

## A Cooperative Federalism Approach to Shareholder Arbitration

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**ABSTRACT.** Arbitration dominates private law across an ever-expanding range of fields. Its latest target, however, may not be a new field as much as a new form: mandatory arbitration provisions built into corporate charters and bylaws. Recent developments in corporate law coupled with signals from the Securities and Exchange Commission suggest that regulators may be newly receptive to shareholder arbitration. What they do next may have dramatic consequences for whether and how corporate and securities laws are enforced.

The debate about the merits of arbitration is well worn, but its application to shareholder claims opens the door to a different set of responses. In particular, the overlapping authority of federal and state actors with respect to corporate law calls for approaches that sound in cooperative federalism. Yet cooperative-federalist approaches have been absent from recent debates about shareholder arbitration. This Essay explains why cooperative federalism is a natural fit for addressing these issues. Moreover, we marshal specific examples of cooperative solutions in this area that could help frame federal-state coordination going forward. Such a cooperative response would avoid unnecessary federal-state conflict and allow policymakers to approach shareholder arbitration with expertise, accountability, and mutual respect.

### INTRODUCTION

We live in the era of the “mass production” of arbitration clauses.<sup>1</sup> Corporations now routinely insert mandatory arbitration clauses into consumer contracts, employment agreements, and other legal documents. During the last few

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1. Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2812 (2015). Professor Resnik refers to mass-produced arbitration “clauses,” rather than mass-produced arbitration, because potential claimants rarely follow through on arbitration. *Id.*

decades, the Supreme Court's aggressive interpretation of the Federal Arbitration Act (FAA)<sup>2</sup> has accelerated the rise of arbitration: arbitrators are deciding more issues; more federal statutory rights are being subjected to mandatory arbitration; and the FAA is preempting more state laws that might stem this rising tide.<sup>3</sup>

Shareholder litigation may be the next target for this mass production.<sup>4</sup> Although arbitration has been available for securities claims by investors against their brokers for decades,<sup>5</sup> developments in a related area of law have opened up new possibilities for mass-produced arbitration clauses. In recent years, corporations and policymakers have begun to pay considerable attention to a new frontier: the inclusion of dispute-resolution provisions in corporate charters and bylaws, including provisions requiring shareholders to arbitrate claims against the corporation and its officers and directors.

Unlike in consumer or employment contracts, there is not even a fiction that shareholders negotiate the terms of corporate governance documents before they buy shares on the New York Stock Exchange.<sup>6</sup> Yet if a corporation had the foresight to include arbitration provisions in its governing documents, some have suggested that its shareholders may be subject to mandatory arbitration—including for nonwaivable claims under federal securities laws.<sup>7</sup>

The consequences of a shift to shareholder arbitration could be substantial. Private litigation, especially private aggregate litigation, is one of the main tools for enforcing securities and corporate law in the United States. A shift to arbi-

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2. United States Arbitration Act, 9 U.S.C. §§ 1-16; 9 U.S.C. §§ 201-208; 9 U.S.C. §§ 301-307 (2012).
  3. See, e.g., J. Maria Glover, *Disappearing Claims and the Erosion of Substantive Law*, 124 YALE L.J. 3052, 3059-74 (2015) (discussing, inter alia, *Stolt-Nielsen S.A. v. AnimalFeeds International*, 559 U.S. 662 (2010), *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), and *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013)); Zachary D. Clopton, *Procedural Retrenchment and the States*, 106 CALIF. L. REV. 411, 419-20 (2018) (same).
  4. See, e.g., Robert J. Jackson, Jr., *SEC Commissioner Jackson Talks Mandatory Arbitration*, CLS BLUE SKY BLOG (Feb. 28, 2018), <http://clsbluesky.law.columbia.edu/2018/02/28/sec-commissioner-jackson-talks-mandatory-arbitration> [<https://perma.cc/JE9S-W92R>] (current Securities and Exchange Commission (SEC) Commissioner noting that “recent changes in the landscape have made [him] more, not less, concerned about [shareholder arbitration]”).
  5. See *infra* Section I.C.
  6. See Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 587 (2016) (“Corporations, by contrast, are organized around principles more akin to trust law [than to contract law], whereby inexpert and often dispersed shareholders are presumed to be incapable of bargaining on their own behalf . . .”).
  7. See *id.* at 585 (collecting cases and sources); Clopton, *supra* note 3, at 419-20 (same).

tration likely would dramatically reduce the number of claims filed, in part because representative actions such as class actions or derivative suits probably would be unavailable.<sup>8</sup> The future of shareholder rights may be at stake.

