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Firm Value and Intracorporate Arbitration

Andrew K. Jennings

ARTICLES

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ABSTRACT

Intracorporate arbitration provisions (IAPs) shift disputes over firms' internal affairs from public courts to private arbitration. These disputes affect the agency costs associated with governing a company, which in turn affect firm value. Thus, a firm that adopts an IAP should expect it to cause an increase or decrease to firm value. Beyond their effects on firm value, IAPs will also test assumptions about shareholders' ability to discipline corporate management and states' authority to regulate firms formed under their laws. In anticipating the emergence of IAPs, markets, practitioners, and scholars must confront what they are to look like and how they are to work. This prospect is uncertain. An IAP could increase firm value by, for example, limiting unmeritorious litigation, or it could reduce firm value by, for example, insulating management from meritorious claims. This article shows that IAPs will not lead inextricably to either of those outcomes. In doing so, it asks a simplifying question: for a given firm, will adopting an IAP likely lead to its value going up, or down?

That question is answered by viewing IAPs as a tool by which firms may treat the civil procedure that is applied to their intracorporate disputes as a value lever. Civil procedure determines whether meritorious claims are vindicated and whether unmeritorious claims are defeated. In addition, civil procedure determines both how long it takes to reach resolution and what resources are required to do so (assuming the substantive law and facts remain constant regardless the procedure). In other words, whether an intracorporate dispute is resolved fairly and *efficiently is determined by the civil procedure chosen for it. Those two factors—how claims are resolved*

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on the merits and what is required in terms of time and resources to resolve them—represent agency costs that help drive firm value up or down. Because "up" is preferable, this article introduces a normative, institutional model of intracorporate arbitration aimed at achieving that outcome, in which a firm adopting an IAP must make a credible commitment to a credible arbitral institution.

INTRODUCTION

The Carlyle Group (Carlyle) is an innovator in the private-equity and leveraged-buyout businesses, managing over $100 billion in assets and indirectly employing hundreds of thousands of people through its portfolio companies.[1] As it prepared to go public in 2012, Carlyle set out to also be a corporate-governance innovator by including a mandatory arbitration provision in its partnership agreement, the document governing its internal management. Under this provision, Carlyle and its equity holders agreed to submit disputes arising under their partnership agreement or state partnership law to binding arbitration, rather than public courts.[2] But, after the Securities and Exchange Commission (SEC)'s Division of Corporation Finance declined to accelerate Carlyle's offering while the arbitration provision was in place,[3] it opted instead to mandate that all internal claims be brought in the courts of Delaware, its state of formation, instead of arbitration.[4] This innovative move had become a road block to Carlyle's going public, and so it settled for a litigation provision closer to the status quo.

Although neither federal law nor SEC regulation *expressly* prohibits mandatory arbitration provisions, Carlyle's example reflected a long-held view of SEC commissioners and staff that these provisions are inconsistent with the securities laws' non-waiver

1. The Carlyle Group L.P., Amend. No. 2 to Registration Statement on Form S-1, at 1 (Jan. 10, 2012) [hereinafter *Carlyle Registration Statement*].

2. *Id.* at A-58–59.

3. Letter of Pamela Long, Assistant Dir., SEC, Div. of Corp. Fin., to Jeffrey W. Ferguson, Gen. Counsel, The Carlyle Group L.P., at 1 (Feb. 3, 2012).

4. *See* The Carlyle Group L.P., Amend. No. 4 to Registration Statement on Form S-1, at A-58–59 (Mar. 15, 2012). This article is about business entities—firms—that may take different organizational forms—corporations, partnerships, limited liability companies, and the like—and that have different types of governing documents—charters, bylaws, partnership agreements, and the like. Although this article uses the publicly traded corporation as its archetype, its arguments apply to other types of firms, public or private, as well, and uses them interchangeably. *Cf.* Peter Molk & Verity Winship, *LLCs and the Private Ordering of Dispute Resolution*, 41 J. CORP. L. 795, 805 (2016) (discussing mandatory arbitration agreements in Delaware limited liability company agreements).

provisions.[5] Whether that view will hold much longer is uncertain, as at least two SEC members have signaled a new openness to these intracorporate arbitration provisions (IAPs). During a summer 2017 speech, Commissioner Michael Piwowar cited Carlyle's experience while encouraging companies to seek relief from the SEC to include mandatory arbitration provisions in their governing documents.[6] This comment, offered in response to an audience question, received quick attention in corporate-governance circles. The next day, legal commentator Alison Frankel wrote that "[t]his could be the start of something huge," noting that Commissioner Piwowar was suggesting that "the SEC is open to the idea of allowing companies contemplating initial public offerings to include mandatory shareholder arbitration provisions in corporate charters."[7] Professor Hal Scott, a supporter of mandatory shareholder arbitration, called the remarks "an important invitation to U.S. public companies" to adopt a practice he believes would have a positive effect for investors and markets. [8]

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5. Securities Exchange Act of 1934, 15 U.S.C. § 78cc ("Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void."); Securities Act of 1933, 15 U.S.C. § 77n ("Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the [SEC] shall be void."); *see also* SEC, Div. of Corp. Fin., No-Action Letter, Pfizer, Inc. (Feb. 22, 2012) ("We note that there appears to be some basis for your view that implementation of the [mandatory arbitration bylaws] proposal would cause the company to violate the federal securities laws.") [hereinafter *Pfizer No-Action Letter*]; Letter of James D. Cox et al., to Mary Jo White, Chair, SEC (Oct. 30, 2013) (noting mandatory arbitration's disfavored view within the SEC, and requesting that the SEC "evaluate the validity of corporate provisions restricting shareholder access to the courts") [hereinafter *Cox Letter*].

6. Michael Piwowar, Comm'r, SEC, Remarks on Businesses, Regulation and the Economy (Jul. 17, 2017) https://www.c-span.org/video/?431364-1/michael-piwowar-remarks-businesses-regulation-economy ("For shareholder lawsuits, right, there is, companies can come to us to ask for relief to put in mandatory arbitration into their charter. There was a company under the prior administration that thought about doing that when they IPOed but decided to pull back because Staff would not give them comfort they would accelerate their filing. I would encourage companies to come and talk to us about that.").

7. Alison Frankel, *Shareholder alert: SEC commissioner floats class-action-killing proposal*, REUTERS (Jul. 18, 2017) https://www.reuters.com/article/us-otc-arbitration/shareholder-alert-sec-commissioner-floats-class-action-killing-proposal.

8. Hal S. Scott, *Shareholders Deserve Right to Choose Mandatory Arbitration*, THE CLS BLUE SKY BLOG (Aug. 21, 2017) clsbluesky.law.columbia.edu/2017/08/21/shareholders-deserve-right-to-choose-mandatory-arbitration.

Later that year, SEC Chairman Jay Clayton told the Senate Banking Committee that the SEC had not articulated a definitive view on the issue, suggested it was a question for state corporate law, and declined to endorse the idea that public courts are the only appropriate fora to bring disputes over a public company's internal affairs.[9] Taken together, Chairman Clayton and Commissioner Piwowar's remarks represent a shift—at least a rhetorical one—from SEC practice opposing intracorporate arbitration to a new openness to it.[10] Although the SEC has yet to announce a change in policy regarding IAPs—whether in the form of rulemaking, waivers, or interpretive guidance—at least one capital-markets lawyer has reported that SEC staff members are encouraging companies to consider adopting IAPs.[11] In early 2019, the SEC again signaled its potentially shifting views. In a no-action letter permitting Johnson & Johnson to exclude a shareholder proposal for the adoption of a mandatory arbitration bylaw, the SEC applied Rule 14a-8(i)(2)'s provision that a proposal may be excluded from a proxy if it would cause the company to violate state—here, New Jersey—law.[12] In comparison, almost seven years earlier, the SEC issued a similar no-action letter to Pfizer, but on the grounds that a mandatory arbitration bylaw might violate *federal* securities law.[13]

Although in one view intracorporate arbitration tackles meritless and value-destroying litigation,[14] another points to the countervailing effect—that these provisions may prevent shareholders from exercising their rights or from holding management accountable.[15] The first case to test mandatory intracorporate

9. *SEC Oversight Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 115th Cong. 2nd Sess. (Sept. 26, 2017) (testimony of SEC Chairman Jay Clayton) https://www.c-span.org/video/?434649-2/securities-exchange-commission-oversigh-hearing.

10. *See* Frankel, *supra* note 7 (quoting Professor Adam Zimmerman, stating that "[t]his is important for the signal it's sending. . . . Piwowar is sending up a flare – this might be okay with us.").

11. Benjamin Bain, *SEC Weighs a Big Gift to Companies: Blocking Investor Lawsuits*, BLOOMBERG (Jan. 26, 2018) https://www.bloomberg.com/news/articles/2018-01-26/trump-s-sec-mulls-big-gift-to-companies-blocking-investor-suits ("[A] partner at law firm Simpson Thacher in Palo Alto, California, said he's heard instances of SEC staff encouraging companies to come forward with proposals that would require shareholders to use arbitration to resolve shareholder grievances.").

12. SEC, Div. of Corp. Fin., No-Action, Johnson & Johnson (Feb. 11, 2019).

13. *See Pfizer No-Action Letter*, *supra* note 5.

14. *See, e.g.*, Scott, *supra* note 8.

15. *See Cox Letter*, *supra* note 5.

arbitration provisions in a public company, *Corvex Management L.P. v. CommonWealth REIT*, highlights this concern.[16] In *CommonWealth REIT*, the trustees of a publicly traded office-building real-estate investment trust (two of whom held a $77M per year contract to manage it) resisted an unsolicited takeover bid from two outside firms.[17] The trustees took defensive measures, including lobbying the Maryland General Assembly to enact favorable legislation.[18] As part of these measures, the trustees also took the newsworthy step of amending the trust's bylaws to require arbitration of its internal disputes, including pending claims that the trustees had violated their fiduciary duties.[19] A Maryland trial court held the bylaw to be within the trustees' authority to adopt and to be an enforceable contract under state law. In addition, the court observed that federal law effected a strong public policy in favor of enforcing agreements to arbitrate.[20] With this result, the trustees were allowed to choose the forum in which they would defend themselves.

CommonWealth REIT could point to a "dystopian future" in which corporate management deploys arbitration bylaws to entrench its control of, and perhaps its ability to extract rents from, a firm.[21] Or IAPs might instead usher in new limits to unmeritorious intracorporate litigation, saving shareholders across the capital markets countless sums in legal fees and settlement costs. This article argues that neither outcome follows necessarily. Rather, adopting an IAP can lead to net negative or net positive outcomes for shareholders and capital markets, depending on how it is designed, managed, and enforced. Given this range of outcomes, the question is not whether these provisions *should* be used, but rather, what conditions *justify* their adoption.

The degree to which a firm's intracorporate disputes—such as shareholder-derivative actions—are resolved fairly and efficiently has an effect, positive or negative, on its economic value. "Fair" resolutions are the vindication of meritorious claims and the defeat of unmeritorious claims. "Efficient" resolutions avoid spending time and

16. Corvex Mgmt. L.P. v. CommonWealth REIT, 24-C13-001111, 2013 WL 1915769 (Md. Cir. Ct. May 8, 2013).

17. *Id.* at *3.

18. Steven Davidoff Solomon, *What's at Stake in the Fight Over a REIT*, N.Y. TIMES DEALBOOK (Apr. 18, 2013) https://dealbook.nytimes.com/2013/04/18/whats-at-stake-in-the-fight-over-commonwealth-reit.

19. *CommonWealth REIT*, No. 24-C13-001111, 2013 WL 191576, at *3.

20. *Id.* at *12, *25, and *27.

21. *See* Solomon, *supra* note 18.

other corporate resources on adjudicating the dispute. The "fairness" factor affects firm value because if meritorious claims are, or are expected to be, vindicated, management is more likely to adhere to its fiduciary duties. This disciplining effect reduces the firm's agency costs—that is, the degree to which management acts for its own benefit rather than that of the corporation—and concomitantly increases the firm's value.[22] In contrast, the success of an unmeritorious claim does nothing to reduce agency costs and instead depletes corporate assets or opportunities—for example through increased director-and-officer insurance premiums or management distraction.[23] The "efficiency" factor affects firm value because litigation *costs*, and the time and resources devoted to litigation use up corporate assets and thwart corporate opportunities. These factors are not independent of each other in affecting firm value: they often offset one another because efficiently resolving a claim (such as through a summary dismissal process) can mean that factually meritorious claims go without vindication.[24]

The potential for bringing meritorious intracorporate claims helps discipline management to act in the firm's best interest.[25] This disciplining reduces the firm's agency costs, which in turn leads to increased firm value.[26] Firms are best off if meritorious intracorporate claims are: (1) vindicated (because management is disciplined) and (2)

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22. *See* James D. Cox, *Compensation, Deterrence, and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745, 746 (1984) ("Corporations respond to managers' tendency to misbehave with a combination of contracting arrangements, monitoring, and signaling. These devices not only curb managers' more extreme tendencies, but also reduce the firm[]'s cost of capital and increase its value."). This article addresses directors and officers as both having a role to play in imposing, or mitigating, agency costs.

23. Richard Squire, *How Collective Settlements Camouflage the Costs of Shareholder Lawsuits*, 62 DUKE L.J. 1, 6 (2012) ("Each of the last four [settlement-related] costs drives up D&O insurance premiums, which shareholders ultimately pay.").

24. *See* Glenn S. Koppel, *Toward a New Federalism in State Civil Justice: Developing a Uniform Code of State Civil Procedure*, 58 VAND. L. REV. 1167, 1206 (2005) ("[I]n balancing the tension between the competing procedural goals of judicial efficiency (e.g., speed and low cost) and fairness (e.g., accuracy in factfinding in individual cases), empirical data can inform rulemakers about whether and to what extent a proposed rule change will reduce cost and delay and at what cost to fairness.").

25. *Cf.* Terry M. Moe, *The New Economics of Organization*, 28 AM. J. POL. SCI. 739, 756 (1984) ("[T]here is no guarantee that the agent, once hired, will in fact choose to pursue the principal's best interests or to do so efficiently. The agent has his own interests at heart . . . .").

26. *See generally* Cox, *supra* note 22.

vindicated quickly (because litigation expense will be lower). Firms are also best off if unmeritorious claims are: (1) defeated (because they offer no potential to discipline management) and (2) defeated quickly (again, to avoid litigation expense). In other words, firm value is promoted when there are fair outcomes (when meritorious claims are vindicated, and unmeritorious claims are defeated) and when claims are resolved efficiently.

A firm can exercise control over these fairness and efficiency factors and their interplay—and thus affect its value—by calibrating the procedures that govern its intracorporate disputes. Civil procedure is thus a lever of firm value. And an effective way for firms to leverage procedure to affect their value is to adopt IAPs. But risks associated with these provisions mean that IAPs also have the potential to harm shareholders. This article confronts these risks and shows that intracorporate arbitration can serve shareholders' fundamental interest in increasing firm value.[27] That outcome is most likely to be achieved when a firm adopts an IAP that makes a credible commitment to a credible arbitral institution. That is, firms must commit themselves to exogenous, independent adjudication of their intracorporate disputes. In turn, a credible arbitral institution makes a set of commitments to its stakeholders, as well as to the public interest: a *commitment to independence*, a *commitment to law*, and a *commitment to process*.

As CommonWealth REIT's management showed, for better or worse, an IAP is a vehicle by which companies may calibrate away from the default civil procedures offered by state or federal courts. And, as the contrast between Carlyle's thwarted IPO plans and the shifting rhetoric from the SEC shows, this is an option that has a clearer path to broad adoption than before. Given the potential spread of IAPs among public firms, the market needs a framework for evaluating whether an IAP will increase, rather than decrease, firm value.[28]

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27. This assumption that shareholders' fundamental interest is in seeing the value of their shares increase is not universally held. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 NYU L. REV. 733, 763 (2005) (acknowledging the "canonical" view that corporate managers must maximize profits, but observing that positive law does not state that rule); *see also* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 2.01(b)(2)–(3) and cmt. d. (Am. Law Inst. 2017) (providing that, like natural persons, corporations *must* follow the law and *may* act in accordance with ethical and charitable considerations).

28. Very few public companies have IAPs, and so this article approaches the value effects from their adoption in mostly general terms. As more firms adopt IAPs, however, the effects of their adoption on share prices can be identified through

This article provides that framework by explaining how IAPs should work in order to effect higher firm value. Part I lays out the framework for intracorporate arbitration, which derives from an intersection of state corporate law, conflict-of-laws principles, and the Federal Arbitration Act (FAA). Part II describes the benefit-cost analysis firms must undertake when deciding whether to adopt IAPs. In deconstructing that analysis into its component pieces, Part II confronts key governance risks raised by IAPs and potential public-policy-based barriers to their adoption. Drawing from Part II's analysis, Part III then demonstrates a normative, institutional model for how value-enhancing IAPs should work. The article closes with a view toward the work that will be needed to apply its institutional model to real-world governance.

I. THE FRAMEWORK FOR INTRACORPORATE ARBITRATION

When a corporation adds an IAP to its charter or bylaws, it obliges its officers, directors, and shareholders to submit disputes over the firm's internal affairs to arbitration, rather than to public courts. This practice's framework follows from three sources: state corporate law, conflict-of-laws principles, and the FAA. This Part lays that framework out and explains that because corporate charters and bylaws are contractual, and because the FAA protects the enforcement of contracts to arbitrate, IAPs should be expected to receive the same treatment as any other contract.[29]

To be sure, the framework outlined in this Part is up for debate.[30] Professor Ann Lipton, for example, has argued persuasively that corporate bylaws are distinguishable from ordinary bilateral contracts in which parties manifest their assent to terms, and that at the least they are not the kind of contract that falls within the remit, or

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econometric methods. This empirical work will be important to showing what effect IAPs have, and, more importantly, what IAP designs, if any, are most associated with increased value.

29. This point is a general one. The FAA covers "maritime transactions" and "commercial" contracts. The latter is a particularly broad category, but it does not encompass every type of contract. *See infra* note 35 and accompanying text.

