MANDATORY ARBITRATION AND THE MARKET FOR REPUTATION

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ABSTRACT

Is mandatory arbitration of shareholder claims desirable? With the blessing of the Supreme Court, mandatory arbitration provisions with class action waivers have become common in contract, consumer, and labor law. Policymakers now consider importing this trend to corporate and securities laws as well. The existing debate centers around consent and compensation: Can shareholders be held to consent to arbitration provisions in the company's corporate governance documents? Are shareholders better off with arbitration, given that litigation currently offers them very little compensation (with high fees)? This Article adopts a different, information-production perspective. It examines how the choice between litigation and arbitration affects the effectiveness of market discipline. Litigation, regardless of the legal outcomes, produces a positive externality: information on corporate behavior. Internal memos, emails, spreadsheets, and transcripts that are exposed in the process give us a glimpse into how the company-in-question is ran. This information helps outside observers reassess their willingness to do business with the parties to the dispute. In other words, litigation shapes the reputations of companies and businesspersons. By shifting from litigation to arbitration, we are likely to save administrative costs, but lose some of the effectiveness of reputational deterrence. While adopting a mandatory arbitration provision can be desirable for a given company, the ex ante effects of allowing such provisions would be overall detrimental to the market.

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INTRODUCTION

Over the past decade, the Supreme Court of the United States has enforced contractual provisions that force arbitration of disputes and ban class actions.[1] Unsurprisingly, companies went on to instill these mandatory arbitration provisions in their contracts with consumers, employees, and customers.[2] Commentators, practitioners, and policymakers have suggested that the mandatory arbitration revolution can, and should, apply to corporate and securities litigation as well.[3] The idea is that companies could amend their charters or bylaws to include such a provision, or go public with it, thereby forcing shareholders to arbitrate their claims individually, putting an end to shareholder litigation as we have come to know it. This Article examines whether such a proposal is socially desirable.

Those in favor of market arbitration often base their argument on the notion that ending shareholder litigation as we came to know it is not a bad thing.[4] They cite evidence on how shareholder litigation fares badly in compensating victims and amounts to little more than a transfer of wealth from investors to lawyers.[5] Yet compensation is not the only measuring stick, or even the most important one. When evaluating a proposed shift from litigation to arbitration, we should also consider deterrence. The critical question is whether litigation has a salutary effect on corporate behavior. Litigation will have such a salutary effect whenever it makes defendants internalize the costs of their misbehavior. Importantly, litigation can make defendants behave better not just by threatening them with legal sanctions, but also indirectly, by threatening them with non-legal sanctions. Litigation can exact (non-insurable) emotional costs. And it can facilitate reputational penalties: the risk of having damning information about how you behaved become public, thereby reducing the willingness of outside observers to trust and do business with you going forward.

This Article focuses on the last point, namely, how litigation facilitates reputational deterrence. Litigation affects reputation by uncovering information to which market players were not privy. Think for example about internal emails exposed during discovery, revealing a systematic cover-up or total lack of checks and balances throughout the corporate hierarchy. Litigation also affects reputations without producing new information, simply by changing the framing, credibility, and saliency of existing pieces of information.

[1] *See* Epic Sys. Corp. v. Lewis, 138 S. Ct. 1612, 1632 (2018); Am. Express Co. v. Italian Colors Rest., 570 U.S. 228, 233 (2013); AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 352 (2011).

[2] *See* Brian Fitzpatrick, *The End of Class Actions?*, 57 ARIZ. L. REV. 161, 164 & n.10 (2015) (compiling references); *infra* note 27.

[3] *See, e.g.*, Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1187 (2013).

[4] *Id.* at 1189-92.

[5] *Id.* at 1192-97.

Evaluating the magnitude of this informational positive externality is a daunting task. Deterrence is hard to measure, and reputation is an even fuzzier concept. To provide some sense of reputational deterrence, I therefore resort to using a proxy: media coverage of corporate behavior. A burgeoning multi-disciplinary literature documents the important role that media scrutiny plays in corporate governance.[6] I ask the prior question, namely, what determines the effectiveness of media scrutiny. In particular, I look at the extent to which media scrutiny relies on court documents. By triangulating several qualitative methods—interviewing reporters, going over a reporters-only database of tip sheets, scouring course syllabi in journalism schools, and conducting content analysis of prizewinning journalistic projects—this Article makes the case that litigation is a key source of impactful media coverage of corporate behavior. Allowing mandatory arbitration will reduce these "law-as-source" benefits, thereby severely limiting the media's role in corporate governance.

The Article proceeds in five parts. Part I maps the contours of the existing mandatory arbitration debate. Existing arguments roughly fall into two categories: those that examine whether arbitration is consistent with state and federal laws, and those that examine whether we would miss litigation if it were replaced with arbitration. Given the strong pro-arbitration push by the Supreme Court and the Trump Administration, it seems that the legal hurdles are cleared for companies wishing to adopt such provisions. The more relevant question becomes: Is it good policy?

To answer the policy question, Part II introduces the theory of how litigation affects reputation. It explains the different stages in the process of reputational sanctions and then shows how litigation affects each stage. This Part then presents suggestive evidence on the extent to which media coverage of corporate behavior relies on information from litigation to give us a sense of what will be lost once we shift to arbitration.

Part III introduces nuance, applying the general reputation-through-litigation theory to shareholder litigation. It highlights how shareholder litigation is more front-loaded than other types of litigation. The main event always comes early: think about the demand requirement in derivative actions or the pleading stage in securities class actions. As a result, plaintiffs in shareholder litigation find it harder to survive motions to dismiss and reach discovery. Yet, counterintuitively, that does not mean that shareholder litigation is less informative. Plaintiffs have developed pre-discovery investigatory tools, such as requesting to inspect the company's books and records or locating current or former employees willing to share damning information. These tools allow not just for better pleading but also for production of reputation-relevant information. Part III also breaks down the differential reputational impact of various types of shareholder litigation: derivate actions, securities class actions, and deal litigation.

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[6] *See infra* Section II.B.1.

Part IV considers the counterfactual: in a world with mandatory arbitration of shareholder claims, could other institutions substitute litigation's informational benefits? This Part assesses the information-production potential of enforcement by the Securities and Exchange Commission ("SEC"), individual arbitration by institutional investors, and standalone requests to inspect a company's books and records, and finds them all wanting. SEC enforcement is geared toward maximizing enforcement numbers rather than information. Individual arbitration is geared toward confidentiality rather than openness. And any information gleaned from requests to inspect the company's books has to remain confidential unless it is filed in conjunction with litigation. The upshot is that a shift to arbitration is bound to result in loss of informational benefits.

Part V sketches policy implications. Recognizing the informational role of litigation puts a thumb on the scales against importing mandatory arbitration provisions to corporate and securities laws. If courts and regulators nevertheless decide to enforce such provisions, we should at a minimum set basic rules ensuring that shareholder arbitration would produce meaningful information. For example, we can mandate "explained awards," whereby the arbitrator provides a short, publicly available factual description of what happened, as well as reasoning for her decision. Finally, the insights developed here on the link between litigation and reputation carry implications beyond the arbitration debate. This Article uses them to reevaluate the desirability of recent developments in Delaware law, such as the doctrines developed in *Corwin v. KKR Financial Holdings LLC*,[7] *In re Trulia, Inc. Stockholder Litigation*,[8] and *Lavin v. West Corp.*,[9] according to how they contribute to the quantity and quality of information flows.

I. THE EXISTING DEBATE

Mandatory arbitration of shareholder claims is hardly a new topic. But the contours of the debate have recently changed. Section I.A synthesizes the first category of existing arguments: whether arbitration provisions are consistent with state and federal laws.[10] Historically, companies considering adopting such provisions had to anticipate facing opposition from the courts and, notably, the SEC.[11] But the line of Supreme Court pro-arbitration decisions, coupled with the Trump Administration pressuring the SEC to change its anti-arbitration stance,

[7] 125 A.3d 304 (Del. 2015).

[8] 129 A.3d 884 (Del. Ch. 2016).

[9] No. 2017-0547, 2017 WL 6728702 (Del. Ch. Dec. 9, 2017).

[10] For a recent, concise summary, see generally Zachary D. Clopton & Verity Winship, *A Cooperative Federalism Approach to Shareholder Arbitration*, 128 YALE L.J. FORUM 169 (2018).

[11] *Id.* at 178.

now signal to companies wishing to adopt such provisions that any remaining legal hurdles will be cleared.[12]

Assuming the legal hurdles are cleared, should companies adopt arbitration provisions? Should the SEC give in to pressures and approve them? Section I.B details the existing policy arguments. The extant debate evaluates the desirability of arbitration by reference to the benchmark—the current state of shareholder litigation. Proponents of the shift to arbitration suggest it will leave investors better off, simply because litigation currently offers them very little compensation with very high fees. Notably missing from the debate, however, is a full account of litigation's deterrence benefits.

A. *Is Mandatory Arbitration Good Law?*

Historically, companies wishing to adopt mandatory arbitration provisions for shareholder claims anticipated facing a slew of legal hurdles. The SEC had steadfastly opposed such provisions, viewing them as a violation of the securities laws' "anti-waiver" provisions.[13] In 2012, for example, the SEC pressured private-equity giant Carlyle to drop a mandatory arbitration provision before it signed off on the company's IPO plans and allowed companies to exclude from their proxy materials shareholder proposals to adopt such provisions.[14]

Getting courts to sign off on arbitration provisions was also far from given. The Federal Arbitration Act ("FAA") enforces arbitration provisions among contractual parties.[15] It was not clear whether corporate governance documents would be considered contracts for FAA purposes, if only because they lack the key feature of bargaining between arm's-length counterparties.[16] A more recent challenge came in 2015, when the Delaware legislature amended its corporate

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[12] David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201, 205 (2015).

[13] The anti-waiver provisions are Securities Act of 1933 § 14, 15 U.S.C. § 77n (2012), and Securities Exchange Act of 1934 § 29(a), 15 U.S.C. § 78cc(a). They disallow waiving compliance with securities laws. On their applicability to arbitration provisions, see Barbara Black, *Arbitration of Investors' Claims Against Issuers: An Idea of Whose Time Has Come?*, 75 LAW & CONTEMP. PROBS. 107, 115 (2012); Webber, *supra* note 12, at 209-10.

[14] Pfizer Inc., SEC No-Action Letter, 2012 WL 587597, at *13 (Feb. 22, 2012); Gannett Co., SEC No-Action Letter, 2011 WL 6859124, at *1 (Feb. 22, 2012); *see also* Clopton & Winship, *supra* note 10, at 178 n.42.

[15] Clopton & Winship, *supra* note 10, at 172.

[16] Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583, 629 (2016). Within this line of argument, there is a distinction between charter and bylaw amendments: the former entail explicit shareholder consent and so they fit better under the FAA. Fitzpatrick, *supra* note 2, at 178.

law to allow forum-exclusion bylaws only if they do not exclude Delaware's courts.[17] A sweeping arbitration provision would run against such law.[18]

In recent years, however, the legal hurdles started clearing.[19] In 2011, the Supreme Court handed down its *AT&T Mobility LLC v. Concepcion*[20] decision, enforcing an arbitration provision with a class action waiver, while ruling that the FAA trumps state contract law.[21] Contract law, like corporate law, is considered the domain of the states, but that did not stop the Court.[22] Then in 2013, the *American Express Co. v. Italian Colors Restaurant*[23] decision upheld *Concepcion* and further expanded the FAA's scope by enforcing the arbitration clause even when it renders a *federal* law (the Sherman Act) ineffective.[24] In both decisions the issue of consent seems to take a backseat to a more policy-oriented approach.[25] Consumers of cell phone plans cannot bargain their way out of take-it-or-leave-it arbitration provisions, yet the Court enforced these provisions on them, suggesting that arbitration is the more effective procedure to handle their disputes. The *Concepcion* and *Italian Colors Restaurant* decisions did more than just signal the lowering of legal hurdles. They also significantly increased the benefits of fighting any remaining legal uncertainties for companies;[26] the real innovation was not in respecting arbitration provisions, but rather in enforcing the class action waivers in these provisions.[27]

[17] DEL. CODE ANN. tit. 8, § 115 (2019) ("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.").

[18] Clopton & Winship, *supra* note 10, at 175-76. Note that section 115 applies only to corporate internal affairs and not to securities litigation. Lipton, *supra* note 16, at 597-98 ("Corporate governance regulation concerns the balance of power between its shareholders, its officers, and its directors, and commonly falls within the rubric understood as the corporation's 'internal affairs.'").