This possibility is more than idle speculation. Already, some foreign entities have included arbitration language in their governance documents. And in the summer of 2017, Securities and Exchange Commission (SEC) Commissioner Michael Piwowar signaled that the SEC might be willing to consider approving U.S. corporate charters that included mandatory arbitration provisions. In a talk at the Heritage Foundation, Piwowar issued this invitation: “For shareholder lawsuits, companies can come to [the SEC] to ask for relief to put in mandatory arbitration into their charters . . . I would encourage companies to come and talk to us about that.”<sup>9</sup> Commissioner Piwowar’s announcement, as well as periodic reports from within the agency,<sup>10</sup> have signaled a potential departure from the SEC’s traditional rejection of mandatory arbitration in this context.

Mandatory arbitration of shareholder claims is not a new proposal. It has roots in policy proposals and academic debate raised periodically since the 1980s.<sup>11</sup> U.S. corporations have sporadically – and so far unsuccessfully – exper-

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8. See David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201, 206-07 (2015); see also Resnik, *supra* note 1, at 2872-73 (finding that almost all credit card arbitration agreements expressly disallowed class arbitration).
  9. Sarah N. Lynch, *U.S. SEC’s Piwowar Urges Companies to Pursue Mandatory Arbitration Clauses*, REUTERS (July 17, 2017, 3:14 PM), <https://www.reuters.com/article/us-usa-sec-arbitration/u-s-secs-piwowar-urges-companies-to-pursue-mandatory-arbitration-clauses-idUSKBN1A221Y> [<https://perma.cc/5H6G-ZPXB>]. Commissioner Piwowar has announced that he will step down in July 2018, following the end of his official term. See Katanga Johnson, *SEC Commissioner Piwowar, a Republican, to Step Down*, REUTERS (May 7, 2018, 3:27 PM), <https://www.reuters.com/article/us-usa-sec-piwowar/sec-commissioner-piwowar-a-republican-to-step-down-idUSKBN1I828F> [<https://perma.cc/K8SF-UM49>].
  10. Benjamin Bain, *SEC Weighs a Big Gift to Companies: Blocking Investor Lawsuits*, BLOOMBERG (Jan. 26, 2018, 4:00 AM), <https://www.bloomberg.com/news/articles/2018-01-26/trump-s-sec-mulls-big-gift-to-companies-blocking-investor-suits> [<https://perma.cc/3UG3-3593>].
  11. See, e.g., John C. Coffee, Jr., *No Exit? Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 953-57 (1988); Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York’s and the US’ Global Financial Services Leadership*, NYC 21, 102-03 (Jan. 22, 2007), [http://www.nyc.gov/html/om/pdf/ny\\_report\\_final.pdf](http://www.nyc.gov/html/om/pdf/ny_report_final.pdf) [<https://perma.cc/L8NS-C8HD>] (explicitly recommending that the SEC reverse its opposition to shareholder arbitration); *Interim Report of the Committee on Capital Markets Regulation*, COMMITTEE ON CAP. MKTS. REG. 72, 110 (Nov. 30, 2006), <http://www.capmktreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf> [<https://perma.cc/K3L8-JEL3>] (proposing mandatory arbitration of shareholder claims); see also Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 820-23 (providing background on proposals to increase the use of mandatory shareholder arbitration agreements).

imented with such provisions, presumably with the goal of avoiding costly (often class-action) litigation.<sup>12</sup> In past decades, rumors circulated that the SEC was considering approving mandatory arbitration in corporate organizational documents.<sup>13</sup> In addition to renewed signals from the SEC, one important aspect of the legal landscape has changed since these earlier debates: state courts have begun to approve corporate governance documents that restrict shareholder litigation to particular courts. This shift has emboldened proponents of shareholder arbitration who view these approvals as a signal that channeling shareholder claims to *arbitration* may now be permissible.<sup>14</sup>

These developments not only suggest that shareholder arbitration may be a pressing concern to corporate actors and those entities that regulate them, but these developments also are a reminder that corporate law is shared space. Corporate governance rules under state law coexist—sometimes uncomfortably—with federal securities laws. Incursions and overlap are not uncommon, but much of the time state and federal actors govern their own, separate spheres.<sup>15</sup> This Essay, however, argues that “staying in your lane” is not an option for state or federal regulators when it comes to the mandatory arbitration of shareholder claims. Even a provision narrowly drafted to cover only federal claims cannot avoid, for example, the question whether the state of incorporation permits mandatory arbitration at all in the corporate context. These battles may be waged in the SEC as well as in state and federal courts—and the outcomes of these battles will determine the landscape of corporate litigation for years to come.

This Essay does not focus on the normative arguments for and against mandatory arbitration. Instead, we start from the assumption that shareholder arbitration is a live policy question, and one which—given the stakes—demands careful analysis. The issue we address is not whether companies should adopt mandatory arbitration provisions or whether the SEC should approve these provisions as a matter of policy. We ask whether and when companies can adopt these provisions without running afoul of state or federal law, and what process state and federal actors can employ to resolve the important policy questions

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12. See *infra* Part I.