30. *But see* 4 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 15:23 (3d ed. 2011) ("The corporation-as-contract theory supports other board-adopted bylaw initiatives such as requiring shareholder suits to be subject to binding arbitration.").

competence, of FAA arbitral procedures.[31] As Part II.C shows, there remain considerable questions whether IAPs may be adopted, how the FAA does or does not apply to them, and under what circumstances they may be enforced. Yet, as Part II discusses,[32] the weight of both corporate-law and FAA precedent is moving in favor of intracorporate arbitration. As Professor Stephen Ware has observed, rather pragmatically, "[a]dhesion contracts are contracts, because most of their terms are routinely enforced by courts throughout the country."[33] That is, adhesive IAPs are unlikely to fare particularly worse than other adhesive contracts when it comes time for enforcement. If that is how these questions will likely be answered, then, the question is what intracorporate arbitration should look like.[34] In getting there, this and the next Part offer best impressions of how, doctrinally and practically, that question will come to demand a concrete response.

This framework, at a high level, goes as follows: (i) disputes over the internal affairs of a corporation will be resolved under the laws of the chartering state regardless what forum hears the dispute; (ii) these disputes are controlled by a corporation's charter and bylaws, which are contractual between the corporation and its officers, directors, and shareholders; (iii) these binding forum-selection provisions in charters and bylaws—of which IAPs are a subset—may be adopted unilaterally by a board of directors, or by a shareholder vote; (iv) the contracts are then applied as "commercial" contracts under the FAA;[35] (v) and, most importantly, the contractual rights to enforce IAPs are protected by the FAA, meaning that arbitration of intracorporate disputes is mandated.

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31. *See generally* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 596–97 (2016).

32. *See infra* note 38. A former justice of the Delaware Supreme Court, for example, explained why this principle led to the vindication of forum-selection bylaws in that state: "Because corporate bylaws are merely contractual agreements between the corporation, its directors, and the stockholders, the Court of Chancery concluded . . . that forum-selection bylaws are presumptively valid." Henry DuPont Ridgely, *The Emerging Role of Bylaws in Corporate Governance,* 68 SMU L. REV. 317, 323 (2015).

33. Stephen J. Ware, *The Politics of Arbitration Law and Centrist Proposals for Reform*, 53 HARV. J. ON LEGIS. 711, 716 (2016).

34. *See also* Verity Winship, *Shareholder Litigation by Contract*, 96 B.U. L. REV. 485, 506–07 (2016) ("Furthermore, Delaware's acceptance of forum selection clauses provided a way to ensure that other procedural provisions are enforced.").

35. 9 U.S.C. § 1 (1947).

In outlining this framework, Section A briefly introduces the internal-affairs doctrine and the contractarian approach to corporate governance, including the conflict-of-laws principles applicable to intracorporate disputes. Section B describes the FAA as establishing a robust national pro-arbitration policy, would likely apply as a matter of course to IAPs.[36] This policy enforces agreements to arbitrate in the face of traditional state hostility to arbitration, which would include state public-policy opposition to intracorporate arbitration.

A. The Internal-Affairs Doctrine and Corporate Governance

1. Internal Affairs and Contractarian Corporate Governance

The internal affairs of a corporation—the relationship between it and its officers, directors, and shareholders in their roles as such—are governed by a hierarchy of public and private law.[37] Heading this hierarchy is the substantive corporate law of the firm's chartering jurisdiction, followed by the firm's charter and then its bylaws. These two governing documents are the contractual foundation of the firm's corporate governance.[38] Under this contractarian approach, the charter

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36. *See* Moses. H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration."); *but see also* Hiro N. Aragaki, *Arbitration's Suspect Status*, 159 U. PA. L. REV. 1233, 1266–67 (2011) (arguing that the Supreme Court's pro-arbitration jurisprudence springs from "the service of reversing . . . anti-arbitration hostility" and not from "prioritiz[ing] arbitration over other forms of dispute resolution.").

37. *See* Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) ("[I]nternal affairs [are those] matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders . . . ."). Examples of matters that are a part of a corporation's internal affairs include those that "involve primarily a corporation's relationship to its shareholders includ[ing] steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (1971).

38. *See, e.g.*, Centaur Partners, IV v. Nat'l Intergroup, Inc., 582 A.2d 923, 928 (Del. 1990) ("Corporate charters and by-laws are contracts among the shareholders of a corporation and the general rules of contract interpretation are held to apply."); Airgas, Inc. v. Air Prods. & Chems., Inc., 8 A.3d 1182, 1188 (Del. 2010) (holding

and bylaws are a private agreement defining the relative rights and responsibilities of officers, directors, and shareholders in the management and control of the firm. Importantly, this corporate-governance contract generally does not vest rights; that is, contractual rights that cannot be altered without a shareholder's consent.[39] Instead, inherent in this governance contract is that its terms may be amended, even without the individual consent of shareholders (who are constructively on notice of this possibility when they acquire their shares).[40]

A corporation's charter and bylaws may be amended by a shareholder vote. State corporate statutes also typically empower a corporation's board of directors to unilaterally amend its bylaws, so long as the firm's charter affirmatively permits it to do so.[41] This power gives boards of directors significant flexibility in designing the governance for their firms. Examples of such unilateral amendments include setting the size of the board of directors itself, mandating advance notice of shareholder proposals, or—as this article discusses—adopting an IAP. Whatever their topic, these amendments too are contractually binding on shareholders, present and future.[42]

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that bylaws are "contracts among a corporation's shareholders"); Garey v. St. Joe Min. Co., 91 P. 369, 374 (Utah 1907) ("[T]he corporate charter is a dual contract—one between the state and the corporation and its stockholders, the other between the corporation and its stockholders . . . .").

39. *See* COX & HAZEN, *supra* note 30, at § 25:4 ("In Delaware, the vested-rights doctrine is generally recognized as a dead letter, and no contemporary decision is likely to be resolved on this basis.").

40. *See* Taylor v. Hinkle, 200 S.W.3d 387 (Ark. 2004) ("[T]he trial court correctly interpreted [an Arkansas corporation's bylaws] to allow amendment of the bylaws by either the stockholders or the directors."); Kidsco, Inc. v. Dinsmore, 674 A.2d 483, 492 (Del. Ch. 1995) ("[A]lthough the by-laws are a contract between the corporation and its stockholders . . . the contract was subject to the board's power to amend the by-laws unilaterally.").

41. *See, e.g.*, DEL. CODE ANN. tit. 8, § 109 ("[A]ny corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors . . . ."); MD CODE ANN., CORPS. & ASSN'S § 2-109 ("[T]he power to adopt, alter, and repeal the bylaws of the corporation is vested in the stockholders except to the extent that the charter or bylaws vest it in the board of directors."); MODEL BUS. CORP. ACT § 10.20(b) (Am. Bar Ass'n 2003) (setting the board's authority to amend the bylaws as a default rule).

42. *See* Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 956 (Del. Ch. 2013) (explaining that the argument "that board-adopted bylaws are not like other contracts because they lack the stockholders' assent—rests on a failure to appreciate the contractual framework established by the [Delaware General Corporation Law] for Delaware corporations and their stockholders.").

2. Intracorporate Disputes

A corporation's board of directors has the authority to manage its day-to-day business. Shareholders, however, hold three primary powers to discipline management: the power to vote, the power to sell, and the power to sue.[43] This article focuses on that final power and its implications for firm value.

Shareholders sue over a firm's internal affairs in large part to discipline its officers and directors.[44] The substantive corporate law of a firm's chartering state governs intracorporate disputes, which might involve, for example, derivative suits alleging breaches of fiduciary duty,[45] exercising statutory shareholder rights, or challenging violations of state law or the corporation's charter or bylaws.[46] This

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43. J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER 40–41 (1958) (identifying voting, selling, and suing as shareholders' primary powers); *see also* Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215, 216 (2000) ("Under corporate law in all states, directors manage the business and affairs of the corporation. Shareholders have only a limited role: They can vote, sell, or sue.").

44. Intracorporate disputes do not include claims arising purely under federal securities law, although those claims may coincide with intracorporate disputes, and some commentators have conflated the two. *See* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 596–97 (2016) ("Many commentators have advocated using charters and bylaws to restrict securities claims (state and federal) and state law corporate governance claims, as a mechanism for curbing frivolous litigation, without distinguishing between the two."). Being a corporation's shareholder is distinct from being a purchaser or seller of its securities, even though the first tends to follow from the second. *See id.* at 598. This article, however, focuses on intracorporate disputes, and thus far the weight of authority is that IAPs could not apply to federal securities claims. *See Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL, 2018 WL 6719718, at *18 (Del. Ch. Dec. 19, 2018) ("[Charter or bylaw forum-selection provisions that] purport to regulate the forum in which parties external to the corporation (purchasers of securities) can sue under a body of law external to the corporate contract (the 1933 Act) [are] ineffective."); *see also* Stephen M. Bainbridge, *Fee-Shifting: Delaware's Self-Inflicted Wound*, 40 DEL. J. CORP. L. 851, 859 (2016) (observing a "substantial likelihood" that fee-shifting bylaws applicable to federal securities claims would be preempted by federal law).

45. *See* Ross v. Bernhard, 396 U.S. 531, 538 (1970) ("The corporation is a necessary party to the action . . . . Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff. The proceeds of the action belong to the corporation and it is bound by the result of the suit.").

46. This article generally takes for granted that the plaintiffs in an intracorporate dispute will be shareholders. Compared to officers and directors, shareholders are "outsiders" and so most governance-related litigation will be shareholder-initiated. However, it applies to intracorporate disputes brought by

tool works *ex ante* in disciplining management to adhere to its fiduciary duties, as the potential for litigation incents management to avoid acts or omissions that could lead to an intracorporate dispute. Suits also provide shareholders with an *ex post* enforcement mechanism when management violates its fiduciary duties.

The internal-affairs doctrine applies across state lines.[47] A court hearing an intracorporate dispute related to a foreign corporation will apply the chartering state's substantive corporate law and its own procedural law.[48] This means that a suit by shareholders of a firm incorporated in New York may be heard in Maryland and that the court in Maryland will apply the corporate law of New York.[49] The ability of shareholders to pursue intracorporate claims outside the chartering state gives rise, however, to the potential for similar or identical claims being brought in multiple jurisdictions. Multi-fora litigation subjects common claims and facts to the jurisdiction of multiple courts, risking inconsistent adjudications as well as conflicts over their preclusive effects.[50] Meanwhile, as an economic concern, multi-fora litigation impedes the ability of firms to pursue business opportunities (particularly in the M&A context) and, in any case, compounds legal fees and other litigation-related costs.[51]

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directors and officers, as well. *See, e.g.*, Pearson v. Exide Corp., 157 F. Supp. 2d 429 (E.D. Pa. 2001) (former officer suing under an indemnification bylaw for the advancement of litigation expenses); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (dissenting director challenging the adoption of a shareholder rights plan).

47. *See* IMO Daniel Kroeber Dynasty Trust, 98 A.3d 924, 939 (Del. Ch. 2014) ("When a Delaware state statute assigns exclusive jurisdiction to a particular Delaware court, the statute is allocating jurisdiction among the Delaware courts. The state is *not* making a claim against the world that no court outside of Delaware can exercise jurisdiction over that type of case."); *In re* IBP, Inc. S'holders Litig., No. 18373, 2001 WL 406292, at *9 n.21 (Del. Ch. Apr. 18, 2001) ("Delaware courts have not hesitated to enforce forum selection clauses that operate to divest the courts of this State of the power they would otherwise have to hear a dispute."); *see also infra* note 54.

48. RESTATEMENT (SECOND) OF CONFLICTS § 313 cmt. e ("Even when a court entertains a suit involving the internal affairs of a foreign corporation, it will . . . usually apply the local law of the state of incorporation in arriving at the ultimate decision of the case.").

49. *Id.*

50. *See* Cal. State Teachers' Ret. Sys. v. Alvarez, 175 A.3d 86 (Table) (Del. 2017) (en banc) (holding that the dismissal by an Arkansas court of a derivative suit involving a Delaware corporation precluded a similar action from being brought in Delaware by new plaintiffs).

51. *But see* Bryce Cullinane, *Unilateral Forum Selection Clauses in Corporate Bylaws: A Synopsis of the Debate*, 7 J. BUS. ENTREPRENEURSHIP & L., 485, 493–94

But corporations may avoid multi-fora litigation by adopting forum-selection bylaws, whether by shareholder vote or unilaterally through board action.[52] Forum-selection bylaws restrict intracorporate disputes to a designated forum. For example, a forum selection clause could restrict litigation of intracorporate disputes to courts in the firm's chartering or headquarters state. These bylaws bind shareholders as part of the corporate-governance contract, serving to curtail multi-fora litigation and its attendant costs.[53] They may also result in other salutary, forum-specific effects. For example, although the same substantive law that governs a given corporation's internal affairs applies regardless the forum, forum-selection bylaws allow firms to choose, as a matter of private ordering, what local procedural law will apply or what types of judges will adjudicate their intracorporate disputes. This power to choose might matter, for example, if a firm decides between one state that quickly resolves civil litigation versus one with a slow docket, or one state with judges who are corporate-law experts versus one in which judges rarely hear such disputes.[54]

B. *The Federal Arbitration Act in the Intracorporate Context*

Arbitration agreements provide for a specialized form of forum selection in which parties submit disputes to private arbitrators, rather than to public courts.[55] As a means of dispute resolution, arbitration

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(2014) ("Plaintiffs argue that this tactic levels the playing field between corporate defendants and shareholder plaintiffs. They assert that without this opportunity, litigation will be inherently tipped in favor of defendants, especially when suits must be litigated in corporation-friendly Delaware.").

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

53. *See generally* Atlantic Marine Constr. Co., Inc. v. U.S. Dist. Ct., 134 S. Ct. 568 (2013) (reaffirming the presumptive enforceability of forum-selection clauses).

54. *See* Baker v. Impact Holding, Inc., No. 4960-VCP, 2010 WL 1931032, at *2 (Del. Ch. May 13, 2010) ("Delaware does not have an overarching public policy that prevents the stockholders of Delaware corporations from agreeing to exclusive foreign jurisdiction of any matter involving the internal affairs of [Delaware corporations].").

55. Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 717 (1999) ("The [Supreme] Court

historically faced hostility from public authorities[56] that Congress enacted the FAA to countermand.[57] In doing so, Congress effected a policy favoring the private-ordering and efficiency opportunities offered by arbitral dispute resolution. The FAA sets a national policy in favor of enforcing contracts "involving commerce" that commit disputes arising under them to arbitration.[58] Contracts "involving commerce" are contracts that fall under the Commerce Clause's broad scope,[59] and the FAA has been interpreted broadly, encompassing consumer-related activities like processing credit-card payments or establishing cellular-phone service.[60]

The FAA applies equally to federal and state courts and preempts state law that prohibits or discriminates against arbitration.[61]

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conceives of arbitration clauses as forum-selection clauses, but not as choice-of-law clauses.").

56. *See* H.R. Rep. No. 68-96 at 1 (1924) ("[T]he need for the [FAA] arises from . . . the jealousy of the English courts for their own jurisdiction. . . . The jealousy survived for so lon[g] a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. The courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment . . . ."); *but see* Hiro N. Aragaki, *Equal Opportunity for Arbitration*, 58 U.C.L.A. L. REV. 1189, 1194 n.29 (2011) ("The text of the FAA is simply too indeterminate, and the congressional record leading to its enactment too sparse, to draw any firm conclusions about the statute's original meaning. What is incontrovertible, however, is that courts routinely deploy antidiscrimination rhetoric to justify the FAA's displacement of state law.").

57. Southland Corp. v. Keating, 465 U.S. 1, 16 (1984) ("The problems Congress faced were therefore twofold: the old common law hostility toward arbitration, and the failure of state arbitration statutes to mandate enforcement of arbitration agreements."); *see also id.* at 12 ("In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.").

58. 9 U.S.C. § 2 (1947) ("A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.").

59. *See, e.g.*, Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 273–74 (1995) ("After examining the [FAA's] language, background, and structure, we conclude that the word 'involving' is broad and is indeed the functional equivalent of 'affecting.'"); Perry v. Thomas, 482 U.S. 483, 490 (1987) (holding that the FAA "embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause").

60. *See* Am. Express Co. v. Italian Colors Restaurant, 570 U.S. 228 (2013) (credit-card payment processing); AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011) (cellular-phone service).

61. *Southland*, 465 U.S. at 16 ("[T]he substantive law the [FAA] created was applicable in state and federal court.").

Federal law exception for contracts from FAA enforcement, but only when Congress expressly provides for such a carve-out.[62] There are, however, limits to FAA enforcement: under its savings clause, an arbitration agreement is revocable "upon such grounds as exist at law or in equity for the revocation of any contract."[63] This clause thus sets arbitration agreements on the "same footing" as any other contract, while protecting them from defenses that are not applicable to contracts generally.[64]

IAPs intersect with the FAA because under the contractarian approach to corporate governance, a firm's charter and bylaws are contractual between its management and shareholders (in those capacities).[65] Thus, unilateral bylaws amendments adopted by boards of directors are part of the corporate-governance bargain that binds shareholders.[66] As a matter of contract formation, shareholders are constructively on notice of this possibility when they acquire their shares, and they have an opportunity to review the firm's charter and bylaws before doing so.[67] The FAA also countenances the imposition of mandatory arbitration provisions when a contract—even an adhesive one—allows one party to make unilateral amendments.[68]

Taken together, the framework for intracorporate arbitration emerges. If corporate charters and bylaws are contractual, then their inclusion of a mandatory arbitration provision should be expected to be treated like any other arbitration agreement. As Part II discusses more fully, intracorporate arbitration remains unsettled in terms of its underlying doctrine, policy, and market considerations. This Part outlines, however, that the intersection of state corporate law, conflict-of-laws principles, and the FAA makes intracorporate arbitration *available* to firms. As the remainder of this article explains, the

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62. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987) ("Like any statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command.").

63. 9 U.S.C. § 2 (1947).

64. Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974).

65. *See supra* note 38 and accompanying text.

66. *See supra* note 40 and accompanying text.

