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CONTRACTING AROUND TWOMBLY

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INTRODUCTION

Pleading standards lie at the center of a heated debate. Following the Supreme Court's decisions in *Bell Atlantic Corp. v. Twombly*¹ and *Ashcroft v. Iqbal*,² commentators have advanced two approaches to pleading. One approach is mainly concerned with allowing plaintiffs access to courts and advocates the low threshold requirement of the liberal pleading standard first established by *Conley v. Gibson*³ and applied for over fifty years in the federal courts. The other approach, which is interested in efficiently deterring the filing of frivolous lawsuits, supports the heightened standard that was endorsed by the Supreme Court in *Twombly* and *Iqbal*.⁴ Each approach maintains that its preferred standard would realize better justice in the federal courts. Both are premised on the foundational assumption that the Federal Rules of Civil Procedure (the Rules) are uniform and transsubstantive.⁵

This Article follows a different approach. Instead of joining the debate over the optimal transsubstantive pleading standard, we study the implications of that standard in a well-defined subset of cases—those in which the parties have prior contractual relationships.⁶ We show that if contracting parties are allowed to contract around the pleading standard that would apply to their prospective disputes, they will be able to solve problems of inadequate screening and to realize

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1. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

2. *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009).

3. *Conley v. Gibson*, 355 U.S. 41 (1957).

4. See *infra* notes 39–41 and accompanying text.

5. See generally Stephen B. Burbank, *Pleading and the Dilemmas of "General Rules,"* 2009 Wis. L. REV. 535 (explaining that *Twombly* and *Iqbal* illustrate the limits of and the costs created by transsubstantivity).

6. Between January 2007 and October 2009, an average of 2,806 cases were filed per month. Rule 12 motions to dismiss were filed in 1,780 of those cases. Of these motions, 499 on average were granted. See *Statistical Information on Motions to Dismiss re Twombly/Iqbal*, Administrative Office of the U.S. Courts Statistics Division, available at http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Motions_to_Dismiss_060110.pdf.

both pre- and post-dispute opportunities that would be unworkable otherwise. As we demonstrate, the option to modify the pleading standard would improve justice and efficiency, irrespective of the transsubstantive pleading standard that applies absent contractual modification.

As transsubstantive rules, the Federal Rules of Civil Procedure aim at securing a just, expeditious, and efficient resolution of all civil disputes in the federal courts.⁷ The Rules are designed to satisfy both the need for substantive justice and the need for a workable procedural system, so as to ensure that litigants have their day in court.⁸ The basic assumption that underlies the Rules is that they should apply to every type of case, regardless of its substantive nature or its merits.⁹ The Rules are based on the notions of uniformity and transsubstantivity, which dictate that they should be applied and interpreted in the same manner in all cases, irrespective of the subject matter in dispute.¹⁰

The Rules are designed to achieve efficiency and justice for every type of case. They purport to represent a balanced combination of

7. FED. R. CIV. P. 1 (“[The Rules] should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding.”); see also *Des Isles v. Evans*, 225 F.2d 235, 236 (5th Cir. 1955) (stating that the primary purpose of the Rules is to secure “speedy and inexpensive justice in a uniform and well ordered manner”).

8. See Charles E. Clark, *The Handmaid of Justice*, 23 WASH. U. L.Q. 297, 318–19 (1938).

9. See FED. R. CIV. P. 1 (“These rules govern the procedure in all civil actions and proceedings in the United States district courts, except as stated in Rule 81.”); Paul D. Carrington, *Making Rules to Dispose of Manifestly Unfounded Assertions: An Exorcism of the Bogy of Non-Trans-Substantive Rules of Civil Procedure*, 137 U. PA. L. REV. 2067, 2079 (1988) (“[P]rocedural rules should have general applicability.”); but see Stephen B. Burbank, *The Transformation of American Civil Procedure: The Example of Rule 11*, 137 U. PA. L. REV. 1925, 1934–35 (1988) (arguing that he knows of no support for Carrington’s proposition that by enacting the Federal Rules Enabling Act of 1934 “Congress intended not only that the same Federal Rules be applicable in all federal district courts, but that the same Rules be applicable in all types of cases, that, in other words, the Rules be not only uniform but also trans-substantive”).

10. On the debate about the desirability of transsubstantive rules, see, for example, Jenny S. Martinez, *Process and Substance in the “War on Terror,”* 108 COLUM. L. REV. 1013, 1018 (2008) (arguing that many procedural rules do not seem to be transsubstantive but are “driven by particular substantive concerns”); see also Stephen B. Burbank, *Of Rules and Discretion: The Supreme Court, Federal Rules and Common Law*, 63 NOTRE DAME L. REV. 693, 716–17 (1988) (arguing that procedural rules should be tailored to specific substantive areas); Carrington, *supra* note 9, at 2079–81 (arguing against substantive tailoring of the Rules); Robert M. Cover, *For James Wm. Moore: Some Reflections on a Reading of the Rules*, 84 YALE L.J. 718, 731 (1974) (criticizing the transsubstantive nature of the Rules); Geoffrey C. Hazard, Jr., *Discovery Vices and Trans-Substantive Virtues in the Federal Rules of Civil Procedure*, 137 U. PA. L. REV. 2237, 2245–46 (1989) (claiming that “although the Federal Rules are trans-substantive, they are not trans-procedural”); Stephen N. Subrin, *Fudge Points and Thin Ice in Discovery Reform and the Case for Selective Substance-Specific Procedure*, 46 FLA. L. REV. 27, 48–49, 54–55 (1994) (arguing against a system of general rules uniformly applied and in favor of rules more closely tailored to distinctions among case types).

procedural values that applies uniformly to all cases in the federal courts.¹¹ As such, they are characterized by a compromise between different interests that might stand in conflict with each other.¹²

While the Rules are designed to provide efficiency and justice in the aggregate, these goals might not be realized in every case. When federal courts apply the Rules irrespective of their individual particularities, the Rules might undermine the efficiency or the justice in “outlier” cases—cases that do not match the typical case envisaged by the framers of the Rules. This is a major drawback of transsubstantive uniform rules.¹³

The inability of compromise-based transsubstantive procedural rules to provide efficiency and justice in all types of cases has assumed importance in the debate that followed *Twombly* and *Iqbal*.¹⁴ At the center of the debate stands the question of whether pleading standards should apply to all cases or be case-specific.¹⁵

The pleading standard serves as the gateway to the judicial system.¹⁶ It is embodied in Rule 8, which requires the plaintiff to provide a “short and plain statement of the claim showing that the pleader is entitled to relief.”¹⁷ The Rule, which has been termed the “key-

11. See Stephen B. Burbank, *Procedure, Politics and Power: The Role of Congress*, 79 NOTRE DAME L. REV. 1677, 1731 (2004) (“[R]ulemakers have consistently interpreted to require Federal Rules that both apply in all federal district courts and that apply in all types of civil cases (i.e., are trans-substantive).”).

12. One such compromise is the balance between access to courts and efficiency. On balancing these competing interests see, for example, Lonny S. Hoffman, *Burn up the Chaff with Unquenchable Fire: What Two Doctrinal Intersections Can Teach Us About Judicial Power over Pleadings*, 88 B.U. L. REV. 1217–19 (2008).

13. See Paul David Menair, *Recasting Complaints: An Argument for Procedural Alternatives*, 12 CHAP. L. REV. 333, 354 (2008) (discussing “the pitfalls of trans-substantive procedure’s attempt to capture all of the nuances of civil practice in one conception of the civil action”); but see Robert G. Bone, *The Process of Making Process: Court Rulemaking, Democratic Legitimacy, and Procedural Efficacy*, 87 GEO. L.J. 887, 920–21 (1999) (arguing that different areas of substantive law would be justified only “if procedure varied extensively with substance” and that “redesigning a procedural system for each substantive area would be wasteful”); Burbank, *supra* note 9, at 1929–41 (criticizing proponents of transsubstantivity for relying on judges to “bridge the gap between formal equality and inequality in fact”).

14. See, e.g., Robert G. Bone, *Twombly, Pleading Rules, and the Regulation of Court Access*, 94 IOWA L. REV. 873, 936 (2009) (arguing that case-screening rules should be substance-specific rather than transsubstantive); Paul Stancil, *Balancing the Pleading Equation*, 61 BAYLOR L. REV. 90, 146 (2009) (rejecting a rigidly transsubstantive approach and recommending bifurcating pleading standards along cost-disparity lines).

15. See, e.g., Bone, *supra* note 14, at 936.

16. See *Phillips v. Cnty. of Allegheny*, 515 F.3d 224, 230 (3d Cir. 2008) (“Few issues in civil procedure jurisprudence are more significant than pleading standards, which are the key that opens access to courts.”).