13. See Black, *supra* note 11, at 821.

14. This development revived hope for mandatory arbitration provisions in corporate governance documents because exclusive-forum clauses are close cousins to mandatory arbitration clauses in that both ultimately determine where disputes will be resolved—whether in a specific court or an arbitral forum.

15. Cf. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 667 (1974) (noting that corporate disclosure regulation has become largely the exclusive province of the federal government, while many other aspects of corporate governance remain within the ambit of state law).

raised by shareholder arbitration. In Part I, we identify the constraints on mandatory shareholder arbitration clauses imposed by state and federal law. And in Part II, we suggest how agencies might navigate these overlapping spheres through state and federal cooperation and consultation at an early stage of policymaking.

Our overall message is that—like countless issues before—questions about how to regulate arbitration provisions in corporate governance documents are amenable to solutions that sound in cooperative federalism. Cooperative federalism has been absent from recent debates about shareholder arbitration, yet we believe the concept is a natural fit for addressing these issues, which arise at the intersection of federal and state authority. Moreover, we marshal specific examples of cooperative solutions in this area that can help frame federal-state coordination going forward. Such a cooperative response would avoid unnecessary federal-state conflict, and it would allow policymakers to approach these issues with expertise, accountability, and mutual respect.

## I. THE LEGAL FRAMEWORK

Corporate regulatory space is shared, both in terms of the governing law and in terms of the legal actors with regulatory authority. We begin by examining the reach of shareholder arbitration clauses, then draw on these underpinnings to address federal and state authority over shareholder arbitration. In short, arbitration provisions addressing shareholder litigation will ultimately run up against important questions of public policy at both the federal and state levels.

### *A. Scope of Mandatory Shareholder Arbitration Clauses*

The starting point for our analysis of mandatory arbitration provisions is a closer look at the provisions at issue. The scope of these provisions varies, prompting two questions: Whose claims do they cover? And what types of claims are covered?

For ordinary contracts, the answer to the question of whose claims are covered is obvious: arbitration clauses cover the claims of the parties to the contract. But corporate organizational documents are different. Corporate charters and bylaws purport to define the relationships among directors, officers, shareholders, and the company itself. More specifically, the mandatory arbitration clauses that have attracted recent attention are aimed at claims by only one set of corporate actors: shareholders. Commissioner Piwowar's comments invited these

provisions for *shareholder* lawsuits specifically, and advocates of mandatory arbitration in corporate charters and bylaws have pointed to pathologies of *shareholder* litigation for justification.<sup>16</sup>

But the term “shareholder litigation” identifies the plaintiffs without specifying the type of claim, which is the subject of our second question. An arbitration clause might broadly track the whole category of shareholder litigation, covering all claims by shareholders regardless of the legal source. Examples of this all-purpose approach can be found in the organizational documents of some non-U.S. corporations that trade on U.S. stock exchanges. Royal Dutch Shell PLC, for example, requires arbitration of all disputes between shareholders and the company, including “all disputes arising under UK, Dutch or US law (including securities laws), or under any other law.”<sup>17</sup> An arbitration provision unsuccessfully proposed for Pfizer in 2012 was similarly broad, reaching “any controversy or claim by shareholders.”<sup>18</sup>

But mandatory arbitration is not necessarily an all-or-nothing game. Mandatory arbitration clauses may designate particular claims for arbitration, leaving other issues for courts.<sup>19</sup> In the context of intracorporate disputes and shareholder litigation under U.S. law, the key distinction is between claims governed by state corporate law (often claims within the “internal affairs doctrine”<sup>20</sup>) and those governed by federal law (often claims under federal securities laws<sup>21</sup>).

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16. See, e.g., Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 757-60 (2015); Stephen M. Bainbridge, *The SEC Should Authorize Mandatory Arbitration of Shareholder Class Action Lawsuits*, PROFESSORBAINBRIDGE.COM (Jan. 30, 2018), <http://www.professorbainbridge.com/professorbainbridgecom/2018/01/the-sec-should-authorize-mandatory-arbitration-of-shareholder-class-action-lawsuits.html> [https://perma.cc/Q787-D83S] (citing Bradley J. Bondi, *Facilitating Economic Recovery and Sustainable Growth Through Reform of the Securities Class-Action System: Exploring Arbitration as an Alternative to Litigation*, 33 HARV. J.L. & PUB. POL'Y 607, 610-11 (2010)).
17. *Annual Report*, ROYAL DUTCH SHELL PLC 77 (2017), [https://reports.shell.com/annual-report/2017/servicepages/downloads/files/shell\\_annual\\_report\\_2017.pdf](https://reports.shell.com/annual-report/2017/servicepages/downloads/files/shell_annual_report_2017.pdf) [https://perma.cc/KSP2-GRX7] (reprinting the company's Articles of Association); see *id.* at 16 (“Our Articles of Association generally require that all disputes between our shareholders . . . and the Company . . . be exclusively resolved by arbitration . . .”).
18. Pfizer Inc., SEC No-Action Letter, 2012 WL 587597, at \*13 (Feb. 22, 2012).
19. See Christopher R. Drahozal & Erin O'Hara O'Connor, *Unbundling Procedure: Carve-Outs From Arbitration Clauses*, 66 FLA. L. REV. 1945, 1950 (2014).
20. The “internal affairs doctrine” provides that the law of the incorporating state generally governs the “internal affairs” of a corporation. What counts as an internal affair has been developed in case law, and roughly encompasses the rights and duties of internal corporate actors to each other. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (AM. LAW INST. 1971).
21. See *infra* notes 36-40 and accompanying text.