67. Public companies must disclose bylaws amendments on Form 8-K within four business days of adoption, thus providing shareholders with constructive notice of the amended corporate contract. SEC Current Report on Form 8-K, Gen. Instruction B (requiring filing within four business days); SEC Regulation S-K, 17 C.F.R. § 229.601(b)(3)(ii) (requiring the amended charter or bylaws to be exhibited as Item 5.03(a) on a Form 8-K).

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

decision *whether* to adopt an IAP stands to affect a firm's value in a significant way, for better or for worse.

II. THE ADOPTION OF INTRACORPORATE ARBITRATION PROVISIONS

As Part I lays out, firms generally can adopt IAPs, but that doesn't mean they *will* or *should*. This article's project is to describe what intracorporate arbitration should look like for firms whose adoption of them is motivated by a desire to increase firm value. Professor Barbara Black has wryly noted that for decades, shareholder-corporate arbitration has been an "idea whose time has come."[69] Indeed, although hundreds of forum-selection provisions have been adopted in corporate governing documents, there have been very few IAPs.[70] This Part explains why. Section A outlines criticisms of adhesive arbitration agreements and urges that these criticisms are important for understanding IAP adoption and, ultimately, for designing institutions that offer firm-value-enhancing approaches to intracorporate disputes. Section B models the decisional analysis surrounding IAP adoption and its impact on firm value. Section C addresses legal and policy limits and barriers to adoption.

A. Learning from the Criticism of Adhesive Arbitration Agreements

The use of arbitration agreements negotiated between sophisticated commercial parties is uncontroversial.[71] These agreements exemplify efficient private ordering and free up the

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

70. Joseph A. Grundfest & Kristen A. Savelle, *The Brouhaha Over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis*, 68 BUS. LAW. 325, 326 (2013); Roberta Romano & Sarath Sanga, *The Private Ordering Solution to Multiforum Shareholder Litigation*, at 2 (ECGI Working Paper Series in Law No. 295, 2015) (746 forum-selection-clause adoptions by U.S. public companies as of mid-2014).

71. Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1489 (2008) ("[T]here is little opposition today to arbitration between sophisticated commercial parties."); *cf.* The Arbitration Fairness Act of 2017, § 2(1), H. 1374, 115th Cong., which proposes a congressional finding that when it was enacted, the FAA "was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power."

dockets of our overworked civil-justice systems.[72] That consensus view does not hold, however, for arbitration agreements whose parties are not all sophisticated or who have substantially different levels of negotiating power. In the context of adhesive arbitration agreements, commentators have criticized agreements drafted by dominant parties (e.g., employers, phone carriers, or banks) as leaving non-dominant parties (e.g., employees or customers) with deficient resort compared to what is available in public courts.[73] Although corporate bylaws are a different type of contract than employment or consumer agreements, the criticism of adhesive arbitration agreements fairly applies to IAPs, too.[74] Whatever their implications in non-corporate contexts, in the intracorporate context, these criticisms must be taken seriously. If IAPs are to be a private-ordering approach to enhancing firm value, the problems alleged to apply to them must be mitigated, including through how they are designed. More, as a matter of IAP adoption, these criticisms will, and do, implicitly shape the perceptions of the market and regulators. Widespread IAP adoption will not happen until market stakeholders have confidence that standard criticisms of

72. *See* Hanes Corp. v. Millard, 531 F.2d 585, 598 (D.C. Cir. 1976), *superseded by statute on other grounds, as recognized in* Nat'l R.R. Passenger Corp. v. Consol. Rail. Corp., 892 F.d 1066, 1071 (D.C. Cir. 1990) (recognizing that arbitration should be favored because it "eases court congestion"); *see also* Barrentine v. Arkansas-Best Freight Sys., Inc., 450 U.S. 728, 752–53 (1981) (Burger, C.J., dissenting) ("The Court seems unaware that people's patience with the judicial process is wearing thin. . . . This Court ought not be oblivious to desperately needed changes to keep the federal courts from being inundated with disputes of a kind that can be handled more swiftly and more cheaply by other methods.").

73. David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, WIS. L. REV. 33, 36 (1997) ("The Supreme Court has created a monster. . . . Given [its] blessing in the name of a 'national policy favoring arbitration,' adhesive pre-dispute arbitration clauses should expand beyond their current strongholds in consumer contracts in health insurance, banking and securities investing to other areas of the economy and society."); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 676 (1996) ("[E]ven a consumer who reads the [arbitration] clause might well lack the legal sophistication to understand its significance, perhaps not recognizing that appeals from arbitration are virtually unwinnable and that little or no discovery may be made available in an arbitration proceeding.").

74. *Cf.* Winship, *supra* note 34, at 521–22 ("The use of litigation provisions in corporate organizational documents implicates deep disagreement about the efficacy and purposes of shareholder litigation, as well as polarized views of the appropriate role of the plaintiffs' bar.").

adhesive arbitration agreements have been overcome in the intracorporate context.

The criticisms of adhesive arbitration agreements reveal two core problems relevant to IAPs:

1. The Procedural Problem

The first problem is the *procedural problem*, in which an arbitration agreement offers different—and usually more limited—procedural rights to parties than would be enjoyed under federal or state civil procedure. These arbitral procedures might include shorter statutes of limitations, heightened pleading standards, non-appealability, reduced discovery opportunities, strict evidentiary standards, or a prohibition on class actions. The Supreme Court's FAA jurisprudence has treated diminished procedures as *streamlined* procedures—features, not bugs—what arbitration is all about. Litigants objecting to the enforcement of such agreements have argued, unsuccessfully, that this approach to procedure makes it difficult or infeasible to vindicate meritorious legal claims.[75] Scholars and state courts have echoed these concerns, noting that restricted arbitral procedures will result in more defendant wins than would occur in judicial fora and that, conveniently, the powerful players that draft these agreements happen to be mostly the defendants in cases brought under them.

One aspect of this problem may give both management and shareholders pause. Arbitration is typically final (other than on the narrow grounds the FAA provides for vacating awards).[76] The lack of an appeals process means that intracorporate disputes—which may affect enormous sums of shareholder wealth—lack an outlet for error correction. Non-appealability, coupled with streamlined, less formal procedures, increases the risk of erroneous decisions. The economy achieved by non-appealable arbitration is a plus in commercial or consumer cases, but it is likely inappropriate for complex, high-stakes intracorporate disputes.[77]

75. That is not to say that the limitations listed here are necessarily inappropriate to the intracorporate context. *But see* Winship, *supra* note 34, at 522 ("[P]arties should not be allowed to circumvent mandatory substantive law by shaping procedure, particularly where one party dictates the contractual terms. If a party cannot contract around a substantive obligation, then the party should not be able to eliminate it by disabling enforcement.").

76. *See generally infra* notes 163 and 184.

77. *See infra* notes 78 and 157 (discussing California's *Discover Bank* rule).

2. The Repeat-Player Problem

The second problem is the *repeat-player problem*, in which the party that drafts an adhesive arbitration agreement will always be a party to disputes under the form, while its counterparties will be one-off players. For example, a telecommunications carrier may have hundreds of thousands of customers who have signed a form service agreement. The carrier will typically be the defendant in disputes under the form, whereas individual customers will be plaintiffs who are only involved in their own personal disputes with the carrier.[78] This imbalance in turn incents the drafter to ensure it has a strong hand in choosing the arbitrator (versus the mutually negotiated arbitrator-selection provisions often found in commercial agreements).[79] Selected arbitrators thus face implicit pressure in each adjudication to find for the drafter, because if it loses too often with Arbitrator A, it may as well start selecting Arbitrator B.[80]

Although the nature of intracorporate claims means that firms will face fewer of them than, say, a carrier would face service disputes with its customers, repeat-player effects may still emerge in the intracorporate context.[81] For example, if Corporation Y selects Jane, a corporate lawyer, as arbitrator, Jane may feel pressure to lean toward management in hopes that she will be selected for the next arbitration. This repeat-player problem arises at both the firm and the market level. Jane may not have any inclination to be selected by Corporation X again as an arbitrator or subsequently to be hired by it for legal

78. *See* Szetela v. Discover Bank, 97 Cal. App. 4th. 1094, 1101 (2002) (describing a mutual class-action waiver in a credit-card agreement as one-sided because "it is difficult to envision the circumstances under which the provision might negatively impact [the bank], because credit card companies typically do not sue their customers in class action lawsuits.").

79. *See* Bruhl, *supra* note 71.

80. For example, disputes between broker-dealers and their customers are almost always heard by arbitral panels organized by the Financial Industry Regulatory Authority (FINRA). FINRA recognizes that positional conflicts can arise when attorneys who work on behalf of the industry hear arbitrations involving it, even when they have no direct conflict. To mitigate this problem, it deems attorneys who practice on behalf of or in proximity to financial-industry clients as "non-public arbitrators" and puts limits on their panel membership. *See* FINRA Manual §§ 12100(y), 12402(a), 12403(a)(1) (2017).

81. *But see* Paul Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws*, BYU L. REV. 65, 92 (2013) (noting that in shareholder-litigation context, shareholders can be repeat players, too, and that the plaintiffs' firms that represent shareholders certainly are).

services. But then, if she wants to serve as an arbitrator for other firms' disputes, or at least to be retained for their other legal matters, she has an incentive to maintain a reputation for being favorable toward management in intracorporate cases. Otherwise, Corporations Y and Z may not call her when they are looking to select an arbitrator.[82] Even assuming that industry arbitrators face no conflict of interest, some will consistently have a pro-management bent, and in a world in which firms have a hand in picking arbitrators, those are the ones who will be in demand.[83]

These problems affect more than after-the-fact vindication of intracorporate claims if, say, directors breach their fiduciary duties. Officers and directors act under the shadow of litigation: the risk of intracorporate litigation has an *ex ante* disciplining effect on management.[84] If an IAP does materially reduce the likelihood that intracorporate claims are successful, this shadow will recede along with its *ex ante* disciplining effect. Under this view, merely adding an IAP to bylaws could increase agency costs and thus diminish firm value, because it would cause management to perceive itself as less constrained by a major vehicle of shareholder power.[85] Without this check, management may begin to act increasingly in its own interest, rather than in the larger interest of the firm.

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82. This is also a criticism of the Delaware judiciary, so the concern is not unique to *arbitral* fora. *See* Lynn M. LoPucki, *Delaware's Fall: The Arbitration Bylaws Scenario*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 35 (Stephen Bainbridge et al. eds., 2018).

83. *See* Stephen J. Choi, Jill E. Fisch, and A.C. Pritchard, *The Influence of Arbitrator Background and Representation on Arbitration Outcomes*, VA. L. & BUS. REV. 43, 86 (2014) (regression analysis showing that arbitrators with securities-industry experience are likelier to make smaller awards in FINRA securities arbitration).

84. Examples of behavior that breaches fiduciary duties include colluding to improperly raise executive compensation, engaging in conflicted transactions, and making material misstatements or omissions in shareholder disclosures surrounding voting matters. *See* John C. Coffee, Jr., *Rescuing the Private Attorney General: Why The Model of Lawyer as Bounty Hunter is Not Working*, 42 MD. L. REV. 215, 218 (1983) ("The conventional theory of the private attorney general stresses that the role of private litigation is not simply to secure compensation for victims, but is at least equally to generate deterrence, principally by multiplying the total resources committed to the detection and prosecution of the prohibited behavior.").

85. *See* Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1613–14 (1989) (observing that "changes in corporate structure are priced" and discussing the potential for charter amendments to reduce share prices).

The retort to these problems is: *economic actors made these agreements and they are within the bounds of the FAA, so let the equities fall where they may*. Indeed, such a retort well sums up the Supreme Court's usual approach to cases involving FAA enforcement. For IAPs, its appeal breaks down, however, because intracorporate disputes often do not involve distinct economic interests in a real sense.[86] Rather, in the intracorporate context, these critical problems should be acknowledged and addressed. Intracorporate disputes are a feature of corporate governance. Their presence, or the threat of their presence, should help to reduce agency costs and thus to increase firm value.[87] And firms that adopt IAPs as part of their governance have flexibility in fashioning the procedures that will apply to the intracorporate disputes. Given that, prospective IAP adopters should proceed based on whether a particular IAP design will increase or decrease firm value. Any IAP design thus must reckon with the procedural and repeat-player problems, an undertaking that Part III tackles.

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86. That is, in shareholder derivative suits, the fiduciaries are usually indemnified, leaving the firm to pay despite being the putative victim of the breach. This is not always the case. For example, a former officer or director who sues for fee advancement under an indemnification bylaw is suing for herself, not for any corporate benefit. Similarly, shareholders exercising their appraisal remedies in the context of an acquisition sue for themselves. And even derivative actions, although the corporation is the real plaintiff in interest, can produce winners and losers among old versus new shareholders depending on direct costs of the action and changes in stock price resulting from them. *Cf.* Marcel Kahan, *Securities Laws and the Social Costs of Inaccurate Stock Prices*, 41 DUKE L.J. 977, 1006 (1992) ("When companies raise capital at inaccurate prices, existing shareholders derive gains to the extent that new investors overpay for their shares, and suffer losses to the extent that new investors underpay."); *cf. infra* note 93.

87. *See infra* notes 88–89 and accompanying text (discussing agency costs and firm value).

B. A Benefit-Cost Analysis of Intracorporate Arbitration

IAPs are a corporate-governance feature.[88] The quality of corporate governance—how well it mitigates agency costs[89] versus how much it itself costs—is one determinant of firm value.[90] A value-maximizing corporation would thus be expected to adopt only those features that are expected to improve governance quality. Governance features themselves may have associated costs on the front end, but they should produce overall positive returns to firm value.[91] To illustrate, imagine a firm that spends two million dollars in legal fees to defend against an intracorporate suit.[92] These fees are part of

88. Corporate-governance features are mechanisms designed to mitigate the agency problem. Some governance features, such as holding shareholder meetings to elect directors or approve extraordinary transactions, are mandated by state corporate law. But modern corporate law, at least applied to U.S. public companies, commits most choices surrounding corporate governance to boards of directors. *See* D. Gordon Smith, Matthew Wright & Marcus Kai Hintze, *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 128 (2011) ("[State corporation] statutes, when combined with federal regulations of corporate governance, have produced public corporations that are almost uniform in one important respect: managers govern corporations, and shareholders participate only on the margins."); Larry Fauver, Mingyi Hung, Xi Li & Alvaro G. Taboada, *Board Reforms and Firm Value: Worldwide Evidence*, 125 J. FIN. ECON. 120, 146 (2017) ("We find that board reforms increase firm value. Reforms involving board and audit committee independence, but not reforms involving separation of chairman and CEO positions, drive the valuation increases.").

89. The agency problem results from the separation of ownership and control that typifies public corporations. This separation means management lacks complete fidelity to the interests of shareholders. Agency costs in the corporate context are the sum of shareholders' monitoring costs, management's bonding costs, and the degree to which management falls short of maximizing shareholder interests. *See* Jensen & Meckling, *supra* note 22, at 313. For example, a firm with high agency costs might have entrenched or conflicted management who defalcate corporate resources or shirk from improving business performance. High agency costs thus inversely correlate with firm value.

90. *See* Ronald W. Masulis, Cong Wang & Fei Xie, *Agency Problems at Dual-Class Companies*, 64 J. FIN. 1697, 1699–1700 (2009) ("[M]isusing corporate cash reserves, demanding excessive remuneration, engaging in shareholder value-destroying acquisitions, and making poor capital expenditure decisions are four possible avenues for corporate insiders to secure private benefits at the expense of outside shareholders.").

91. *See supra* note 87 and accompanying text.

92. *See* James R. Murray & Jared Zola, *Uptick in Shareholder Derivative Lawsuits Challenging Large M&A Deals Calls for Greater Attention to D&O Insurance*, BNA (May 2, 2014), https://www.bna.com/uptick-shareholder-derivative-n17179890139 (explaining that investigation, special litigation committee, and defense costs may reach "millions of dollars").

shareholders' overall agency costs (because it is shareholder wealth that is no longer available for distribution).[93] Despite these fees, the suit may well be worthwhile if it helps discipline management to make decisions that deliver more than two million dollars in benefits to the firm (i.e., decisions that would not have been made absent that discipline). In other words, the utility or disutility of an IAP—whether it is "worth it"—must be evaluated in terms of whether it improves or reduces the quality of corporate governance.[94]

This insight underlies why corporations do or do not adopt IAPs, suggesting a model for the non-adoption/adoption decision that assumes firms (1) are value-maximizing, (2) are constantly assessing whether to adopt an IAP, and (3) will do so once adoption is expected to improve governance quality and thus to increase firm value. Overall, this assessment will follow a benefit-cost analysis: are the aggregate benefits to be obtained from an IAP greater than the direct and indirect costs of adoption?[95] Given these assumptions, the adoption assessment goes as follows:

Benefit-Cost Analysis	**Result**
(Direct + Indirect) Benefits ≤ (Direct + Indirect) Costs	No IAP
(Direct + Indirect) Benefits > (Direct + Indirect) Costs	Adopt IAP

The benefits on the right of the inequality represent direct and indirect savings a corporation might obtain from shifting intracorporate disputes to arbitration, such as decreased legal fees or nuisance settlements[96] (direct savings flowing to the financial

93. *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1536 (2006) ("[B]ecause the costs of securities class action—both the settlement payments and litigation expenses on both sides—fall largely on the defendant corporation, its shareholders ultimately bear these costs indirectly and often inequitably.").

94. Michael Van Gorder, Comment, Boilermakers v. Chevron*: Are Board Adopted Arbitration Bylaws Valid Under the Delaware General Corporation Law?*, 39 DEL. J. CORP. L. 443, 465 (2014) ("It is likely that some corporations will find the cost savings, efficiency, and flexibility of arbitration to be a solution to intra-corporate disputes while others will not.").

95. Changes to corporate governance are typically initiated by management even if shareholder approval is ultimately sought or required. *See* Smith, Wright & Hintze, *supra* note 88. Although IAPs may be adopted by either the board or shareholders, this article makes the simplifying assumption that the decision whether to adopt will be made solely by the board and that there is no bar to it doing so (i.e., shareholders will not withhold a necessary approval).