[19] Black, *supra* note 13, at 108.

[20] 563 U.S. 333 (2011).

[21] *Id.* at 352.

[22] Fitzpatrick, *supra* note 2, at 187.

[23] 228 U.S. 228 (2013).

[24] *Id.* at 235-36.

[25] Lipton, *supra* note 16, at 592-93.

[26] Black, *supra* note 13, at 118.

[27] As of 2017, eighty percent of the big one hundred companies use mandatory arbitration clauses in employment contracts, and over sixty million Americans have signed such arbitration clauses. ALEXANDER J.S. COLVIN, ECON. POLICY INST., THE GROWING USE OF MANDATORY ARBITRATION (2017), http://www.epi.org/publication/the-growing-use-of-mandatory-arbitration [https://perma.cc/QHN4-VMQ2]; IMRE S. SZALAI, EMP. RIGHTS ADVOCACY INST. FOR LAW & POLICY, THE WIDESPREAD USE OF WORKPLACE ARBITRATION AMONG AMERICA'S TOP 100 COMPANIES (2017), http://employeerightsadvocacy.org/wp-

A similar pro-arbitration turn may be taking place inside the SEC, with nudges from the Trump Administration.[28] In 2017, the U.S. Treasury prepared a report (in response to Executive Order 13,772) on how to relax regulations that stymie activity in capital markets.[29] The Treasury report identified reducing the costs of litigation as a key step toward reinvigorating U.S. stock listings and recommended that the SEC investigate a shift to arbitration.[30] The media has since reported that the Trump Administration keeps pushing the SEC to reverse its anti-arbitration stance and that the SEC now privately signals to companies its willingness to change course.[31] In July 2017, then-SEC Commissioner Michael Piwowar floated the idea in a public speech[32]: "For shareholder lawsuits, companies can come to us to ask for relief to put in mandatory arbitration into their charter . . . . I would encourage companies to come and talk to us about that."[33]

Given this evident pro-arbitration bent, mandatory arbitration provisions are now much more likely to be considered consistent with state and federal laws.[34] Why have we yet to see companies rushing to adopt them? We can conjecture that there is a first-mover disadvantage that companies fear. The first company

content/uploads/2017/09/Insitute-2017-Report-Widespread-Use-Of-Workplace-Arbitration.pdf [https://perma.cc/756Q-NVSW].

[28] The Trump Administration's pro-arbitration bent is evident in other areas of the law as well, illustrated in instances where it overruled attempts by regulators such as the Consumer Financial Protection Bureau to bypass class action waivers. For an elaboration, see Roy Shapira, *Law as Source: How the Legal System Facilitates Investigative Journalism*, 37 YALE L. & POL'Y REV. 153, 207-08 (2018).

[29] STEVEN T. MNUCHIN & CRAIG S. PHILLIPS, U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL MARKETS: REPORT TO PRESIDENT DONALD J. TRUMP (2017) [hereinafter THE TREASURY REPORT].

[30] *Id*. at 33-34.

[31] 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.

[32] *See* 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-idUSKBN1A221Y [https://perma.cc/M6K9-6SFX] ("A key U.S. securities regulator on Monday voiced support for possibly allowing companies to tuck language into their initial public offering paperwork that would force shareholders to resolve claims through arbitration rather than in court.").

[33] Bain, *supra* note 31. It should be noted that Commissioner Piwowar has since left his position, and that Chairman Clayton has so far indicated that when picking its battles, mandatory arbitration is hardly the first hill the SEC will die on. *See* Rick Fleming, Inv'r Advocate, Sec. & Exch. Comm'n, Address at PLI's the SEC Speaks in 2018, Washington, D.C.: Mandatory Arbitration: An Illusory Remedy for Public Companies Shareholders (Feb. 24, 2018), https://www.sec.gov/news/speech/fleming-sec-speaks-mandatory-arbitration [https://perma.cc/CQ5S-MEJQ].

[34] *See* Fitzpatrick, *supra* note 2, at 183 n.101; Lipton, *supra* note 16, at 596 (contending that the Supreme Court FAA-jurisdiction trumps Delaware's recent section 115 amendment).

that adopts such a provision will expose itself to the costs associated with defending its stance in the courtroom and the court of public opinion.[35] However, once the first test case proves successful, there is reason to expect many other companies to follow.[36] Is that a good thing?

B. *Is Mandatory Arbitration Good Policy?*

Those in favor of shifting to mandatory arbitration usually make their case by criticizing the existing state of shareholder litigation.[37] Shareholder litigation has two main rationales: compensation and deterrence.[38] By now there is wide agreement that shareholder litigation fares badly on the first prong: compensation.[39] The recoveries that shareholder plaintiffs get are nominal.[40] And in the rare cases where compensation is not nominal, critiques continue, it is circular.[41] That is, because the company itself (directly or through insurance) is the one often compensating the plaintiffs, the costs are borne by the company's existing shareholders. Diversified investors are therefore as likely to receive payment as plaintiffs, as they are to pay as defendants. Once you factor in the transaction costs of litigation (notably, lawyers' fees), many scholars conclude that shareholder litigation merely transfers wealth from investors to lawyers.[42] Against this background, mandatory-arbitration proponents claim that a shift to arbitration will actually improve things for consumers/investors. Arbitration will generate higher monetary reliefs with lower transaction costs (a quicker, more cost-effective procedure).[43]

A glaring weakness in the existing arguments for arbitration and against litigation is the lack of attention to the other social goal of litigation, namely,

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[35] *See* Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 DEL. J. CORP. L. 751, 809 (2015); Scott & Silverman, *supra* note 3, at 1221; Webber, *supra* note 12, at 211 (noting that Institutional Shareholder Services may pull its weight and recommend voting against directors who adopt such provisions).

[36] *See* Bain, *supra* note 31; Fitzpatrick, *supra* note 2, at 191.

[37] *See* Clopton & Winship, *supra* note 10, at 174 n.16.

[38] *See, e.g.*, John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1538 (2006).

[39] *See* Scott & Silverman, *supra* note 3, at 1192; Webber, *supra* note 12, at 214.

[40] As is supposedly illustrated by the fact that many investors do not even bother to collect their share of settlement funds. James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 421-24 (2005). For evidence on low recoveries in derivative suits, see Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1749 (2010); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 84 (1991).

[41] *See* Coffee, Jr., *supra* note 38, at 1556-58.

[42] *See* Jill E. Fisch, *Confronting the Circularity Problem in Private Securities Litigation*, 2009 WIS. L. REV. 333, 337.

[43] *See, e.g.*, Clopton & Winship, *supra* note 10, at 172.

deterrence.[44] This is a broader issue: most empirical work on shareholder litigation focuses on compensation, leaving deterrence understudied.[45] In the arbitration versus litigation debate, those favoring arbitration bypass the lack of evidence by assuming that little compensation translates into weak deterrence.[46] A perfect illustration comes from the abovementioned Treasury report: the report mentions the possibility that securities class actions contribute to deterrence, only to quickly dismiss it by invoking the low-and-circular compensation point, and then calls for considering a shift to arbitration.[47] While it is understandable that difficulties in measuring deterrence make it much less amenable to empirical work, deterrence is simply too important to be ignored or lumped together with compensation.[48]

Deterrence does not hinge solely on compensation. Litigation can impose costs on defendants—making them internalize the social costs of their misconduct—even without compensating plaintiffs. Pertinently, litigation can expose defendants to nonlegal (and uninsurable) sanctions. It can impose emotional costs on defendants.[49] And it can hurt their reputations.[50] In other words, when assessing deterrence, we need to consider both direct- and indirect-deterrence effects of facilitating non-legal sanctions.

The existing arguments *against* mandatory arbitration tend to ignore the indirect-deterrence angle. One common type of criticism emphasizes the adverse effects of arbitration on plaintiffs in specific disputes. The arbitration procedure

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[44] *See* Myriam Gilles & Gary Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 107 (2006) (noting and criticizing literature's "compensationalist" approach).

[45] *See* James D. Cox & Randall S. Thomas, *Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the U.S. Securities Law*, 6 EUROPEAN COMPANY & FIN. L. REV. 164, 182 (2009) ("Compensation and deterrence frequently are joined together in debates over the social value of securities class actions. Much of the empirical research . . . bears directly on the former, but as seen here there is very little on the latter.").

[46] *See, e.g.*, Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1956 (2013) (arguing that shareholder class actions "fail to deter the wrongdoer managers, as they virtually never pay out of pocket").

[47] THE TREASURY REPORT, *supra* note 29, at 33-34.

[48] *See* Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic Ex Post Regulation*, 43 GA. L. REV. 63, 92-93 (2008); Cox & Thomas, *supra* note 45, at 183 (noting that deterrence remains an "extremely important area for future research"); Webber, *supra* note 12, at 263 & n.339 (compiling references).

[49] *See, e.g.*, Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 489 n.7 (2007) (discussing how emotional and reputational impact of shareholder litigation will affect directors and officers directly).

[50] *See, e.g.*, Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1104 (1997); Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 19 (2015).

is tilted in favor of defendants, who get to pick their favorite arbitrators and curtail discovery, the argument goes.[51] Shifting to arbitration may result in more meritorious claims getting barred to begin with[52] or in a transfer from small to large shareholders.[53] These criticisms are mostly generic and well-debated,[54] and I have little to add.

This Article raises another type of concern, namely, the adverse effects of arbitration on third parties. There exist ample accounts that highlight the positive externalities of litigation that will be lost if we shift to mandatory arbitration. Yet most of these arguments emphasize "legal" externalities. That is, they claim that litigation cultivates a vibrant, constantly evolving law that can instruct corporate behavior.[55] A shift to arbitration would deprive "the community of shareholders and corporations of access to a developing body of legal norms with which to meet changing economic conditions,"[56] as well as the benefit of having judges tell "corporate insiders what the law expects of them."[57]

This Article spotlights a different version of positive externalities: non-legal externalities. It emphasizes how litigation produces valuable public information on the behavior of market players. Litigation, in this version, does not just help potential defendants plan ahead and avoid legal landmines; it does not just help regulators prioritize better; it also helps market players—consumers, suppliers, and investors—make better decisions regarding with whom to keep doing

[51] Lipton, *supra* note 16, at 120 n.93.

[52] *Id.* at 120.

[53] Webber, *supra* note 12, at 258 (suggesting that in a world where compensation is paid only to big institutional investors, a semi-circularity problem will arise, with small investors paying for big investors).

[54] In the sense that we hear them in other realms of legal scholarship as well.

[55] *See, e.g.*, Burch, *supra* note 48, at 117-18; Lipton, *supra* note 16, at 637; Lynn M. LoPucki, *Delaware's Fall: The Arbitration Bylaws Scenario*, *in* CAN DELAWARE BE DETHRONED?: DELAWARE'S DOMINANCE IN CORPORATE LAW 35, 51 (Stephen M. Bainbridge et al. eds., 2018); Webber, *supra* note 12, at 229.

[56] G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517, 561-62 (1989).

[57] 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/QRR8-9QAG]; *see also* Ann M. Lipton, *Limiting Litigation Through Corporate Governance Documents*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION 176, 187 (Griffith et al. eds., 2018). Another version of the legal-externalities argument is that litigation helps regulators by spotlighting problems that regulators were not previously aware of or had the political cache to tackle. *Cf.* Claire A. Hill, Caremark *as Soft Law*, 90 TEMPLE L. REV. 681, 692 (2018) (stating *Caremark* litigation affects behavior by shaping company reputation among relevant regulators).

business.[58] In other words, litigation facilitates a functioning market for reputation.

II. How Shifting to Arbitration Affects the Market for Reputation

Legal scholars are well aware that reputation matters in the commercial world. But we rarely delve into how exactly reputation matters, or how reputation interacts with the law.[59] This Part provides the theoretical framework to understanding law-and-reputation interactions, while subsequent parts apply the general theory to shareholder litigation. Section II.A explains how reputation works, and why it is bound to be affected by litigation. Section II.B provides suggestive evidence for just how much litigation affects reputation by looking at the extent to which media coverage relies on court documents.