17. FED. R. CIV. P. 8(a)(2).

stone”¹⁸ or the “jewel in the crown”¹⁹ of the procedural system embodied in the Federal Rules, was designed to simplify the pleading system²⁰ and to “focus litigation on the merits of a claim.”²¹ As the starting point of the litigation process, the Rule’s primary objective has traditionally been to put the defendant on notice of the claim asserted against him.²²

When a court is presented with a motion to dismiss a claim pursuant to Rule 12(b)(6), it applies the pleading standard to examine whether the claimant failed “to state a claim upon which relief can be granted.”²³ By setting the threshold requirements that the plaintiff must satisfy in order to have access to discovery and other procedural mechanisms applied throughout litigation, this Rule serves as the gatekeeper to the federal courts.²⁴

For over fifty years, since the Supreme Court’s decision in *Conley*, courts have interpreted the threshold requirement of the pleading standard liberally,²⁵ asserting that “a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”²⁶ The rationale behind the liberal con-

18. CHARLES ALAN WRIGHT & MARY KAY KANE, *LAW OF FEDERAL COURTS* § 68, at 470 (6th ed. 2002) (“The keystone of the system of procedure embodied in the rules is Rule 8.”).

19. Patricia M. Wald, *Summary Judgment at Sixty*, 76 TEX. L. REV. 1897, 1917 (1998).

20. The drafters of the Federal Rules did not want to follow the common law and code pleading regime. See generally Stancil, *supra* note 14, at 90.

21. *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 514 (2002).

22. At common law, pleadings served not only notice, but also “factual development, winning issues, and disposing of sham claims.” Christopher M. Fairman, *The Myth of Notice Pleading*, 45 ARIZ. L. REV. 987, 990 n.17 (2003) (citing WRIGHT & KANE, *supra* note 18).

23. FED. R. CIV. P. 12(b)(6).

24. For exceptions to the Rule, see FED. R. CIV. P. 9(b), which requires that “a party must state with particularity the circumstances constituting fraud or mistake.” See also Private Securities Litigation Reform Act (PSLRA) of 1995, 15 U.S.C. § 78u-4(b)(2) (2006); Richard L. Marcus, *The Revival of Fact Pleading Under the Federal Rules of Civil Procedure*, 86 COLUM. L. REV. 433, 435 (1986) (claiming, long before *Twombly*, that “[n]ot only has pleading practice survived, but fact pleading, the bête noir of the codes, seems to be enjoying a revival in a number of areas in which courts refuse to accept ‘conclusory’ allegations as sufficient under the Federal Rules”).

25. *Swierkiewicz*, 534 U.S. at 514 (“Given the Federal Rules’ simplified standard of pleading, [a] court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations.”) (quoting *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984) (alteration in original)). See, e.g., *Leatherman v. Tarrant Cnty. Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) (discussing the “liberal system of ‘notice pleading’ set up by the Federal rules”).

26. *Conley v. Gibson*, 355 U.S. 41, 45–46 (1957). But see Christopher Fairman, *Heightened Pleading*, 81 TEX. L. REV. 551, 553–54 (2002), which claims that despite the Supreme Court’s decision in *Conley*, federal courts have adopted heightened pleading standards in a variety of situations, such as civil rights, conspiracy, defamation, and antitrust and asserting that

[w]hole categories of cases have been singled out for special procedural treatment, thereby limiting the substantive rights of certain plaintiffs. Erecting these procedural

struction of the pleading standard was to preserve the plaintiff's ability to get her day in court and to uphold the principle that "the purpose of pleading is to facilitate a proper decision on the merits."²⁷ The application of a liberal pleading standard ensured that the notice was sufficient to prevent surprise from the defendant²⁸ and relied on summary judgment to bar frivolous claims from reaching trial.²⁹ Under the liberal pleading standard, most complaints passed the pleading threshold.³⁰

The recent decisions in *Twombly* and *Iqbal* have endorsed a new paradigm. *Twombly* dismissed an antitrust class action for alleged parallel conduct unfavorable to competition.³¹ The Court repudiated *Conley's* liberal "no set of facts" pleading standard and ordered the dismissal of the case.³² It stated that the pleading standard requires the plaintiff to allege facts that suggest "plausible grounds"³³ for the existence of the alleged misconduct and stressed that the complaint must include factual allegations sufficient "to raise a right to relief above the speculative level."³⁴ Following this standard, a plaintiff may no longer state a general description of her claim and await pretrial discovery to reveal the necessary evidence to support her allegations. Stating a claim "requires more than labels and conclusions, and a for-

hurdles creates classes of disfavored cases and denies plaintiffs determination on the merits—a substantive effect masked as procedural. In the process, the transsubstantive nature of the rules is eroded; the procedure of procedure is ignored.

27. *Conley*, 355 U.S. at 48.

28. See *Swierkiewicz*, 534 U.S. at 512; *Tang v. New York*, 487 F.2d 138, 145 (2d Cir. 1973) (noting that the aim of Rule 8 is to "prevent surprise").

29. See, e.g., Kendall W. Hannon, *Much Ado About Twombly? A Study on the Impact of Bell Atlantic Corp. v. Twombly on 12(b)(6) Motions*, 83 NOTRE DAME L. REV. 1811, 1820 (2008) ("[T]he Supreme Court throughout the latter half of the twentieth century largely embraced a liberal pleading standard and allowed a case to proceed so long as the adversary had 'fair notice' of the claim. Policy considerations and concerns regarding unmeritorious claims were, under this regime, properly addressed at the discovery and summary judgment stage.").

30. See, e.g., Scott Dodson, *Comparative Convergences in Pleading Standards*, 158 U. PA. L. REV. 441, 451–52 (2010) ("Despite these lower court attempts to impose heightened pleading standards after *Conley*, the Supreme Court consistently rebuffed them."); Fairman, *supra* note 22, at 997 ("[W]hen called upon to address pleading issues square on, the Court continually—and unanimously—embraces simplified notice pleading.").

31. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 549 (2007).

32. A defendant who claims that a pleading motion fails to pass the pleading threshold may file a motion to dismiss under Rule 12(b)(6). The court faced with such motion does not hear any challenge to the merits of the case, but rather accepts the allegations in the claim as true and grants the plaintiff the benefit of all inferences that can be derived from the facts pled. See *Browning v. Clinton*, 292 F.3d 235, 242 (D.C. Cir. 2002) ("At the Rule 12(b)(6) stage, 'we do not assess the truth of what is asserted or determin[e] whether a plaintiff has any evidence to back up what is in the complaint.'" (quoting *ACLU Found. of S. Cal. v. Barr*, 952 F.2d 457, 467 (D.C. Cir. 1991))).

33. *Twombly*, 550 U.S. at 556.

34. *Id.* at 555.

mulaic recitation of the elements of a cause of action will not suffice.”³⁵ Relying on the pitfalls of costly discovery, the Court stated that because “the threat of discovery expense will push cost-conscious defendants to settle even anemic cases,” it is necessary that the pleading standard will remove those cases which have not founded the hope that discovery will reveal relevant evidence to support the claim.³⁶

Some commentators hoped that the *Twombly* pleading standard would be confined to antitrust cases.³⁷ However, this hope was unfulfilled in *Iqbal*, which asserted that the heightened pleading standard applies transsubstantively to all civil actions, irrespective of their particularities.³⁸ Thus, the debate over the aggregate implications of the *Twombly* pleading standard has intensified after *Iqbal*. Some commentators argue that the decisions are not revolutionary but rather are consistent with the Supreme Court’s prior notice pleading approach,³⁹ while others defend the decisions as setting the correct pleading standard.⁴⁰ But the vast majority of commentators have strongly criticized *Twombly*’s standard for radically departing from prior policy and its devastating consequences on plaintiffs’ access to the courts.⁴¹

35. *Id.*

36. *Id.* at 559.

37. Some commentators originally suggested that *Twombly* does not speak about procedural law, but rather about antitrust law. See generally Keith Bradley, *Pleading Standards Should Not Change After Bell Atlantic v. Twombly*, 102 Nw. U. L. REV. 117 (2007); but see Richard A. Epstein, *Bell Atlantic v. Twombly: How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 WASH. U. J.L. & POL’Y 61, 64 (2007) (arguing that “[t]here is no reason to confine the logic of [*Twombly*’s] decision to antitrust cases”).

38. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (2009).

39. See, e.g., Edward A. Hartnett, *Taming Twombly, Even After Iqbal*, 158 U. PA. L. REV. 473, 474 (2010) (arguing that the *Twombly* standard “can be understood as equivalent to the traditional insistence that a factual inference be reasonable”); Adam N. Steinman, *The Pleading Problem*, 62 STAN. L. REV. 1293, 1298 (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1442786 (challenging “the conventional wisdom that *Iqbal* and *Twombly* run roughshod over a half-century’s worth of accumulated wisdom on pleading standards”).

40. See, e.g., Douglas G. Smith, *The Twombly Revolution?*, 36 PEPP. L. REV. 1063, 1067 (2009) (“*Twombly* thus presents a welcome clarification of modern pleading standards that is likely to increase the efficiency and fairness of modern civil practice.”).