96. *See* Joy v. North, 692 F.2d 880, 892 (2d Cir. 1982) (recognizing "attorney's fees and other out-of-pocket expenses related to the litigation and time spent by

statements) and decreased executive distraction or impediment to strategic transactions (indirect savings on transaction costs).[97] The costs on the left represent direct and indirect costs an IAP may cause, such as litigation over the adoption of an IAP itself (direct costs) and discounts to stock prices (e.g., if shareholders believe an IAP will increase agency costs and thus lower firm value) or reputational harm with market actors that oppose IAPs (indirect costs).[98]

Alternatively, the inequality laid out in the chart above can be thought of at a higher level: taking the benefits and costs of IAP adoption together, *ceteris paribus*, does the firm have an expected net increase to its firm value? If "yes," then the value-maximizing firm will adopt the IAP because whatever costs shareholders will bear from that decision they will more than recoup in benefits. This analysis is driven by the insight that the procedures that apply to intracorporate disputes are one determinant of overall agency costs and hence, indirectly, firm value. Civil procedure is a value lever. Although firms can deploy this lever to some extent by selecting between state fora, in reality, procedure is substantially similar across the federal and state systems.[99] The degree of private-ordering flexibility inherent in an

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corporate personnel preparing for and participating in the trial" and "indemnification which is mandatory under corporate by-laws, private contract or [state] law" as direct costs of derivative actions).

97. *See id.* (recognizing the "impact of distraction of key personnel by continued litigation" and "potential lost profits" from bad trial publicity as indirect costs of derivative actions).

98. *See infra* Part II.C. The leading proxy advisors, whose recommendations many institutional investors rely on in casting their proxy ballots, oppose corporate-governance features like IAPs. GLASS LEWIS, UNITED STATES GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE 17 (2019) (warning that it may recommend that shareholders vote against the re-election of chairs or members of governance-committees of companies that "require arbitration of shareholder claims"); *see also* INST'L S'HOLDER SERVS., UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 14 (2019) (recommending that shareholders generally vote against or withhold votes from directors when the board unilaterally amends the bylaws or charter "in a manner that materially diminishes shareholders' rights"); *see also* Grundfest & Savelle, *supra* note 70, at 356 ("[T]he true costs of adopting [forum-selection] provisions arise in the context of the litigation that occurs over their validity and enforcement, and the opposition likely to arise from shareholder advocacy groups.").

99. *See* Winship, *supra* note 34, at 532 ("The laboratory benefit is also a reason to prefer tailored procedure to other forms of contract procedure that select a court. Forum selection does not offer this opportunity for experimentation. Its main function in the context of corporate litigation is to consolidate disputes in one forum."). *But see* Koppel, *supra* note 24, at 1184–85 (examining the declining influence of the Federal Rules of Civil Procedure on the states' civil procedures).

IAP, however, allows a firm greater leverage in increasing (or decreasing) its value.

The following income statements and their simplifying assumptions illustrate how an IAP, as a procedural lever, can affect firm value. Scenario A is a control in which the firm does not have an IAP, while scenarios B1 through B3 are parallel scenarios in which the firm has adopted differing IAPs.

(in monetary units)	**A**	**B1**	**B2**	**B3**
Net Revenue	500	500	500	500
(Net Expense)*	(400)	(400)	(400)	(426)
Intracorporate Dispute Expense				
(Legal Fees)	(5)	(2)	(2)	(0)
(Settlements/Judgments)	(20)	(20)	(10)	(0)
Net Profit	75	78	88	74
Firm Value**	750	780	880	740

* This amount excludes "Intracorporate Dispute Expense."

** Assume (a) that the income statement is one-off and there is no opening balance and (b) that the market strictly values the firm at a 10x multiple of its net profit.

In B1, the IAP's streamlined procedures result in a 60% decrease to legal-fee expense (e.g., fewer lawyers' billable hours), with no impact on actual settlement/judgment expense (i.e., the outcomes of intracorporate claims are the same as in A—they are merely less expensive to reach). This reduction in legal-fee expense results in a 4.00% increase in firm value as compared to A. If legal fees are viewed as *ex post* agency costs, in this case agency costs have decreased, given no change in the merits outcomes of the firm's intracorporate disputes or to its net revenue or expense.

In B2, legal-fee expense is reduced (compared to A) just as with B1, but settlement/judgment expense is also cut in half. This impact on settlement/judgment expense could stem, for example, from arbitral procedures that make vindicating meritorious claims, or obtaining settlements from unmeritorious claims, more difficult or from *ex ante* disciplining of management to more closely align its actions with shareholder interests rather than face streamlined intracorporate claims (i.e., in which it has a greater chance of losing than with a public judicial proceeding). In any case, the combined reduction in legal-fee and settlement/judgment expense results in a 17.33% increase in firm value compared to A. These multiple possible explanations for B2's reduced settlement/judgment expense

nevertheless all suggest that agency costs have been reduced. That follows because net revenue and expense are the same as in A, suggesting that the business has not suffered from the presence of an IAP (e.g., management is not using the IAP to shirk or defalcate).

The final scenario demonstrates, however, that an IAP can cause an increase in agency costs and a concomitant decrease in firm value. In B3, the IAP has resulted in the elimination of expense related to intracorporate disputes. This result might owe, for example, to arbitral procedures that significantly reduce the ability of shareholders to vindicate intracorporate claims and thus remove shareholder litigation as a tool for disciplining management. The scenario also shows that with management freed of this disciplining constraint, the entire savings attributable to intracorporate-dispute expense has been wiped out by an increase to net expense. That increase in net expense might result, for example, from increases to executive and director compensation or reduced focus on advancing the business. It might even result from conflicted dealings with officers or directors (e.g., a director leasing real estate to the firm at above-market rates). In any case, the result is an overall increase in agency costs and a 1.33% *decrease* in firm value compared to A.

This is all to say that IAPs are not the right governance feature for all firms. Not all IAPs should be expected to increase firm value. For the value-maximizing firm, an IAP may be counterproductive: its benefits (say, faster resolution of intracorporate disputes) can be less than its costs (say, opposition from shareholders, regulators, and the like, reflected by lower share prices). Indeed, this point aligns with the fact that IAPs are rare among public companies.[100] What causes this rarity? The answer may partly owe to managers and their counsel failing to consider IAPs' possibilities, or to the SEC's long-running opposition to them.[101] But, even absent those two constraints, the best explanation is that firms will look to market practice,[102] and novelty

100. *Cf.* Christos Ravanides, *Arbitration Clauses in Public Company Charters: An Expansion of the ADR Elysian Fields or a Descent into Hades?*, 18 AM. REV. INT'L ARB. 371, 393 (2007) (identifying forty foreign-private issuers with IAPs whose shares traded directly or indirectly on U.S. stock exchanges in 2007). In comparison, only one domestic public company had an IAP that year, and it was essentially a shell company. *Id.* at 394.

101. *See supra* note 5 and accompanying text.

102. *Compare* Curtis J. Milhaupt, *Property Rights in Firms*, 84 VA. L. REV. 1145, 1194 (1998) ("The competitive efficiency concerns that drive the mechanisms of convergence operate far more powerfully on firms than on political agents and organizations. Thus, convergence will occur only where the political and social structures that account for institutional inertia can be overcome."), *with* Lucian Arye

and rarity thus sustain each other. In a world in which IAPs are not common, a firm needs a compelling reason to become an early adopter. The risk-adjusted cost of adopting an IAP absent demonstrated, positive market practice may indeed be quite high. *Will we be sued over this; if so, will we win; what will shareholders think; how will our reputation be affected* are among the questions any prospective early IAP adopter must ask itself. And only once the waters are sufficiently proven by early adopters will other firms wade in.[103]

The proving in that case would be in showing that any costs of IAPs are outweighed by their benefits. This result could prove true because inputs to the benefit-cost analysis are not static (particularly on the cost side). If early adopters are able to demonstrate that the risks of an IAP are not as great as reckoned, this experience would mean that for many firms IAPs would pass benefit-cost muster.[104]

Circumstances do sometimes lead firms to adopt novel corporate-governance features.[105] Some firms and their counsel may come to recognize that they face challenges that warrant the adoption of IAPs—that the benefits in those discrete cases are significant enough to outweigh the costs.[106] These firms will become early

Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (arguing that corporate governance is path dependent, not convergent, and offering explanations for this effect).

103. *See* Smith, Wright & Hintze, *supra* note 88, at 174 ("By facilitating private ordering, we would expect each corporation to become a laboratory of corporate governance, experimenting with different models of shareholder participation and ultimately producing a diversity of governance forms and practices.").

104. A positive experience like this is unlikely to be an accident, however. As shown in this and Part III, maximizing the benefits to intracorporate arbitration and minimizing its costs is a matter of institutional design. A value-increasing intracorporate arbitral design will seek to enhance both the efficiency and fairness of a corporation's governance. The benefits and costs discussed in this Part roughly hew to the efficiency and fairness factors discussed in Part III.

105. Perhaps the most celebrated, studied, and (at the time) controversial example of companies adopting a novel corporate-governance feature was the shareholder rights plan, or poison pill. *See* Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 897–98 (2002) ("Shareholders . . . may have learned to love the pill. According to this explanation, shareholder pressure to remove pills would be isolated and concentrated in the relatively few companies that failed to adopt effective adaptive devices."). See also, for an example of this early-adopter theory, the discussion of *Boilermakers* in note 115 and its accompanying text.

106. This adoption decision assumes that there is not a less aggressive or commonly used governance feature that would obtain the same benefit level at a

adopters. As an example, imagine a mature company whose new growth model relies heavily on speculative acquisitions, transactions which risk being impeded by slow-moving derivative challenges. Or consider a company that has eye-raising executive-compensation practices, but that believes its plan properly aligns to its business objectives. Or, as in the Carlyle example from the Introduction, think of a private partnership that is going public and whose principals want to maintain a governance structure they consider crucial to the business.[107] In these examples, whether shareholder claims opposing these practices are meritorious or not,[108] avoiding duplicative litigation and resolving cases speedily may result in substantial savings. Those savings are in the reduction in attorney's fees, yes. But they are also in reducing opportunity costs, allowing management to

lower cost. For example, a corporation that merely seeks to avoid intracorporate litigation in multiple fora could solve this problem by adopting a forum-selection provision in favor of a preferred state's courts. Given the narrow goal, a forum-selection provision should be chosen because it would not implicate the barriers discussed in Parts II.B and II.C that IAPs face. In contrast, a firm that seeks to address another problem, one resolvable by calibrating the civil procedure applicable to its disputes, might find IAP adoption to be more appropriate.

107. Early IAP adoption may be seen in IPO companies, especially in companies whose founders maintain a substantial amount of voting or executive control. Investors may or may not discount stock prices in IPOs with aggressive or unusual corporate-governance structures, but there are examples of newly public firms adopting them. *See, e.g.*, Snap, Inc., Amend. No. 3 to Registration Statement on Form S-1 (Feb. 27, 2017) (public offering of non-voting shares only); Facebook, Inc., Amend. No. 8 to Registration Statement on Form S-1 (May 16, 2012) (ten-to-one voting ratio between insider and public shares). Of course, the Carlyle example in the Introduction involved a private partnership transitioning to public status and whose principals would maintain a leadership role in the business.

108. This article assumes that firms have a legitimate interest in avoiding unmeritorious claims and in streamlining the resolution of the meritorious ones. Sometimes officers and directors have acted ultra vires or have breached their fiduciary duties. These are the cases that intracorporate litigation is made for. Meanwhile, at least some intracorporate litigation is unmeritorious, if not outright vexatious or frivolous. Which claims are which is debatable, and sussing out the difference is beyond this project. *Cf.* Elliot J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2056, 85–56 (1995) (defining a "strike suit" as when a "plaintiff's attorney initiates the action without reasonable grounds to believe it has merit or, having initiated an action reasonably believing it was meritorious, the attorney maintains the action after discovery makes clear the action lacks merit" and concluding that such an action "has a negative net present value, since the plaintiff has no prospect of prevailing on the merits and her attorney inevitably will incur additional costs by continuing the litigation.").

carry on business absent the distraction of pending litigation.[109] The savings in these examples *would* come at a cost themselves. Firms that face the types of challenges of these hypothetical early adopters might already have a strained reputation with investors. Adopting an IAP to mitigate these challenges might result in a net gain (i.e., the firm can focus on its business, good for firm value), but it might concurrently further harm the early adopter's reputation (i.e., decreasing investor willingness to buy its shares, bad for firm value).

If early adopters successfully mitigate the costs—i.e., if they demonstrate to the market that intracorporate arbitration at least preserves the governance equilibrium between management and shareholders or makes it more favorable to shareholders—these experiences will catalyze increased adoption by reducing *ex ante* cost perceptions among market participants and regulators. Conversely, if these early adopters demonstrate that intracorporate arbitration tilts the governance equilibrium nakedly toward management (and thus increases agency costs), the perceived costs discussed earlier will be realized and IAP adoption will be persistently rare. The following chart illustrates this point:

109. *See* Coffee, *supra* note 93.

Post- versus Pre-Adoption Costs	**Shareholders' Cost Perception**	**Result**
$C \leq C_0$	*Shareholders perceive ability to bring meritorious intracorporate disputes and obtain relief is the same or* increased *compared to prior to IAP adoption.*	IAPs becomes increasingly common in market practice. Adopters include those without significant risk of facing costly intracorporate disputes and those with strong shareholder relations.
$C > C_0$	*Shareholders perceive ability to bring meritorious intracorporate disputes and obtain relief is* decreased *compared to prior to IAP adoption.*	IAPs remain rare in market practice. Adopters include those with significant risk of facing costly intracorporate disputes and those with weak shareholder relations.

This comparison isolates just the costs of adopting an IAP, which flow mainly from changes in shareholders' ability to use intracorporate litigation as a vehicle for disciplining management. In either of these cases, a corporation might decide to adopt an IAP because the benefit-cost analysis justifies it, but the initial $C \leq C_0$ case would be expected to predominate if IAPs are to become a common market practice. In that case, shareholders see, *ceteris paribus*, the agency costs they bear decreased or stay static. This result might mean, for example, that streamlined arbitral procedures make it more convenient for shareholders to pursue meritorious claims or that the arbitrators chosen by the IAP's selection process have corporate-law expertise superior to the judges of the firm's chartering jurisdiction. In the second $C > C_0$ case, shareholders see, *ceteris paribus*, agency costs increase. This might owe, for example, to arbitral procedures that reduce opportunities to obtain the discovery needed to prove a meritorious claim.

Because adopting an IAP necessarily involves making choices in what a given corporation's arbitral procedures will look like, the costs of adoption are variable. If IAPs increase these costs over the status quo—i.e., because they are untested and thus cause market or

legal uncertainty—then they will be used only by firms that can obtain oversized benefits that outweigh these costs. If IAPs come to be associated with less uncertainty, however, the costs of adopting them will be lower and thus they will be used by firms that stand to derive more modest benefits from them. To illustrate this point, consider the hypothetical costs and benefits for an early IAP adopter, E. If E adopts an IAP, it expects to bear a total cost of 20 value units, the sum of discounts to its stock price (driven by market uncertainty regarding the IAP itself) and legal expense from defending the validity of the provision.[110] However, E will accept the 20 units of cost in exchange for 30 units of expected benefit (e.g., because it is a frequent target of derivative claims), a net plus of 10 units. But if early adopters like E demonstrate a model for how IAPs can reduce agency costs, then a reduced level of market and legal uncertainty surrounding them will lead to reduced costs for the typical firm's IAP and thus to a broader universe of adopters. For example, if the hypothetical new cost associated with IAP adoption is 5 value units, then it is worthwhile for a later firm, L, to adopt one even if it expects benefits of only 8 value units (e.g., it rarely faces derivative claims), a net plus of 3 units. In other words, early adopters will require outsized benefits to offset the outsized costs associated with adopting an IAP. Lower the cost of IAP adoption and the universe of firms that can obtain a net benefit from them grows.

Thus, managing costs is the key to IAP adoption and, as Part III shows, is the harder part of designing a model for how intracorporate arbitration is to be done. With this general explanation for a firm's non-adoption/adoption decision in place, the remainder of this Part discusses several legal cost categories in deeper detail. This discussion will apply to both the early-adopter and the later-adopter firm, although early adopters will realize these costs more acutely. These issues revolve around unsettled legal and policy questions that can directly add to the costs of an early adopter (i.e., early adopters must overcome legal and policy limits).[111]

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110. Of course, litigation is not a given. *See* Eric Talley, *Public Ownership, Firm Governance, and Litigation Risk*, 76 U. CHI. L. REV. 335, 352–55 (2009) (observing that governance features were not a statistically significant predictor of shareholder litigation).

111. For comparison, forum-selection bylaws were formerly a novel corporate-governance feature. Now, at least 746 public companies have adopted them. *See* Romano & Sanga, *supra* note 70.

C. *Legal Barriers to Intracorporate Arbitration*

Courts have not thoroughly tested or vindicated IAPs.[112] There is no Supreme Court or leading state precedent, for example, adopting the framework offered by Part I. Even if there were such a case, boards must still only adopt IAPs that are consistent with their fiduciary duties, meaning the risk of as-applied challenges to IAPs is persistent. In light of this uncertainty, IAP adoptions, especially early ones, face legal barriers, whether as facial or as-applied challenges from shareholders or as opposition from state governments.[113]

Early adopters in particular should prepare for facial and as-applied challenges.[114] *Boilermakers* exemplifies this risk.[115] Prior to the Delaware Chancery Court's decision in that case, a dozen public companies that adopted forum-selection bylaws were sued by shareholders on the ground that the bylaws violated the Delaware General Corporation Law (DGCL).[116] Once faced with these suits, all but two rescinded these provisions, though the court later held their adoptions to be within the defendant boards' authority.[117] The two holdout defendants, Chevron and Federal Express, despite their success, nevertheless bore the expense of litigation, including between them at least eight lawyers' hourly rates.[118] And once an early

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112. True, there is *Commonwealth REIT*. *See supra* note 16 and accompanying text. But one trial-court decision regarding a specialized kind of public company (a real-estate investment trust) hardly makes for new black-letter law.