[58] There exist several accounts that allude to the informational benefits coming from litigation. Professor Amanda Rose maintains that the real function of Rule 10b-5 claims is producing information. These claims amount to shareholders outsourcing the monitoring of managers to the class action bar, she claims. Yet Rose focuses on how litigation, in effect, does not fulfill this function effectively, and so we may be better off without litigation, relying solely on public enforcement, or on whistleblowing programs. *See* Amanda M. Rose, *Form vs. Function in Rule 10b-5 Class Actions*, 10 DUKE J. CONST. L. & PUB. POL'Y 57, 66-67 (2015) [hereinafter Rose, *Form vs. Function*]; Amanda M. Rose, *Better Bounty Hunting: How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1258 (2014) [hereinafter Rose, *Better Bounty Hunting*]; Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2174 (2010). I address the argument that shareholder securities litigation does not produce information in Part III, *infra*, and the argument that we are better off with just SEC enforcement or just whistleblowing in Part IV, *infra*. Professor Elizabeth Burch alludes to an argument that is very close to ours. She claims, "[A]rbitrations make marketplace justice impossible," as public accountability cannot be achieved "when the information needed for consumers to self-select is kept private." Burch, *supra* note 48, at 119-20. Yet Burch does not fully develop the information-producing argument or how it affects the market for reputation, instead focusing on other disadvantages of arbitration, such as freezing the development of the law, or lack of public scrutiny of arbitrators' decisions. *Id*. at 117-18. Professors Gorga and Halberstam's well-developed account of the benefits of discovery in corporate litigation is also very relevant here. *See* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law,"* 63 EMORY L.J. 1383 (2014). Yet they focus on how information from discovery stimulates the development of case law, ignites internal changes in companies, or informs regulators. *See id.* I, by contrast, emphasize the reputational effects, coming not from the defendant companies or their regulators, but rather from other market players.

[59] Corporate and securities law, in particular, are an area where the interactions between law and reputation are especially pronounced. Shapira, *supra* note 50, at 14-15.

A. *How Litigation Facilitates Reputation*

1. How Reputation Works

Commercial legal scholars frequently invoke the disciplinary force of reputation.[60] The argument is intuitive: upon hearing bad news about the company, stakeholders would infer that the company's "type" is worse than they have realized and accordingly reduce their willingness to do business with the company going forward. Investors hearing about a corporate governance scandal will start demanding higher returns for their investment, customers hearing about a product recall will purchase fewer products, and so forth. The aggregate of diminished business opportunities constitutes the reputational sanction for violating market norms. And the background threat of losing reputation deters corporate misbehavior ex ante.[61]

The problem with this argument is that it treats reputation as a straightforward, binary process: companies that behave well earn a good reputation, while those that behave badly tarnish their reputation. Yet a nascent body of literature shows just how noisy reputational rewards and sanctions can be.[62] Not all bad news is created equal. Similar behaviors lead to different reputational outcomes. One company weathers fraud allegations relatively unscathed while another goes bankrupt. One top executive takes the fall when her company misbehaves while another is unaffected.

In particular, legal scholars too often assume that bad news automatically translates into reputational damages. The fact that news came out (that is, that an allegation of corporate misconduct became public) is a necessary, but not a sufficient, condition for meaningful reputational damage to occur. Several additional conditions have to hold: *diffusion*, *certification*, and *attribution*.[63] Damning information has to be widely diffused so that it reaches a critical mass of stakeholders in order for the reputational sanction to be meaningful.[64] Information that was widely diffused has to be certified as credible for the

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[60] *See, e.g.*, JONATHAN R. MACEY, THE DEATH OF CORPORATE REPUTATION 10-20 (2013) (discussing reputation in the financial fraud context); Mitchell Polinsky & Steven Shavell, *The Uneasy Case for Product Liability*, 123 HARV. L. REV. 1437, 1449 (2010) (discussing reputation in the product safety context).

[61] Roy Shapira, *Reputation Through Litigation: How the Legal System Shapes Behavior by Producing Information*, 91 WASH. L. REV. 1193, 1201 (2016).

[62] *Id*. at 1203-07.

[63] Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The* DuPont *Case* 25 (Nat'l Bureau of Econ. Research, Working Paper No. 23866, 2017), http://www.nber.org/papers/w23866 [https://perma.cc/Y4KA-KQ92].

[64] *See* Julian F. Kolbel, Timo Busch & Leonhardt M. Jancso, *How Media Coverage of Corporate Social Responsibility Increases Financial Risk*, 38 STRATEGIC MGMT. J. 2266, 2280 (2017).

company's stakeholders to consider it seriously.[65] And even information that was diffused and certified has to first be attributed to deep-seated flaws that are likely to reoccur in the future, in order for the company's stakeholders to update their beliefs and act on it.[66]

None of these stages—attribution, certification, or diffusion—are automatic. Consider attribution first. The magnitude of reputational sanctions depends to a large extent on how stakeholders perceive the *indicativeness of future behavior*.[67] To generalize: when stakeholders attribute the bad news to a one-off mistake, such as a rogue low-level employee who was subsequently fired, the reputational sanction is likely to be small. By contrast, when stakeholders attribute the bad news to a deep-seated flaw, such as a total breakdown of internal checks and balances throughout the corporate hierarchy, the reputational sanction is likely to be large. In other words, stakeholders try to figure out not just what happened, but also *how* things happened. Yet stakeholders often lack information about how things happened. Questions such as "who knew what when?" or "could top management have stopped it?" can normally be answered only with access to internal company communications. Even when information is available, stakeholders' attention is limited, and their judgment is too biased to reach the "correct" attribution.[68] As a result, stakeholders overreact to some types of misbehaviors and underreact to others.

Aside from problems with how stakeholders calibrate their response to information, the market for reputation also suffers from problems with how information intermediaries select and diffuse information.[69] For large companies, reputation is largely a function of media coverage.[70] Yet the media has difficulties scrutinizing corporate behavior, due to a plethora of factors: lack of expertise, dependence on corporate sources or advertising revenues, and

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[65] After all, stakeholders do not change what they think about the company based on any piece of information spread by a fly-by-night rumor propagator.

[66] *Cf.* Kolbel, Busch & Jancso, *supra* note 64, at 2271 (implying that reputational sanctions will be large when shareholders believe misbehaving firms had capacity to act differently but did not).

[67] *See* Thomas Noe, *A Survey of the Economic Theory of Reputation: Its Logic and Limits*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION 114, 117 (Timothy G. Pollock & Michael L. Barnett eds., 2012).

[68] *See* Shapira, *supra* note 61, at 1204; *see also* Michael L. Barnett, *Why Stakeholders Ignore Firm Misconduct: A Cognitive View*, 40 J. MGMT. 676, 676-77 (2014) (discussing stakeholders' limited attention); Yuri Mishina, Emily S. Block & Michael J. Mannor, *The Path Dependence of Organizational Reputation: How Social Judgment Influences Assessments of Capability and Character*, 33 STRATEGIC MGMT. J. 459, 459 (2012) (discussing stakeholders' judgment biases).

[69] Shapira, *supra* note 61, at 1205-06.

[70] David L. Deephouse, *Media Reputation as a Strategic Resource: An Integration of Mass Communication and Resource-Based Theories*, 26 J. MGMT. 1091, 1096 (2000).

catering to their audiences' own biases.[71] As a result, too often meaningful information is not spotlighted and diffused.[72]

Finally, another source of noise in the market for reputation is those who are sanctioned—the misbehaving companies themselves.[73] Companies do not take reputational sanctions as given. Rather they invest vast resources in attempts to instill doubt in the credibility of the allegations, affect stakeholders' attribution, and limit the damning information's diffusion.[74]

The upshot is that, when left alone, market players will have a hard time getting quality information on corporate behavior and translating it into accurate reputational judgments. But in reality, the market is rarely left alone. Reputational "enforcement" operates in the shadow of legal enforcement.

2. How Litigation Affects Reputation

Litigation affects the process of reputational sanctions along all of the above-mentioned stages: revelation of information, attribution, certification, and diffusion.

First and foremost, litigation helps market players by uncovering new pieces of information on the corporate misconduct in question (the *revelation* stage). The legal system vests fact-finding powers in private litigants to probe and demand relevant information from their rivals.[75] Market players who follow litigation[76] can get information to which they previously could not have been privy.[77] The classic example here is internal email communications exposed during the discovery stage, showing just how big the organizational cover-up was.

[71] *See* Stefano DellaVigna & Matthew Gentzkow, *Persuasion: Empirical Evidence*, 2 ANN. REV. ECON. 643, 659-60 (2010) (arguing media caters to its audiences' biases); Jonathan Reuter & Eric Zitzevitz, *Do Ads Influence Editors? Advertising and Bias in the Financial Media*, 121 Q.J. ECON. 197, 225 (2006) (arguing media slants coverage in favor of big advertisers); Damian Tambini, *What Are Financial Journalists For?*, 11 JOURNALISM STUD. 158, 159 (2010) (arguing financial journalists often have too little experience and expertise to scrutinize their subject matter).

[72] Shapira, *supra* note 28, at 159-67.

[73] Shapira, *supra* note 61, at 1206-07.

[74] Roy Shapira, *Amenable Controls: How Companies Influence Laws, Reputation and Morals*, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE, AND SUSTAINABILITY (Beate K. Sjåfjell & Christopher Bruner eds., forthcoming 2019) (manuscript at 13-14) (on file with author).

[75] Gorga & Halberstam, *supra* note 58, at 1416-17; Shapira, *supra* note 61, at 1214.

[76] Or, more realistically, get information from litigation through information intermediaries such as the media or analysts.

[77] Shapira, *supra* note 28, at 173-76 (reporting, based on series of interviews with journalists, that journalists look to complement information they get from human sources with information they can find in court documents, because such documents extract, with power of subpoenas and threat of perjury, information that journalists cannot get elsewhere).

Litigation helps not only by revealing new information, but also by processing existing information (the *attribution* stage). Judicial opinions are good at fleshing out patterns of misbehavior, organizing large chunks of information, and making it all less complex for outside observers. In particular, judicial opinions often make it easier on market players to assess how intentional the actions in question were—an important determinant of reputational sanctions. Think, for example, about securities litigation, where the judge has to make inferences about *scienter* from the outset. Reputational impact is not limited to the (rare) disputes that culminate in a judicial verdict. Even in cases that settle early, legal documents that come out during pleading, discovery, or trial help not just by drawing outside observers' attention to a misbehavior they were not aware of, but also by adding detail and analysis on how things happened.[78]

The third way in which litigation affects reputation is through *certification*. A well-developed psychology literature tells us that not all sources of information are created equal: stakeholders are more likely to update their beliefs and act on information when they perceive the source as credible.[79] Judicial opinions are normally considered disinterested and fair, and, in the case of Delaware, the business community considers judges to be reputable experts. Depositions and testimonies are given under oath. Documents are produced under the threat of perjury. Indeed, journalists I interviewed for a law-and-media project told me that the mere phrase "according to court documents" is a rhetorical device they use to increase their story's credibility.[80] A journalist may have all the information she needs from another source, but she would still find it valuable to search for corroboration in court documents to increase the chances that her story reverberates.

Finally, litigation affects reputation by shaping the frequency and tenor of media coverage (the *diffusion* stage). Litigation feeds the media with what communication scientists call "information subsidies."[81] Court documents reduce the costs to journalists of covering the story.[82] They often provide information that is well-documented and detailed, and contains good quotes from internal company documents. Importantly, information from court documents is invaluable for investigative reporters because it is practically *libel-*

[78] Gorga & Halberstam, *supra* note 58, at 1419-44 (describing information-forcing regime of shareholder litigation); Shapira, *supra* note 28, at 174.

[79] DellaVigna & Gentzkow, *supra* note 71, at 657.

[80] Shapira, *supra* note 28, at 175. The added weight attached to court documents can be explained by a well-developed literature in psychology on source-credibility effects. *See* Shapira, *supra* note 61, at 1224.

[81] *See generally* OSCAR H. GANDY, JR., BEYOND AGENDA SETTING: INFORMATION SUBSIDIES AND PUBLIC POLICY (1982) (coining term).

[82] Shapira, *supra* note 28, at 180-89 (providing evidence from interviews with reporters, reporters' tip sheets, journalism school syllabi, and communication science literature).

proof; as long as the media reports accurately from court documents, it is shielded from defamation liability.[83]

B. *To What Extent Does Litigation Facilitate Media Scrutiny?*

The previous Section explained *why* and *how* market players rely on information coming from litigation. This Section offers suggestive evidence on *how much* market players rely on information from litigation. Reputation is a fuzzy concept that does not easily lend itself to direct statistical proof. Instead of quixotically trying to measure it directly, I use media coverage as proxy.

