corporate and securities laws before turning to limitations arising under procedural law. As we will see, there are not clear legal guidelines, although recent case law provides investors with reason to be more optimistic about their ability to engage in procedural private ordering in cases filed under state law as opposed to cases filed under federal law.

1. Corporate and Securities Laws

The procedural rules outlined in this Section relate to both fiduciary duty claims made under state law and securities class actions filed under the federal securities laws. As a result, these rules will have to pass muster under both state corporate law and federal securities law, at least if they purport to cover both types of claims. At the state level, Delaware has been the pioneer in addressing private ordering in shareholder litigation, with few other states addressing the issue. As discussed above, the Delaware Court of Chancery itself first raised[297] the issue and upheld various types of procedural amendments to corporate bylaws.[298] The Delaware legislature banned one specific form of private

[294] *See, e.g.*, DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463, 471 (2015) (holding that the Federal Arbitration Act does not permit states to prohibit class action waivers in arbitration contracts).

[295] *See, e.g.*, David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389, 419 ("In the EDGAR database, terms shifting costs to the losing party in litigation are omnipresent."); W. Mark C. Weidemaier, *Customized Procedure in Theory and Reality*, 72 WASH. & LEE L. REV. 1865, 1922 (2015) (finding that 23.9% of sample contracts included loser-pay provisions).

[296] *See* Hoffman, *supra* note 295, at 395-96 ("We appear to be currently in a period where some terms are widely accepted—like forum selection—while others operate only at the margins—like those that would limit discovery.").

[297] *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010) ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

[298] *See, e.g.*, ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014) ("[W]e hold that fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law."); Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013) ("The plaintiffs' argument that stockholders must approve a forum selection bylaw for it to be contractually binding is an interpretation that contradicts the plain terms of the contractual framework chosen by stockholders who buy stock.").

ordering (fee-shifting provisions)[299] but it has expressly permitted forum selection bylaws (as long as Delaware is the selected forum) and stayed silent on other forms of private ordering.[300]

This does not mean that Delaware courts would approve all forms of procedural private ordering. In *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Supreme Court of Delaware held that fee-shifting bylaws are facially valid.[301] It then noted, however, that whether a specific bylaw provision is enforceable depends "on the manner in which it was adopted and the circumstances under which it was invoked."[302] The Court then referenced earlier decisions invalidating bylaws that were enacted by directors to protect their positions as board members or by a controlling shareholder seeking to enlarge its own power in inequitable ways.[303] Although the Delaware legislature later prohibited fee-shifting bylaws,[304] the court's analysis provides a useful framework for analyzing other possible forms of private ordering related to shareholder litigation.

Under this framework, the proposed procedures set out above should be facially permissible.[305] The motives of the enacting party (either the board or majority shareholders) matter, however, so a court could theoretically strike down a bylaw amendment adopted at a specific company if the court believed that the amendment was motivated by selfish or other improper motives.[306] For example, if a controlling shareholder included a bylaw amendment that made it impossible for any other shareholders to challenge the controller's breach of fiduciary duty, a Delaware court would likely invalidate the bylaw.[307] In general, however, Delaware currently gives corporations wide latitude to amend the rules governing shareholder litigation.

That said, private ordering is still a relatively new phenomenon in Delaware, and new limitations could emerge, especially as Delaware is asked to evaluate new variants of procedural bylaws. Some scholars have suggested that

[299] *See* DEL. CODE ANN. tit. 8, § 109(b) (2019) ("The bylaws may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim.").

[300] *See id.* § 115 ("The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State.").

[301] *See* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014).

[302] *See id.*

[303] *See id.* at 558-59 (citing Schnell v. Chris-Craft Indus., 285 A.2d 437, 439 (Del. 1971) (setting aside board adopted amendment that moved meeting one month earlier); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1080 (Del. Ch. 2004) (enjoining bylaw that required unanimous assent on any board action)).

[304] DEL. CODE ANN. tit. 8, § 109(b).

[305] *See supra* Part II (discussing proposed procedures).

[306] *See ATP Tour*, 91 A.3d at 558-59.