113. The biggest barrier to IAPs has been, and to some extent still is, the SEC's longstanding view—albeit it unaccompanied by rulemaking or explicit interpretive guidance—that IAPs would violate the federal securities laws. *See supra* note 5 and accompanying text. As the Introduction explains, that view's hold appears to be slipping, meaning that the main legal and regulatory opposition to IAPs will shift to the states. *See supra* notes 6–11 and accompanying text.

114. *See* Winship, *supra* note 34, at 536–37 ("Uncertainties about the validity of litigation provisions and concern that shareholders will react negatively have been barriers to adoption. . . . To a certain extent, uncertainty about the validity of bylaws—the first barrier to adoption—may be temporary. Courts may issue binding decisions in the future.").

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

116. Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 759–60 (2015).

117. *Id.*

118. *Boilermakers*, 73 A.3d at 937 (listing eight attorneys of record between Chevron and FedEx). Or rather, the Chevron and FedEx shareholders bore the cost of the litigation because attorney and other fees—whether directly or through increased directors-and-officers-insurance premiums—resulted in a reduction to the defendants' balance sheets.

adopter's IAP survives facial challenge, that is not the end to potential challenges. Even corporate-governance features that courts have facially vindicated, such as the shareholder-rights plan (or poison pill), remain subject to as-applied challenges.[119]

1. Facial and As-Applied Challenges[120]

In adopting an IAP, directors must act consistently with the corporation's best interests. Courts will review the propriety of adoption under the business-judgment rule: judges will generally not second guess directors' rational business decisions absent some breach of fiduciary duty.[121] This standard means that an IAP may be adopted by a board if its members have a rational belief that the provision will benefit the firm.[122] For example, directors may determine that an IAP will limit frivolous intracorporate claims, or reduce legal fees or time-to-resolution for meritorious ones. It also means that an IAP may not be adopted by directors whose purpose is to breach their duty of

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119. For example, in *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court upheld the use of poison pills as a permissible exercise of directorial authority. 493 A.2d 946 (Del. 1985). But since *Unocal*, Delaware courts have heard numerous as-applied challenges to directors' use of poison pills as defensive corporate-governance features. *See, e.g.*, Versata Enter., Inc. v. Selectica, Inc., 5 A.3d 586 (Del. 2010); Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998); In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59 (Del. 1995). *See also* the discussion of the business-judgment rule *infra* note 121 and accompanying text.

120. IAPs will typically be adopted by boards as unilateral bylaws amendments, and that is the scenario this article focuses on. But they may also be adopted in charters (either initially or as amended and approved by shareholders) or as shareholder-adopted bylaws. *See supra* note 34 and accompanying text. In cases in which shareholders have blessed an IAP, there generally will be fewer fiduciary-duty-related issues with adoption (although they could still arise, e.g., based on a board's voting recommendation to shareholders). However, a board's decision whether to enforce an IAP in a given case will always be subject to directors' fiduciary duties. *See* Schnell, *infra* note 125.

121. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805 (Del. 1984) ("It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."); *see also* CAL. CORP. CODE §309(a) ("A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."); Black v. Fox Hills North Cmty. Ass'n, Inc., 599 A.2d 1228, 1231 (Md. Ct. Spec. App. 1992) ("The 'business judgment' rule . . . precludes judicial review of a legitimate business decision of an organization, absent fraud or bad faith.").

122. *See supra* note 52.

loyalty, say, in order to insulate themselves from claims. Such a breach might be evidenced by onerous arbitral procedures (for example, high filing fees[123] or significantly curtailed opportunities for discovery) or by adopting an IAP that applies to pending litigation. In addition, a board's decision to enforce an IAP—even if it was adopted or approved by shareholders—is subject to directors' fiduciary duties.[124] That is, if it is in a corporation's best interests that an intracorporate dispute proceed in a court rather than in arbitration, then a board must not enforce an IAP.[125] This decision too may end up in litigation.[126]

Directors face legal risk in adopting any defensive governance feature. In the case of intracorporate arbitration, the FAA's interaction with state corporate law complicates and adds to this risk. IAPs are an agreement to arbitrate. Given the FAA's robust national pro-arbitration policy, IAPs generally should be expected to withstand collateral attacks (i.e., challenges to the arbitration itself, not the underlying intracorporate claim). The FAA does allow for non-enforcement of arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract."[127] It also provides for the vacation of arbitral awards "procured by corruption, fraud, or undue means," for arbitrator corruption or partiality, and for

123. *See* American Express Co. v. Italian Colors Rest., 570 U.S. at 236 (Scalia, J.) (acknowledging that "filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable" could satisfy the "effective vindication" exception to arbitration-agreement enforceability); Green Tree Fin. Corp. Ala. v. Randolph, 531 U.S. 79, 91–92 (2000) (suggesting that prohibitively expensive filing fees could render an arbitration agreement unenforceable).

124. *See* Paramount Comm'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 48 (Del. 1994) ("[C]ontractual provisions . . . may not validly define or limit the directors' fiduciary duties under Delaware law or prevent . . . directors from carrying out their fiduciary duties under Delaware law. To the extent that such provisions are inconsistent with those duties, they are invalid and unenforceable.").

125. In its landmark decision in *Schnell*, the Delaware Supreme Court found a board's amendment to a corporation's bylaws to advance the date of shareholder elections to be a fiduciary breach because, despite its authority to amend the bylaws, it did so for the purpose of thwarting a proxy challenge. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971).

126. Whether the arbitrability of a given claim depends on directors not violating their fiduciary duties in enforcing arbitration—and whether this question itself is determined by a court or an arbitrator—is an open question. *See* Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 84 (2002) ("[A] disagreement about whether an arbitration clause in a concededly binding contract applies to a particular type of controversy is for the court."); First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 947 (1995) (whether a party consented to arbitration is subject to independent judicial review).

127. 9 U.S.C. § 2 (1947).

arbitrators exceeding their authority or engaging in prejudicial misconduct.[128] These exceptions, however, address extreme cases. Although the Supreme Court has acknowledged that arbitration requires a level of due process, it is a rare case in which an arbitration agreement is not enforced, or an arbitral award is not confirmed.[129] Instead, the Court's FAA decisions have steadily approved the streamlining of civil-litigation procedures as an important part of the FAA's national pro-arbitration policy.[130]

IAPs are, however, a special case of arbitration agreement in that they may be unilaterally imposed by actors (directors) who are obliged to act in the best interests of other contractual parties (corporations, or, indirectly, shareholders). This obligation extends both to the creation of the arbitration agreement and to its enforcement.[131] The Supreme Court has accepted, albeit in the consumer context, unilaterally imposed arbitration provisions as being within the FAA's remit. In *Concepcion*, the Court enforced a class-waiver arbitration provision that AT&T imposed as a unilateral amendment, which was permitted in its initial adhesive contract with its mobile-phone customers.[132] That result exemplifies the Court's history of upholding robust (even, arguably, aggressive) uses of arbitration agreements, meaning it is primed to enforce IAPs.

Yet the potential for collateral attacks on IAP adoption and enforcement still presents a legal barrier. The unilateral imposition of an arbitration agreement worked in *Concepcion*, but there AT&T owed no fiduciary duty to its customers, only those duties owed by one arms' length contracting party to another.[133] But in binding shareholders present and future to bylaws amendments, directors must look out for the corporation's best interests. This duty is a substantive

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128. 9 U.S.C. § 10 (1947).

129. *See generally* Richard C. Reuben, *Personal Autonomy and Vacatur After* Hall Street, 113 PENN. ST. L. REV. 1103 (2009) (explaining why attempts to vacate an arbitral award rarely succeed).

130. *See generally, e.g.,* DIRECTV, Inc. v. Imburgia, 136 S. Ct. 463 (2015); *Italian Colors*, 570 U.S. at 228; CompuCredit Corp. v. Greenwood, 565 U.S. 95 (2012).

131. *See* Hills Stores Co. v. Bozic, 769 A.2d 88, 107 (Del. 2000) (judicial approval of "a board's decision to put defenses in place on a clear day does not mean that the board will escape its burden to justify its use of those defenses in the heat of battle . . . .").

132. *Concepcion*, 563 U.S. at 336.

133. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

right held by a corporation under state law and is not waived by the presence of an IAP (arbitration agreements are procedural and do not affect substantive rights).[134]

Owing to the rarity of IAPs, courts are not yet encountering this intersection of corporate fiduciary duties with FAA enforcement. But those cases will likely proceed in two steps: first, whether, under state law, boards have acted ultra vires or in breach of their fiduciary duties in adopting or enforcing an IAP, and second, whether (i) adoptions are consistent with the FAA's Section 2 (agreement formation) or (ii) agreement enforcement complies with the FAA's Sections 4 (agreement enforcement) or 9 through 11 (award vacation). Given the FAA's "liberal federal policy favoring arbitration,"[135] the first step will generally dispose of the second because an improper adoption means an arbitration agreement was not formed, while a decision to enforce an IAP that is inconsistent with directorial duties would also call into question whether the provision is binding in that case.[136]

Facial challenges may be a one-time governance cost (either for each firm or for one landmark case that establishes the permissibility of IAPs generally), but as with any defensive corporate-governance feature, as-applied challenges will remain a risk for the lifetime of an IAP. The cost of dealing with this collateral litigation may be acceptable if an IAP sufficiently reduces overall agency costs. Prospective adopters, however, must carefully weigh the potential costs of collateral litigation in evaluating whether they expect an IAP to reduce the firm's agency costs (and hence increase its value).

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134. *Concepcion* and *Italian Colors* made this distinction by pointing out that although plaintiffs were unable to access their ideal method—a class action—for pressing their legal claims, they nevertheless had access to an arbitral forum to vindicate those claims. *See Concepcion*, 563 U.S. at 333; *Italian Colors*, 570 U.S. at 228.

135. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

136. Whether directors violate their fiduciary duties in a given case by enforcing an IAP is a question of fact. *See* FDIC v. Jackson, 133 F.3d 694, 700 (9th Cir. 1998). This could very well mean that an IAP adopter risks the muti-fora litigation it IAP is aimed partly at avoiding. For example, if a shareholder files an intracorporate dispute in state court, the company may, under the FAA, seek enforcement of the IAP. This collateral litigation would require disposition before the shareholder's intracorporate case could arbitrated. *See Schnell, supra* note 125. Joseph Grundfest and Kristen Savalle have argued that although the choice of Delaware as an exclusive forum will survive a collateral challenge, a "more nuanced analysis" is appropriate for considering whether the selection of a foreign forum violates the board's fiduciary duties. Grundfest & Savalle, *supra* note 70, at 403–04.

Importantly, directors who adopt IAPs have considerable discretion in designing what their intracorporate arbitration will look like. They will greatly mitigate the risk of facing collateral litigation, or experiencing losses if they do, by designing arbitral procedures that are demonstrably in the corporate interest, that enhance governance quality, and that are efficient and fair for intracorporate parties.[137]

2. State Public-Policy Opposition

Although *CommonWealth REIT* demonstrates at least one state court recognizing the enforceability of IAPs under its corporate laws,[138] shareholder challenges may be catalyzed by state public-policy opposition to intracorporate arbitration. The Supreme Court's FAA jurisprudence frequently invokes that hostility to arbitration motivated the statute's passing.[139] Although state public-policy opposition to arbitration agreements has manifested most commonly with employment or consumer contracts, in some states IAPs will likely also receive close scrutiny and public-policy opposition. The stakes of many intracorporate disputes are high.[140] This point is especially true for states that actively compete in the national marketplace for corporate chartering.[141] These states, and others that view IAPs as contrary to their public policy, may seek to prohibit,

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137. At a minimum, for example, an IAP should accommodate the board's fiduciary duties by including a "fiduciary out" provision. Granted, even without an express "fiduciary out" provision, one may be implied. *See Paramount*, *supra* note 124. Adopters would also be better able to defend against as-applied challenges if their IAPs are adopted on a "clear day" and not in contemplation of any specific intracorporate dispute. *Cf.* Hollinger Int'l v. Black, 844 A.2d 1022, 1080–81 (Del. Ch. 2004) (holding invalid bylaws amendments that were "clearly adopted for an inequitable purpose and have an inequitable effect").

138. *CommonWealth REIT*, No. 24-C13-001111, 2013 WL at 1915769.

139. *Southland Corp.*, 465 U.S. at 16; *see generally* Aragaki, *supra* note 56 (explaining the Supreme Court's doctrinal test for determining when state law is preempted by the FAA and, further, describing the Court's preemption framework as a principle of antidiscrimination).

140. For example, Cornerstone Research examined public M&A deals announced in 2010 and 2011 and found that deals valued over $100M drew 5.1 lawsuits on average. CORNERSTONE RESEARCH, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS, at 3 (2012), http://www.cornerstone.com/files/upload/Shareholder_MandA_Litigation.pdf. Eleven deals drew fifteen or more lawsuits each, e.g., the Express Scripts acquisition of Medco Health Solutions was valued at $29.37B and drew twenty two suits. *Id.*

141. *See* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) for an explanation of the competitive market for corporate chartering.

restrict, or regulate IAPs. Those efforts would set the stage for the further development, and likely extension, of FAA jurisprudence.

i. The Intersection of State Corporate Law and the FAA

Delaware offers the leading example of state public-policy opposition to IAPs. During its 2015 session, the Delaware General Assembly added Section 115 to the DGCL, which permits the adoption of forum-selection provisions by Delaware corporations.[142] The grant of this new power was in itself of no moment; it was already recognized by *Boilermakers*.[143] Rather, this amendment effected a policy of allowing Delaware corporations to direct intracorporate disputes to any forum they like, so long as that forum is a Delaware court. Under Section 115, a shareholder of a Delaware corporation may bring intracorporate litigation in Delaware courts notwithstanding any other forum-selection provision, such as one specifying arbitration or the courts of the state where the firm is headquartered.[144] Thus, the amendment constrains governance options by purporting to expand them, while superseding precedent that Delaware courts have no special claim to adjudicating the intracorporate disputes of Delaware corporations.[145] Delaware is not

142. 80 Del. Laws ch. 40, § 5 (2015) (adding DEL. CODE ANN. tit. 8, § 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, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State. 'Internal corporate claims' means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery.

143. *See* Boilermakers, 73 A.3d at 934.

144. S.B. 75 syn., 148th Gen. Assemb., Reg. Sess. (Del. 2015) ("Section 115 does not address the validity of a provision of the certificate of incorporation or bylaws that selects a forum other than the Delaware courts as an additional forum in which internal corporate claims may be brought, but *it invalidates such a provision selecting the courts in a different State, or an arbitral forum, if it would preclude litigating such claims in the Delaware courts*.") (emphasis added).

145. *See Baker*, *supra* note 54.

alone. Maryland has adopted a similar rule in its own corporate statute.[146]

In one case, *Bonanno v. VTB Holdings, Inc.*, the Delaware Chancery Court has treated Section 115 as facially valid, albeit with regard to a shareholder agreement that selected Texas as the exclusive intracorporate forum.[147] As the Chancery Court noted in that case, the Supreme Court's decision in *M/S Bremen* upheld the enforceability of contractual forum-selection clauses subject to a "strong public policy" exception, which Section 115 suffices to express.[148] However, no state or federal court has tackled Section 115, or a provision like it, with regard to intracorporate *arbitration*.

Section 115 exemplifies the potential for state public-policy opposition against IAPs.[149] The interaction of state corporate law with the FAA creates difficult second-order questions that this kind of opposition could express.[150] The FAA is a policy against anti-arbitration discrimination, and the Supreme Court has been watchful over state efforts to undermine this national policy through facially neutral means. Rather than pursue explicit regulation of intracorporate arbitration (as with the DCGL's Section 115), states might try to police IAPs in subtler ways. For example, state law determines what

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146. MD CODE ANN., CORPS. & ASSN'S § 2-113(b)(2)(ii) ("The charter or bylaws of a corporation may not prohibit bringing an internal corporate claim in the courts of this State or a federal court sitting in this State.").

147. Bonanno v. VTB Holdings, Inc., C.A. No. 10681-VCN, 2016 WL 614412 (Del. Ch. Feb. 8, 2016).

148. *Id.* at 14 (quoting M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 15 (1972)) ("A contractual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision."); *see also Southland Corp.*, 465 U.S. at 10 ("In enacting § 2 of the [FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.").

149. *Concepcion*, 563 U.S. at 342 ("Other examples are easy to imagine. The same argument might apply to a rule classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury (perhaps termed 'a panel of twelve lay arbitrators' to help avoid preemption). Such examples are not fanciful, since the judicial hostility towards arbitration that prompted the FAA had manifested itself in 'a great variety' of 'devices and formula' declaring arbitration against public policy.") (quoting Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 406 (2d Cir. 1959)).

150. For example, the validity of a contract's arbitration provision is determined by a court. Rent-A-Center v. Jackson, 561 U.S. 63, 70–71 (2010). If the arbitration provision is facially valid, then the validity of the contract itself is determined by the arbitrator. *Id.*

directors' fiduciary duties are, and state courts (or legislatures) could construe those duties in a way that impedes the adoption or enforcement of an IAP. Or legislatures could amend their corporate statutes to require shareholder approval of IAPs (but not other bylaws provisions). Because the adherence of directors to their fiduciary duties is fundamental both to board adoption and to the enforcement of IAPs, these efforts would set a collision course with the FAA.[151]

Courts and arbitrators faced with this intersection of state corporate law and the FAA must confront it as a new frontier in FAA jurisprudence.[152] Actions seeking to enforce arbitration agreements usually conclude in favor of arbitration. But an intracorporate-arbitration/fiduciary-duty case would require a deeper, more searching analysis than do typical FAA-enforcement actions.[153] Fiduciary duty binds directors' discretion for designing and enforcing arbitral provisions, as compared to the discretion of parties to agree to contractual terms when dealing at arm's length. As a concrete example, a court or arbitrator may find that directors violate their fiduciary duties by adopting or enforcing an IAP that outright prohibits discovery. Prohibiting discovery, the reasoning would go, runs against the corporate interest by making proving, and thus vindicating, meritorious intracorporate claims difficult or infeasible. That decision would be distinguishable from one holding a consumer arbitration

151. *Cf. Concepcion*, 563 U.S. at 334 ("When state law prohibits outright the arbitration of a particular type of claim, the FAA displaces the conflicting rule.").