An arbitration clause might explicitly limit its reach to one type of claim. Consider the example of exclusive-forum-selection bylaws, which, like arbitration clauses, purport to define the permissible sites for resolution of shareholder claims. A common model bylaw selects Delaware as the forum for shareholders' claims that arise under state corporate law, while remaining silent as to other claims.<sup>22</sup> Alternatively, an arbitration clause might channel federal and state law claims to different forums. Blue Apron (a company that provides food-delivery services), for example, included a charter provision that designates Delaware as the forum for state corporate law claims and federal courts as the exclusive forum for certain securities claims.<sup>23</sup>

Whether these clauses cover federal, state, or all claims has consequences for the relative importance of federal and state regulation. Nevertheless, regardless of their scope, all such clauses fall somewhere within a shared federal-state regulatory space.

### *B. State Law*

The organizational documents of corporations are a core province of state corporate law. State corporate codes typically govern the nature, form, and content of corporate organizational documents. Sections of state corporate codes dictate the contents of the corporate charter and bylaws, for instance.<sup>24</sup> For both types of organizational documents, state corporate codes describe a general category of provisions that might be included, as well as expressly permitting some provisions and expressly prohibiting others.<sup>25</sup>

Delaware state law currently limits the ability of Delaware corporations to adopt mandatory arbitration charter provisions or bylaws.<sup>26</sup> In 2013, the Delaware Chancery Court held that forum selection bylaws were facially valid, and a

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22. Joseph A. Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. 333, 352, 380-81 (2012).

23. See Blue Apron Holdings, Inc., *Restated Certificate of Incorporation*, art. XIII (Dec. 22, 2016), <https://investors.blueapron.com/~media/Files/B/BlueApron-IR/documents/governance-documents/certificate-of-incorporation.pdf> [https://perma.cc/XT2S-4924] (designating the Delaware Chancery Court for derivative suits and internal affairs claims and federal district courts for shareholder claims under the Securities Act of 1933).

24. See DEL. CODE ANN. tit. 8, §§ 102(a), 109(b) (2018); see also MODEL BUS. CORP. ACT §§ 2.02, 2.06 (AM. BAR ASS'N 2016) (providing a model set of requirements for corporations' articles of incorporation and model recommendations for bylaws).

25. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(1) (2018) (permitting a general category of provisions for certificates of incorporation); *id.* § 115 (permitting expressly certain forum selection clauses for "internal corporate claims").

26. See *id.* § 115.

year later the Delaware Supreme Court approved fee-shifting clauses.<sup>27</sup> These decisions triggered further litigation, debate, and ultimately state-level legislation that amended the permissible contents of Delaware corporations' charters and bylaws.<sup>28</sup> The Delaware Code now prohibits fee shifting, but it permits exclusive-forum charter provisions and bylaws as long as they do not exclude Delaware courts.<sup>29</sup> Because mandatory arbitration provisions would exclude Delaware courts, Delaware corporations currently cannot include sweeping arbitration provisions in their governance documents.<sup>30</sup>

The structure of the Delaware legislation highlights the underlying federalism issues. The legislation banned mandatory arbitration clauses only for one type of business organization (the corporation) incorporated in one state (Delaware). And the Delaware legislation reaches only mandatory arbitration of "internal corporate claims," roughly state law corporate governance claims. In other words, the state legislation was silent as to whether it reaches non-state-law disputes, triggering debate over what that silence means for the arbitration of shareholders' federal claims.

### C. Federal Law

Although corporate law is traditionally a matter of state concern, mandatory arbitration provisions governing shareholder litigation would implicate two important areas of federal law. First, these provisions exist against the backdrop of federal law governing arbitration, specifically the FAA. Second, because these provisions govern shareholder claims, they also concern federal securities laws.