41. See, e.g., Bone, *supra* note 14, at 875 (“Many judges and academic commentators read the decision as overturning fifty years of generous notice pleading practice.”); Scott Dodson, *Pleading Standards After Bell Atlantic Corp. v. Twombly*, 93 VA. L. REV. 135, 138 (2007) (“Clearly, Conley’s ‘no set of facts’ language is dead.”); Brian Thomas Fitzsimons, *The Injustice of Notice & Heightened Pleading Standards for Antitrust Conspiracy Claims: It Is Time to Balance the Scale for Plaintiffs, Defendants, and Society*, 39 RUTGERS L.J. 199, 201 (2007) (suggesting that the Supreme Court’s decision in *Twombly* should be set aside); Hoffman, *supra* note 12, at 1261 (criticizing *Twombly* for ignoring “information asymmetries”); Randy Picker, *Twombly, Leegin, and the Reshaping of Antitrust*, 2007 SUP. CT. REV. 161, 177 (“*Twombly* shrinks the domain of private plaintiffs”); A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431, 432, 437 (2008) (arguing that *Twombly* is “quite at odds with the Court’s position heretofore” and a

Unlike the vast recent scholarship on pleading standards, we do not take sides in the debate over which is the most just, fair, and efficient transsubstantive pleading standard. Instead, we focus on a subset of disputes in which litigants had prior contractual relationships. Our premise is that whichever standard is more adequate in the aggregate, there are cases in which its application might frustrate the goals that it purports to achieve. The application of the *Twombly* standard might bar suits from reaching the courts, even if they should be heard. Conversely, the pre-*Twombly* standard might allow claims in court, even if they should have been barred.

Focusing on the *Twombly* standard, we argue that some instances in which the application of the standard would perform inadequate screening can be remedied.⁴² We explain that parties who have a contractual relationship prior to the dispute can overcome this inadequacy by agreeing at the contracting stage to opt for the pre-*Twombly* standard.⁴³ We show that in some cases a contractual stipulation for this standard would not only serve as a better screening mechanism of suits, but it would also increase the contracting parties' joint surplus in three ways: (1) by eliminating strategic opportunistic behavior, (2) by affecting the incentives of the parties to comply with their contractual obligations and the substantive rules applicable to their legal relationship, and (3) by enabling parties to signal information that would otherwise be unavailable to their counterparts.⁴⁴

Hence, we propose a novel approach for addressing the question of whether the *Twombly* standard performs better than its predecessor in contract cases. We suggest that the answer to this question should be informed by analyzing the costs of modifying the *Twombly* standard and the difficulties in implementing such modification, in addition to evaluating the proportion of cases in which the standard would have been chosen by contracting parties. As we show, even if in the aggregate the *Twombly* pleading standard would have been chosen less often, it may still promise improved efficiency and justice in contract cases due to its lower modification costs.

"break from the Court's previous embrace of notice pleading" and that requiring plaintiffs to offer factual allegations that plausibly suggest liability is a particular burden when key facts are likely obtainable only through discovery); Adam N. Steinman, *What Is the Erie Doctrine? (And What Does It Mean for the Contemporary Politics of Judicial Federalism?)*, 84 NOTRE DAME L. REV. 245, 278 (2008) (arguing that *Twombly* represents "a substantial change to the pleading standard that had traditionally applied in federal court"); *Leading Cases-Federal Jurisdiction and Procedure*, 121 HARV. L. REV. 305, 309 (2007) ("The majority's view runs counter to the text of the Rules, Supreme Court precedent, and the historical purpose of notice pleading.").

42. See *infra* notes 53–64 and accompanying text.

43. See *infra* notes 77–94 and accompanying text.

44. See *infra* notes 77–94 and accompanying text.

The Article proceeds as follows. Part II identifies the circumstances in which the *Twombly* standard would induce inadequate screening and discusses the implications of any such inadequacies on the parties' pre-dispute behavior.⁴⁵ This Part also explains why the *Twombly* standard cannot be modified by the litigants after the dispute arises. Part III features the advantages of pre-dispute modifications of the *Twombly* standard.⁴⁶ It examines how such modifications can correct screening inadequacies, maximize the parties' joint contractual surplus, and allow them to signal their private information and choose prospective counterparts based on their private information at the time of contracting. Part IV explains the alternative ways for contractually modifying the *Twombly* standard.⁴⁷ It examines the costs of such modifications and concludes that because the modification of the *Twombly* standard is more feasible and less costly to implement than the modification of the pre-*Twombly* standard, it may prove better in contract cases.

II. SCREENING UNDER THE TWOMBLY PLEADING STANDARD

Access to the courts is not without its limits.⁴⁸ Screening mechanisms enable the courts to draw the line between suits that should proceed to trial on their merits and those that should be barred from being pursued. As a matter of fairness and efficiency, such mechanisms aim at striking a balance between the claimant's interest in having her day in court and the defendant's interest in avoiding the harassment of meritless suits.⁴⁹ Screening mechanisms purport to enable access to justice for claimants while protecting defendants and the judicial system from undue costs and burdens.⁵⁰

The following screening mechanisms are available at the pretrial stage: (1) the Rule 11 requirement that attorneys certify the propriety of any pleadings, motions, and other papers they sign; (2) Rule 12(b)(6) dismissal for failure to state a claim upon which relief can be

45. See *infra* notes 48–75 and accompanying text.

46. See *infra* notes 76–94 and accompanying text.

47. See *infra* notes 95–108 and accompanying text.

48. See Frank I. Michelman, *The Supreme Court and Litigation Access Fees: The Right to Protect One's Rights—Part 1*, 1973 DUKE L.J. 1153, 1169.

49. Bone, *supra* note 14, at 909 (“[A] procedural system must balance two moral rights: the defendant’s right to be free from intentionally filed meritless suits and the plaintiff’s right of access to file a meritorious suit.”); Hoffman, *supra* note 12, at 1218 (claiming that the judicial system should be “open to claimants, but if the doors of justice are opened too wide, then means are needed for intercepting those cases that, in hindsight, ought not to have been welcomed in the first place”).

50. See ROBERT G. BONE, *THE ECONOMICS OF CIVIL PROCEDURE* (2003) 125–49 (analyzing the error and process costs of pleading rules).

granted; (3) Rule 16, which allows the court to eliminate frivolous claims; and (4) the Rule 56 summary judgment motion. The purpose of each of these mechanisms is to distinguish between meritorious suits that should be heard and frivolous suits that are filed by opportunistic claimants attempting to extract nuisance settlements from defendants. Of these mechanisms, the pleading standard set by Rule 8 and examined on a Rule 12(b)(6) motion to dismiss induces the earliest screening by the court in its pre-discovery capacity. If Rule 12(b)(6) is adequately applied, it has the potential to screen out frivolous suits most effectively.⁵¹

Like the underlying notion of any procedural rule, the basic premise of the pleading standard is to balance the interests of the adversarial litigants by ensuring fairness and efficiency in the resolution of their dispute.⁵² However, as the standard is transsubstantive and applies uniformly to all types of civil suits regardless of their specific characteristics or merit, there may be instances in which it would prove inadequate by frustrating the fragile balance between the litigants' interests.

Because the pleading standard serves as the gatekeeper to the federal courts and is applied prior to discovery, a court's decision following a 12(b)(6) motion to dismiss a claim for failing to comply with its requirements could have severe implications for a claimant who wishes to have her day in court. Similarly, a court's rejection of a motion to dismiss may have adverse consequences over a defendant who would then have to incur the high costs of discovery before he could move for summary judgment. Thus, while in many instances a pleading standard may effectively screen cases, there are other instances in which its application might fail to do so. In the remainder of this Article, we explain these inadequacies, discussing their effects

51. Rule 12(b)(6) has been termed "the most promising new tool" in the regulation of cases at the pleading stage. Hoffman, *supra* note 12, at 1221; *see also* Spencer, *supra* note 41, at 486 (claiming that the *Twombly* Court rejected the other mechanisms as ineffective and "turn[ed] the entire system on its head by transforming the 12(b)(6) motion to dismiss into the front-end gatekeeper against groundless claims").

52. *See, e.g.*, 1 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 1.21(1)(a) (3d ed. 2010) ("The application of orderly rules of procedure does not require the sacrifice of fundamental justice, but rather the Rules must be construed to promote justice for both parties, not to defeat it. This mandate is met if substantial justice is accomplished between the parties."); *see also* Bone, *supra* note 14, at 908 ("[P]laintiff's right to access must be balanced against defendant's right to reasons."); Carrington, *supra* note 9, at 2074 ("Procedure rules that are, or are even seen to be, designed to favor one set of litigants produce outcomes that are less acceptable to their adversaries. In the larger and most traditional senses of the phrase, Equal Protection of the Law requires a 'level playing field' in legal dispute resolution."); Fairman, *supra* note 22, at 990 ("[T]he Federal Rules are essentially a reform effort designed to ensure litigants have their day in court.").

on pre-dispute behavior and the inability to correct them through post-dispute stipulations.