152. Challenges to the validity of an arbitration provision itself are decided by a court, whereas challenges to the validity of the entire contract are decided by an arbitrator. Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 445–46 (2006) ("[A]n arbitration provision is severable from the remainder of the contract. . . . [U]nless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance.").

153. For example, in *Italian Colors* and *Concepcion*, the Supreme Court identified informality and confidentiality as two of arbitration's most beneficial features. Whatever benefits firms may obtain from intracorporate arbitration, confidentiality and (to a degree) informality are likely not among them. Intracorporate disputes deal with a large body of assets, whose residual beneficiaries (shareholders) are widely dispersed and who have an attenuated link to their managerial agents. Firms may be better off resolving intracorporate disputes with less formality than that of traditional litigation, but these types of disputes require more process than cellular-phone billing disputes. *Cf. Concepcion*, 563 U.S. at 344–45 (2011) ("It can be specified, for example, that proceedings be kept confidential to protect trade secrets. And the informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.") (citations omitted). And, as a practical matter, their outcomes should not be kept confidential from shareholders or the market.

agreement unenforceable because its limitations on discovery hinder a plaintiff's ability to make a case. In this light, arbitration in the intracorporate context must focus on a firm's ability to maximize its value through private ordering. This point implies that enforcing directors' fiduciary duties would empower courts and arbitrators to require greater arbitral due process than might be regarded as a minimum in other FAA contexts. Policing how far this power extends against the overall backdrop of the FAA's pro-arbitration policy, though, will be a challenging undertaking. Firms that adopt IAPs must factor this uncertainty into their IAP designs.

ii. Categories of State Public-Policy Opposition

Delaware's Section 115 and public policies like it are unlikely to survive challenge under the FAA.[154] It is instructive, though, to consider the state-based anti-IAP policy categories discussed in the next paragraphs. For example, although it is hard to be sure of the Delaware legislature's motivations for adopting Section 115, it is worth considering how the following categories might apply.[155] These categories are not only descriptive explanations for why states might pursue public-policy opposition to IAPs, but they are also justifications defendants might offer for why anti-IAP policy is not preempted by the FAA.

State public-policy opposition to intracorporate arbitration, whether judicial or legislative, will fall into one or more of three categories: shareholder protection, law development, or franchise defense. State public-policy opposition may take several forms,

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154. *See* Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 391, 408–09 (2004) (explaining why state laws that apply to arbitration and some other types of contract clauses, but not all contract clauses, are preempted by the FAA).

155. *But see* James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH U. L. REV. 257, 257 (2015) (suggesting that Section 115 was at least partly motivated by "pacifying" the Delaware bar that it would not lose "lucrative shareholder suits . . . because of the chilling effect of a loser pay rule for shareholder suits."). The Corporate Council, a body within the Delaware State Bar Association, acknowledged the potential that in advocating for Section 115, it would be criticized for the legislation's appearance of protectionism. It rejected this criticism as failing to "address the substance or merits of the issues." Corporate Council, Delaware State Bar Ass'n, *Explanation of Council Legislative Program* at 10 (2015), https://www.corporatedefensedisputes.com/files/2015/03/COUNCIL-SECOND-PROPOSAL-EXPLANATORY-PAPER-3-6-15-U0124513.pdf.

including judicial applications of corporate law to prohibit or burden the use of IAPs or legislation allowing shareholders to bring intracorporate litigation in state court notwithstanding the presence of a mandatory IAP.[156] Opposition might even be as modest as statutes requiring shareholder approval of IAPs, or statutes that expressly *authorize* IAPs subject to procedural conditions that go beyond the minimal due process required by the FAA. The breadth of the Supreme Court's construction of the FAA means that state attempts to bar or burden IAPs are vulnerable to challenge. However, as Part II.B describes, policy opposition is a barrier to IAP adoption because it imposes on adopting corporations the uncertainty and cost of vindicating their IAPs.

Shareholder protection. The first category, shareholder protection, deals with opposition to arbitration out of a belief that it allows for insufficient vindication of substantive state rights, or even serves to make substantive state rights effectively unenforceable.[157] This belief is motivated by the criticism of arbitration that it, compared to a judicial forum, creates procedural hurdles for claimants and privileges drafting parties (usually employers or consumer companies, but in this case, management). In this view, state opposition seeks to ensure that plaintiffs—typically, shareholders—have access to state-run judicial process, which it reckons to be fairer and more equitable than arbitration. Shareholder protection may also take the form of a state asserting its interest in protecting the shareholders of firms formed under its laws, which it may have a particular strategy for effecting.[158]

As Part I.B discusses, the Supreme Court in *Concepcion* and *Italian Colors* has rejected this view: it is no reason to discriminate against an arbitration provision that a judicial forum may closer

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156. *See* notes 144, 148, and accompanying text.

157. For example, *Concepcion* held California's *Discover Bank* rule—which prohibited barring class-action waivers in adhesive arbitration agreements involving small amounts of damages, unequal bargaining power, and the use of class-action waivers to insulate the drafter from claims—to be preempted by the FAA. *See* 563 U.S. at 352, *abrogating* Discover Bank v. Sup. Ct., 113 P.3d 1100 (Cal. 2005).

158. *See* Helen Hershkoff & Marcel Kahan, *Forum-Selection Provisions in Corporate "Contracts"* at 6 (NYU L. & Econ. Res. Paper Series No. 17-28) (2017) ("Arguably, [forum-selection terms'] emergence in corporate practice is part of a strategy to curb abuses in representative litigation, with the Delaware judiciary as chief designer of that strategy. Centralizing intra-corporate disputes involving Delaware corporations—as is achieved through corporate forum-terms—may be necessary to assure that Delaware's strategy is not undermined by other state courts.").

approach a state's ideal of what civil due process should look like (provided the arbitration satisfies the FAA's minimum due-process requirements).[159] But, as Part I.B further discusses, this decisional law would extend to state opposition to intracorporate arbitration as well.[160] As Part III explains, however, robust due process for all parties to intracorporate arbitration is an imperative of intracorporate arbitral design, even if it is not a justification for states to discriminate against IAPs.

Law development. The second category, law development, opposes arbitration out of concern that it "ousts"[161] the jurisdiction of state courts and thus threatens to impoverish the development of state corporate law. This effect follows from state courts hearing fewer cases and thus having fewer opportunities to expand, explain, or modify corporate law.[162] This and the prior category seem most likely to be offered by states or litigants in justifying policies that discriminate against IAPs. However, as with the shareholder-protection concerns discussed above, a policy opposing intracorporate arbitration on law-development grounds would likely not withstand challenge under the FAA. It is, after all, a criticism that can be leveled against a fair portion of the arbitrations that already occur, particularly those that raise novel legal or factual issues.[163] Nevertheless, just as

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159. Under the FAA, arbitral awards may be vacated on limited grounds. *See supra* note 128 and accompanying text. More, the Supreme Court has remained open to an "effective vindication" exception to arbitration-agreement enforcement, a functional due-process requirement for the arbitration context. *See supra* note 123 and accompanying text.

160. Note, however, that the criticism implicit in this first category touches this article's main project—what intracorporate arbitration should look like.

161. *See* M/S Bremen, 407 U.S. at 12 ("The argument that [forum-selection] clauses are improper because they tend to 'oust' a court of jurisdiction is hardly more than a vestigial legal fiction. It appears to rest at a core on historical judicial resistance to any attempt to reduce the power and business of a particular court . . . ."); *see also* Bernhardt v. Polygraphic Co. of Am., Inc., 350 U.S. 198, 210–11 (1956) (Frankfurter, J., concurring) (referring to the "traditional judicial hostility against ousting courts . . . of their jurisdiction.").

162. *See* Michael A. Scodro, Note, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927, 1949 (1996) ("Another difficulty with resolving novel legal questions in private arbitration is the fact that this very process deprives the courts of the opportunity to resolve unsettled issues of statutory interpretation.").

163. *See* Rex R. Perschbacher & Debra Lyn Bassett, *The End of Law*, 84 B.U. L. REV. 1, 30 (2004) ("[A]rbitration resolves disputes without contributing to the body of law and without providing information to the public. The increase in arbitration clauses and arbitration proceedings means that more and more potential law is being lost.").

with the shareholder-protection criticism above, this second category hits a legitimate policy concern. The opportunities state courts have to interpret their corporate laws is a function of the volume and types of cases they get. The resulting decisions are a public good for all firms chartered in that state: more decisional law brings greater certainty to the law as it applies to a given firm's own governance. If cases (particularly the novel ones) are diverted to arbitration, there is a real risk of impoverishing the development of states' corporate laws.[164] That would be a particular blow to the public interest because a case's precedential value flows downstream from its litigants' interests in resolving their dispute.[165]

Arbitrators hearing intracorporate cases also benefit when they have clear, controlling precedent to guide their analyses. Thus, diminished corporate dockets would threaten to increase legal uncertainty for all firms regardless which fora hear their intracorporate disputes. For IAP adopters, this is a risk they too have an interest in mitigating because, like any other firm, they benefit from certainty regarding their governance. In keeping with that interest, Part III offers institutional design principles to avoid impoverishing law and even, possibly, to enrich it.

Franchise defense. The third category, franchise protection, like "law development," opposes arbitration in order to avoid judicial "ouster," but is motivated by a policy of defending a state judiciary's competitive advantage, say, for its adjudicative expertise.[166] There

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164. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 31 (1991) (petitioner contending because "arbitrators often will not issue written opinions" and due to the "inability to obtain effective appellate review," that there will be a "stifling of the development of the law."). Judge Harry Edwards, in urging broader judicial review of arbitral awards, warned of "public law issues [being] resolved by nongovernmental bodies." Harry T. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 668, 672 n.13 (1986).

165. *See* Edward Brunet, *Questioning the Quality of Alternate Dispute Resolution*, 62 TUL. L. REV. 1, 19–20 (1987) ("Society gains more from litigation than would be produced if litigation were left to the private market."); Geoffrey C. Hazard, Jr. & Paul D. Scott, *The Public Nature of Private Adjudication*, 6 YALE L. & POL'Y REV. 42, 59 (1988) ("Ordering by public justice produces decisions resting on considerations that transcend the immediate dispute and the immediate parties [whereas] [o]rdering by private disposition can involve a normative frame of reference that includes only the immediate parties.").

166. Professor Lynn LoPucki described forum-selection bylaws as starting a vicious cycle for Delaware's chartering business: the clauses prompt management strategically to take cases out of Delaware courts, thus influencing Delaware courts to become more favorable to management (to protect their franchise) and thereby damaging Delaware charters' legitimacy in the market. Professor LoPucki views

may be different motivations for franchise defense, but foremost would be a state securing its corporate chartering revenue in the national market for corporate law.[167] This final category, whether it is intended to favor the state's interest or the interest of some of its citizens, is protectionist. Franchise protection against IAPs would clash with the FAA and the Constitution's Dormant Commerce and Full Faith and Credit Clauses, leaving it vulnerable to legal challenge.[168] The vulnerability of such a policy would, of course, be greater if it was motivated by private interests (e.g., to preserve attorneys' business) versus purely state interest (e.g., to maintain state chartering revenue).[169]

IAPs as a potential "coup de grace" for Delaware, because without cases, it would lose its judiciary-based competitive advantage over other states' chartering franchises. Lynn M. LoPucki, *Delaware's Fall: The Arbitration Bylaws Scenario*, *in* CAN DELAWARE BE DETHRONED?: EVALUATING DELAWARE'S DOMINANCE OF CORPORATE LAW 35 (Stephen Bainbridge et al. eds., 2018).

167. Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate* Law, 34 DEL. J. CORP. L. 57, 64 (2009) (recognizing the risk of pro-management "partisanship in Delaware's own adjudication" stemming from its "financial and prestige-based stakes in promoting its successful chartering business").

168. *See* Tenn. Coal, Iron, & R.R. Co. v. George, 233 U.S. 354-60 (1914) ("[A] state cannot create a transitory cause of action and at the same time destroy the right to sue on that transitory cause of action in any court having jurisdiction. That jurisdiction is to be determined by the law of the court's creation and cannot be defeated by the extraterritorial operation of a statute of another state, even though it created the right of action."). Some courts, however, have erroneously dismissed causes of actions because they have interpreted a state's law as assigning exclusive jurisdiction to its courts, rather than allocating subject-matter jurisdiction within its own judiciary. For example, in *Reserve Solutions Inc. v. Vernaglia*, a books-and-record claim against a Delaware corporation was dismissed on the basis of the DGCL vesting "exclusive" jurisdiction over such claims in Delaware's Chancery Court. 438 F. Supp. 2d 280, 286 (S.D.N.Y. 2006). *But see IMO Daniel Kloiber Dynasty Trust, supra* note 47 (observing that Delaware state statutes that assign exclusive jurisdiction to a particular Delaware court are merely allocating jurisdiction among the Delaware courts—not making a claim that no court outside of Delaware can exercise jurisdiction).

169. *See* United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Wast Mgmt. Auth., 550 U.S. 330 (2007) (recognizing that states may discriminate against out-of-state economic actors in favor of *their* economic interests (but not those of private in-state actors), an exception to the rule that under the Dormant Commerce Clause such out-of-state discrimination receives strict-scrutiny review). Professor Jill Fisch has argued that although self-interested Delaware attorneys played a part in Section 115's passage, the legislation promoted public interests, particularly around revenue, and so it should not be viewed as protecting the business interests of the Delaware bar. Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1673–74 (2016).

III. FAIRNESS, EFFICIENCY, AND TWO MODELS OF INTRACORPORATE ARBITRATION

Whether IAPs are accepted by the market depends whether the market expects them to have a positive or a negative effect on firm value. This Part argues that intracorporate arbitration *can* increase firm value, and that it is most likely to do so if it is conducted through a well-designed institution, rather than through an ad hoc, non-institutional approach.

A. *Efficiency and Fairness in Intracorporate Arbitration*

Intracorporate arbitration could decrease agency costs by reducing the expense to the firm of being sued by shareholders (or directors or officers)—that is, efficiency—while preserving or even enhancing litigants' ability to vindicate meritorious claims—that is, fairness.[170] These two terms map more or less onto the benefit and cost sides of the inequality laid out in Part II.B. This Part argues that these two factors can (and should) increase in tandem, despite the intuition that enhancing one (usually, efficiency) will degrade the other (usually, fairness).[171]

"Efficiency" is the degree to which corporate resources are not spent on intracorporate disputes, whether that expense comes from, e.g., legal fees, settlements, or managerial distraction.[172] A completely efficient procedure resolves intracorporate claims instantly (whether they succeed on the merits or not) so that no corporate resources are spent getting to the resolution.

Improvements to efficiency result in direct and indirect savings. They are achieved, for example, by limiting costs related to duplicative or unmeritorious litigation, and also in reducing costs associated with resolving meritorious claims. Duplicative claims are avoided via IAPs the same as with any other forum-selection provision, by avoiding litigating over the same issues in multiple fora. For example, shareholder suits are often criticized as being driven by plaintiffs' attorneys seeking rent, who initiate nuisance cases that

170. *See* Koppel, *supra* note 24.

171. These two defined terms offer a useful way for thinking about monitoring and agency costs generally, but the use of them here is limited to intracorporate disputes. *See* Koppel, *supra* note 24, who uses these terms in much that same way as this article.

172. This article does not attempt to define what is and is not an "unmeritorious" claim.

result in attorney fees but little, if any, benefit to the corporation or its shareholders.[173] Accepting that view, for argument's sake, these attorneys will have reduced incentive to pursue nuisance claims because a single forum (potentially one with a reluctant take on settlements that result mainly in attorney fees, or with heightened pleading standards) or streamlined process presents less opportunity to collect rent.

And "fairness" is the degree to which meritorious intracorporate claims are vindicated and unmeritorious claims are defeated, no matter the corporate or litigant resources or time, needed to reach the outcome. At its core, fairness is the ability of shareholders to vindicate meritorious intracorporate claims. Shareholders sufficiently empowered to pursue such claims are able to exert *ex ante* discipline on management. Well-disciplined management is motivated to pursue corporate interests over its own, partly out of a desire to avoid litigation, especially litigation it is likely to lose (i.e., meritorious claims).[174] Fairness comprises both the ability of

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173. *See* Charles R. Korsmo & Minor Myers, *The Structure of Stockholder Litigation: When Do the Merits Matter?*, 75 OHIO ST. L.J. 829, 839 (2014) ("[A] danger always exists that legal claims may be brought not in the realistic expectation of a judgment on the merits but rather to capitalize on the nuisance value of the claim."); Elliot J. Weiss & Lawrence J. White, *File Early, then Free Ride: How Delaware Law (Mis)shapes Shareholder Class Action*, 57 VAND. L. REV. 1797, 1855 (2004) (suggesting that rather than plaintiffs' attorneys being motivated to advocate for shareholders, it is "more likely" that they "are motivated primarily by self-interest and that their litigation efforts . . . produce little in the way of meaningful benefits for the shareholders . . . ."); Lucian Arye Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437, 440 (1988) (describing a plaintiff's ability to impose litigation costs on defendants as a lever to extract settlements for uncertain claims).

174. Granted, that are doubts regarding the importance and efficacy, as a matter of governance, of this monitoring tool because directors and officers of public companies are typically exculpated for breaches of their duty of care and enjoy indemnification coverage paid for by the corporation, i.e., ultimately, the shareholders. *See* Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 785 (2006) ("Corporate directors operate within a pervasive web of accountability mechanisms that substitute for monitoring by residual claimants."). That is not to say derivative actions don't carry personal consequences. After all, defendants face reputational risk and inconvenience when they are sued for breaching their fiduciary duties, even if they don't themselves foot the bill. *See* Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1140 (2006) ("The limited deterrence provided by out-of-pocket liability is supplemented by market incentives, reputation, and other soft incentives, including the substantial nuisance of being sued.").

shareholders and other stakeholders to access an equitable adjudicative forum (for example, with unbiased adjudicators and adequate procedural rights) and also to do so at a reasonable cost (for example, with the ability to pool resources in a class or to obtain reimbursement from the corporation). Fairness to shareholders also means that unmeritorious claims are not vindicated because they, by definition, serve no monitoring or disciplinary purpose and instead waste corporate assets and thwart corporate opportunities, including through the legal expenses they cause and their ability to distract management and delay business initiatives.