[307] *See id.*

Delaware's permissive approach may not always be appropriate.[308] Professor Verity Winship, for example, has noted that section 102(b)(7) of the Delaware General Corporation Law permits corporations to eliminate the liability of directors for violations of the duty of care, but not the duty of loyalty.[309] On its face, this restriction concerns the substantive law, not procedural rules, but substance and procedure are not wholly separate. Given section 102(b)(7) limitations, a corporation should not be able to use procedural rules to block claims that it is not allowed to eliminate directly.[310] As an example, a standing requirement that is so stringent that makes it impossible for any shareholder to file a duty of loyalty claim would contravene section 102(b)(7), despite its procedural frame. Similarly, a heightened pleading requirement that required representative plaintiffs to plead information to which they do not have access could also run afoul of the law. The procedures set out in Part II, however, are intended to better sort fiduciary duty claims, not rule them out entirely, and thus should be permissible.[311] Accordingly, even if Delaware does adopt additional limits on private ordering, investors should still be able to adopt the suggestions in this Article, at least when it comes to fiduciary duty claims.

The federal securities laws raise far greater hurdles for shareholders seeking to experiment with customized procedure.[312] The securities laws expressly invalidate "any . . . provision binding any person . . . [to] waive compliance with any provision" of the securities laws.[313] The Supreme Court held that a provision is void under securities laws if it "weaken[s] [a party's] ability to recover."[314] Interpreting this standard, the Court has further held that mandatory arbitration clauses do not run afoul of this provision because plaintiffs can still recover on

[308] *See, e.g.*, Kaufman & Wunderlich, *supra* note 223, at 357-58 (arguing that bylaw changes should be governed by *Unocal* standard).

[309] *See* DEL. CODE. ANN. tit. 8, § 102(b)(7); Winship, *supra* note 20, at 524-25 (explaining limitations imposed by section 102(b)(7)).

[310] *See* Winship, *supra* note 20, at 525 (stating that this approach "would not prevent procedural limits that fall short of waiver").

[311] Delaware has also held that, although shareholders can amend corporate bylaws on their own, their amendments cannot infringe on the board's fundamental right to control the business and affairs of the corporation. *See* DEL. CODE ANN. tit. 8, § 141(a). Delaware courts have held that this limitation means that shareholder-driven amendments to corporate bylaws can only "define the process and procedures by which those decisions are made." *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 235 (Del. 2008). This limitation should not affect the proposals in this Article, which, by definition, relate to procedural matters.

[312] *See* Winship, *supra* note 20, at 529-30 (stating that "securities law does not have an enabling structure that would support broad experimentation").

[313] *See* 15 U.S.C. § 77n (2012); *id.* § 78cc(a) ("Any condition stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void.").

[314] Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 230 (1987) (quoting Wilko v. Swan, 346 U.S. 427, 432 (1953)).

their claims within arbitration.[315] Scholars have speculated, however, that other types of customized procedures would not pass muster if they make it more difficult for plaintiffs to recover on their claims.[316]

This interpretation could call into question some of the procedures recommended in this Article, at least when applied to federal securities class actions. Standing requirements, for example, would not only weaken certain shareholders' right to sue, but bar them entirely. Similarly, fee-shifting or cost-shifting provisions could discourage shareholders from suing if they fear that they could later be held personally liable for the defendants' fees and costs. As a result, the securities laws may well prohibit these forms of customized procedure.[317]

Other forms, however, should pass muster. Nonwaivable forum selection clauses, for example, simply specify where shareholders must sue; they do not weaken their right to sue. Similarly, bans on nonmonetary settlements limit the forms of relief that shareholders can obtain, but do not impact whether shareholders can sue in the first instance. This analysis means that the securities laws may permit a narrower range of procedures than state corporate law, but at least some of the proposed procedures are likely still permissible. In drafting their proposed bylaws, however, shareholders should be careful to limit the applicability of those procedures that may run afoul of the securities laws.[318]

The Delaware Court of Chancery recently addressed another possible legal hurdle related to procedural private ordering in federal securities class actions. Building on the scholarship of Professor Ann Lipton,[319] the Delaware Court of Chancery recognized that charters and bylaws are intended only to address the internal affairs of corporations, including "the fiduciary relationships that exist within the corporate form."[320] In contrast, the court held that these state-created documents cannot limit the laws of other sovereigns, including the federal securities laws, even if the plaintiff is a shareholder of the corporation in

[315] *See id.* ("The voluntariness of the agreement is irrelevant to this inquiry: if a stipulation waives compliance with a statutory duty, it is void under § 29(a), whether voluntary or not.").