A. *Inadequate Screening: The Asymmetric Information Barrier*

The *Twombly* pleading standard demands greater factual specificity from the plaintiff than its predecessor. While, according to the pre-*Twombly* standard, a plaintiff's complaint "should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief,"⁵³ the new standard requires the plaintiff to allege facts which render the claim "plausible"⁵⁴ and sufficient to "raise a right to relief above the speculative level."⁵⁵

When the plaintiff possesses the information necessary to assert the facts to meet the burden of the "plausibility" threshold, the *Twombly* standard is adequate.⁵⁶ The plaintiff would have no trouble in presenting sufficient evidence to support her assertions that she is entitled to relief. The balance between the opposing interests of the litigants would therefore be properly maintained.

The *Twombly* standard is also effective in weeding out meritless claims. A strategic plaintiff who files a frivolous suit hoping to extract a nuisance settlement from the defendant would be barred from pursuing it to the discovery stage under *Twombly*. The claimant's obligation to provide facts in support of her allegations enables the court to curtail abusive and opportunistic behavior by dismissing any unsubstantiated frivolous claim at an early pretrial stage. Because the plaintiff who files a frivolous suit would not be able to produce the facts supporting her allegation at the filing stage, the dismissal of her claim would protect the defendant from extensive discovery and high costs. Thus, the *Twombly* pleading standard efficiently screens out frivolous suits.

The situation is different when the plaintiff has a meritorious claim but does not possess the necessary facts to pass the *Twombly* threshold.⁵⁷ This situation is characterized by "information asymmetry" at

53. *Conley v. Gibson*, 355 U.S. 41, 45–46 (1957).

54. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

55. *Id.* at 555.

56. *Bone*, *supra* note 14, at 909 ("[S]tricter pleading treats plaintiffs who do not have access to information less favorably than plaintiffs who do have access.").

57. *See, e.g.*, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 327 n.9 (2007) ("Any heightened pleading rule . . . could have the effect of preventing a plaintiff from getting discovery on a claim that might have gone to a jury, had discovery occurred and yielded substantial evidence."); *Bone*, *supra* note 14, at 884 ("[E]nhancing the pleading burden risks screening meritorious suits."); *Spencer*, *supra* note 41, at 488 (stressing that by imposing the *Twombly* standard,

the pre-filing stage.⁵⁸ It is often the case that a defendant has exclusive access to relevant information and evidence critical to the claim.⁵⁹ When the information is in the defendant's sole custody, the plaintiff will not be able to assert facts that she cannot know prior to discovery.⁶⁰ In this case, the *Twombly* standard might bar the plaintiff from pursuing her claim in court, even if it has merit.⁶¹ Thus, when the information needed is privately held by the defendant, and the plaintiff cannot access it with reasonable investigation, the *Twombly* standard may result in the dismissal of claims that should have proceeded to discovery.⁶²

We do not claim that the *Twombly* standard is always inferior to its predecessor. We only make the point that it might perform inadequate screening under certain circumstances. Under the pre-*Twombly* standard, a plaintiff with a meritorious claim who did not possess the relevant facts to substantiate her allegation would not be barred from engaging in discovery to uncover the necessary evidence.⁶³ The standard relied on liberal discovery rules and summary judgment motions to screen out frivolous claims. Thus, if the claim had merit, the claimant could reveal the facts needed to support her allegations, and the case would proceed to trial.

Nevertheless, in the cases where the *Twombly* standard would perform proper screening, the pre-*Twombly* standard failed to do so. When the defendant did not hold any private information, the liberal pleading standard allowed the plaintiff to proceed with a lawsuit and

the Court makes it possible "that valid claims that could have found support through discovery never make it into the system").

58. See, e.g., Matthew A. Josephson, Note, *Some Things Are Better Left Said: Pleading Practice After Bell Atlantic Corp. v. Twombly*, 42 GA. L. REV. 867, 894 (2008) ("Plaintiffs often face the problem of not being able to access concrete evidence at the pleading stage because the information concerning a particular controversy is accessible to only one party, usually the defendant.").

59. Picker, *supra* note 41, at 164 ("Plaintiffs will often have much less information about possible liability than defendants.").

60. See, e.g., Spencer, *supra* note 41, at 481 (claiming that "plausibility pleading rejects potentially valid, meritorious claims" and that under this standard there is no confidence that a claim that was dismissed was frivolous or not).

61. See Hoffman, *supra* note 12, at 1256.

62. During the pre-*Twombly* era, a plaintiff could state her allegations "upon information and belief" when she did not possess the information necessary to assert her allegations. See, e.g., Hartnett, *supra* note 39, at 503. This was also the case in *Twombly*. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1951 (2009) (quoting ¶ 96 of the complaint). This traditional formulation solved the problem of information asymmetry. However, under the *Twombly* regime, it seems that such a formulation would not suffice to cross the heightened pleading standard. See Hartnett, *supra* note 39, at 505 (suggesting that "the phrase 'upon information and belief' . . . should be retired").

63. Spencer, *supra* note 41, at 482 (arguing that a liberal pleading standard is appropriate in instances where the plaintiff does not possess the information needed to assert her allegations).

extract a positive settlement from the defendant, even if she knew it was frivolous.⁶⁴ In those cases, the *Twombly* standard would prove better.

B. The Pre-Dispute Implications of Inadequate Screening

Like the implications of any procedural rule, those of Rules 8 and 12(b)(6) are not limited to the post-dispute filing stage. They are also relevant before the dispute.

Procedural rules direct and shape the parties' behavior during litigation, as well as before a dispute arises or a suit is filed.⁶⁵ Because the parties expect any future dispute to be litigated according to the Federal Rules, these Rules affect the probable outcome that litigation would shape the parties' pre-dispute behavior. They affect the parties' incentives to comply with substantive law as well as the parties' willingness to engage in a dispute, to bring a suit, to invest in the litigation, or to consider the possibility of a settlement.⁶⁶

Similarly, any screening mechanism may incentivize the parties' behavior before and after a dispute arises. As a procedural device, a screening mechanism would affect the parties' decisions whether to comply with substantive law and, if a dispute arises, whether to engage in litigation or settle.

As we explained, the application of the *Twombly* pleading standard as a screening mechanism might be inappropriate in cases of post-dispute information asymmetry—cases in which a plaintiff with a meritorious claim lacks the factual assertions necessary to pass the pleading threshold because such information is privately held by the defendant. In these cases, a prospective defendant who knows that he will have exclusive possession of the relevant information and that the claimant will not have access to this information prior to discovery might reduce his level of care and have weaker incentives to satisfy his legal

64. For an economic analysis of the plaintiff's opportunity to extract a positive settlement based on the defendant's discovery costs, see David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3 (1985); Stancil, *supra* note 20, at 92; Lucian A. Bebchuk & Alon Klement, *Negative-Expected-Value Suits* (Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 656, 2009).

65. See LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* 272–73 (2002); STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* 392–401 (2004); Steven Shavell, *The Level of Litigation: Private Versus Social Optimality of Suit and of Settlement*, 19 INT'L REV. L. & ECON. 99, 100–01 (1999).

66. The analysis of procedural rules from an *ex ante* perspective was first advocated in Bruce L. Hay, *Procedural Justice—Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803 (1997). For a more critical approach, see generally Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485 (2003); Lawrence B. Solum, *Procedural Justice*, 78 S. CAL. L. REV. 181 (2004).

duties because he knows that any suit brought against him is likely to be dismissed prior to discovery. Thus, the *Twombly* standard might dilute the defendant's incentives to comply with substantive law.

Take, for example, a medical negligence case. A prospective defendant who knows that he will have sole knowledge and control of the evidence about his level of care prior to the dispute will abstain from exercising care because a prospective claimant will not be able to pursue a claim against him without obtaining the necessary information through discovery. Exercising care is costly, and because the expected sanction for not exercising care is low due to the high probability of early dismissal, a prospective defendant would prefer not to exercise due care.

Again, the pre-*Twombly* pleading standard might have adverse pre-dispute implications. In the medical negligence example, under the pre-*Twombly* standard, prospective defendants might expect opportunistic claimants to file suits irrespective of the merits of their claims. Because defendants would have to incur the high costs of discovery before being able to move for summary judgment, this would raise the cost of medical services and lower incentives for exercising proper care.⁶⁷ Thus, in cases of expected information symmetry after the dispute, the pre-*Twombly* standard had its unique pre-dispute inefficiencies. Such inefficiencies are corrected by the stricter *Twombly* standard.