There is a consistent tension between the efficiency and fairness factors. Assuming that the burdens of production and persuasion rest on the party bringing an intracorporate claim, a highly efficient process—perhaps one with no discovery or testimony and short, summary hearings—would efficiently dispatch unmeritorious claims. By definition, unmeritorious claims are incapable of having their burdens of proof carried, and thus it redounds to shareholders' benefit if they are efficiently defeated before they can waste corporate assets. But just as efficiency would prevent false positives, it would also cause false negatives. Meritorious claimants must also carry their burden, and a highly efficient process would prevent proving many—or, perhaps, most—of them. Shareholders are harmed when meritorious claims—and the disciplining and monitoring roles they serve—go unvindicated. But, despite this tension between efficiency and fairness, optimizing for both factors is an important goal of intracorporate-dispute procedure, just as it is for any civil procedure.[175] These factors hold particular salience for intracorporate disputes because resolving them, for the most part, is *not* doing the work of balancing equities between two economically distinct litigants. Apart from unreimbursed plaintiff costs, the corporation generally bears the entire cost of intracorporate litigation, whether directly or through higher premiums paid for directors-and-officers

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175. Professor Jessica Erickson describes civil procedure as a process for sorting meritorious from unmeritorious claims. *Heightened Procedure*, 102 IOWA L. REV. 61 (2016). She criticizes "transsubstantive" civil procedure—procedure that applies to all cases—as being suboptimal. This suboptimality results from different substantive areas of the law being associated with different causes of unmeritorious claims. *Id.* at 62–63. Instead of being transsubstantive, she argues that procedure should be calibrated to detect a lack of merit as it typically manifests in different substantive areas of law. In doing so, she points out that legislatures have already followed this approach in some areas, including medical malpractice and securities fraud. *Id.* at 109, 113.

insurance.[176] When shareholders sue, they tax themselves. And so the procedures applied to intracorporate disputes help determine how much of a firm's resources go to managing its agency costs (and those expenses themselves roll into its overall agency costs).

In light of this tension, one key appeal of IAPs is the opportunity to resolve intracorporate disputes under procedural rules that are both more efficient *and* fairer than those offered by judicial fora, or that at least do a better job of optimizing between the two. This opportunity is realized by calibrating rules to the unique needs and context of intracorporate disputes, rather than to civil litigation generally.[177] The rules might, for example, set default document and deposition discovery schedules that are tailored to certain types of intracorporate disputes (the point being to get claimants the discovery that they need to prove claims without wasting time and resources on discovery disputes or motion practice). This opportunity can also be achieved by quasi-procedural rules, such as by being flexible in where arbitrations physically occur and by eliminating the participation of local counsel when lead attorneys do not practice in the forum state.[178] The point is that the tension between efficiency and fairness is natural and constant, but an improvement to one need not necessarily cause a decline in the other.

Assuming the substantive corporate law applied to a dispute is fixed regardless the forum, and assuming that adjudicators always reach the correct legal and factual conclusions under given procedural constraints,[179] then procedure is the determinant of the agency costs

176. *See* Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB POL'Y 1187, 1194 (2013) ("Class actions generally result in institutional stockholders effectively suing themselves, paying high defense costs and giving plaintiffs' attorneys a large percentage of the settlement amount.").

177. *See supra* notes 99 and 175.

178. For example, proceedings might be in city convenient to the parties or their law firms. This flexibility would allow parties to avoid the expense of hiring local counsel in the dispute venue, or traveling for hearings or trials.

179. This simplifying assumption means that adjudicators will correctly understand and apply substantive law to the facts, but it also means that procedure necessarily shapes the factual record and thus can influence the application of the law to the facts. *But cf.* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U.L. REV. 542, 589 (1990) ("Because of Delaware's small size and its many corporate charters, Delaware judges see a high proportion of corporate cases, and develop corporate expertise".). *But see* David Horton, *Clause Construction: A Glimpse into Judicial and Arbitral Decision-Making*, 68 DUKE L.J. 1322, 1358–68 (2019) (finding that arbitrators are statistically more likely than federal courts to construct arbitration clauses as allowing class actions).

attributable to the claim. Procedure's role as a value lever means that a procedure that vindicates meritorious claims and defeats unmeritorious claims with perfect efficiency will increase firm value, whereas one that takes an indefinite amount of time and that vindicates unmeritorious claims and defeats meritorious ones will decrease value. Beyond those two outer limits of the efficiency/fairness function, the equilibrium between the two will determine whether their combined effect on firm value is positive or negative. This article's project is to show that firms can affect that equilibrium. The next two Sections describe two models for doing so—non-institutional arbitration and institutional arbitration—and explain that the latter is most likely to be associated with improvements to efficiency and fairness, and thus to increases in firm value.

B. *The Non-Institutional Model*

The first model is the non-institutional model, a default in which firms replace the exogenous institutional authority of courts with internally developed arbitral procedures and practices. Firms following this approach draft bespoke IAPs that specify procedures for filing a complaint, selecting the panel, and conducting the arbitration. Under this model, arbitrators typically will be drawn as individuals, rather than as members employed by any particular institution. And, although an IAP might adopt or modify an external set of arbitral rules to govern its intracorporate arbitrations (such as those of the American Arbitration Association), the external author of those rules (even if it is an institution) has no direct role in enforcing them.[180] The problem with this ad hoc approach is that it may result in a reduction to firm value due to the procedural and repeat-player problems laid out in Part II.A. These results might flow in some cases from management's designing the IAP to support its entrenchment or defalcation. More alarmingly, these problems could also arise innocently from management that simply wants to reduce the cost of intracorporate litigation, but that adopts procedures that make it harder to vindicate meritorious claims.[181]

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180. For example, the IAP proposed by Carlyle specified that the Rules of Arbitration of the International Chamber of Commerce would apply to the extent they were consistent with the IAP itself. *Carlyle Registration Statement*, *supra* note 1, at A-59.

181. For example, a special litigation committee might propose a well-regarded practitioner to serve as arbitrator, ignoring the risk that on a daily basis she

That is not to say that a non-institutional IAP could not increase firm value and thus earn market confidence as an appropriate corporate-governance feature. Thoughtful counsel might well design intracorporate arbitral procedures that balance the efficiency and fairness factors this Part discusses. Early IAPs using this approach would then become public precedents, giving firms models and empirical observations from which to develop efficient and fair IAPs for subsequent adopters. This world is possible. But this approach is a gamble for firms and the market to take. The flexibility of corporate governance means that firms have many options for value-maximizing private ordering. This flexibility does not mean, however, that management, left to devise and control a key constraint—that is, being sued—on its own acts and omissions will choose efficient and fair arbitral procedures and practices or stick to them if they end up frustrating its own interests. In other words, management has an incentive to choose arbitral procedures that benefit management. And even if it does not choose such procedures in the first place, if claimants are successful under them, management has an incentive to change the procedures to become more defensive. Thus, the endogeneity that inheres in this model could lead to higher agency costs in the form of reduced *ex ante* managerial discipline and diminished opportunities for *ex post* enforcement.[182]

If anything, the repeat-player problem discussed in Part II.A appears persistently, and ominously, in the non-institutional model. After all, management is likely to have an outsized influence on the selection of arbitrators under this model. It is easy to imagine that arbitrators (whether retired judges, practicing attorneys, legal academics, or others) seen as more favorable to management are more likely to be picked. Instead, shareholders will have a better guarantee that intracorporate claims are heard efficiently and fairly if IAPs require exogenous enforcers, a role traditionally played by courts. Whatever benefits firms could achieve from IAPs, dispatching with adjudicative exogeneity is unlikely to lead to them.

The non-institutional model is one in which IAPs, at least compared to judicial fora, are apt to privilege management in intracorporate disputes over meritorious shareholder claims. This

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works on behalf of the management of her existing clients and is likely to see issues through their eyes.

182. *See* Lipton, *supra* note 44, at 628 n.261 ("Even forum selection bylaws are not comparable [to IAPs] because it is the unique ability of parties to the action, such as directors, to manipulate arbitral procedures that gives rise to the suspicion of self-interest; public courts are not susceptible to the same manipulation.").

model may be designed intentionally by management to reach this result, thereby insulating it from intracorporate challenge. In such cases, the gains from efficiency achieved by intracorporate arbitration may well be offset by the costs to fairness, leading either to management's lack of focus on value-maximization or its engaging in conflicted behavior. At the same time, aspects of this model might be adopted by well-meaning boards that are motivated simply to direct their intracorporate disputes into a forum that avoids duplicative or unmeritorious litigation and that speeds up the resolution of these disputes. But the adoption of this model by well-meaning firms may nevertheless result in costs that exceed benefits. This is because the model's features may diminish management discipline, which in turn may lead to reduced firm value (even if that is not the motivation for adopting an IAP). These risks counsel that a firm's management, shareholders, and advisers should carefully consider the dynamic implications for the firm's value before adopting an IAP employing this non-institutional model. But the risks also raise a question: is there a better way?

C. The Institutional Model

The non-institutional model is characterized by endogenous arbitral procedures and practices that are unconstrained by an adjudicative institution. Under the institutional model, however, a firm makes a credible commitment to a credible institution. That is to say, an adopting firm must satisfy the market that its intracorporate disputes will be heard by an arbitral institution that (i) efficiently and fairly enforces state corporate laws and the firm's charter and bylaws and (ii) is exogenous to and independent of the firm's management. An "arbitral institution" may take on many potential organizational forms, such as not-for-profit associations set up by public companies or the securities industry, judicial bodies within national stock exchanges, for-profit service providers, or something else altogether. At minimum, an "arbitral institution" is an institution with permanent and expert personnel and established rules and procedures that effect a privately ordered adjudicative system designed for resolving intracorporate disputes.

This model recommends a relatively formal approach to dispute resolution that goes beyond what would be expected in the non-institutional model or that would be seen in most commercial or consumer arbitrations. This is not a rejection of the benefits of the informality of arbitration but, rather, an embrace of arbitration's

private-ordering flexibility to adapt to the context of the dispute. Adjudications by an arbitral institution may be more formal than those whose "essential virtue [is] resolving disputes straightaway."[183] But these adjudications will at the same time be more flexible and informal than traditional litigation. The procedural formalities this model maintains—such as the issuance of written opinions and the availability of appeals—accommodate that a single intracorporate dispute implicates the interests of many shareholders and, in some instances, enormous amounts of shareholder wealth.[184] This context justifies borrowing features of traditional litigation. Doing so means that there will not only be better adjudicative results in the intracorporate context, but also increased market acceptance of the arbitral forum itself.

Part III.C describes the institutional model and the credible arbitral institution in terms of design principles. These design principles are meant to resolve, or at least to mitigate, arbitration's potential deficiencies, including concerns about procedural adequacy, the repeat-player problem, and the stifling of law development. The model's design principles comprise three broad commitments: a *commitment to independence*, a *commitment to law*, and a *commitment to process*. These commitments look to the efficiency and fairness factors discussed in Part III.A so that neither is decreased in order to increase the other. Admittedly, it is possible that firms could satisfy some of these commitments with a non-institutional IAP approach. Without the personnel, market credibility, and longevity of an arbitral institution, however, it would be highly challenging to satisfy these commitments consistently.

1. Commitment to Independence

Institutional independence signals that a firm's corporate governance is constrained by an exogenous adjudicative authority. A corporation's credible commitment to submit intracorporate disputes

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183. Hall Street Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 588 (2008).

184. *Cf.* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 657 (1985) (Stevens, J., dissenting) ("Despotic decisionmaking of this kind is fine for parties who are willing to agree in advance to settle for a best approximation of the correct result in order to resolve quickly and inexpensively any contractual dispute that may arise in an ongoing commercial relationship. Such informality, however, is simply unacceptable when every error may have devastating consequences for important businesses in our national economy and may undermine their ability to compete in world markets.").

to an institution frees that institution to act independently, i.e., to adjudicate without bias and to impose procedural rules aimed at increasing efficiency and fairness, and thus, firm value. This independence means overcoming the repeat-player problem: if management is disappointed with the outcome in case *n*, it cannot easily change the rules to improve its outcome in case $n+1$. It also means that the institution does not face implicit threats that it will lose its caseload or funding if defendants are disappointed with its decisions.

The credibility of the commitment is two-sided. Management can lock itself in and promise to submit its intracorporate disputes to a given institution and its rules, but, owing to its power to amend the firm's bylaws, management holds a key to its own cell. The institution can, however, impose costs on firms and their management in exercising that power, which would effect a constraint on exit that in turn bolsters the overall credibility of the commitment between the firm, the institution, and the rules.

First, a fairly credible commitment can be effected by a firm itself, either as a matter of shareholder democracy or routine investor relations. For example, it might submit an IAP to a shareholder vote as a charter amendment, thereby protecting the IAP from unilateral amendment by the board of directors. In weaker forms of this shareholder-centric approach, a firm might submit an IAP bylaw for non-binding shareholder approval, or management may simply (and strenuously) communicate to investors that it is committed to the firm's IAP and its designated arbitral institution and rules. In these weaker cases, a board of directors is not legally constrained: it may break its commitment by unilaterally amending the IAP, but doing so risks shareholder opposition, e.g., from selling shares, proxy contests, shareholder proposals, withheld votes for directors' elections, or litigation.

This commitment can be helped along through institutional design, which should include the power to refuse to take jurisdiction.[185] This power to refuse can be one of the strongest

185. For example, in *In re* Salomon Inc. Shareholders' Litigation, an employment agreement was used to compel arbitration of a shareholder derivative claim before the New York Stock Exchange (NYSE). 68 F.3d 554, 556 (2nd Cir. 1995). The NYSE, however, invoked a provision of its constitution allowing it to decline jurisdiction. *Id.* The district court refused to appoint a substitute arbitrator, reasoning that the arbitration agreement had been followed, i.e., the case was sent to arbitration, the arbitrator refused jurisdiction, and thus to trial the matter must go. *Id.* at 556–57. The Second Circuit affirmed, observing that "the arbitration

defenses to institutional independence. The power to refuse means that a credible arbitral institution has internal jurisdictional rules to accept cases only when a firm has made a pre-dispute commitment to the institution as its exclusive forum and has also fulfilled its ongoing obligations (e.g., paying annual fees to help fund the institution). The power to refuse has teeth. If a firm has adopted an IAP and is unable to use it (because the institution designated in the provisions refuses to take jurisdiction), not only does the firm lose the benefits it intended to receive, but management loses face amidst a potentially sensitive, public litigation.[186]

This point conceives of arbitral institutions as akin to insurers. To have a loss covered by insurance, one must have bought a policy before the loss event.[187] Here, in order to have its intracorporate cases adjudicated by an arbitral institution, the firm must have already adopted an IAP that commits it to that institution and its rules. The insurance comparison grows stronger considering that annual fees might naturally go up based on the number and outcomes of firms with intracorporate disputes, just as insurance premiums go up and down based on experience ratings.[188]

The power to refuse jurisdiction allows an arbitral institution to strengthen firms' commitment by imposing conditions to entry. And the ability to impose conditions to entry also implies the ability to constrain exit. Assume that institutional jurisdictional rules would require privity between the firm and the institution, say, through a membership agreement. If one role of the arbitral institution is to

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agreements here required that any arbitration be before the NYSE, and not before any other arbitral forum." *Id.* at 561.

186. For example, if a firm faces an intracorporate dispute and the arbitral institution designated in its IAP refuses to take jurisdiction, then the board is left with few options. *See id.* It could amend its IAP to specify non-institutional arbitral procedures or to designate another arbitral institution. Either of those amendments would come on an "unclear day" however and thus subject the directors to added scrutiny. *But see* Hills Stores Co. v. Bozic, 769 A.2d 88,107 (Del. Ch. 2000) (noting that enforcement of a defensive measure may still be scrutinized even if the measure was adopted on a clear day). The board could also waive its IAP, accept litigation in a public court, and forgo all of the benefits the IAP was intended to achieve.

187. 44 AM. JUR. 2d *Insurance* § 812 (2018) ("Payment of premiums is a crucial factor in determining whether the insured is covered for specific types of risks.").

188. *See* Almon R. Arnold, *Experience Rating*, 55 YALE L.J. 218 (1945) (experience rating in unemployment insurance). These fees would presumably be more than offset by direct and indirect savings attributable to the move to intracorporate arbitration (*see supra* Part II.B (discussing the benefit-cost analysis of IAP adoption)).

constrain management exogenously, a membership agreement could keep management from breaking its announced commitment. The agreement might, for example, impose a waiting period before a firm may designate another arbitral institution (or a non-institutional arbitral procedure), subject to exceptions for the exercise of directors' fiduciary duties, shareholder approval, or other good-cause standards. Constraints on exit would not entirely prevent a board from amending its IAP. There may be legitimate and compelling business reasons for doing so that are consistent with a firm's interests. The stickiness they and other commitment mechanisms would generate together, however, would help ensure that those changes are made only for compelling and good reasons.

As a consequence of these commitment mechanisms, taken together, both an arbitral institution and the market can be confident in the independence of that institution and its integrity as an exogenous adjudicative authority. To that end, it is not hard to imagine a world in which firms seek to inspire market confidence by committing to an arbitral institution and in which successful arbitral institutions, by controlling entry and exit, will be able to protect their independence.[189]

2. Commitment to Law

i. A credible arbitral institution follows the law

Arbitrators, like public courts, must follow the law.[190] As a practical matter, however, arbitrators have a freer hand in applying controlling law than do public judges; they needed not issue reasoned decisions and, when they do, their legal conclusions are subject to highly deferential review.[191] A lack of explicit and thorough legal

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189. In this regard, the arbitral institution is a positive signal to the market about the quality of the firm's governance, just as stock-exchange listing requirements do now. *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1457 (1997) ("Exchanges should have strong incentives to adopt rules that benefit investors."); Douglas C. Michael, *Untenable Status of Corporate Governance Listing Standards Under the Securities Exchange Act,* 47 BUS. LAW. 1461, 1468–69 (1992) ("A listing does, of course, confirm the legitimacy of the issuer and the security, but the NYSE's development of corporate governance listing standards, even in its infancy, indicated a concern beyond assuring such basic requirements.").