The reputation literature tells us that the media is not just a recorder of reputation but also an important determinant of reputation.[84] Section II.B.1 synthesizes the most relevant-for-our-purposes insights from that literature on how media scrutiny shapes corporate governance. This literature raises the question of what determines media scrutiny: Which corporate governance debacles are being covered and which are not? How are they covered? And so on. Section II.B.2 presents evidence on the determinant most relevant for our purposes: litigation. By triangulating several methods, most notably content analysis of prizewinning investigative reports, I conclude that legal sources stand behind the majority of impactful media stories.

1. The Media's Role in Corporate Governance

Commercial legal scholars have traditionally understudied issues of how information is diffused, and what role the media plays in corporate governance.[85] Yet a nascent-but-burgeoning literature in other fields keeps producing evidence on the effects of agenda-setting, framing, and diffusion by the media. Communication scholars categorize the media's impact into capital-markets effects and corporate-governance effects.[86] Within the former category, financial economists have shown that the scope and tone of media coverage moves stock market prices even when the media reports contain no new information. One classic study found that a front-page *New York Times* article about a biotech company caused the stock prices to skyrocket, even though the article contained no new information and was actually repeating information that the *Times* had previously published in a back-page story.[87] More broadly, the

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[83] *Id.* at 173; *see also* Tamar Frankel, *Court of Law and Court of Public Opinion: Symbiotic Regulation of the Corporate Management Duty of Care*, 3 N.Y.U. J.L. & BUS. 353, 357 (2007).

[84] *See generally* Deephouse, *supra* note 70.

[85] *See* Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media*, *in* THE RIGHT TO TELL: THE ROLE OF MASS MEDIA IN ECONOMIC DEVELOPMENT 107, 108-09 (2002).

[86] *See* Tambini, *supra* note 71, at 161-62.

[87] *See* Brian J. Bushee et al., *The Role of the Business Press as an Information Intermediary*, J. ACCT. RES., Mar. 2010, at 12-13 (discussing how coverage by mass media

intensity of media coverage was found to be conducive to the quality of financial markets.[88]

Within the latter category—corporate-governance effects—studies find that media scrutiny increases the responsiveness of corporate decision-makers to shareholders,[89] as well as to salient outside groups, such as environmentalists.[90] Survey-based evidence shows that top managers view negative media coverage as the biggest threat to corporate reputation.[91] Pertinently, a recent study found that media coverage of corporate misconduct creates financial risk: one negative article brings with it an increase in credit risk in the magnitude of about $1.3 million in additional servicing of debt.[92] In fact, the law itself acknowledges the key role of the media in disciplining corporate behavior. The doctrine developed in *In re Caremark International Inc. Derivative Litigation*,[93] for example, treats prior media coverage as a red flag that should propel directors to act or indicate that their internal monitoring channels were not functioning.[94]

Once we recognize the salutary effect of media scrutiny on corporate behavior, the question becomes what determines media scrutiny. In particular, we are interested in the link between litigation and media coverage.

2. Litigation's Role in Media Coverage

In a previous project, I examined whether, how, why, and how much media coverage relies on so-called legal sources: court documents, regulatory investigation reports, Freedom of Information Act ("FOIA") requests, and so on.[95] I tackled these questions from multiple angles: I interviewed over forty veteran reporters and editors, searched a members-only database of reporters'

affects stock returns even when not breaking new information); Gur Huberman & Tomer Regev, *Contagious Speculation and a Cure for Cancer: A Nonevent that Made Stock Prices Soar*, 56 J. FIN. 387, 387-90 (2001).

[88] *See* Dyck & Zingales, *supra* note 85, at 107-11.

[89] *See, e.g.*, Jennifer R. Joe, Henock Lewis & Dahlia Robinson, *Managers' and Investors' Responses to Media Exposure of Board Ineffectiveness*, 44 J. FIN. & QUANTITATIVE ANALYSIS 579, 588-92 (2009) (discussing how media scrutiny of board effectiveness pushes scrutinized company to adopt more shareholder-value-enhancing behaviors); Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 60, 104-12 (discussing how media coverage of shareholder activism in controlled companies increases likelihood of accepting the advocated change).

[90] *See* Dyck & Zingales, *supra* note 85, at 105-07.

[91] *See* Joe, Lewis & Robinson, *supra* note 89, at 580 (discussing 2002 survey "in which managers rank negative press as the greatest threat to corporate reputation, ahead of corporate unethical behavior and litigation"); Tambini, *supra* note 71, at 160.

[92] *See* Kolbel, Bush & Jancso, *supra* note 64, at 2281.

[93] 698 A.2d 959 (Del. Ch. 1999).

[94] *See id.* at 964; Michael J. Borden, *Of Outside Monitors and Inside Monitors: The Role of Journalists in* Caremark *Litigation*, 15 U. PA. J. BUS. L. 921, 935 (2013) (identifying "a newspaper report detailing illegal behavior" as red flag under *Caremark*).

[95] *See generally* Shapira, *supra* note 28.

tip sheets, scoured syllabi in the Investigative Reporting 101 courses in leading journalism schools, and analyzed the content of prizewinning investigative projects.

The triangulation of all these methods yielded several sets of insights, which can be boiled down for our purposes into one sentence: in today's world, legal sources are probably the single most important source of investigative reporting. To illustrate, consider how in over half of all the investigative projects that won the Pulitzer Prize between 1995-2015, legal sources played the "but-for" role.[96] That is, without access to legal documents, the reporters would not have been able to publish their impactful stories. The effectiveness of media scrutiny in a given (geographical or topical) area therefore depends to a large extent on how much the law in that area facilitates information flows.[97] The law facilitates information flows directly—as a function of the scope and enforcement of disclosure laws, the permissibility of freedom of information laws, or the incentives provided by whistleblowers laws.[98] The law also facilitates information flows indirectly—as a function of the openness and the discovery awarded in private litigation or regulatory enforcement.[99]

Yet before we can apply the insights from this general law-as-source project to our topic here, we need to answer two questions. First, to what extent do law-as-source benefits stem from the specific channel of litigation, rather than from other legal sources such as disclosure requirements or regulatory enforcement? After all, we are interested in the desirability of shifting to mandatory arbitration, and disclosure or public enforcement will supposedly remain intact even if such a shift occurs. Second, to what extent are the law-as-source benefits of litigation relevant to our particular type, namely, shareholder litigation?

We have a clear answer to the first question: litigation plays a key role, often more important than other types of legal sources.[100] Granted, some media probes rely heavily on "direct" legal sources, such as FOIA requests or companies' public filings with the SEC. But a lot of times, the smoking gun comes rather from "indirect" legal sources, such as law enforcement actions. The reason, in a nutshell, is that direct sourcing channels rely on powerful players volunteering information.[101] Indirect sourcing channels, by contrast, rely on forcing damning information out of powerful players. This fundamental difference can make information extracted during litigation/regulatory investigations more conducive to the work of investigative journalists trying to understand how the powerful behaved, relative to information selectively released by the powerful themselves.

[96] *Id.* at 186.
[97] *Id.* at 168-69.
[98] *Id.* at 204.
[99] *Id.*
[100] *Id.* at 171-73, 189-92.
[101] *Id.* at 168.

The second question—whether shareholder litigation is as informative as other types of litigation—is harder to answer directly, if only because the content analysis of prizewinning projects does not provide many relevant data points.[102] What the law-as-source study does offer in that regard are more general observations regarding how the media relies on information from litigation when it investigates companies.[103] It seems that litigation's role is actually more pronounced in investigative reporting on corporate behavior, as opposed to investigative reporting on the public sector or the third sector.[104] Virtually every reporters' tip sheet or course syllabus that deals with how to investigate businesses mentions searching court documents. When I asked investigative reporters why this is so, they suggested a straightforward answer: business journalists rely more heavily on court documents because they have a hard time sourcing stories on business companies in other ways.[105] A journalist trying to hold big government to account will have much easier time getting, for example, tips from the politician's rivals or relying on FOIA requests or public-records laws.[106]

The added difficulty of getting information on private businesses seems to increase the demand for getting information from litigation. And, in the words of the Dean of Columbia Journalism School, the supply tends to meet the demand: "[T]here's hardly a company in this world that is not being sued, and this is where you get a window [into what is going on in the company]."[107] A great illustration comes from a study that documented the lack of watchdog journalism by the financial media leading up to the 2008 financial crisis. That study singled out four counterexamples of great investigative pieces.[108] When I took a closer look at these projects—the rare pieces that did spotlight the shady Wall Street practices that contributed to the crisis—I learned that all of them

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[102] After all, very few journalistic prizes are awarded for covering corporate governance issues.

[103] Shapira, *supra* note 28, at 194-97.

[104] *Id.*

[105] In general, communication scholars have long recognized that holding big business accountable is actually tougher than holding big government accountable. *See, e.g.*, JAMES T. HAMILTON, DEMOCRACY'S DETECTIVES: THE ECONOMICS OF INVESTIGATIVE JOURNALISM 151 (2016); MICHAEL SCHUDSON, THE SOCIOLOGY OF NEWS 140 (2003).

[106] As prizewinning business journalist Jesse Eisinger noted, "The structure of business news . . . is that the businesses control the news to a much greater degree than in any other area of the media. In politics, you have a built-in adversarial system . . . ." Asher Schechter, *Business Journalism Fails Spectacularly in Holding the Powerful to Account*, PROMARKET (May 30, 2017), https://promarket.org/business-journalism-fails-spectacularly-holding-powerful-account/ [https://perma.cc/CS3G-FWPT].

[107] Shapira, *supra* note 28, at 196 (quoting Steve Coll).

[108] Dean Starkman, *Power Problem*, COLUM. JOURNALISM REV., May-June 2009.

relied heavily on court documents.[109] Without litigation, media scrutiny of corporate behavior would lose most of its already-diminished effectiveness.

Up to this point, we have broadly discussed litigation against businesses. It is time to delve into specifics and introduce the unique nuances of information-production in shareholder litigation.

III. INTRODUCING NUANCE: THE REPUTATIONAL IMPACT OF CORPORATE AND SECURITIES LITIGATION

Different types of litigation produce information of different quantities and qualities. Shareholder litigation works differently than, say, product liability litigation. And within shareholder litigation, derivative suits work differently than securities class actions. This Part introduces nuance to the reputation-through-litigation argument. Section III.A examines the differences between shareholder litigation and other types of litigation. Plaintiffs in shareholder litigation have a tougher task surviving the motion to dismiss and reaching discovery. Yet, perhaps counterintuitively, this feature of shareholder litigation does not necessarily hurt its ability to affect reputation markets. Plaintiffs' lawyers have developed pre-filing investigatory tools that allow them to plead better and extract valuable, timely information even before discovery. Section III.B then discusses how different types of shareholder litigation affect the market for reputation differently.

A. *Front-Loaded Investigations*

One could claim that shareholder litigation is less likely to produce informational benefits than other types of litigation, because it is more likely to get killed in its infancy. Since the mid-1990s, a series of legislative and judicial reforms have severely curtailed a plaintiff's ability to survive the motion to dismiss stage, let alone reach full-blown discovery.[110] How can we expect useful information to come out from litigation if only a few complaints reach discovery, and even fewer lead to published judicial opinions? Without the benefit of

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[109] *Id.* A 2000 story that spotlighted the Wall Street-subprime connection relied on litigation in California that found the Lehman Brothers responsible for practices of lender clients. Diana B. Henriques & Lowell Bergman, *Mortgaged Lives: A Special Report; Profiting from Fine Print with Wall Street's Help*, N.Y. TIMES, Mar. 15, 2000, at A1. A 2005 story relied on court documents to show how financial companies pushed for bad loans. Mike Hudson & E. Scott Reckard, *Workers Say Lender Ran 'Boiler Rooms,'* L.A. TIMES, Feb. 4, 2005, at A1. A 2007 story did the same by collecting information from fifteen separate lawsuits against the Lehman Brothers. Michael Hudson, *How Wall Street Stoked the Mortgage Meltdown*, WALL STREET J., June 27, 2007, at A1. A 2009 post-mortem analysis relied on court documents to show how wholesalers bent the rules in every way. David Segal, *Financial Fraud Is Focus of Attack by Prosecutors*, N.Y. TIMES, Mar. 12, 2009, at A1.

[110] Cox & Thomas, *supra* note 45, at 169.

discovery, how can litigators add information that other market players do not already know?[111]

The rebuttal is straightforward: reforms that made it tougher to survive earlier stages in litigation did not eliminate the information-production, but merely *front-loaded* it. To generalize: plaintiffs in shareholder litigation likely file more fact-rich, detailed initial complaints.[112] They likely conduct more pre-discovery investigations.[113] As a result, information about defendants' behavior is generated at much earlier stages of the litigation process. Shareholder litigation affects the market for reputation even in its infancy.