C. Correcting Screening Inadequacies: The Zero-Sum Problem

The Federal Rules of Civil Procedure feature a flexible approach that allows litigants to agree to procedural stipulations.⁶⁸ For example, litigants may consent to waive the right to a jury trial,⁶⁹ to agree on the extent of discovery proceedings⁷⁰ or to the taking of depositions,⁷¹ or consent to forgo their right to appeal.⁷² Litigants would agree to make such stipulations if the stipulations would reduce their litigation expenditures, lower their risks, and not adversely affect the

67. For an analysis of the effect of inaccuracy of judgments on activity levels and incentives to take care, see generally Louis Kaplow & Steven Shavell, *Accuracy in the Assessment of Damages*, 39 J.L. & ECON. 191 (1996); Louis Kaplow & Steven Shavell, *Accuracy in the Determination of Liability*, 37 J.L. & ECON. 1 (1994); Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307 (1994).

68. See STEPHEN C. YEAZELL, *CIVIL PROCEDURE* 138 (7th ed. 2008) ("One of the hallmarks of the U.S. law is the extent to which the rules of procedure are 'default' rules, rules that govern if the parties have not agreed to something else.").

69. FED. R. CIV. P. 39(a)(1).

70. FED. R. CIV. P. 29; see also Jay E. Grenig, *Stipulations Regarding Discovery Procedure*, 21 AM. J. TRIAL ADVOC. 547-48 (1998).

71. FED. R. CIV. P. 29(a).

expected outcome of the litigation.⁷³ Thus, by customizing their litigation procedures to fit their specific needs, adversaries can improve the efficiency and justice of their individual lawsuits.⁷⁴

Litigants will agree to make procedural stipulations if such arrangements are well-suited to their interests. However, when their interests are diametrically opposed—that is, when the arrangement benefits only one litigant and undermines the interests of her adversary—the litigants will not agree. This situation is characterized by the paradigm of a “zero-sum game.” A zero-sum game is a strategic situation in which one party’s gain implies the other party’s loss.⁷⁵ Clearly, in a zero-sum game, litigants are not likely to agree to any procedural stipulation. Even if a litigant was willing to pay her adversary for agreeing to shift from one rule to its alternative, the most she would be willing to pay would equal her gain from that shift. However, because this gain equals her adversary’s loss, the adversary would be willing to assume it only for a larger payment. Therefore, in any zero-sum game situation, no agreement between the litigants is possible.

The choice of a pleading standard is a prototypical example of a zero-sum game situation. While litigants may reduce costs and risks by agreeing to modify procedures, they are unlikely to agree to modify the applicable pleading standard even when its application results in inadequate screening. The reason is simple: any agreement to shift to the alternative standard would be purely distributive, benefiting the plaintiff at the expense of the defendant.

Take, for example, a case where the defendant possesses the information needed by the plaintiff to pass the *Twombly* standard. After the dispute arises, the defendant has no interest in agreeing to supply the plaintiff with the relevant information to substantiate her allegations. Thus, the defendant is unlikely to agree to the pre-*Twombly* standard under which the plaintiff could survive a motion to dismiss. Similarly, the defendant would not agree to waive his right to file a motion to dismiss pursuant to Rule 12(b)(6) for failing to state a claim. Because the plaintiff’s and the defendant’s interests stand in

72. See, e.g., *Acton v. Merle Norman Cosmetics, Inc.*, 163 F.3d 605 (9th Cir. 1998) (unpublished table decision); *U.S. Consol. Seeded Raisin Co. v. Chaddock & Co.*, 173 F. 577, 579 (9th Cir. 1909) (dismissing appeal based on post-dispute agreement).

73. For a general discussion of stipulations, see 73 AM. JUR. 2D *Stipulations* § 15 (2001).

74. For a thorough discussion of post-dispute procedural stipulations, see generally Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461 (2007).

75. See R. DUNCAN LUCE & HOWARD RAIFFA, *GAMES AND DECISIONS* 158 (1958); MARTIN J. OSBORNE & ARIEL RUBINSTEIN, *A COURSE IN GAME THEORY* 21 (1994).

direct conflict, no arrangement to opt out of the *Twombly* pleading standard is feasible.

In conclusion, the *Twombly* pleading standard may serve as a just and efficient screening mechanism in many cases. However, because it cannot accommodate all cases, its application might obstruct efficiency and justice in cases of meritorious claims characterized by asymmetric information where the defendant holds private information that is essential to establish his liability. Such inefficiencies would be pronounced before and after the dispute.

While an agreement to opt for the pre-*Twombly* standard cannot be beneficial for both litigants from their post-dispute perspectives, this is not the case when the argument is made before the dispute arises. As we show next, such an agreement can be beneficial for contracting parties if it is made at the pre-dispute stage when the parties agree on their substantive rights and obligations in performing their contract. We show that because the parties' interests are aligned at the time of contracting, they can realize a mutual joint surplus by opting for the screening standard that would best accommodate their specific circumstances.

III. THE ADVANTAGES OF CONTRACTING AROUND *TWOMBLY*

In the previous Part, we showed how the *Twombly* pleading standard might lead to inaccurate screening.⁷⁶ We also explained why the zero-sum characteristic of the pleading standard makes it impossible for litigants to modify it once a dispute arises and a suit is filed.

In this Part, we explain how contracting parties can avoid the inadequacies of the *Twombly* standard by agreeing ahead of the dispute, at the time of contracting, to adopt a procedural mechanism that would better screen their prospective suits.⁷⁷ We show that contracting parties can increase their joint surplus in the contract by mutually agreeing to opt out of the *Twombly* standard and adopt its predecessor.⁷⁸ We also argue that the parties can overcome the zero-sum problem ingrained in pleading standards and that they can successfully address any pre-dispute inefficiencies caused by inappropriate screening.⁷⁹ We further explore additional benefits that the contracting parties can

76. See *supra* notes 68–75 and accompanying text.

77. Much of the theoretical analysis in this Section relies on Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1 (1995), and Hay, *supra* note 66, at 1803. See also Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209 (2000).

78. See *infra* Parts III.A, III.B.

79. See *infra* Part III.B.

realize by agreeing to adopt the pre-*Twombly* standard. We explain how any such pre-dispute stipulations can curtail strategic opportunism and efficiently structure the parties' primary behavior.⁸⁰ Finally, we show how a pre-*Twombly* stipulation enables the parties to signal information they exclusively possess at the contracting stage and to sort among prospective counterparts based on that private information.⁸¹

Pre-dispute procedural stipulations are not foreign to contracts.⁸² For instance, contracting parties often agree to adopt forum selection clauses,⁸³ choice of law clauses,⁸⁴ clauses dealing with appointment of service agents or waiver of notice,⁸⁵ limitation period clauses,⁸⁶ or clauses waiving the right to a trial by jury.⁸⁷ Contracts may also mod-

80. See *infra* Parts III.A, III.B.

81. See Part III.C *infra*.

82. See generally Henry S. Noyes, *If You (Re) Build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J. L. & PUB. POL'Y 579 (2007); David H. Taylor & Sara M. Cliffe, *Civil Procedure by Contract: A Convolved Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085 (2002); Elizabeth Thornburg, *Designer Trials*, 2006 J. DISP. RESOL. 181.

83. See, e.g., *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9–10 (1972) (holding that forum selection clauses are prima facie valid in federal courts sitting in admiralty).

84. See U.C.C. § 1-301 (2005); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 186 (1988) (“Issues in contract are determined by the law chosen by the parties in accordance with the rule of § 187 and otherwise by the law selected in accordance with the rule of § 188.”); see also *Dykes v. DePuy, Inc.*, 140 F.3d 31, 39 (1st Cir. 1998) (“[C]ourts will uphold the parties’ choice as long as the result is not contrary to public policy and as long as the designated state has some substantial relation to the contract.” (quoting *Steranko v. Inforex, Inc.*, 362 N.E.2d 222, 228 (Mass. App. 1977))).

85. See, e.g., *Nat’l Equip. Rental Ltd. v. Szukhent*, 375 U.S. 311, 316 (1964) (holding that parties may agree “to permit notice to be served by the opposing party, or even to waive notice altogether”); see also *Beautytuft, Inc. v. Factory Ins. Ass’n*, 48 F.R.D. 15, 27 (E.D. Tenn. 1969) (citing *Szukhent*, 375 U.S. at 311); *Barker v. Greenstreet Fin., L.P.*, 823 So. 2d 195, 196 (Fla. Dist. Ct. App. 2002) (upholding service by mail and noting that contractual provisions for service were effective and did not violate rules, statutes, or due process). The Federal Rules provide for waiver of service of process and direct mailing of the complaint. See FED. R. CIV. P. 4(d)(1)(G).