[316] *See, e.g.*, William K. Sjostrom, Jr., *The Intersection of Fee-Shifting Bylaws and Securities Fraud Litigation*, 93 WASH. U. L. REV. 379, 403 (2015) (acknowledging that "no court has yet addressed whether a fee-shifting bylaw is void under the anti-waiver provisions as applied to federal securities law claims," but stating that he believes that they would be void because "a fee-shifting bylaw weakens [shareholders'] ability to recover under federal securities law").

[317] *See Shearson/Am. Express*, 480 U.S. at 220.

[318] *See, e.g.*, HeartWare Int'l, Inc., Current Report (Form 8-K) (June 27, 2016) (adopting forum selection clause that only applied to state fiduciary duty claims).

[319] *See* Lipton, *supra* note 214, at 597 ("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 corporations' 'internal affairs.'").

[320] Sciabacucchi v. Salzberg, C.A. No. 2017-0931-JTL, 2018 WL 6719718, at *2 (Del. Ch. Dec. 19, 2018).

question.[321] As a result, the court invalidated a charter provision that required the corporation in question's shareholders to bring all claims under the Securities Act of 1933 in federal court.[322]

This case creates another hurdle for institutional investors who may want to alter the procedural rules that govern securities class actions. Viewing these hurdles in tandem, federal law explicitly prohibits any constraint on a shareholder's ability to file a federal securities claim, and state law prohibits use of state-created charters and bylaws to affect these claims. As a result, under current law at least, any amendments to procedural rules should be limited to shareholder lawsuits filed under state law and should explicitly disclaim application of these amendments to federal securities class actions.

2. Procedural Law

The corporate and securities laws are not the only laws that govern customized procedure. Shareholders must also ensure that procedural law permits them to amend the specific procedures in question. For example, can parties alter the discovery rules set out in Federal Rule of Civil Procedure 12(b)(6) and *Twombly*? Can they completely replace the federal rules governing discovery with their own? These questions are perhaps even more difficult than those in the prior Section because the field of civil procedure provides fewer clear guidelines. Most procedural rules do not specify whether they are default or mandatory rules, and courts have provided little overarching guidance on this question.

Despite this legal ambiguity, there are three clear limitations. First, parties cannot enter into private agreements that expand the jurisdiction of the courts,[323] a limitation that in this context primarily affects forum selection bylaws. If shareholders propose such bylaws, they cannot choose a federal forum for all shareholder claims if the federal courts do not have a basis for jurisdiction over these claims. Conversely, federal courts have exclusive jurisdiction over federal securities claims, so shareholders could not choose a state court forum for these claims.[324] Second, although there is some debate about whether bylaws are technically contracts,[325] parties could still be subject to common-law principles

[321] *See id.* at *18 ("[A] Delaware corporation cannot use its charter or bylaws to regulate the forum in which parties bring external claims, such as federal securites law claims.").

[322] *Id.* at *23 ("The nominal defendants lack authority to use their certificates of incorporation to regulate claims under the 1933 Act. The Federal Forum Provisions are ineffective and invalid.").

[323] *See, e.g.*, Noyes, *supra* note 180, at 583 (outlining limitations on procedural rule changing through contract).

[324] 15 U.S.C. § 78aa (2012).

[325] *Compare* ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 558 (Del. 2014) (holding that corporate bylaws are "contracts among a corporation's shareholders" (quoting Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010))), *with* Lipton, *supra* note 214, at 587 (arguing that "corporate governance arrangements are not contractual").

rooted in contract law, which prohibits provisions that are unconscionable or made under duress.[326] In a number of cases, for example, courts have used the unconscionability doctrine to invalidate limitations on discovery that unreasonably limit one side's access to information, especially in cases involving substantially unequal bargaining power between the parties.[327] Finally, shareholders cannot include customized procedures in corporate bylaws that significantly impair the rights of third parties.[328] In this discovery context, for example, this limitation might mean that bylaws cannot expand Federal Rule of Civil Procedure 45 subpoena power to compel third parties to provide more information than they would otherwise have to provide in a shareholder lawsuit.[329]