The front-loaded information production takes different degrees and forms, as a function of the forum and type of claim. With corporate governance matters settled in state courts, the main pre-discovery investigatory tool is requesting to inspect the defendant company's books and records ("section 220 requests," to use the Delaware jargon).[114] With securities claims settled in federal courts, section 220 requests are unavailable, and so plaintiffs frequently resort to soliciting inside informants, who confidentially provide damning information about their current or former employers.

1. Corporate Claims in State Courts: Section 220 Requests

In derivative actions, the main event comes before the suit even starts: the demand requirement.[115] To survive the demand-requirement stage, plaintiffs practically need to convince the courts that demand is futile because the company's board is too self-interested to make the right decision.[116] To do that, plaintiffs need to meet a heightened pleading standard and show that a majority of the board is implicated in the alleged wrongdoing.[117] And they need to clear

[111] *See* Rose, *Better Bounty Hunting*, *supra* note 58, at 1258 ("Many [fraud-on-the-market] suits produce no new information because they come after the fraud has been exposed by other sources and do not otherwise enrich the public's understanding of what occurred."). There is potential for irony in such a rebuttal, to the extent the criticism comes from those who pushed for installing hurdles to shareholder litigation and now claim that we should do away with litigation because it is hurdled. *Cf.* Steven Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOYOLA U. CHI. L.J. 669, 699 (2014).

[112] Geoffrey P. Miller, *Pleading After* Tellabs, 2009 WIS. L. REV. 507, 532.

[113] *See, e.g.*, Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 711 (7th Cir. 2008) (describing complaint's pre-discovery reliance on confidential sources with ties to company).

[114] DEL. CODE ANN. tit. 8, § 220 (2019).

[115] To bring a claim, the plaintiff has to first make a demand on the company's board to pursue that claim.

[116] Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

[117] FED. R. CIV. P. 23.1(b)(3); Stone v. Ritter, 911 A.2d 362, 366-71 (Del. 2006).

those hurdles without having the benefits of discovery.[118] The solution to this pleading challenge came from the Delaware courts, which started imploring plaintiffs to use all "tools at hand" to generate information pre-suit, particularly their right to inspect the company's books.[119] Plaintiffs heeded the call and started filing section 220 requests more frequently and more broadly.[120]

Granted, section 220 requests do not generate the same quantity and quality of information as full discovery does.[121] But the practice of section 220 requests has developed such that shareholders now use them not just to get technical information such as stock-list materials, but also to extract all internal company documents related to the alleged wrongdoing, such as board minutes, internal memos, and spreadsheets.[122] Forcing companies to volunteer such information can affect reputations, both directly and indirectly. Directly, section 220 requests that produce internal corporate communications give the market a peek behind the corporate curtain, with answers to reputation-relevant questions such as "who knew what when."[123] Indirectly, section 220 requests allow better pleading and so increase the chances of reaching full discovery, where more relevant information is likely to come out.

A good illustration comes from the well-known Disney litigation. There, the initial complaint was dismissed for failure to meet the demand requirement.[124] The plaintiffs regrouped and submitted a section 220 request, which generated internal company documents: letters, emails, memoranda, and board minutes. Armed with the information, the plaintiffs amended their complaint, and this time survived the motion to dismiss, proceeded to discovery and then a full trial.[125] In a separate paper, I analyzed at length the content of media coverage

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[118] *See* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000); Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands—Reprise*, 28 CARDOZO L. REV. 1287, 1293 (2006).

[119] Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996).

[120] For an excellent survey of the rise of section 220 requests, see Radin, *supra* note 118. For a timely update on how recent doctrinal developments make section 220 requests ever more important, see Joel Friedlander, Friedlander & Gorris, P.A., *Confronting the Problem of Fraud on the Board*, HARV. L. SCH. F. ON CORPORATE GOVERNANCE & FIN. REG. (Jan. 3, 2019), https://corpgov.law.harvard.edu/2019/01/03/confronting-the-problem-of-fraud-on-the-board/ [https://perma.cc/C8ZC-VY8G].

[121] Borden, *supra* note 94, at 954 (discussing limits of pre-discovery investigation during derivative litigation).

[122] Randall S. Thomas & Kenneth J. Martin, *Using State Inspection Statutes for Discovery in Federal Securities Fraud Actions*, 77 B.U. L. REV. 69, 84 (1997) (naming documents and materials available to plaintiffs under Delaware's corporate inspection statute).

[123] For real-life examples of what plaintiffs request, see Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands*, 26 CARDOZO L. REV. 1595, 1626-28 (2005).

[124] *In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 342 (Del. Ch. 1998) (summarizing proceedings including dismissal due to failure to meet demand requirement).

[125] *See In re* Walt Disney Co. Derivative Litig., 825 A.2d 275 (Del. Ch. 2003).

of the Disney-Ovitz debacle before, during, and after the Disney litigation.[126] The upshot was that the earlier stages of the process shaped the frequency and tenor of how the media covered Disney, thereby affecting the reputations of the company and individuals involved.[127]

2. Securities Claims in Federal Courts: Soliciting Whistleblowers

With securities class actions, the main event similarly comes early: the motion to dismiss.[128] Out of the many challenges that securities class actions faced over the recent decades,[129] most relevant for our purposes is the combination of heightened pleading standards with a stay on discovery.[130] The 1995 Private Securities Litigation Reform Act ("PSLRA") requires that plaintiffs plead facts with particularity, showing a strong inference of scienter.[131] Such facts about the defendant's state of mind must be pled without the benefit of discovery, as the PSLRA also stayed discovery until after the motion to dismiss is decided. As a result, virtually all defendants file motions to dismiss, and plaintiffs have a tough time surviving such motions.[132]

The combination of heightened pleading standards and stayed discovery seems at first glance like a death knell to information production. Yet here as well, a closer look reveals a different, more dynamic story. Plaintiffs' lawyers

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[126] Shapira, *supra* note 50, at 24-40.

[127] Interestingly, the reputational effects of litigation there starkly differed: the company's reputation recovered, while the reputation of individual decision-makers took a beating. Shapira, *supra* note 61, at 1227-30 (detailing media fallout that damaged reputations of Disney executives and directors implicated in litigation).

[128] Stephen J. Choi & Adam C. Pritchard, *The Supreme Court's Impact on Securities Class Actions: An Empirical Assessment of* Tellabs, 28 J.L. ECON. & ORG. 850, 851 (2012); Gideon Mark, *Confidential Witness Interviews in Securities Litigation*, 96 N.C. L. REV. 789, 794 (2018) ("Consequently, the ultimate outcome of the litigation is substantially dependent on the resolution of motions to dismiss. If plaintiffs survive the motion, 'their chances of a major settlement increase exponentially.'" (quoting William S. Freeman & Catherine T. Zeng, *The Trouble with 'Confidential Witness' Allegations*, LAW360 (Feb. 3, 2012, 2:12 PM), https://www.law360.com/articles/303826/the-trouble-with-confidential-witness-allegations [https://perma.cc/Q8PR-JT56])).

[129] Webber, *supra* note 12, at 203-04.

[130] 15 U.S.C. §§ 77z-l(b), 78u-4(b)(3)(B) (2012). Other important hurdles that were introduced include a loser-pays provision, a safe harbor for certain forward-looking statements, and restricting aider-and-abettor liability. *See id.* § 78u-4(f).

[131] The Supreme Court later clarified that "a strong inference" means pleading facts that would make "a reasonable person . . . deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 314, 324 (2007).

[132] Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA's Internal-Information Standard on '33 and '34 Act Claims*, 76 WASH. U. L.Q. 537, 578 (1998). Indeed, following the one-two punch of heightened pleading standards and a stay on discovery, dismissal rates in securities class actions doubled. Cox & Thomas, *supra* note 45, at 169.

who faced mounting hurdles had to raise their game and conduct more pre-complaint and pre-discovery investigations.[133] They are now said to possess much more information in the motion to dismiss stage, relative to plaintiffs in other cases,[134] and are more likely to plead their allegations in an "awesomely detailed" way.[135]

Unlike in corporate litigation, section 220 requests were not available to plaintiffs, since the law blocks their usage in securities litigation.[136] Plaintiffs had to resort to alternative investigatory tools.[137] Among them, the most common and effective seems to be soliciting whistleblowing: finding current and former employees willing to share damning inside information on the behavior of defendants.[138] Indeed, reliance on "information provided by confidential witnesses" has become almost universal in securities class actions.[139]

These inside informants frequently provide information that outside observers are not privy to, regarding what and how things happened. To illustrate:[140] In *Tsirekidze v. Syntax-Brillian Corp.*,[141] a former top officer provided details on

[133] Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 711 (7th Cir. 2008) (describing complaint's reliance on confidential sources with ties to company); Burch, *supra* note 48, at 74 n.40; Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 929.

[134] Miller, *supra* note 112, at 532.

[135] *Id.*

[136] The Securities Litigation Uniform Standards Act of 1998 ("SLUSA") precludes securities class actions from being litigated in state courts, thereby limiting the ability to use state-backed rights to inspect the books. Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.); Gorga & Halberstam, *supra* note 58, at 1423. And Delaware's Court of Chancery explicitly disallowed the filing of a section 220 request to assist the requesting shareholder in her pleading in federal courts. *See, e.g.*, Beiser v. PMC-Sierra, Inc., No. 3893-VCL, 2009 WL 483321, at *11-13 (Del. Ch. Feb. 26, 2009).

[137] *See* Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 FORDHAM J. CORP. & FIN. L. 551, 553 (2007) ("[P]laintiffs' law firms—particularly in securities cases subject to heightened pleading standards—have hired professional investigators and significantly expanded their pre- and post-filing investigations . . . .").

[138] *See, e.g.*, Michael J. Kaufman & John M. Wunderlich, *Resolving the Continuing Controversy Regarding Confidential Informants in Private Securities Fraud Litigation*, 19 CORNELL J.L. PUB. POL'Y. 637, 639-40 (2010) ("Quite often, to meet the PSLRA's heightened pleading requirements, plaintiffs rely on statements from confidential sources.").

[139] Ariel S. Lichterman, *Confidential Witnesses: The Reform Act and the Battle at the Pleading Stage*, 8 CARDOZO PUB. L. POL'Y & ETHICS J. 609, 626 n.86 (2010); Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554 & n.15 (2011).

[140] For these examples and many others, see Kaufman & Wunderlich, *supra* note 138, at 640 n.3. *See generally* Miller *supra* note 112.

[141] No. CV-07-2204-PHX-FJM, 2009 WL 275405 (D. Ariz. Feb. 4, 2009).

how defendants cooked the books.[142] In *Silverman v. Motorola, Inc.*,[143] eight former employees explained how the company knowingly omitted facts about technological difficulties.[144] In *Hubbard v. BankAtlantic Bancorp, Inc.*,[145] former bank employees fleshed out claims about shady lending practices.[146] As with section 220 requests, the usage of such insider informants affects the market for reputation both indirectly by increasing the chances that complaints reach full discovery, and directly by providing information that can be picked up by the media even at a preliminary stage.[147]

Another element that makes the preliminary stages in securities class actions informative is that the judges themselves are more proactive in generating information. Because the motion to dismiss effectively turned into something akin to a summary judgment, judges examine the pleading with much more rigor.[148] And because courts in securities class actions must investigate all sources of competing inferences of *scienter*, they often probe even information that was not included in the initial complaint.[149]

B. *How Different Types of Shareholder Litigation Affect Reputation Differently*

The reputational impact of shareholder litigation varies as a function of the type of claim. To risk over-generalizing, we can rank the potential for information-production in a descending order as follows: derivative actions, and particularly fiduciary duty litigation of the *Caremark* type; securities class actions; and deal/appraisal litigation.

Derivative actions, and in particular *Caremark* litigation, are geared to produce reputation-relevant information. These types of claims implicate questions about the quality of corporate governance: what top managers knew, could they have done more to stop it, and so on. Information produced during section 220 requests, discovery, or trial on these questions would likely tell outside observers something about the quality of information flows and checks and balances in the company: whether the board has the right incentives and capabilities to prevent tunneling by the CEO, whether the company has a deep-

[142] *Id.* at *4-5.

[143] No. 07 C 4507, 2008 WL 4360648 (N.D. Ill. Sept. 23, 2008).

[144] *Id.* at *5-6.

[145] 625 F. Supp. 2d 1267 (S.D. Fla. 2008).

[146] *Id.* at 1273-74.