86. In some jurisdictions, parties may limit the time in which actions based on contract may be brought. See, e.g., *Gifford v. Travelers Protective Ass’n*, 153 F.2d 209, 211 (9th Cir. 1946); *Chilcote v. Blue Cross & Blue Shield United*, 841 F. Supp. 877, 879 (E.D. Wis. 1993) (citing *Order of United Commercial Travelers v. Wolfe*, 331 U.S. 586, 608 (1947) (stating that limitation periods are valid provided they are reasonable)). Some jurisdictions also recognize the ability to contractually extend the statute of limitations for a reasonable time. See, e.g., *Collins v. Env’tl. Sys. Co.*, 3 F.3d 238, 242 (8th Cir. 1993) (applying Minnesota law). Others, however, do not allow parties to extend the statute of limitations at all. See, e.g., *E.L. Burns Co. v. Cashio*, 302 So. 2d 297, 301 (La. 1974) (denying the right to extend the statute of limitations).

87. See U.S. CONST. art. VII. Federal Rule 38(d) explicitly permits ex post contractual waiver of the right to jury trial. However, courts have also enforced ex ante agreements to waive this right. See, e.g., *Herman Miller, Inc. v. Thom Rock Realty Co.*, 46 F.3d 183, 189 (2d Cir. 1995); *Leasing Serv. Corp. v. Crane*, 804 F.2d 828, 833 (4th Cir. 1986). On jury trial waivers, see Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. 167, 169–70 (2004); Chester S. Chuang, *Assigning*

ify specific procedural mechanisms. For example, non-disclosure agreements often contain pre-dispute stipulations over future provisional measures. Some contracts include symmetric clauses which allow each party to obtain injunctive relief without being required to post a bond or other security,⁸⁸ while other contracts include asymmetric clauses that enable only the party who might suffer irreparable harm from breach to seek temporary injunctive relief without the necessity of posting a bond or other security.⁸⁹

In this Part, we examine the advantages of pre-dispute contractual stipulations, both symmetric and asymmetric, as they affect pleading standards. In Part IV, we demonstrate how such stipulations may indeed be incorporated into the contract, and we compare the costs of doing so before and after *Twombly*. We show that while the pre-*Twombly* pleading standard was difficult to incorporate into a contract and implement in court, contracting around *Twombly* is easier and is therefore expected to be applied more often.

A. *Symmetric Application of the Pleading Standard*

The main obstacle in agreeing to modify the *Twombly* pleading standard after a dispute arises is the standard's distributive effect. Any post-dispute agreement could change the outcome of the litigation, thus benefiting one litigant at the expense of his adversary. This is not necessarily the case, however, before the dispute arises.

An agreement to opt out of *Twombly* and embrace the pre-*Twombly* standard is more likely at the time of contracting because the parties are acting behind a "veil of ignorance."⁹⁰ They typically do not know which of the many contingencies that could lead to a dispute will actually materialize. They do not necessarily know who will assume the role of plaintiff or defendant and which party will be more likely to benefit from adopting a particular pleading standard.⁹¹

the Burden of Proof in Contractual Jury Waiver Challenges, How Valuable Is Your Right to a Jury Trial?, 10 EMP. RTS. & EMP. POL'Y J. 205, 207–08 (2006).

88. See, e.g., Asset and Purchase Agreement between The Brown Schools, Inc. and Psychiatric Solutions, Inc. (Feb. 13, 2003), available at cori.missouri.edu/pages/ksearch.htm (registration required).

89. Employment Agreement Between Infocrossing, Inc. and Charles Auster § 10(c) (June 15, 2000), available at core.missouri.edu/pages/ksearch.htm (search for "Contract ID 688028").

90. The concept of a "veil of ignorance" was first introduced by JOHN RAWLS, *A THEORY OF JUSTICE* 136–37 (1971), which states that when the parties are assumed to be situated behind a veil of ignorance "[t]hey do not know how the various alternatives will affect their own particular case."

91. Procedural arrangements can also affect the risk exposure of the parties. They may either increase that risk or decrease it depending on the circumstances. There are also non-strategic reasons why procedural stipulations are more likely before the dispute than after it, as the par-

Take, for example, a simple partnership contract. Such a contract often relies on mutual and shared trust between the partners, as neither partner can monitor each and every action of his counterpart. Consequently, in the case of a disagreement, one partner might hold information and documents (concerning accounting issues, for example) which the other partner might not possess. This implies that the *Twombly* pleading standard might prevent the latter from crossing the pleading threshold even if she is certain that her counterpart breached his contractual obligations. The lack of necessary facts to substantiate her allegations would thus prevent her from pursuing her suit because she might not be able to obtain the information without discovery.

As we already explained, the distributive effects of modifying the pleading standard could impede any post-dispute stipulation over it. After the dispute arises, the defendant would not agree to a pre-*Twombly* standard because the *Twombly* standard would enable him to more easily pursue a 12(b)(6) motion to dismiss the lawsuit. However, because at the time of contract neither partner knows who will be the one to sue or to be sued, they may prefer to opt for the more relaxed pre-*Twombly* standard.

The parties' agreement to a symmetric pre-*Twombly* standard would enable each partner to file a suit in the event of a dispute without concern that the information supporting his claim might only be in the possession of his co-partner. This agreement would increase the parties' joint contractual surplus, solidify their mutual trust, and strengthen their relationship. Agreeing to the pre-*Twombly* standard also would increase the parties' incentives to perform their contractual obligations because each would know that the other could easily survive dismissal of the lawsuit in the event of a default. At the same time, the parties' future distributive gains and losses from their stipu-

ties are less subject to psychological barriers and biases. For review of such psychological effects at the time of litigation, see, for example, Linda Babcock et al., *Forming Beliefs About Adjudicated Outcomes: Perceptions of Risk and Reservation Values*, 15 INT'L REV. L. & ECON. 289 (1995) (exploring litigants' over-optimism and risk preferences as a function of their assigned role in experimental settings); Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 129-42 (1994) (showing that even in the absence of strategic bargaining, psychological processes create barriers that preclude out-of-court settlements in some cases); Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113 (1996) (analyzing the effects of framing theory of risk on litigants' decision making); but see Russell Korobkin & Chris Guthrie, *Psychology, Economics and Settlement: A New Look at the Role of the Lawyer*, 76 TEX. L. REV. 77 (1997) (providing experimental evidence supportive of the hypothesis that lawyers as a class share an analytical orientation to decision making that can correct for litigants' psychological barriers and biases).

lation would cancel each other out because they are equally likely to either benefit or suffer from it.

So far we have shown that an agreement to waive the right to file a motion to dismiss or similarly to opt for the pre-*Twombly* pleading standard can be desirable for both contracting parties at the pre-dispute stage if at that stage, the parties' information regarding future litigation contingencies is symmetric and if such a stipulation is not expected to undermine the interest of one contracting party at the expense of her counterpart. In the following sections, we demonstrate that even if we relax both assumptions of pre-dispute symmetric information and post-dispute symmetric application of the pre-*Twombly* standard, an arrangement to opt for this standard can still be achieved.

B. Realizing Pre-Dispute Efficiencies

As we demonstrated, any pleading standard affects the pre-dispute behavior of prospective litigants. Just as the *Twombly* standard might impact the behavior of prospective litigants before the dispute, a stipulation to adopt the pre-*Twombly* standard might also have an effect on the contracting parties' behavior. While at the post-dispute stage the adversaries will not modify the pleading standard due to its zero-sum effect, at the pre-dispute stage they may choose to modify the standard if it allows them to realize pre-dispute efficiencies, even if the application of the standard is expected to be asymmetric.

This proposition can be demonstrated using a numerical example. Suppose that in a contract between a food chain store and a supplier, the parties expect that the supplier will hold private information regarding the quality of his products and that the chain store can only obtain the information through discovery. Suppose also that the value of the contract for the chain store is 100 if the product's quality is high, and the supplier's cost is 70. If the quality is low, the value of the contract for the chain store is only 80 and its cost for the supplier is 60. In this example, the joint surplus of high quality products is 30 (100-70), and the joint surplus of low quality products is only 20 (80-60). Therefore, both parties would prefer a contract requiring the supplier to provide high quality products.

In this case, the parties might prefer a pre-*Twombly* standard at the contracting stage. Although a pre-dispute stipulation for a pre-*Twombly* standard would have asymmetric implications, this stipulation would nevertheless increase the parties' welfare. If the parties do not opt for such a standard, then a combination of post-dispute information asymmetry and the *Twombly* standard might bar future meritorious lawsuits by the chain store even if the quality supplied is low.

The parties would have little incentive to agree to high quality products if these problems prevented effective enforcement of any contractual obligation on the matter.

Because the parties' joint surplus resulting from a contract for high quality products is higher than one for low quality products, the parties can agree at the outset to opt for a pre-*Twombly* standard and divide the excess surplus of 10 (30-20) at the time of contracting. Under this standard, the supplier would know that the chain store's threat to sue is credible in the event that he defaults and provides low quality products. The supplier would therefore provide high quality products as agreed. Thus, although opting for a pre-*Twombly* standard may work against the supplier after the dispute arises, it is in his interest to adopt it at the time of contracting.⁹²

To summarize, opting out of *Twombly* at the contracting stage can affect the parties' behavior and induce better performance of their contractual obligations. The excess surplus they can realize by opting for a pre-*Twombly* pleading standard does not depend on the symmetry of the future application of their agreement. Such an arrangement is possible even if it is more likely to benefit one party than the other. The latter would still opt for the pre-*Twombly* standard because he can share the pre-dispute excess surplus at the time of contracting.