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27. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 555 (Del. 2014) (approving a fee-shifting bylaw in a Delaware nonstock corporation); *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 956 (Del. Ch. 2013) (approving exclusive-forum bylaws).
  28. See generally Verity Winship, *Shareholder Litigation by Contract*, 96 B.U. L. REV. 485 (2016) (outlining these developments and providing a framework for analyzing them).
  29. DEL. CODE ANN. tit. 8, §§ 102(f), 109(b), 115 (2018). Charters and bylaws may require "that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State" but may not "prohibit bringing such claims in the courts of this State." *Id.* § 115.
  30. See S.B. 75, 148th Gen. Assemb., synopsis § 5 (Del. 2015) (enacted) (describing the statute as "invalidat[ing] 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); see also MD. CODE ANN., CORPS. & ASS'NS § 2-113(b)(2)(ii) (West 2018) ("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.").



Under the FAA, arbitration agreements are presumptively valid, irrevocable, and enforceable. This presumption is triggered, however, only if corporate governing documents count as “contracts” under the FAA.<sup>31</sup> Whether a corporation’s governing documents are contracts under the FAA is not settled. Good public-policy reasons exist for rejecting this characterization.<sup>32</sup> And as a practical matter, corporate governance documents lack a central feature of contracts: the bargain.<sup>33</sup> State law might fill the gap in FAA jurisprudence by answering whether charters and bylaws count as “contracts.”<sup>34</sup> But even in state law, where judicial rhetoric often depicts these documents as contractual, corporate governance documents do not carry all of the consequences of contract.<sup>35</sup>

One might think that this FAA question is moot because of provisions in the securities statutes that bar waivers of compliance with the securities laws.<sup>36</sup> These provisions could be understood to prohibit waivers of access to courts, and thus shareholder-arbitration provisions that covered securities claims would be unenforceable under the statute. However, the Supreme Court has upheld mandatory arbitration of certain securities claims against brokers despite the nonwaiver provision.<sup>37</sup> The Court left open a narrow basis for invalidating such a clause: it might collide with the nonwaiver provision if arbitration were “inadequate to protect . . . substantive rights.”<sup>38</sup> This standard is difficult to meet,

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31. The FAA’s key substantive provision refers to arbitration provisions in a “contract.” See 9 U.S.C. § 2 (2012).
32. Professor Ann Lipton has ably demonstrated that internal corporate documents lack many of the defining features of contracts in FAA jurisprudence and that treating them as contracts could have deleterious consequences across a range of issues – but she also concedes that the Supreme Court might disagree either because of its “substantive vision of arbitration’s virtues” or because of its “robust view of shareholder consent.” See Lipton, *supra* note 6, at 592, 640.
33. Indeed, the cases enforcing mandatory arbitration of securities claims that we describe below may be distinguishable because the arbitration clauses were in signed customer agreements.
34. Barbara Black, *Arbitration of Investors’ Claims Against Issuers: An Idea Whose Time Has Come?*, 75 LAW & CONTEMP. PROBS., no. 1, 2012, at 107, 113 (citing *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 994 (1995)).
35. See generally Verity Winship, *Litigation Rights and the Corporate Contract*, in THE CORPORATE CONTRACT IN CHANGING TIMES (William Savitt et al. eds., forthcoming) (discussing state law determining whether corporate organizational documents count as contracts).
36. Securities Act of 1933 § 14, 15 U.S.C. § 77n (2012); Securities Exchange Act of 1934 § 29(a), 15 U.S.C. § 78cc(a) (2012).
37. See *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 229, 238 (1987); see also *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 481 (1989); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519-20 (1974).
38. See *McMahon*, 482 U.S. at 229.

particularly given the Supreme Court's aggressive interpretation of the FAA in recent years.<sup>39</sup>

Federal inputs also come from the SEC, especially for public companies. The SEC polices mandatory arbitration clauses in several regulatory contexts, including through its review of companies' registration statements and its screening of shareholder proposals.<sup>40</sup> Although it has not issued more general policy guidance, the agency has long indicated its opposition to the inclusion of mandatory arbitration clauses in corporate charters and bylaws. It has refused, for example, to accelerate registration statements with charters that contain such a clause.<sup>41</sup> In the context of shareholder proposals, SEC staff have suggested that mandatory arbitration charter provisions might violate securities laws.<sup>42</sup> Indeed, the SEC's anti-arbitration stance may be a key reason we have not seen a proliferation of shareholder arbitration provisions to date.

However, it seems that the SEC's position against mandatory arbitration of shareholder claims may be wavering.<sup>43</sup> A change in SEC policy on this topic could cause a surge in new shareholder arbitration provisions.

In sum, federal law is not entirely clear on the validity of arbitration provisions in corporate organizational documents. The SEC has staked out a position, but there are reasons to believe that this position might change. And the federal courts in recent decades have signaled an interest in ever-broader readings of the FAA. These pro-arbitration trends run counter to recent developments in state law, as Delaware has sought to limit the ability of corporations to use mandatory arbitration to restrict shareholder litigation.