[147] Even if we assume that the market somewhat discounts information coming from unidentified disgruntled employees, the practice of relying on them affects reputation through at least two indirect channels: producing copies of internal corporate documents that speak for themselves, and, as mentioned, increasing the chances that the claim would survive the motion to dismiss and reach full discovery.

[148] Miller, *supra* note 112, at 533.

[149] *Id.*

rooted, calculated-disregard-to-market-norms culture, and so on. These are questions that outside investors care deeply about, but usually have very little information on. In other words, these are reputation-relevant questions.

Securities class actions implicate different issues (e.g., alleged spreading of false information) and proceed under different rules, which are much more restrictive from an information-production perspective than the ones applied by Delaware courts. Following PSLRA and Securities Litigation Uniform Standards Act ("SLUSA"), plaintiffs in securities class actions have fewer chances to survive a motion to dismiss and reach discovery, no ability to use section 220 requests, and so on.[150] Delaware, by contrast, has traditionally adopted a more permissible approach to flushing out disputes in courts, and letting cases proceed to discovery even when the odds that these complaints will ultimately win are slim.[151] Still, the few securities cases that win the uphill battle and survive a motion to dismiss generate, by definition, nontrivial pieces of information on the state of mind of corporate decision-makers.

Several scholars dismiss the informational value of securities class actions, claiming that by the time these claims are filed, the market already knows what happened from other sources.[152] These scholars usually cite in support of their assertion a study by Professors Dyck, Morse, and Zingales ("DMZ"), which examined "who blows the whistle on corporate fraud."[153] DMZ tracked the first time that allegations of fraud were covered in the media and deciphered the sources that broke the news. They found that the filing of class actions breaks news about fraud in only three percent of the cases.[154] In most other cases, the

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[150] *See supra* Section III.A.2.

[151] Doctrines in cases such as *Zapata Corp. v. Maldanado* and *Kaplan v. Wyatt* stand in contrast to the approach of other state business courts or federal courts. *See* Kaplan v. Wyatt, 499 A.2d 1184, 1192 (Del. 1988) (finding trial court had discretion on how much discovery to accord to plaintiffs in early stages); Zapata Corp. v. Maldanado, 430 A.2d 779, 789 (Del. 1981) (applying enhanced standard of review to special litigation committee conduct); *see also* WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 392 (4th ed. 2012) (describing different approaches of judicial deference to decisions of special litigation committees).

[152] *See, e.g.*, William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 122 (2011) ("Overall we see little in the way of a supplemental informational contribution [from securities class actions]."); Rose, *Better Bounty Hunting*, *supra* note 58, at 1258 ("Class action lawyers are corporate outsiders and thus have no inherent advantage in detecting corporate misconduct by virtue of their position.").

[153] *See* Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2213 (2010); Rose, *Better Bounty Hunting*, *supra* note 58, at 1258; Scott & Silverman, *supra* note 3, at 1198; *see also* Rose, *Form vs. Function*, *supra* note 58, at 66.

[154] *See* Dyck, Morse & Zingales, *supra* note 153, at 2214.

revelation comes from other sources, such as the firm's employees, investigative reporters, and stock analysts.[155]

Yet it is one thing to acknowledge DMZ's findings that litigation is not the first to tell the market what happened, and another thing to maintain that litigation has no impact on reputation markets. To recast the discussion from Part II above: litigation can shape reputations even without breaking news, simply by changing the framing and saliency of existing bits of information. Litigation can affect stakeholders' views on how things happened (the attribution stage), enhance the perceived credibility of news (the certification stage), and dictate the volume and tenor of media coverage (the diffusion stage). DMZ themselves explicitly acknowledged as much: "[T]he fact that [plaintiffs' lawyers] only reveal 3% of the cases does not mean that private litigation is useless in preventing fraud. . . . [I]t can help publicize and make credible the claims made by other whistleblowers."[156]

Finally, deal litigation has historically produced relatively less reputation-relevant information than both derivative actions and securities-fraud class actions. These claims revolve around showing mispricing in a given, one-off transaction. They do not implicate an ongoing breakdown of checks and balances. In appraisal rights litigation, for example, plaintiffs do not even have to extract information showing that laws were intentionally violated. As a result, fewer internal company documents will be asked for and produced in these types of claims. To be sure, even in deal litigation we may occasionally get relevant documents from expedited discovery, showing conflicts of interest and the board acquiescing to the CEO.[157] But these are not the norm.[158]

IV. CAN OTHER INSTITUTIONS SUBSTITUTE LITIGATION'S INFORMATIONAL BENEFITS?

To fully examine the desirability of shifting to mandatory arbitration, we need to consider not just the informational benefits of litigation in its current state, but also the counterfactual: in a world without shareholder litigation, will other enforcement mechanisms step up and provide similar informational benefits to

[155] *Id.*

[156] *Id.* at 2230.

[157] *See* Joel Friedlander, *Vindicating the Duty of Loyalty: Using Data Points of Successful Stockholder Litigation as a Tool for Reform*, 72 BUS. LAW. 623, 646 (2017) (compiling examples of wrongdoing uncovered by litigation).

[158] In more recent developments, plaintiffs tried to start using appraisal litigation strategically, as a channel that allows them to reach discovery, which can then be used to dig up information that will lead to a follow-up fiduciary duty litigation. Yet the Delaware courts were quick to curb the investigation-through-appraisal-discovery channel. For a concise summary, see Edward Micheletti, Jenness Parker & Bonnie David, Skadden, Arps, Slate, Meagher & Flom LLP, *M&A Litigation Developments: Where Do We Go From Here?*, HARV. L. SCH. F. ON CORPORATE GOVERNANCE & FIN. REG. (July 18, 2018), https://corpgov.law.harvard.edu/2018/07/18/ma-litigation-developments-where-do-we-go-from-here/ [https://perma.cc/4RPP-Q8SZ].

the ones we currently get from litigation? This Part considers three such alternatives for information production: public enforcement headed by the SEC (Section IV.A), individual arbitration headed by big institutional investors (Section IV.B), and section 220 requests or whistleblowing by aggrieved shareholders and employees (Section IV.C). The bottom line is the same: none of these institutions would be able to meaningfully substitute the information that would be lost if we switch from litigation to arbitration.

A. *SEC Enforcement*

One could argue that in a world where private enforcement happens behind closed doors, public enforcement can still produce enough information to facilitate proper reputational deterrence. The SEC's enforcement division arguably possesses better tools and incentives than private litigants to produce credible information. The SEC enjoys broader investigative powers compared to the ones private litigants typically enjoy in a post-PSLRA world.[159] And as for incentives, private litigants are incentivized to trade away information for money: it is not just that they settle too early and often, but also that they settle too secretly.[160] Almost every settlement comes with some form of a confidentiality clause.[161] By contrast, the SEC can produce press releases that detail their investigations in a fairer way than plaintiffs-lawyer-worded complaints or media briefs. A shift from litigation to arbitration would therefore only crystalize the waters, as the information environment would be dominated by the better-informed and more credible SEC's enforcement division.

I accept this argument in a limited sense: in a specific dispute, SEC enforcement may indeed be equally or more informative than private litigation. But I reject the argument as far as the big picture is concerned: the overall information that comes out of SEC enforcement actions as a whole *cannot* fully substitute for the overall information that comes out due to private litigation. Private enforcement produces information in ways and on types of misconduct on which the SEC consistently under-produces information.

For one, the SEC faces budgetary constraints. It does not have the ability to pursue all investigations of misconduct that private litigators have traditionally taken on.[162] The limited resources mean that the SEC has to prioritize targets,

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[159] *See* Rose, *Better Bounty Hunting*, *supra* note 58, at 1258.

[160] Shapira, *supra* note 28, at 204 (noting strong incentive for parties to "stipulate to keep details of the dispute private").

[161] *See, e.g.*, Jon Bauer, *Buying Witness Silence: Evidence-Suppressing Settlements and Lawyers' Ethics*, 87 OR. L. REV. 481, 491 nn.16-19 (2008).

[162] The SEC Investor Advocate acknowledged this himself. *See* Fleming, *supra* note 33 ("Because of the limited scope of the SEC's resources, investors themselves have typically borne a large share of the responsibility for policing the markets and rooting out misconduct."); *see also* Samuel Issacharoff, *Regulating After the Fact*, 56 DEPAUL L. REV. 375, 381 (2007) (arguing private enforcement expands the inherently limited resources of

and various empirical studies show that the SEC prioritizes in a distorted way. The SEC has historically favored going after small fish rather than big fish[163] and provided laxer treatment for firms that are more politically connected.[164] The plaintiffs' bar, by contrast, pursues companies with much bigger market caps and without apparent political biases.[165] Private litigation is therefore likely to pursue—and flush out information on—instances of corporate misconduct that public enforcement ignores.

To clarify, when questioning the SEC's incentives, one does not need to assume a hardcore regulatory capture story. The SEC under-produces information simply because it maximizes what it is being measured upon.[166] The SEC emphasizes the total amount of fines it collects and the number of enforcement actions it opens.[167] These are the observable yardsticks against which the SEC's monitors—in the media, Congress, or academia—measure the SEC's success.[168] From our viewpoint, the problem is that in pursuing these numbers, the SEC too often trades off information.

Consider, for example, how the SEC often lets the targets of its enforcement actions influence the language and timing of the enforcement action press release.[169] As part of the negotiations, defendants get to revise the regulator's drafts and often are not required to admit wrongdoing. Further, the SEC often files and settles its enforcement actions simultaneously.[170] This allows defendants to put a "nothing to see here" spin on what could have been damning indications about their behavior. In other words, defendants largely control how

government enforcement); Webber, *supra* note 12, at 266 (observing that "resource constraints suggest that public actors may be limited in their ability to fill the void").

[163] *See* Cox & Thomas, *supra* note 45, at 172-73 (summarizing studies over the years showing SEC tends to target smaller firms); Stavros Gadinis, *The SEC and the Financial Industry: Evidence From Enforcement Against Broker-Dealers*, 67 BUS. LAW. 679, 685 (2012) (showing "big firms (and their employees) uniformly faced lower sanctions than small firms and their employees").

[164] *See* Maria M. Correia, *Political Connections and SEC Enforcement*, 57 J. ACCT. ECON. 241, 242 (2014); Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOK. L. REV. 117, 117-18 (2004) (arguing SEC's failure to pursue large firms likely caused by agency's capture by those firms); Frank Yu & Xiaoyun Yu, *Corporate Lobbying and Fraud Detection*, 46 J. FIN. & QUANTITATIVE ANALYSIS 1864, 1864 (2011).

[165] *See* James D. Cox & Randall S. Thomas, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 779 (2003).

[166] *See* Shapira, *supra* note 50, at 50; Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 901 (2016).

[167] *See* MACEY, *supra* note 60, at 13; Shapira, *supra* note 50, at 51-54.

[168] *See* Shapira, *supra* note 50, at 54 ("The SEC's constituencies . . . evaluate the SEC mostly according to readily observable yardsticks . . . .").

[169] *See* Jason E. Siegel, *Admit It! Corporate Admissions of Wrongdoing in SEC Settlements: Evaluating Collateral Estoppel Effects*, 103 GEO. L.J. 433, 454 (2015).

[170] *See* Shapira, *supra* note 50, at 49 n.179 (compiling references showing this SEC practice).

and when information from SEC investigations about them will be diffused to the public, thereby limiting the reputational impact of SEC enforcement.[171]

Relatedly, and as another illustration of how maximizing numbers comes at the expense of producing information, consider the evidence on the types of offenses that the SEC goes after. The SEC tends to target whole industries for minor offenses.[172] Targeting whole industries may help boost enforcement numbers, but it does not affect reputations: the stakeholders of company *X* cannot punish the company for misbehaving if all of company *X*'s competitors face similar allegations (they cannot take their business elsewhere).[173] Further, the SEC has increasingly targeted companies for strict liability offenses such as failure to report insiders' transactions.[174] Strict liability cases can be investigated and prosecuted quickly, but they produce little reputational value[R1]: the enforcement action would tell the market that something happened, but would not normally elaborate on how things happened. It would not produce internal company documents showing who knew what when.

A recent study provided evidence that private attorneys may be better at flushing out certain types of misconduct than the SEC.[175] The study found that the credibility of the defendant company's disclosures takes a bigger hit following a standalone class action than it does following a standalone SEC investigation.[176] Institutional ownership and earnings responsiveness—both proxies for how the market perceives disclosure credibility—drop more for companies that were targeted by a class action than they do for companies that were targeted by the SEC.[177]

To reemphasize, private litigants' incentives to produce information are far from perfect. But we should not treat private litigation and SEC enforcement as a horserace where we need to determine the sole winner of information production. We can acknowledge that both systems are flawed and still recognize that the systems' coexistence can make things better as long as each system's flaws are imperfectly correlated with the other's.[178] For example,

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[171] *See id.* at 53 (quoting former SEC commissioner who decried practice of effectively letting defendants dictate agenda and framing of what happened).