Beyond these specific limitations, scholars argue that there are other, more fundamental limits on parties' ability to craft their own procedures. These proposed limits reflect foundational concerns about the influence of private parties over the workings of a deliberately public judicial system. Scholars have phrased this concern in different ways. Professor Sarah Randolph Cole argues that a court reviewing customized procedures should determine whether the agreement would "impermissibly undermine the institutional integrity of the court."[330] Professor Robert Bone argues that bespoke procedure cannot interfere with the judge's ability to engage in principled reasoning, which he argues is the "core element of adjudication."[331] Professor Judith Resnik influentially criticized the contractual model of civil procedure as failing to take account of "substantive agendas about the meaning of justice."[332] Regardless of the specific phrasing, the idea is that there are certain attributes and goals of the American judicial system that are so fundamental to its legitimacy that private parties cannot contract around them.[333]

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[326] *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339 (2011) (referencing "generally applicable contract defenses, such as fraud, duress, or unconscionability").

[327] *See, e.g.*, Colter L. Paulson, *Evaluating Contracts for Customized Litigation by the Norms Underlying Civil Procedure*, 45 ARIZ. ST. L.J. 471, 513-14 (2013) ("The availability of discovery has become a lynchpin of state law unconscionability, and courts have not hesitated to find arbitration agreements unconscionable that attempt to limit the amount of discovery available to plaintiffs.").

[328] *But see* Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1373 (2012) (arguing that party decision-making in litigation may already harm third parties in number of ways, and yet no one seriously suggests prohibiting all party decisions that impact third parties).

[329] FED. R. CIV. P. 45.

[330] Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199, 1205 (2000).

[331] *See, e.g.*, Bone, *supra* note 328, at 1390.

[332] *See* Resnik, *supra* note 292, at 666 (arguing that courts should not ignore "political and distribution[al] consequences of procedural rulemaking").

[333] *Id.* ("The deployment of process to achieve substantive goals is deeply entrenched in the Constitution.").

These concerns reflect the fact that litigation between private parties is not an entirely private enterprise, as the example of shareholder litigation itself reflects. Shareholder litigation is not just about curtailing agency costs in the particular companies that are sued; these suits also aim to raise the standards of managerial behavior across the corporate world.[334] Through the concept of general deterrence, multimillion dollar judgments are intended to send a message not just to the targeted defendants, but also to managers at other companies who are in a position to engage in similar misconduct.[335] Even more broadly, shareholder litigation aspires to improve the functioning of the financial markets, ensuring that shareholders have sufficient confidence in the markets to invest their capital.[336]

These aspirational goals mean that institutional investors and corporate boards should not have unfettered power to re-write the procedural rules that govern shareholder litigation. Judges must play a key role in ensuring that any new rules are sufficiently aligned with the public interest. Current law does not precisely delineate the scope of this oversight responsibility, but judges should review any new procedures against the backdrop of the public interest, striking down those that unnecessarily threaten the shareholder litigation enterprise.

The procedures proposed in Part II should not run afoul of these limitations. If done right, they would not improperly expand the jurisdiction of the federal courts, violate the unconscionability doctrine, or impair the right of third parties. Nor should they raise eyebrows on public policy grounds. The goal of these procedures is to better sort cases with merit from those without—a goal that is aligned with the public interest in encouraging efficient litigation. Indeed, these provisions should enhance the compensatory and deterrent goals of shareholder lawsuits, which both shareholders and the public more broadly should support. If investors overreach in particular instances, however, the judicial branch can invalidate the provisions. The legislative branch can also intervene and statutorily overrule the provisions, as Delaware did in the context of fee-shifting bylaws.[337]

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334 *See* James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 280-81 (2015) ("The norms that flow from litigation's enforcing fiduciary standards strengthen sensible management of firms and thus contribute to increased economic activity. The norms themselves shape best practices and in that way reduce agency costs as well as uncertainty. Each in turn yields a public benefit.").

335 *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1090 (1997) (stating that three benefits of shareholder litigation normally mentioned are "compensation, specific deterrence, and general deterrence").

336 *See, e.g.*, *id.* at 1099-105.

337 *See* DEL. CODE ANN. tit. 8, § 109(b) (2019); Francis Pileggi, *Delaware Proposes New Fee-Shifting and Forum Selection Legislation*, DEL. CORP. & COM. LITIG. BLOG (Mar. 6, 2015), https://www.delawarelitigation.com/2015/03/articles/commentary/delaware-proposes-new-fee-shifting-and-forum-selection-legislation/ [https://perma.cc/J7JD-Z4SY] (describing process leading up to the legislation).