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39. See generally Resnik, *supra* note 1 (evaluating the implications of the Supreme Court's FAA jurisprudence).

40. 17 C.F.R. § 240.14a-8 (2017).

41. See, e.g., Miles Weiss et al., *Carlyle Drops Class-Action Lawsuit Ban as Opposition Mounts*, BLOOMBERG (Feb. 3, 2012, 5:57 PM EST), <https://www.bloomberg.com/news/articles/2012-02-03/carlyle-drops-class-action-lawsuit-ban> [<https://perma.cc/5SZE-BNYH>] (“Carlyle Group LP abandoned a plan to ban shareholders from filing class-action lawsuits after U.S. regulators threatened to block a stock sale the private-equity firm is seeking to complete as soon as April.”).

42. Gannett Co., SEC No-Action Letter, 2011 WL 6859124, at \*1 (Feb. 22, 2012) (allowing the company to exclude a proposal for mandatory arbitration because “there appear[ed] to be some basis for [the] view that implementation of the [mandatory arbitration] proposal would cause the company to violate the federal securities laws”); Pfizer Inc., SEC No-Action Letter, 2012 WL 587597, at \*1 (Feb. 22, 2012) (similar); see also Carl W. Schneider, *Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate*, 4 INSIGHTS 5, 24 (1990) (reporting that SEC staff considered shareholder arbitration provisions to “seriously impair[] the deterrent function of private rights of action” and “violate[] the anti-waiver provision of the federal securities laws”); *supra* note 36 and accompanying text.

43. See *supra* notes 9-10 and accompanying text.

## II. COOPERATIVE FEDERALISM

The previous Part demonstrated that federal and state actors have overlapping claims of authority for the regulation of shareholder arbitration. What should we make of these overlapping claims? This perennial question lends itself to a few commonly suggested but unsatisfying options. First, it is possible that federal regulators and each of the fifty states will independently settle on the same regulatory strategy. We have our doubts. Second, it is also possible that federal and state regulators will stay in their lanes.<sup>44</sup> We find this unlikely as well,<sup>45</sup> and for reasons explained below, we think we can do better as a matter of policy.

A third option is conflict. Corporations could adopt (SEC-encouraged) arbitration provisions in seeming conflict with state corporate codes, claiming that the FAA preempts those state limits. Or the SEC could issue some form of administrative determination that purportedly negates any conflicting state law;<sup>46</sup> for example, disregarding or preempting any state law that limits the arbitration of securities claims against corporations incorporated in that state.<sup>47</sup>

Resolving either of these conflicts would require facing fraught questions of statutory and perhaps constitutional law. A conflict implicating the FAA would likely require the Supreme Court to determine whether bylaws and charters qualify as “contracts” under the statute.<sup>48</sup> An administrative-preemption instrument could expressly authorize arbitration of shareholder claims, but it would pose countless new challenges.<sup>49</sup> Moreover, not only are these questions thorny,

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44. It is at least theoretically possible that state and federal regulators could identify mutually exclusive spheres of regulation. *See, e.g.*, Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485, 1491 (1994) (“There was, in fact, a time when the Supreme Court flirted with the idea of establishing absolute, mutually exclusive domains for the state and federal governments.”).

45. *See, e.g., id.* at 1499 (“[I]t’s no longer possible to maintain a fixed domain of exclusive state jurisdiction . . . .”) (emphasis omitted).

46. *See* Exec. Order No. 12,988, 61 Fed. Reg. 4,729, 4,731 (Feb. 5, 1996) (requiring that new federal regulations “specif[y] in clear language the preemptive effect, if any, to be given to the law”); *see also* Catherine M. Sharkey, *Federalism Accountability: “Agency-Forcing” Measures*, 58 DUKE L.J. 2125, 2156 n.122 (2009) (noting that EO 12,988 applies to independent agencies such as the SEC).

47. A conflict also would arise if the SEC (or Congress) were to enact a broad rule (or statute) expressly preempting any state corporate-law provisions that limit shareholder arbitration clauses. This strikes us as much less likely than the options we propose in text, however.

48. Given the stakes of this issue and the Supreme Court’s interest in arbitration, *see supra* note 39 and accompanying text, we suspect that the Supreme Court may be interested in addressing this question sooner rather than later.

49. For example: what is the scope of “administrative preemption”? Would this hypothetical administrative determination be within the scope of the SEC’s authority? What deference, if

but compelling the courts – and ultimately the Supreme Court – to answer them also has costs of its own. For one thing, waiting for the Supreme Court to resolve these issues will create unnecessary uncertainty, perhaps for a prolonged period.<sup>50</sup> For another, as a matter of institutional design, we suspect that the Supreme Court is not well-positioned to resolve these issues. Policy decisions in this area would benefit from the expertise of both federal securities regulators and state actors familiar with internal corporate governance issues.