[172] *See* MACEY, *supra* note 60, at 225, 236.

[173] *See* Shapira, *supra* note 50, at 52.

[174] *See* Velikonja, *supra* note 166, at 969-70.

[175] *See* Stephen J. Choi & A. C. Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison*, 13 J. EMPIRICAL LEGAL STUD. 27, 46 (2016); *cf.* Jackson, Jr., *supra* note 57.

[176] *See* Choi & Pritchard, *supra* note 175, at 43.

[177] *Id.* at 46.

[178] *See also* John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 226-27 (1983) (referring to private litigation as a failsafe mechanism that checks problems with public enforcement); William B. Rubenstein, *Why Enable Litigation?: A Positive Externalities Theory of the Small*

private litigants have incentives to get damning information out early in the process, to survive the motion to dismiss and leverage their claims into a hefty settlement.[179] The SEC, by contrast, keeps any damning information it extracts confidential until after a settlement is reached.[180] In general, SEC commissioners and staffers have long acknowledged that private litigation guards against selective enforcement and inaction on part of the SEC.[181] In a world without private litigation, defendants would have stronger incentives to dilute SEC enforcement efforts.[182] This will dilute not just legal deterrence but also reputational deterrence.

B. *Individual Arbitration*

One common criticism of mandatory arbitration provisions with class action waivers goes as follows: these provisions do not merely change the procedure for settling disputes, but rather effectively eliminate disputes, since victims who suffered small damages will not pursue their claims individually.[183] At first glance, such criticism applies less forcefully in our context, where there are big institutional investors that may have a large enough stake to vigorously pursue individual claims in arbitration.[184] In a world without class actions, institutional investors may even have a legal duty to monitor and follow through on potential misconduct by companies they invest in.[185] The question for our purposes is not whether individual arbitration by institutional investors would generate enough

Claims Class Action, 74 UMKC L. REV. 709, 725 (2006) (claiming that even if private litigation is flawed, sheer diversity of enforcers is valuable).

[179] *See* Gorga & Halberstam, *supra* note 58, at 1426.

[180] *Id.* at 1428 & n.236.

[181] *See, e.g.*, Burch, *supra* note 48, at 101-02 (quoting former SEC commissioner describing private litigation as a "safety valve" protecting against agency capture); Jill E. Fisch, *Class Action Reform,* Qui Tam*, and the Role of the Plaintiff*, 60 LAW & CONTEMP. PROBS. 167, 199 (1997); Ramirez, *supra* note 111, at 722 n.358, 724 nn.364 & 367 (citing material showing vital role of private litigation as acknowledged by SEC); *see also* John Chiang et al., *State Treasurers' Opposition Against Forced Arbitration or Class Action Waivers in Shareholder Agreements*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 13, 2018), https://corpgov.law.harvard.edu/2018/07/13/state-treasurers-opposition-against-forced-arbitration-or-class-action-waivers-in-shareholder-agreements/#more-109049 [https://perma.cc/D283-A9NJ].

[182] *Cf.* Coffee, Jr., *supra* note 178, at 227.

[183] As Professor Resnik notes, the recent changes have brought an explosion in arbitration *provisions*, not arbitration, because the provisions effectively diffuse the disputes altogether. *See generally* 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 (2015).

[184] Webber, *supra* note 12, at 264. In fact, evidence shows that institutional investors already opt out of class actions in order to pursue their claims individually. *See* Fitzpatrick, *supra* note 2, at 191.

[185] *See* Webber, *supra* note 12, at 220.

compensation, but rather whether it would generate enough information. I tend to answer in the negative, for the following reasons.

For one, fewer instances of corporate misconduct will get flushed out. The whole impetus behind the arbitration-provisions wave is wanting to *avoid* the need to resolve certain disputes.[186] Even in cases where the individual harm is big enough on paper, it is not clear that institutional investors would actually pursue a remedy. Evidence from Europe, where only big institutional investors can bring derivative actions, suggest that in reality most valuable claims are not pursued, partly because it is easier for managers to collude and convince the few players who can bring a claim to not bring it.[187] Similarly, in the United States, Professors Bebchuk and Hirst recently showed that none of the large index funds had been the lead plaintiff in *any* securities class action over the past ten years.[188] They interpret this evidence as suggesting that institutional investors with high-enough stakes prefer, for various reasons, not to vigorously pursue their claims.[189]

Even if one assumes that institutional investors would regularly pursue claims in arbitration, one has to acknowledge that the procedure in arbitration starkly differs from court procedures in ways that limit information production.[190] Discovery tends to be *much* more limited.[191] Depositions are taken only rarely.[192] Plaintiffs' investigations normally do not extract internal company documents.[193] And so on. In theory, arbitration provisions can be amended to demand a more information-extracting, akin-to-litigation procedure. But that

[186] *Id*. at 210 ("The primary purpose of arbitration provisions in this context is not to shift shareholder claims from judges to arbitrators, but to eliminate the claims entirely by undermining their economic viability.").

[187] *See* Martin Gelter, *Mapping Types of Shareholder Lawsuits Across Jurisdictions*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION, *supra* note 57, at 459, 471; Kristoffel Grechenig & Michael Sekyra, *No Derivative Shareholder Suits in Europe: A Model of Percentage Limits and Collusion*, 31 INT'L REV. L. & ECON. 16, 16 (2011).

[188] Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 199 COLUM. L. REV. (forthcoming 2019) (manuscript at 55) (observing avoidance of lead plaintiff position by "Big Three" index funds).

[189] *Id.*

[190] *See* Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1641 n.51 (2005) (noting arbitration's limits on discovery hinder claimants' access to information); Samuel M. Ward & Michael A. Toomey, *Mandatory Arbitration Does Not Give Stockholders A Choice*, CLS BLUE SKY BLOG (Aug. 28, 2017), http://clsbluesky.law.columbia.edu/2017/08/28/mandatory-arbitration-does-not-give-stockholders-a-choice/ [https://perma.cc/PHT9-7R4T].

[191] *See* Sternlight, *supra* note 190, at 1641 n.51 (noting most arbitration procedures sharply curtail discovery).

[192] *Id.*

[193] *Id.*

would defeat the purpose behind the wave of arbitration provisions.[194] A key purpose in shifting to arbitration, besides eliminating disputes, is limiting the negative publicity from disputes. Confidentiality and privacy are hallmark features in the arbitration procedure.[195] It is therefore hard to imagine companies agreeing to an expansive discovery regime in arbitration.

C. *Section 220 Requests and Whistleblowing*

As noted above, filing section 220 requests and finding inside informants are two important investigatory tools in shareholder litigation.[196] One could claim that we do not need litigation to employ these channels of extracting information. These are *pre*-filing investigatory tools, after all, which would supposedly remain available even if we switch to mandatory arbitration.[197]

The argument that standalone section 220 requests (not in conjunction with litigation) can substitute the informational benefits of litigation is easily refutable. It is inconsistent with the logic of incentives and inconsistent with the law. There is a good reason that section 220 requests are usually filed in conjunction with litigation. A shareholder would be willing to go through the costs and trouble of fighting companies for information only when said shareholder (or, more realistically, a plaintiffs' law firm) anticipates a potential financial bonanza down the road. Shareholder litigation provides the super-charged economic incentives needed to make the fight worth it.

Even if we assume proper incentives for filing standalone section 220 requests,[198] the law makes such requests irrelevant from an information-production standpoint. The courts have conditioned granting section 220 requests on confidentiality.[199] If a shareholder wants to enjoy her rights to inspect the books, she must first agree to not diffuse the information she receives.[200] As a result, the only time when section 220 information escapes confidentiality and becomes available is when the requesting shareholder uses the information in conjunction with court filings, such as the initial complaint or

[194] *Cf.* Lipton, *supra* note 16, at 639 (observing arbitration's informality and lack of formal discovery run counter to litigation's information producing characteristics).

[195] Burch, *supra* note 48, at 117; Webber, *supra* note 12, at 243.

[196] *See supra* Section III.A (describing role of section 220 requests and inside informants).

[197] *Cf.* Rose, *Better Bounty Hunting*, *supra* note 58, at 1289 (claiming that we are better off with incentivizing whistleblowers than counting on securities-fraud class actions to provide information).

[198] Perhaps, for the sake of argument, in a world without class actions, institutional investors would vigorously pursue their individual claims in arbitration and would file section 220 requests to aid their cause.

[199] *See* Radin, *supra* note 123, at 1388 (showing most courts will typically "condition its judgment in Section 220 cases on the entry of a reasonable confidentiality order").

[200] *See id.* at 1389.

as attachments to a motion.[201] In other words, information gleaned from section 220 requests can only affect reputations when it is filed with the court.

The argument that standalone whistleblowing would replace litigation's informational benefits is harder to refute. There is no law prohibiting the release of information coming from whistleblowers outside litigation, and the incentives problem has supposedly been addressed in the Dodd-Frank Act.[202] Still, there exist ample indications that without litigation, the whistle-blowing would not make an impact. Litigation adds value to the information revealed by amplifying, certifying, and diffusing whistleblowers' claims. To illustrate, consider *Freund v. Lucent Technologies, Inc.*,[203] where plaintiffs submitted a section 220 request for all the materials that were filed in a whistleblowing action (brought by a former senior official who had been fired in retaliation).[204] While the initial whistleblowing did not reverberate publicly, the *Lucent* litigation made the whistleblower's information more salient and coverable by the media.[205]

As the *Lucent* example illustrates, without litigation, such whistleblowing would be akin to a tree falling in the forest where no one is around—did it really make a sound? With litigation, the whistle gets widely echoed by the press.

V. IMPLICATIONS

This Article argues that litigation provides helpful information on corporate behavior to investors and the general public. Recognizing the informational role of litigation generates important policy implications. In particular, it puts a thumb on the scales against enforcing mandatory arbitration for shareholder claims. If policymakers and courts nevertheless decide to enforce arbitration provisions, we need to design arbitration procedures that allow more information to come out from arbitration. Section V.A elaborates.

Recognizing the informational role of litigation also generates broader implications beyond the mandatory arbitration point. Generally speaking, the desirability of legal institutions should be evaluated (also) according to how they contribute to the quantity and quality of information flows. Section V.B broadens our scope by evaluating the desirability of recent Delaware doctrinal developments such as *Corwin*, *Trulia*, and *Lavin*.[206]

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[201] *See id.* at 1643.

[202] Dodd-Frank Wall Street Reform and Consumer Protection Act § 922, 15 U.S.C. § 78u-6 (2012) (amending § 21F of the Securities Exchange Act of 1934).

[203] No. 18893, 2003 WL 139766 (Del. Ch. Jan. 9, 2003).

[204] *Id.* at *1-2; Radin, *supra* note 118, at 1352.

[205] *See, e.g.*, Carol J. Loomis, *The Whistleblower and the CEO*, FORTUNE (July 7, 2003), http://archive.fortune.com/magazines/fortune/fortune_archive/2003/07/07/345538/index.htm [https://perma.cc/F4S7-2SEG] (detailing alleged fraud brought to light by litigation).

[206] *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 308 (Del. 2015); Lavin v. West Corp., No. 0217-0547-JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017); *In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884 (Del. Ch. 2016).

A. *The Case Against Arbitration (or for a More Informative Arbitration Procedure)*

Before we jump into policy proposals, let me be careful not to overstate my claim. There are two important qualifications. First, any evidence for the informational benefits of litigation is more qualitative in nature. We know that reputation matters, we know that media scrutiny matters, and we know that litigation matters to media scrutiny and reputation. But we have not yet quantified how much exactly it matters: What is the size of these informational benefits of litigation? Second and relatedly, even if one is convinced that the size of the informational benefits is significant, one still needs to weigh them against the significant costs of litigation.[207] After all, our aim is not to maximize production of information, but rather to optimize it. Perhaps the tradeoff that mandatory arbitration offers—less informational benefits with less administrative costs—is worth it from a societal perspective. Against this background, this Section describes what we can and cannot say regarding policy implications.