In the end, shareholders have a crucial role to play in reforming shareholder litigation, but they cannot re-draft procedural rules in a vacuum. Shareholder litigation has both public and private aims, and any new procedures adopted among private parties must be subject to public oversight by judges and legislators. The question therefore is not whether shareholders should control these lawsuits to the exclusion of other gatekeepers. Instead, it is whether shareholders should play a more active role in this area than they currently do, while still subject to oversight by judges and legislators. A rulemaking partnership will protect the public interest more than any of the individual gatekeepers will do on their own.

Stepping back, therefore, procedural law likely places fewer limits on investors' ability to rewrite procedural rules than the state and federal substantive law. As discussed above, given current SEC regulations and relevant case law, institutional investors can likely rewrite the procedural rules that govern shareholder lawsuits filed under state law.[338] On the other hand, they are likely to face significant legal challenges if they extend their efforts to federal securities class actions.[339] Investors, however, should not view these limitations as a reason to stay away from procedural private ordering altogether. Rewriting the procedural rules that govern state fiduciary duty claims would have a significant impact on this entire category of litigation, which includes nearly all shareholder derivative suits and many merger class actions.

Just as importantly, the rules related to procedural private ordering are still in their infancy. It has been less than a decade since the Delaware Court of Chancery first suggested that corporations adopt forum selection clauses for these state claims,[340] and courts and the SEC are just starting to envision the possibilities of private ordering in this legal sphere. Moreover, much of the concern about procedural private ordering stems from the fact that corporate boards have driven these efforts, and the results have reflected their bias and self-interest. Allowing institutional investors to lead this effort does not raise the same concerns because they have the right financial incentives to adopt measured procedural reforms. If they are successful in reforming shareholder lawsuits filed under state law, perhaps lawmakers will expand their ability to impact lawsuits filed under federal law as well. In short, the time has come to experiment more broadly with procedural private ordering, especially if this experimentation is in the hands of those with the most financial skin in the game.

CONCLUSION

Shareholder litigation is a failed experiment. Judges, legislatures, and corporate boards have all tried to fix the problems with these suits, but none of their proposals have worked. This troubled history presents an opportunity for a

[338] *See supra* notes 312-318 and accompanying text (discussing possible procedural limitations due to SEC rules).

[339] *See supra* notes 312-318 and accompanying text.

[340] *In re* Revlon, Inc. S'holder Litig., 990 A.2d 940, 960 (Del. Ch. 2010).

new group—institutional investors—to take the lead in reforming this area of the law. Institutional investors are uniquely situated to take on this challenge because they stand on both sides of shareholder lawsuits. As a result, they have financial incentives that the other groups which have tried to reform these suits do not. Investors can use this position to draw on lessons from the field of civil procedure, which offers specific solutions to the problems in these cases. Corporate law has already started to experiment with new procedural rules in corporate bylaws, but investors can go much further, adopting an array of procedural options to address the specific challenges in shareholder litigation.

This proposal also offers broader lessons about private ordering in the litigation system. In most types of litigation, private ordering is one-sided, with defendants writing the provisions that will govern future litigation. Corporations and consumers, for example, are equally bound by dispute resolution provisions included in commercial contracts, even though corporations have nearly exclusive control over the drafting of these provisions.[341] This disparity is then reflected in the content of the provisions, with the inclusion of arbitration provisions, class action waivers, and fee-shifting provisions that have sparked broad public and scholarly apprehension.[342] Shareholder litigation, however, is one of the few areas where the same party stands on both sides of the litigation. This unique positioning opens the door to a new approach to private ordering in litigation that balances the competing interests in a more equitable way. Corporate law should capitalize on this opportunity and give shareholders a chance to reform shareholder litigation.

[341] *See, e.g.*, Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 431 (2002) ("Likely ninety-nine percent of paper contracts consist of standard forms, and now, with increasing alacrity, people agree to terms by clicking away at electronic standard forms on web sites and while installing software ('clickwrap' contracts).").

[342] *See, e.g.*, Omri Ben-Shahar, *Fixing Unfair Contracts*, 63 STAN. L. REV. 869, 873 (2011) (discussing "how to repair contracts that contain excessively one-sided terms"); Daniel Akst, Opinion, *Those Crazy Indemnity Forms We All Sign*, N.Y. TIMES, Dec. 9, 2012, at SR4.