The good news is that the well-worn path of cooperative federalism<sup>51</sup> offers a way out of this dilemma. We think the SEC should take it. We are especially optimistic about this approach because it is consistent with current executive branch policy and with tools already in the SEC's toolkit.

Federal law is often sensitive to state-law interests and routinely incorporates state-law principles.<sup>52</sup> Federal administrative law has come to embrace the importance of federalism as well.<sup>53</sup> In 1999, President Bill Clinton issued Executive Order 13,132, parsimoniously titled “Federalism.”<sup>54</sup> EO 13,132 called upon executive agencies to take federalism principles seriously, and requires that “[e]ach agency shall have an accountable process to ensure meaningful and timely input by State and local officials in the development of regulatory policies that have

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any, is due the SEC? Should the evaluation of agency action account specially for state interests?

50. For example, the Supreme Court often prefers percolation among lower courts and circuit splits. *See* SUP. CT. R. 10(a).
51. Cooperative federalism, as the name suggests, imagines cooperative relationships between the federal government and the states. This could include formal federal-state collaborations, or “a sharing of regulatory authority between the federal government and the states that allows states to regulate within a framework delineated by federal law.” Philip J. Weiser, *Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663, 665 (2001). *See generally* Roderick M. Hills Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and “Dual Sovereignty” Doesn’t*, 96 MICH. L. REV. 813 (1998) (offering a useful discussion of cooperative federalism); Susan Rose-Ackerman, *Cooperative Federalism and Co-optation*, 92 YALE L.J. 1344 (1983) (same).
52. State property law is often an input in federal-law cases. *See, e.g.*, 19 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE & PROCEDURE JURISDICTION AND RELATED MATTERS* § 4520 (3d ed. 2018) (collecting examples). Federal common law presumptively incorporates state law. *See e.g.*, *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979).
53. Indeed, the SEC itself addresses state-law issues in many of its legal determinations. *See, e.g.*, Verity Winship, *Cooperative Interbranch Federalism: Certification of State-Law Questions by Federal Agencies*, 63 VAND. L. REV. 181, 203-05 (2010) (collecting cases of SEC applying state law and finding that nine percent of no-action letters included state law determinations); *see also* *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010) (interpreting requirement in the Securities Act of 1933 that SEC consider efficiency as requiring consideration of state law).
54. Exec. Order 13132, 64 Fed. Reg. 43,255 (Aug. 4, 1999).

federalism implications.”<sup>55</sup> Administrative law scholars have cataloged various agencies’ efforts to comply with the order, and they have explored how many of the benefits of federalism can translate to the administrative law context.<sup>56</sup>

Although independent agencies such as the SEC are not required to follow EO 13,132—the Order merely “encourage[s]” independent agency compliance<sup>57</sup>—we think it is a model for SEC consideration of state interests in shareholder arbitration. Indeed, cooperative corporate law federalism turns criticism of administrative federalism on its head. Critics have worried that using state participation to protect state interests in administrative law is in tension with the goals of expertise and accountability, which may be hindered by state participation.<sup>58</sup> Although this might be true for many areas, it does not accurately characterize corporate governance. State consultation not only is consistent with the background norm of state supremacy in corporate law, but it also is consistent with the goals of expertise and accountability. Whether one agrees with their substantive choices, it is clear that Delaware legislators and Delaware courts have expertise on issues of internal corporate governance, perhaps greater expertise even than that of the SEC. On accountability, as explored in more detail below, the state consultation we propose in this Essay requires the participation of state political actors and may ultimately result in a state legislative response. In short, therefore, cooperative federalism has the potential to protect state interests *and* promote expertise and accountability in corporate law.

Assuming that federalism has something to contribute to the shareholder arbitration issue, is there any reason to believe that the SEC could effectively use cooperative federalist tools?<sup>59</sup> Perhaps. In 2007, Delaware took the unusual step of authorizing its highest court to answer certified questions from the SEC<sup>60</sup>—a

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55. *Id.* at 43,257. When possible, the EO calls for consultation “early in the process of developing the proposed regulation.” *Id.*

56. See, e.g., Gillian E. Metzger, *Administrative Law as the New Federalism*, 57 DUKE L.J. 2023 (2008) (addressing this topic and collecting sources); Miriam Seifter, *States, Agencies, and Legitimacy*, 67 VAND. L. REV. 443, 461-73 (2014) [hereinafter Seifter, *States, Agencies, and Legitimacy*] (same); Miriam Seifter, *States as Interest Groups in the Administrative Process*, 100 VA. L. REV. 953, 970-79 (2014) [hereinafter Seifter, *States as Interest Groups*] (same); Sharkey, *supra* note 46 at 2155-72 (same). Metzger and Sharkey are more positive about the role of states in administrative law than Seifter. See *supra* and sources.