First and most basically, the information-production argument puts a thumb on the scales against mandatory arbitration. A thumb on the scales and not a decisive vote, because we only have suggestive evidence. But what we have is enough to caution against replacing litigation with arbitration without first gaining better evidence and a better understanding of the positive externalities of litigation. Securities markets are fraught with asymmetric information and super-charged incentives to cheat. Reputational deterrence is important to their proper functioning.[208] And litigation seems to be important to the proper functioning of reputational deterrence. The direct costs of litigation are well-researched and salient to us, while the costs of reputational *under*-deterrence are not. If one has to conjecture, I would surmise that the latter far outweigh the former.[209]

If courts and regulators nevertheless allow companies to adopt arbitration provisions, the second set of policy implications comes in: providing insight into how we would want such arbitration to look. Ideally, in the area of corporate and securities laws we would want arbitration that injects some valuable information into the market. Is there a way to get the cost-saving aspects of arbitration without losing the information-extracting benefits of litigation?

At a minimum, we would want an accessible database of disputes with "explained awards"—arbitrators should include a short summary of who did

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[207] *See* Amanda M. Rose, *The Shifting* Raison D'Etre *of the Rule 10b-5 Private Right of Action*, *in* RESEARCH HANDBOOK ON REPRESENTATIVE SHAREHOLDER LITIGATION, *supra* note 57, at 39, 52.

[208] *See generally* MACEY, *supra* note 60.

[209] *See* Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 713 (1996) (asserting costs of fraud outweigh costs of litigation).

what to whom, when, and why that is a bad thing. The requirement of explained awards should come from, and be monitored by, the SEC or another regulator. Leaving things to the market will simply not work, as the experience with the Financial Industry Regulatory Authority ("FINRA") arbitration forum shows. For over a decade now, FINRA has used a rule that requires explained awards only upon joint requests from both parties.[210] This opt-in mechanism produced "very, very few" actual explained awards.[211] A better design would be to mandate explained awards, or at least set the default differently, so that the parties can opt out of explained awards only upon joint request.

To emphasize: even if arbitration proceeds with a searchable database of disputes and explained awards, it would probably produce much less law-as-source benefits compared to litigation. Most of the impact that law enforcement has on media coverage comes not so much from the outcomes of disputes, but rather from documents that were produced in earlier stages of the process (discovery, depositions, and so on).[212] Arbitration entails much less information-extracting[213] and would surely be less useful to third parties trying to figure out what and how things happened.

B. *Beyond the Arbitration Debate: How to Facilitate Better Information Flows*

1. Shareholder Litigation

Regardless of where one stands on mandatory arbitration, recognizing the informational role of litigation allows us to reevaluate many other legal institutions according to how they contribute to information production.

Take for example the never-ending reforms to securities litigation. Legal scholars often lump all reforms together as hurdles meant to make plaintiffs' lawyers lives harder. But from an information-production angle, not all hurdles are created equal. Counterintuitively, some of them may be conducive for information production and reputation markets. A big issue for facilitating informational benefits from litigation is how to incentivize plaintiffs' lawyers to add credible information to the mix, instead of merely piggybacking on others' efforts or introducing noise. A reform that limits plaintiffs' lawyers' ability to file and settle complaints solely on the basis of drops in stock prices (or

[210] Barbara Black & Jill Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 17, 18 (2006) (describing FINRA's proposed rule change allowing parties to request an explained award).

[211] Jill Gross, *FINRA Arbitrator Writes Explained Award to Create Precedent*, INDISPUTABLY (June 30, 2017), http://www.indisputably.org/?p=11070 [https://perma.cc/7HES-96WV] (describing difficulty of securing agreement from all parties for explained decisions).

[212] Shapira, *supra* note 28, at 174 n.103 (arguing information gleaned at pretrial stage often serves as key source for reporting by media).

[213] *See supra* Section IV.B.

announcements of mergers) and a few sentences cut-and-pasted from a media piece is therefore desirable. Similarly, heightened pleading standards reduce the incentives to piggyback and push plaintiffs to "spend significant amounts of time and money conducting private investigations of the merits of their claims in order to uncover any nonpublic information."[214] At the same time, there is a tradeoff: setting the bar too high risks losing the informational value from meritorious cases that could have generated valuable information had they reached discovery.

Similarly, Delaware's 2016 *Trulia* decision, which signaled the end of rubberstamping disclosure-only settlements is actually good for information production.[215] Such settlements usually come in deal litigation, before the transaction-in-question closes, and without much pre-discovery investigative efforts or adversarial back-and-forth in litigation.[216] Unsurprisingly, evidence suggests that the disclosure afforded in such settlements is of little value.[217] From this angle, there is no justification to reward plaintiffs' lawyers who do not help the market better understand what and how things happened.

The analysis becomes murkier when factoring another recent Delaware landmark decision—2015's *Corwin*. *Corwin* maintains that the deferential business judgment standard of review applies where a "transaction not subject to the entire fairness standard of review is approved by a fully informed, uncoerced majority of the disinterested stockholders."[218]

For a while it seemed like *Corwin* (together with *Trulia* and *C&J Energy Services, Inc. v. Miami General Employees*)[219] would severely curtail plaintiffs' ability and incentives to reach discovery and produce valuable information on corporate behavior.[220]

However, more recent developments of Delaware doctrine have seemingly reversed the trend and restored balance. Plaintiffs' lawyers reacted to *Corwin* by

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[214] *See* Cox & Thomas, *supra* note 45, at 186.

[215] *See In re* Trulia, Inc. Stockholder Litig., 129 A.3d 884, 904 (Del. Ch. 2016).

[216] *See* Friedlander, *supra* note 157, at 631.

[217] *See* Jill E. Fisch, Sean Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557, 563-68 (2015); Webber, *supra* note 12, at 228.

[218] Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

[219] 107 A.3d 1049 (Del. 2014).

[220] Following *Corwin*, plaintiffs (1) have less chances of surviving the motion to dismiss and reaching discovery; and (2) *do not want* to ask for expedited discovery, because even if they find a smoking gun, the defendant companies can simply publish supplemental disclosure, leaving plaintiffs' lawyers with nothing. *See* Friedlander, *supra* note 120, at 4. While *Corwin* limits plaintiffs' chances of reaching discovery post-closing, *Trulia* and *C&J Energy* limit plaintiffs' chances of reaching discovery pre-closing. *In re Trulia Inc.*, 129 A.3d at 891-97; *C&J Energy Services, Inc.*, 107 A.3d at 1067-73.

concentrating efforts on making section 220 demands.[221] Delaware's 2017 *Lavin* ruling facilitated this alternative channel of information production, by stating that a *Corwin* defense (that is, an informed shareholder vote) does not absolve the company from having to produce documents in section 220 demands.[222] Then, the 2019 *KT4 Partners LLC v. Palantir Technologies, Inc.*[223] ruling further boosted the chances of information production, by broadening the scope of inside information that should be provided under section 220 demands.[224] The court clarified that companies may have to produce internal emails and other forms of electronic communication, which plaintiffs can then use not only to defeat a *Corwin* defense (showing that the vote was coerced or uninformed) but also to establish breach of fiduciary duty claims.[225] In the past year alone there have been several vivid examples for plaintiffs succesfully obtaining relevant, damning information through the section 220 channel.[226] From this vantage point, Delaware's recent doctrinal developments seem to have struck the right balance between deference to business judgements and ability to extract information on probematic behavior.

There is a broader point here about striking a delicate balance between incentivizing lawyers to work hard to produce meaningful information and not making it too hard so that, even if they want to produce information, they simply do not have the tools to do so. To simplify a bit, the key to solve the tradeoff is keeping the pleading standards high while allowing liberal usage of pre-filing investigatory tools. Courts should allow liberal usage of section 220 requests to foster meaningful information-production in corporate litigation. They should similarly allow liberal usage of confidential sources in the pleading stage in securities litigation.[227] Any problem with misusage of requests to inspect books or reliance on informants can be exposed and dealt with later, once the suit reaches discovery.

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[221] Another reaction to *Corwin* has been an increase in appraisal claims, where plaintiffs would attempt to use the discovery granted in appraisal proceedings to establish breach of fiduciary duties. But this development has since been somewhat curtailed by Delaware's *DFC Global* and *Dell* decisions, which limited plaintiffs' chances in advancing their appraisal claims. *See* DFC Glob. Corp. v. Muirfield Value Partnership, L.P., 172 A.3d 346, 371 n.131 (Del. 2017); Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd., 177 A.3d 1, 46-47 (Del. 2017).

[222] Lavin v. West Corp., No. 2017-0547, 2017 WL 6728702, at *7 (Del. Ch. Dec. 9, 2017).

[223] No. 281, 2019 WL 347934 (Del. Jan. 29, 2019).

[224] *Id.* at *11.

[225] *Id.* On the desirability of including electronically stored information under the section 220 scope see, for example, Francis G.X. Pileggi, Kevin F. Brady & Jill Agro, *Inspecting Corporate 'Books and Records' in a Digital World: The Role of Electronically Stored Information*, 37 DEL. J. CORP. L. 163 (2012); Friedlander, *supra* note 120.

[226] *See KT4 Partners LLC*, 2019 WL 347934, at *1; Morrison v. Berry, 191 A.3d 268, 273 (Del. 2018); *In re* Tesla Motors Stockholder Litig., No. 12711-VCS, 2018 WL 1560293, at *1-10 (Del. Ch. Mar. 28, 2018).

[227] *See* Kaufman & Wunderlich, *supra* note 138.

2. SEC Enforcement

This Article already evaluated the information-production aspects on SEC enforcement more generally, in Section IV.A above. This Section looks more specifically at two recent changes to SEC policy. First, the SEC has shifted in recent years to more administrative filing: they file their enforcement actions not with courts, but rather with the SEC commission. Of course, there are pros to streamlining the process and cons to eliminating the option to serious outside scrutiny.[228] But from our angle, the most important aspect of the shift is that it allows the SEC to almost always open and settle an enforcement action on the same day. The first time the market learns information about the alleged misbehavior is when the case is announced as closed. And the press release explaining what happened is heavily massaged by the defendant-company's public relations and legal departments.

From an information-production perspective, it would be better to separate the filing from the settling. Think about it as a notice-and-comment period of sorts: the SEC will announce the filing of an enforcement action with a brief explanation of what was found in initial investigations. The media will report on the allegations, and because these allegations are not comingled with the settlement announcements, the market will give them full attention. Perhaps even more information would come out. Then, after a short period, the SEC would be free to negotiate and settle the action.

A second development in SEC policy is the pronounced commitment to demand more admissions in settlements.[229] On paper, the pronounced shift is supposed to be good for reputation markets. Yet early evidence is not promising. Studies document a small uptick in admissions, which does not translate into an uptick in accountability.[230] The SEC requires admissions from small fish, and the admissions given are largely nominal.[231] In fact, there is reason to believe that the new policy may end up making enforcement less informative:

[228] Urska Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J. FORUM 124, 133 (2016).

[229] The change was instituted following Judge Rakoff's vocal criticisms of the SEC settlements practices, which ignited a public backlash. *See* Sec. & Exch. Comm'n v. Citigroup Global Mkts Inc., 827 F. Supp. 2d 328 (S.D.N.Y. 2011), *vacated and remanded*, 752 F.3d 285 (2d Cir. 2014); Sec. & Exch. Comm'n v. Bank of Am. Corp., 653 F. Supp. 2d 507, 509 (S.D.N.Y. 2009); Shapira, *supra* note 50, at 50 & n.188 (providing references for intense media coverage and congressional hearings).

[230] *See* David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution that Wasn't*, 103 IOWA L. REV. 113, 116 (2017) (noting miniscule increase in admissions); Verity Winship & Jennifer K. Robbennolt, *An Empirical Study of Admissions in SEC Settlements*, 60 ARIZ. L. REV. 1, 1 (2018).

[231] *See* Rosenfeld, *supra* note 230, at 150 (arguing SEC largely avoids seeking admissions in cases with potential "collateral consequences").

defendants use as bargaining chips the regulator's need to score admissions. To get admissions, the SEC trades away fewer incriminating disclosures.[232]

CONCLUSION

This Article spotlighted an understudied aspect of shifting from litigation to arbitration: how it would affect market discipline. Litigation, however imperfect, generates a positive externality of public information on corporate behavior. It thus deters misbehavior not just directly, through compensation, but also indirectly, through information and facilitating media scrutiny. Accordingly, even if one assumes that specific victims would fare better under individual arbitration,[233] one has to acknowledge that third parties and the economy as a whole may fare worse, due to less effective reputational deterrence.

[232] Siegel, *supra* note 169, at 454.

[233] This is a highly questionable assumption. *See* Resnik, *supra* note 186, at 2804.