C. Conveying Pre-Contractual Information

We have assumed so far that the parties' information about future contingencies is symmetric at the time of contracting. This assumption, however, is not always accurate. A negotiating party may possess private information that his partner cannot verify prior to contracting.

Take, for example, a start-up company and a large technology firm that enter a joint venture agreement for the development of a new technological product. The start-up might hold private information pertaining to the prospect of its product's success. However, both parties would find it difficult to verify such information at the time of contracting, especially if the start-up is concerned about opportunistic use of this information by the large firm.

The informed party could signal its private information by assuming additional contractual obligations. In the joint venture example, the start-up could agree to pay high liquidated damages in the event of

92. Clearly, opting for the pre-*Twombly* standard is desirable only when the parties' concern with future frivolous suits is low and the cost of future information asymmetry is high. Otherwise, they may abstain from such modification.

failure.⁹³ The higher the start-up's probability of success, the lower the expected cost of such a commitment. Therefore, the higher the start-up's probability of success, the lower the premium it would demand for assuming the risk of future liquidated damages.

However, the effectiveness of a liquidated damages provision, or any other substantive mechanism for that matter, depends on the relevant pleading standard. If the start-up continues to hold its private information by the time development fails, the technology firm might find it difficult to satisfy the *Twombly* pleading standard in court. This obstacle would render the liquidated damages provision ineffective. Thus, a signal by the start-up might require more than a substantive obligation. The start-up may have to agree to lower the pleading threshold to enable the firm to file a suit and move to discovery in the event of a breach.

The start-up can contract to adopt the pre-*Twombly* standard. Because the costs of such a stipulation would be higher for a start-up that believes its prospects are low than for a start-up that believes its prospects are high, the start-up may use this procedural stipulation to signal to the firm this information about its prospects.

More concretely, suppose that the probability of success is low—0.2, for example, for an average start-up, but this probability is 0.7 for a select few start-ups. Suppose also that the technology firm will sue the start-up whenever the product fails and that the parties agree on liquidated damages of 100. Finally, suppose that any such future lawsuit will be dismissed if the pleading standard is high.

An average start-up is subject to suit with a probability of 0.8, whereas the high-probability start-up expects to be sued only with a probability of 0.3. As such, the expected cost of agreeing to a low pleading standard is 80 for the average start-up but only 30 for the high-probability start-up. In fact, if we assume that the start-up's liability would depend on its private records—which would be discovered if a lawsuit were filed and survived a 12(b)(6) motion to dismiss—then the expected cost of agreeing to a low pleading standard would be even lower for the high-probability start-up because no damaging evidence would be uncovered.

If the firm offers to increase the premium it pays the start-up in return for a low pre-*Twombly* standard by 50, for example, then only a high-probability start-up would agree to such an offer. The average

93. For a discussion of liquidated damages as a signaling device, see Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369, 379 (1990).

start-up would demand a higher minimum premium for this modification and would therefore decline the firm's offer. The high-probability start-up can signal its private information by agreeing to lower the pleading standard in return for any premium which is lower than 80.

It is important to distinguish between the different uses of pre-dispute pleading standard stipulations. The stipulation used in the above example is not meant to change the start-up's primary behavior. Rather, its aim is to enable efficient signaling. This aim is different from the one we gave in the previous Part in which the stipulation was used to shape pre-dispute behavior. In the example here, it is assumed that the probability of success varies among start-ups not because of their investment in development *after* contracting, but because of private information they hold *before* contracting.⁹⁴ Modification of the procedural mechanism in this example was therefore used only to signal pre-contractual information.

In conclusion, by agreeing at the contracting stage to a pre-*Twombly* stipulation, contracting parties have the opportunity to signal their private information to each other. The modifiable pleading standard thus serves as a welfare-enhancing, information-producing mechanism for the contracting parties, and this mechanism may be unavailable otherwise.

IV. TWOMBLY AS A DEFAULT PLEADING STANDARD

So far we have shown that by opting for the pre-*Twombly* standard, contracting parties can resolve inadequate screening and realize pre- and post-dispute gains. In this Part, we make two further claims. The first claim is observational: we explain why the Supreme Court's decisions in *Twombly* and *Iqbal* present an opportunity for contracting parties to make pre-dispute pleading stipulations and show that such an opportunity is easier to implement today than it was in the pre-*Twombly* era. We show that contracting around the heightened *Twombly* standard in favor of the liberal pre-*Twombly* standard is much easier to negotiate, draft, and enforce than the reverse modification.

94. See generally Albert Choi & George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503 (2008), which demonstrates how litigation costs can help induce efficient behavior given the possible abuse of the legal system and its inaccuracy. Thus, their argument concerns the necessity of litigation costs to overcome moral hazard problems. *Id.* Our argument here is different, as it shows how the choice of the pre-*Twombly* standard allows the parties to overcome adverse selection problems. For a similar argument, see Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 863-64 (2006).

Our second claim is normative: we maintain that the lower costs of contracting around the *Twombly* standard must be taken into account when evaluating its effects in contract cases. We explain that even if the *Twombly* standard is not the standard that most parties would have contracted for if given the choice,⁹⁵ it may nevertheless prove preferable for contracting parties compared with the pre-*Twombly* standard due to the lower costs of contracting around it.

A. *The Low Costs of Contracting Around Twombly*

Contracting parties who agree at the pre-dispute stage that the application of the *Twombly* standard might inadequately screen meritorious claims may opt out of it using one of two possible options. One option is to modify the standard directly and adopt the pre-*Twombly* standard. The other option is to agree at the outset to waive the right to file a 12(b)(6) motion if a suit is filed. Either option would assure the parties that in the event of a dispute, neither party would likely be barred from pursuing discovery to obtain any information necessary to substantiate its allegations.⁹⁶

There are various possible formulations for adopting the pre-*Twombly* pleading standard in a contract. Recent proposals in the United States Senate and House of Representatives provide serviceable language for such provisions. For example, the Notice Pleading Restoration Act of 2009 provides that a court “shall not dismiss complaints under rule 12(b)(6) or (e) of the Federal Rules of Civil Procedure, except under the standards set forth by the Supreme Court of the United States in *Conley v. Gibson*.”⁹⁷ Another option would follow the language of *Conley* as proposed by the Open Access to Courts Act of 2009, which reads, “A court shall not dismiss a complaint under subdivision (b)(6), (c) or (e) of Rule 12 of the Federal Rules of Civil Procedure unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim which would entitle the plaintiff to relief.”⁹⁸ Clearly, there are many other possible contractual formulations for implementing the same standard, and elaborating on their exact wordings exceeds the scope of this Article. It suffices to note

95. See, e.g., Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597 (1990).

96. The parties may employ one-sided modification that would apply only if one of them is to file a lawsuit. Although such modifications implicate similar arguments as the symmetric modification we analyze, they may still raise some distinctive concerns. In the interest of clarity, we leave the analysis of these modifications for future research.

97. Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009).

98. Open Access to Courts Act of 2009, H.R. 4115, 111th Cong. (2009).

that any of these formulations would simply revert back to the legal equivalent of the pre-*Twombly* standard.

Waiving the right to file a 12(b)(6) motion in either a future lawsuit or in certain pre-defined situations is much easier to implement as well as to enforce than the adoption of the pre-*Twombly* standard.⁹⁹ The clear language of such a stipulation would avoid uncertainty in interpretation by expressly denying the defendant's right to file a motion to dismiss. Simplicity, however, may come at the cost of over-inclusiveness because it would give the plaintiff wide latitude to file many types of lawsuits.¹⁰⁰

Like any contractual arrangement, a pre-dispute stipulation modifying a pleading standard imposes bargaining and formation costs on the parties. The parties are likely to evaluate these costs against the benefits of a modification when deciding on the terms of the contract. Because these costs are more certain than the benefits at the time of contracting, the benefits must be large enough to justify the costs of contracting.

Whatever option the parties choose to adopt when agreeing to contract around the *Twombly* standard, this option would clearly be much easier to implement than attempting the reverse modification during the pre-*Twombly* era. During the pre-*Twombly* era, if contracting parties were to adopt a different standard, they would have had to adopt and formulate a novel, heightened pleading standard specifically tailored to their needs. Formulating the limits of a new heightened pleading standard would have proven cumbersome and increased the costs of negotiating and drafting that standard.