57. Exec. Order 13132, *supra* note 54, 43,259.

58. Seifter, *States, Agencies, and Legitimacy*, *supra* note 56, at 449-50.

59. Because the SEC is actively considering these issues—and because Congress has not expressed significant interest in the subject—we focus on the SEC as the federal component of our cooperative federalism proposals.

60. Act of May 3, 2007, 76 Del. Laws, ch. 37, § 1 (2007); see Winship, *supra* note 53, at 192-98 (discussing certification from non-Article III courts generally and Delaware’s “experiment” with the SEC specifically).

process usually reserved for communications between courts.<sup>61</sup> In 2008, the SEC certified a question related to Delaware law.<sup>62</sup> Less than two months later, the Delaware Supreme Court answered.<sup>63</sup> This SEC-Delaware certification process “exhibit[s] respect for state sovereignty[,] . . . further[s] general values of federalism and comity . . . [and] takes advantage of state courts’ expertise in state law . . . .”<sup>64</sup> It also suggests the SEC is capable of engaging in cooperative federalism.

The SEC could adopt a federalist posture to shareholder arbitration through a number of strategies. Under one possible strategy, without any contact with any state official, the SEC could simply condition its judgment regarding arbitration clauses on state law. The SEC would announce a general policy that intracorporate provisions regulating arbitration are valid only to the extent permitted by the law of the state in which the corporation is organized. The SEC would then apply its conditional-approval principle in individual cases—and, in so doing, it could use certified questions when necessary to determine the scope of state law. The SEC also could take the same stance without announcing a formal policy. In that case, the SEC would evaluate a particular registration statement (or other action) in light of state law, perhaps signaling that this approach would be replicated in future cases. This harmonization would avoid the costs of conflict while also capturing the benefits of federalism—just as with corporate regulation generally in the United States.

Alternatively, the SEC could follow the model of EO 13,132 and directly consult with state regulators and legislators who work on these issues. State officials, too, could affirmatively reach out to the SEC to promote cooperation. A consultative approach might encourage the SEC to be sensitive to state corporate law, and it might encourage state actors to more clearly delineate the scope of state law.

Indeed, any method of federal-state interaction might encourage states (especially Delaware) to act. As we mentioned, Delaware has seemingly punted on the question whether Delaware corporations may adopt arbitration provisions

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61. See, e.g., *Lehman Brothers v. Schein*, 416 U.S. 386, 390–91 (1974) (praising the use of certified questions to state courts).

62. See *Certification of Questions of Law Arising from Rule 14a-8 Proposal by Shareholder of CA, Inc.*, SEC (June 27, 2008), <http://www.sec.gov/rules/other/2008/ca14a8cert.pdf> [<https://perma.cc/9VAT-ZVLA>].

63. *CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 228 (Del. 2008); see also *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014) (answering certified question from a federal court).

64. *Winship*, *supra* note 53, at 211. Certification also may provide for review in situations where agency action may otherwise be unreviewable. *Id.* at 212.

that apply to non-Delaware claims. Of course, Delaware might decide not to regulate such provisions, but our proposal puts the ball in Delaware's court to make a formal, transparent choice about this corporate law issue. In this way, this approach would have a preference-eliciting effect on the states, which can have positive consequences for accountability and expertise, while remaining consistent with the background norm of state primacy in corporate law. In addition, states would have the benefit of federal expertise when making their choices about arbitration.<sup>65</sup>

Any of these approaches would be preferable to the federal-state conflict we warned of earlier. If the SEC elected to directly incorporate state law, the potential for conflict would evaporate and decision-making authority would be allocated to the appropriate level. If the SEC instead chose consultation, conflicts might still arise, though they would potentially be moderated if federal regulators ultimately adapted their policies to better conform to state law, or if state legislatures and regulators adapted their policies to better match federal law.<sup>66</sup> Moreover, we might give a federal agency more deference in intruding on traditional areas of state regulation if it consulted in good faith with states first. It would be even better if these administrative actions were judicially reviewable, and one benefit of our certification approach is that it would subject potentially unreviewable actions to a court for review. At a minimum, though, pre-consultation with state actors would make administrative actions more expert, more accountable, and more politically palatable.

## CONCLUSION

Sooner or later, policymakers will have to decide whether corporate governance documents can require arbitration of shareholder claims. How state and federal actors should respond to this development remains an open question. Corporate law implicates both federal and state authority, and thus shareholder arbitration should be resolved with respect for the shared nature of this regulatory space. Cooperative federalism provides solutions that are particularly well suited to these institutional design challenges. We hope that federal and state actors will consider its lessons.

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65. In this way, the solution we advocate is not simply acquiescence to state preferences but a truly cooperative solution to a problem of federal and state concern.

66. Of course, these proposals are not mutually exclusive. The SEC could make its approvals conditional on state law, but also work directly with state regulators to develop better overall policies for the future.

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