190. *Mitsubishi Motors Corp.*, 473 U.S. at 619–20.

191. Arbitral awards may be vacated on a manifest-disregard-of-law standard. *See* Wilko v. Swan, 346 U.S. 427, 437 (1953), *overruled on other grounds by*

analysis may suit two-party commercial or low-stakes consumer arbitrations. But it does not suffice for intracorporate disputes, which determine the relative rights of disparate stakeholders to assets that may be valued in the many billions of dollars.[192] More, the corporate law that applies to a firm is one determinant of its overall agency costs; markets need uniformity and predictability in how that law applies to a firm's governance in order to assess its value.[193]

To achieve this uniformity and predictability, an arbitral institution fills the role of a state court adjudicating an intracorporate dispute involving a foreign corporation. In this mindset, arbitrators adjudicate intracorporate disputes in accord with the corporate statutes and case law of the firm's chartering jurisdiction. Not only is this the appropriate legal-analytical approach to adjudicating intracorporate disputes, but it also signals to the market that a firm's governance follows predictable rules.

This principle also implies that an arbitral institution will employ high-quality arbitrators who are expert in substantive law and competent in managing the adjudicative process. These arbitrators might include retired judges, legal academics, practitioners, or even experienced businesspeople. Indeed, the benefits of expert adjudicators may be felt especially by firms chartered in states that lack judiciaries experienced with complex corporate cases or that have political, social, or economic conditions that may impede impartial adjudication. One appeal of leading chartering jurisdictions like Delaware and Maryland is the quality of their judiciaries. For firms incorporated in other states, arbitral institutions may substitute for judicial corporate-law expertise, thereby reducing the risk (i.e.,

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Rodriguez de Quijas v. Shearson/American Exp. Inc., 490 U.S. 477 (1989). This standard, however, is forgiving and can be hard to police, particularly when arbitrators do not issue written opinions. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros, 70 F.3d 418, 421 (6th Cir. 1995) ("When faced with questions of law, an arbitration panel does not act in manifest disregard of the law unless (1) the applicable legal principle is clearly defined and not subject to reasonable debate; and (2) the arbitrators refused to heed that legal principle.").

192. *See Gilmer*, 500 U.S. at 31–32 (responding to the petitioner's argument that arbitration's lack of written decisions impoverishes law development by noting that the NYSE's arbitration rules require written decisions, and that, nevertheless, settlement agreements do not produce precedent).

193. *See* Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001).

unreliable or unpredictable courts) of incorporating in a non-leading jurisdiction.[194]

ii. A credible arbitral institution develops the law

As Part II.C notes, states might actively oppose IAPs because of their potential to impoverish the development of local corporate law. This is a real problem: reduced intracorporate caseloads result in fewer opportunities for judges to expand, explain, or modify the law. In turn, this diminished output of precedent means that going forward, the application of corporate law is less predictable than it otherwise could be, an implicit cost imposed both on IAP adopters and non-adopters. Arbitral institutions have the ability to mitigate this issue by actively contributing to the development of the law.

Well-reasoned arbitral decisions stand to become persuasive authority, thus mitigating the problem of impoverishing law development. Of course, only chartering-jurisdiction precedent is binding on the resolution of a corporation's intracorporate disputes.[195] But, judicial precedents of State X construing the law of State Y are persuasive, both for State Y itself and its sister courts.[196] This persuasive authority derives partly from the comity states show each other under our federal system. An arbitral institution may not, of course, receive this same consideration. But persuasiveness is also a function of the reputation of the adjudicator, the integrity of the proceeding, and, perhaps most importantly, the insight and rigor of the legal analysis.[197] An arbitral institution is fully capable of exhibiting

194. *See* Black, *supra* note 179 ("If a state's precedents are thin, it can use Delaware case law as precedent in its courts until a base of domestic precedents is built up."); *but cf.* Perschbacher & Basset, *supra* note 163 (suggesting that potential precedents may be "lost" as a result of arbitration).

195. *See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 90 (1987) ("[A] corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.").

196. 20 AM. JUR. 2d *Courts* § 139 (2018) ("The decision of a state court does not have stare decisis effect in a court of another state. However, such decisions may guide a state court's decisions . . . .").

197. Frederick Schauer, *Authority and Authorities*, 94 VA. L. REV. 1931, 1946–47 (2008) ("A judge in the Southern District of New York is required to follow Second Circuit and Supreme Court decisions but is not required to follow or even notice the conclusions of the Eastern District of New York, the New York Court of Appeals, the Third Circuit, Wigmore on Evidence, the *Harvard Law Review*, the

these qualities. An institution that develops a reputation among judges and market participants as thoughtfully handling novel issues may well see its reasoning followed by courts.[198] Indeed, courts already consult secondary sources such as restatements, treatises, and normative scholarship in tackling novel questions.[199] Because arbitral precedents apply the law to actual controversies that are tested through the adversarial process, they may well come to be consulted frequently, even if they do not carry the prestige of *judicial* precedents.[200]

The role of an arbitral institution in law development may be especially salutary for states that lack a well-developed corporate case law. For these states, an arbitral institution's reasoned application of their laws may increase market perceptions of predictability and consequently lower the risks of non-uniformity or unpredictability previously attributed to them. This persuasive authority may on the margins prompt firm organizers to choose to organize in states with (as of now) underdeveloped corporate case law. This move would in turn lead to a virtuous cycle of increased caseloads in those states and, with them, further law development and a more competitive national market for corporate chartering.

iii. A credible arbitral institution corrects its errors

A common feature of arbitration is its one-step, binding nature and focus on bringing quick and economical ends to disputes. Appealing an arbitral decision undermines this economy.[201] Besides,

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High Court of Australia, the Constitutional Court of South Africa, or the European Court of Human Rights.").

198. *Cf. id.* at 1943 ("[I]f an agent is genuinely persuaded of some conclusion because she has come to accept the substantive reasons offered for that conclusion by someone else, then authority has nothing to do with it.").

199. *See id.* at 1947 (explaining that a judge of the Southern District of New York may consult any of the non-binding sources of law mentioned *supra* note 197, but that it would be controversial for her to consult astrology, family conversations, tabloids, or the Bible).

200. *See* Andrea K. Bjorklund, *The Emerging Civilization of Investment Arbitration*, 113 PENN ST. L. REV. 1269, 1273 (2009) ("[T]he public availability of arbitral awards facilitates the subsequent referral to prior awards in the development of a jurisprudence constant in international investment law.").

201. The FAA provides limited grounds for the vacation of arbitral awards. *See supra* note 124 and accompanying text. Parties to an arbitration agreement may not contractually expand the FAA's grounds for federal-court review of arbitral decisions. *See Hall Street Assocs., L.L.C.*, 552 U.S. at 589 ("[T]he statutory text

the idea of appealing an arbitral decision at first sounds procedurally unworkable because arbitrations typically do not produce much of a record and thus leave few, if any, errors to correct on appeal, short of hearing a case de novo.[202] Yet, although non-appealability may be a feature for commercial and consumer arbitrations, it is a bug for intracorporate arbitrations. Intracorporate disputes affect the interests of disparate shareholders and may determine the control of substantial corporate assets. In "bet-the-company" scenarios, non-appealable adjudication is trapeze without a net.[203] The risk of prejudicial error may be small, but it is real. For example, one analysis found that the Delaware Court of Chancery's overall reversal rate in 2002 was 0.26%, or 16.4% of appealed cases.[204] This analysis illustrates that even for a highly-regarded judiciary like Delaware's, appeals provide an error-correcting benefit in a meaningful share of cases. Moreover, beyond the professional motivation to reach legally and factually correct decisions, the possibility of appeal may motivate arbitrators to adhere all the closer to the law and to follow their institution's rules.[205]

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gives us no business to expand the statutory grounds [for judicial review of arbitral decisions].").

202. *Cf. Wilko*, 346 U.S. at 436 (1953) ("As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact,' . . . cannot be examined."); INTERNATIONAL INSTITUTE FOR CONFLICT PREVENTION & RESOLUTION, CPR ARBITRATION APPEAL PROCEDURE AND COMMENTARY 6 (2007) (setting as pre-conditions for arbitration appeals "[that] the arbitrators in the original proceeding be required to apply the law, [and that there be] a record of the original proceeding and a written award stating findings of fact and conclusions of law.").

203. John C. Coates IV, *Managing Disputes Through Contract, Evidence from M&A*, 2 HARV. BUS. L. REV. 295, 310–11 (2012) (suggesting that in the public-company M&A context, arbitration is disfavored by parties because "reduced appeal rights mean that arbitration decisions can be expected to be less 'accurate' . . . than other decisions."). *Cf. Mitsubishi Motors Corp.*, 473 U.S. at 656–57 (Stevens, J., dissenting) ("Arbitration awards are only reviewable for manifest disregard of the law . . . and the rudimentary procedures which make arbitration so desirable in the context of a private dispute often mean that the record is so inadequate that the arbitrator's decision is virtually unreviewable.").

204. William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success"*, U. ILL. L. REV, 95, 104 (2009).

205. *See generally* David E. Klein & Robert J. Hume, *Fear of Reversal as an Explanation of Lower Court Compliance*, 37 L. & SOC. REV. 579 (2003) (suggesting that the fear of reversal by an appellate court motivates trial judges to comply with the law); *cf.* Reuben, *supra* note 129, at 1149 ("[A]n arbitrator is more likely to be careful in rendering the award because of concerns about his reputation than for fear

No one, after all, likes to be reversed. An added effect of appealability is that arbitrators would follow their institution's own state-law precedents absent superseding authority from state courts or statute. In that light, the arbitral appeals process would contribute to the institution's law-development role and would help it avoid internal decisional conflicts.

This institutional model presumes no appellate-procedural design in particular. An arbitral institution could replicate the two-tiered appellate model used by the federal and many state judiciaries. Or, it could follow Delaware, where only one tier of appellate review suffices.[206] Whatever the appellate-procedural design, however, appeals are an important contingency, both for *ex ante* disciplining of first-level arbitrators and for *ex post* error correction. The principles expressed by the *commitment to law* and the *commitment to process* sections in this Part aim to ensure that appeals are available and that records get generated, in turn making the error-correction work of appeals possible.

3. Commitment to Process

Part III.A argues that, *ceteris paribus*, the efficiency and fairness of the civil procedure applicable to an intracorporate dispute partly determines a firm's *ex ante* and *ex post* agency costs. Intracorporate arbitration gives firms the ability to lever their agency costs through the procedures they choose. In that light, intracorporate arbitration can be thought of not only as a forum-selection decision, but also as a procedure-selection decision. This design principle urges that a credible institution is committed to process, i.e., to developing and effecting efficient and fair arbitral procedures. What those procedures look like and what starting point they use—e.g., the Federal Rules of Civil Procedure or the American Arbitration Association's Commercial Arbitration Rules and Mediation Procedures—is beyond this article, but it does offer these two points on institutional design.

First, procedural rules available to an IAP-adopting firm should be flexible, but not limitless. Increased competition among rule

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of being vacated because of manifest disregard of the law, especially when application of the doctrine is so rare.").

206. The same one-tier review may well suffice for arbitral institutions, too: apart from merely being sufficient, two levels of review would perhaps diminish efficiency without offering a compensating gain to fairness (which, in the appellate setting, means error correction).

sets would be a positive market development, but endless variety would overwhelm market participants and make meaningful comparisons between corporate-governance arrangements difficult. An arbitral institution should develop rule sets calibrated to the needs of different firms based on their shareholder compositions, life stages, public or private status, size, or even, potentially, industry. For example, the procedures applicable to a public large-cap company may require more formality than those of closely held private concerns. Which rule set applies to a given firm need not be left to management's choosing, but might well be categorical. For example, the SEC and national stock exchanges classify companies according to shareholding, market capitalization, and other metrics and impose some rules on them based on those classifications.[207] With categorical rule sets, a large-cap company might be required to use procedures designed to safeguard the interests of disparate shareholders, like requiring public,[208] reasoned decisions and more plaintiff-friendly discovery defaults.

Beyond categorical defaults based on firm type, an arbitral institution might—and probably should—offer procedural opt-ins and opt-outs consistent with its conception of what an efficient and fair procedure looks like for a given type of firm. For example, private and small-cap public companies might be allowed to opt for more streamlined procedures, or private companies might be allowed to opt for non-public decisions. By setting a procedural baseline appropriate to different firm types, an arbitral institution will nurture its own credibility in the market. At the same time, providing some optionality would allow firms themselves to calibrate the rules that apply to their unique circumstances and thus, ideally, to recognize marginal increases to their value.

Second, the development of procedural rule sets should be the collaborative effort of intracorporate stakeholders, including representatives of management; institutional and retail shareholders; corporate-finance and legal scholars; and legal, financial, accounting, and other practitioners. That is to say that an institution's arbitral procedures should be developed by multi-stakeholder panels that

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207. *See* SEC Regulation 12B, 17 C.F.R. § 240.12b-2 (defining "accelerated filer," "large accelerated filer," and "emerging growth company" based in part on revenue or market capitalization); NYSE LISTED COMPANY MANUAL § 1 (2018) (setting listing rules based on, inter alia, issuer type and capitalization).

208. Professor Jennifer Arlen has argued, for example, that "[i]f you take shareholder suits out of the light of day and put them in a dark closet, you lose the deterrent effect." Frankel, *supra* note 7.

combine interest with expertise. An institution might, for example, convene multiple panels to deal with different procedural rule sets, appellate procedures, ethical codes, and administrative concerns. The recommendations of these panels to amend or add rules would subsequently be taken up by a governing body within the institution (just as advisory committees within the federal judiciary recommend rule amendments for adoption by the Supreme Court).[209] Of the different ways for developing an institution's procedures, a multi-stakeholder approach would be the most likely to set up efficient and fair arbitral procedures and practice. That is because this approach ensures that procedural designs are thoughtfully considered by an array of experts and interested parties whose participation conveys this fact to the market and who contribute their own professional credibility in joining the effort.

CONCLUSION

As a matter of state corporate and federal arbitration law, firms may adopt IAPs. For the most part, they have yet to do so, but the trend toward IAPs may be approaching. After all, one of the most significant barriers to IAP adoption—the opposition of the SEC—is now in serious question. But from here, firms will only adopt IAPs when they result in greater benefits than costs. Thus, the current state of non-adoption owes in significant part to the costs associated with adopting an uncommon defensive corporate-governance feature. That is, *will we be sued*, *what will investors think*, and similar questions.

IAPs will emerge as a regular feature of U.S. public-company governance in two stages, the second of which is not guaranteed to come along. In the first stage, firms will become early adopters if they are less sensitive to the costs of early adoption than their peers. These firms may be IPO companies (particularly ones with founders who are active in their management) that face lower potential market costs to adopting novel corporate-governance features. Those features would not depart from a preexisting governance baseline (because the company doesn't have one). Early adopters may also be companies that face significant or frequent intracorporate litigation, whether meritorious or not, and thus have more to gain than to lose from adopting an IAP. Of course, they may also be firms whose

209. 1 GUIDE TO JUDICIARY POLICY, *Procedures for the Judicial Conference's Committee on Rules of Practice and Procedure and Its Advisory Rules Committees* § 440 (2011) (setting procedures for advisory rules committees).

management is motivated to thwart monitoring or discipline by its shareholders. And in the second stage of IAP adoption, if it comes, the prior early adoptions will have given the market comfort that when these provisions are adopted and implemented appropriately, their effect on firm value is likely to be positive. To be sure, for early adopters, too, IAPs may lead to an increase in firm value, but that increase would result from outsized benefits offsetting outsized costs.[210]

As Part III lays out, the second stage of IAP adoption is most likely to be reached if early firms do not adopt non-institutional provisions, but rather make credible commitments to credible arbitral institutions. This article has explained, in broad principles, what a credible arbitral institution looks like. Its project is incomplete. Those principles must still be expanded upon and turned into real institutions. Doing so will perhaps not be an undertaking that requires great ingenuity or novelty because there are already established models for arbitral institutions. These examples include the industry-based takeover panel that governs, and adjudicates disputes over, M&A transactions in the United Kingdom.[211] Closer to home, internal judicial bodies within the national stock exchanges or FINRA show that important corporate and financial disputes can be appropriately adjudicated outside public courts.[212]

None of these dispute-resolution institutions have been set up to handle the full array of intracorporate disputes (not to mention more than fifty state and territorial corporate laws under which those disputes arise). They do, however, offer best practices and learning that can be applied to the institutional model presented here. If IAPs are in the offing, and if this article is more or less on point in terms of the pitfalls to IAPs it presents, then market participants, practitioners, and scholars must confront what intracorporate arbitration is to look

210. *See supra* Part II.B.

211. *See* THE PANEL ON TAKEOVERS AND MERGERS, THE CITY CODE ON TAKEOVERS AND MERGERS (2016).

212. NYSE LISTED COMPANY MANUAL § 8 (setting forth the procedures for involuntary delisting and internal appeals); THE NASDAQ STOCK MARKET RULES, Equity Rule 10001 (2008) (delegating certain arbitration functions to FINRA); FINRA, *Arbitration and Mediation*, FINRA.ORG, https://www.finra.org/arbitration-and-mediation. *See also* Ed Beeson, *Law360's FINRA Arbitration Cheat Sheet*, LAW360 (Feb. 22, 2016), https://www.law360.com/articles/761547 ("Call it the Thunderdome of the securities industry. For the 4,000 firms, 637,000 registered representatives and millions of investors in the U.S. brokerage industry, there's practically one way to settle disputes: Financial Industry Regulatory Authority arbitration.").

like. What will the arbitral institutions be? How will they work? Who will staff them? What empirical effects will they have? How will objections to them be overcome? Those questions remain outstanding, but this article has begun pushing them toward resolution.