Moreover, the parties would have difficulty in predicting how courts would interpret their tailored standard. Accustomed to the pre-*Twombly* standard, courts would be confronted with enormous diffi-

99. Furthermore, opting for a pre-*Twombly* standard might seem more complex than agreeing not to file a 12(b)(6) motion because some commentators have argued that *Twombly* did not change any of the Supreme Court's prior notice-pleading thresholds. See sources cited *supra* note 39.

100. The choice between a pre-*Twombly* standard and a waiver of the right to file a 12(b)(6) motion is similar, in some respects, to the choice between a standard-type and a rule-type stipulation. See generally Scott & Triantis, *supra* note 94, at 814, whose key insight is that contracting parties can efficiently shift costs between the time of contracting and the time of dispute by varying the degree of precision of contract provisions and terminology. Similarly, parties can increase what Scott and Triantis call the "incentive bang for the contracting-cost buck" by modifying evidentiary rules that would apply to future disputes. *Id.* at 823. See also Choi & Triantis, *supra* note 94, at 503 (demonstrating that increasing litigation costs may induce better incentives to perform contractual obligations); Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127 (1997) (discussing the advantages of contracting around preferred bankruptcy procedures).

culties in interpreting and applying the parties' specific standard. As the enormous amount of scholarship following *Twombly* demonstrates,¹⁰¹ even if the standard is well-settled, there are difficulties in interpreting and applying it. An attempt to implement a similar standard embedded in a contract would have certainly created enormous interpretational uncertainties.

Finally, and perhaps most significantly, a contractually tailored heightened pleading standard would have severely limited the plaintiff's access to court and courts would have been unlikely to enforce it. The turmoil following the Supreme Court's decisions in *Twombly* and *Iqbal* is only further suggestive of the harsh implications of any such change.

In contrast, the costs of contracting around *Twombly* are lower and the likelihood that such a contract would be enforced in court is higher. This is true especially if the parties agree to waive the right to file a motion to dismiss and also if they opt for the alternative approach of formulating their own pre-*Twombly* standard. Drafting their own pre-*Twombly* standard requires the parties to refer back to the well-established formulation in *Conley*. That standard is a minimal one and operates as a natural focal point on which the parties may agree.

All these factors imply low negotiation and formulation costs as well as low costs of enforcement by the court. Consequently, there is a high likelihood that such a stipulation would indeed be effectively enforced. Furthermore, opting out of the *Twombly* standard provides greater potential access to the courts and therefore does not raise any constitutional concerns. The high likelihood of enforcement of a pre-*Twombly* stipulation clearly maximizes the utility from incorporating this standard into the contract.

B. Evaluating *Twombly* in Contract Cases

The comparison between the *Twombly* and the pre-*Twombly* pleading standards in contract cases is informed by two rationales. One rationale advocates the majoritarian standard—this is the standard that most parties would have contracted for if they had a choice. The alternative rationale advocates the standard that minimizes the costs of contracting around, implementing, and failing to modify the pleading standard.¹⁰² The two rationales do not stand in conflict because

101. See sources cited *supra* note 39.

102. For a comparison of the two rationales in substantive law, see generally Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92–93 (1989); Ian Ayres & Robert Gertner, *Majoritarian v. Minoritarian Defaults*,

contracting parties must consider both the costs of modification and the number of cases in which such modification would be necessary.¹⁰³ We now demonstrate how these rationales affect the desirability of the two pleading standards.

As we explained, contracting parties would choose the *Twombly* standard when they expect to hold symmetric information at the time of the dispute and when they expect the plaintiff to file a frivolous suit designed to impose high discovery costs on the defendant. Conversely, parties would choose the pre-*Twombly* standard when they expect that the prospective defendant would hold private information necessary for the plaintiff to substantiate her claim.¹⁰⁴ Because discovery costs are low¹⁰⁵ and information is symmetric in most contract cases, the pre-*Twombly* standard may be optimal for most cases. But the *Twombly* standard may nevertheless prove better for contracting parties because its modification is much easier to incorporate into the contract and enforce in court.

Suppose, for the sake of argument, that contracting parties would prefer the pre-*Twombly* standard to apply in 90% of cases and the *Twombly* standard in the remaining 10% of cases. Suppose also that the expected loss of efficiency due to any inadequate pleading standard is 100.¹⁰⁶ Finally, suppose that modification cost of the *Twombly* standard is 10, whereas the pre-*Twombly* standard is too costly to modify.¹⁰⁷

Under the pre-*Twombly* standard, the total cost would equal 10—an inefficiency cost of 100 in 10% of the cases. Under the *Twombly* standard, there would be no inefficiency cost because all contracting parties that prefer the pre-*Twombly* standard would contract for it. Yet each modification would cost 10. Thus, the total cost of the *Twombly* standard would equal 9—a modification cost of 10 in 90%

51 STAN. L. REV. 1591 (1999) [hereinafter Ayres & Gertner, *Majoritarian v. Minoritarian Defaults*].

103. See Ayres & Gertner, *Majoritarian v. Minoritarian Defaults*, *supra* note 102, at 1593 (explaining how the choice between majoritarian and minoritarian defaults should be made); Lucian Ayre Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORG. 284, 287 (1991) (“The measure of social welfare is taken to be the sum of buyers’ expected value from contract performance, less seller’s costs of precautions, and less parties’ costs of communication.”).

104. See discussion *supra* Part II.C.

105. See, e.g., Thomas E. Willging et al., *An Empirical Study of Discovery and Disclosure Practice Under the 1993 Federal Rule Amendments*, 39 B.C. L. REV. 525, 531 (1998) (finding that “for most cases, discovery costs are modest”).

106. This expected loss takes into account the probability of pre- and post-dispute inefficiencies that would result from the improper standard.

107. In particular, this implies that the costs of modification are higher than 100.

of the cases. Therefore, in this example, the *Twombly* standard is more efficient even though it would be modified in 90% of the cases.

Obviously, this conclusion depends on the specific assumptions made in the example. If the modification cost of the *Twombly* standard were higher, if the modification cost of the pre-*Twombly* standard were lower (in particular, lower than the efficiency loss due to the inadequate standard), or if the inefficiencies caused by each standard were different, then the pre-*Twombly* standard might prove more efficient. On the other hand, an efficiency of the *Twombly* standard is its potential to signal information and screen frivolous suits better than the pre-*Twombly* standard. This factor was not taken into account in the previous example but would support its conclusion.

The literature on substantive defaults has long observed that defaults are “sticky” and that parties often refrain from contracting around them.¹⁰⁸ In the case of pleading standards, the stickiness of the pre-*Twombly* standard can be explained by the specific difficulties in contracting for a novel alternative standard and implementing it in court. By comparison, the *Twombly* standard might prove less sticky due to the relative simplicity of contracting around it. Because contracting parties who wish to opt out of *Twombly* would revert to the familiar standard of *Conley*, *Twombly* may prove less sticky than its predecessor. This may make the *Twombly* standard preferable in contract cases.

In conclusion, we do not claim that the *Twombly* standard is necessarily more efficient or just than the pre-*Twombly* standard. We only suggest that if the possibility of contracting around the pleading standard is taken into account, then the comparison of the two pleading standards in contract cases calls for a different set of considerations than the ones often debated in non-contractual cases. In particular, in light of the possibility of pre-dispute modification of the pleading standard, the costs of modification and of implementing a modified standard should be considered. Because the *Twombly* standard is easier to modify than its predecessor, it may prove more efficient in contract cases absent modification, even if it would perform inadequate

108. See, e.g., Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 109 (2002). There are many behavioral regularities that increase the stickiness of defaults, such as the status quo bias, anchoring, and loss aversion heuristics. See Russel Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583 (1998); Russel Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 611–12 (1998). Also, informed parties may be reluctant to contract around the default because revealing private information would have significant effect on the price or other contract terms. See Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615, 617 (1990).

screening in most of those cases. Whether the *Twombly* standard would indeed prove superior depends on the proportion of contracts that would modify it and on the costs of both modification and implementation.

V. CONCLUSION

The debate over *Twombly* and *Iqbal* is premised on the assumption of the transsubstantivity of the Federal Rules of Civil Procedure. Thus, the debate contrasts different views of the overall inefficiencies and injustices created by alternative pleading standards. While any pleading standard might prove efficient and just in the aggregate, any pleading standard will also fail to realize these goals in some cases. When parties have prior contractual relationships, they may correct any inefficiency and injustice created by the pleading standard by contracting around the standard. We explained why modifying the pleading standard is simpler under the *Twombly* legal regime than under the pre-*Twombly* standard. Hence, the *Twombly* standard may prove efficient and just irrespective of its screening inadequacies if these inadequacies can be corrected by pre-dispute modification.

This Article does not challenge the transsubstantivity of procedural rules, nor does it advocate adopting special rules for contract cases. It only suggests that allowing parties the option to contract around procedural rules can improve justice and efficiency. In view of such an option and the evaluation of the efficiency and justice in cases where the parties have prior contractual relationships, the parties must consider the effects and costs of such pre-dispute procedural modifications.