Contracting Around Twombly

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CONTRACTING AROUND TWOMBLY

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ABSTRACT

The Supreme Court's recent decisions in Bell Atlantic Corp. v. Twombly and Ashcroft v. Iqbal have generated a heated debate over which is the most just and efficient transsubstantive pleading standard. Unlike the vast scholarship that followed these decisions, we do not take sides in this debate. Instead, we focus on a subset of cases in which litigants have prior contractual relationships. We argue that if contracting parties are allowed to contract around the Twombly pleading standard, they will be able to overcome problems of inadequate screening and to realize both pre-dispute and post-dispute opportunities that would prove unfeasible otherwise.

Hence, we propose a novel approach for addressing the question 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 the proportion of cases where this modification would have been chosen by contracting parties. As we show, even if aggregatively, over all contracts, the Twombly pleading standard would have been chosen less often, it may still promise improved efficiency and justice in contract cases, due to the lower costs of contracting around it.

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INTRODUCTION

Pleading standards stand 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 two approaches have been advanced. One approach, whose main concern is the effect of pleading standards on plaintiffs' access to courts, advocates a liberal reading of the pleading standard and supports maintaining the low threshold requirements that were applied in the Federal Courts for over fifty years since *Conley v. Gibson*.³ 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 and efficiency in the federal courts. Both are premised on the foundational assumption that the Federal Rules of Civil Procedure are uniform and transsubstantive.⁵

This essay 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 both post-dispute and pre-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.

Being transsubstantive, the Federal Rules of Civil Procedure aim at securing a just, expeditious, and efficient resolution of all civil disputes in the federal

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¹ 550 U.S. 544 (2007)
² 129 S. Ct. 1937 (2009)
³ 355, U.S. 41 (1957)
⁴ See *infra*, notes 34-36.
⁶ Between January 2007 and October 2009 the number of contract cases filed in federal courts was over 2,500 cases each month. Within these cases, in about 40% defendants have filed a Rule 12 motion to dismiss. Of these motions, about third were granted. See *Statistical Information on Motions to Dismiss re Twombly/Iqbal*, Administrative Office of the U.S. Courts, available on http://www.uscourts.gov/rules/Motions%20to%20Dismiss.pdf
The rules are designed to satisfy both the need for substantive justice and for a workable procedural system, so as to ensure that litigants have their day in court. 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. That is, the rules are based on the notion of uniformity and transsubstantivity, which dictates that they should be applied and interpreted in the same manner in all cases, irrespective of the subject matter in dispute.

The rules are designed to achieve efficiency and justice for every type of case. They purport to represent a balanced combination of procedural values that applies uniformly to all cases in the federal courts. As such, they are

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7 Fed. R. Civ. P. 1(“They should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding”). Des Isles v. Evans, 225 F. 2d 235, 236 (5th Cir. 1955) (The primary purpose of the rules is to secure “speedy and inexpensive justice in a uniform and well ordered manner.”);


9 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 Bogey of Non-Trans-Substantive Rules of Civil Procedure, 137 U. PA. L. REV. 2067, 2079 (1989) (“[P]rocedural rules should have general applicability.”). See however, Stephen B. Burbank, The Transformation of American Civil Procedure: The Example of Rule 11, 137 U. PA. L. REV. 1925, 1934-35 (1989) (arguing that he knows of no support for the 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 transsubstantive.”).


11 Stephen B. Burbank, Procedure, Politics and Power: The Role of Congress, 79 NOTRE DAME L. REV. 1677, 1731 (2004) (Stating that “rule makers 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 transsubstantive).” )
characterized by a compromise between different interests that might stand in conflict with each other.\textsuperscript{12}

While the rules are designed to provide efficiency and justice in the aggregate, these goals might not be realized in every case. Being applied to all suits brought in federal courts, 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’ envisage by the framers of the rules. This is a major drawback of transsubstantive uniform rules.\textsuperscript{13}

The inability of compromise-based transsubstantive procedural rules to provide efficiency and justice in all types of cases has assumed immense importance in the debate that followed

Twombly and

Iqbal. At the center of the debate stands the question how to construct the pleading standard according to Rules 8 and 12(b)(6) of the Federal Rules of Civil Procedure (FRCP).

The pleading standard serves as the gateway to the judicial system.\textsuperscript{14} 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”.\textsuperscript{15} The Rule, which has been termed the “keystone”\textsuperscript{16} or the “crown jewel”\textsuperscript{17} of the procedural system embodied in the Federal rules, was designed with the view to adopt a simplified pleading system\textsuperscript{18} and to focus the litigation on the merits of the

\textsuperscript{12} Such as the balance between access to courts and efficiency. On balancing these competing interests see, e.g., 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 (2008).


\textsuperscript{14} See , Phillips v. County of Allegheny, 515 F.3d 224, 230 (3rd Cir. 2008) (“Few issues in civil procedure jurisprudence are more significant than pleading standards, which are the key that open access to courts.”).

\textsuperscript{15} Fed. R. Civ. P. 8(a).

\textsuperscript{16} CHARLES ALAN WRIGHT & MARY KAY KANE, LAW OF FEDERAL COURTS 715 (6th ed. 2002).

\textsuperscript{17} Patricia M. Wald, Summary Judgment at Sixty, 76 TEX. L. REV. 1897, 1917 (1998).

\textsuperscript{18} The drafters of the Federal Rules did not want to follow the common law and code pleading regime. See, Paul Stancil, Balancing the Pleading Equation, 61 BAYLOR L. REV. 90, 109 (2009)
dispute.\textsuperscript{19} Being the starting point of the litigation process, the pleading's primary objective has traditionally been to put the defendant on notice of the claim asserted against him.\textsuperscript{20}

When a court is seized with a motion to dismiss a claim pursuant to Rule 12(b)(6), it applies the pleading standard in order to examine whether the claimant failed to state a claim upon which relief can be granted.\textsuperscript{21} By setting the threshold requirements that the plaintiff must satisfy in order to have access to discovery and to other procedural mechanisms applied throughout litigation, the rule serves as the gatekeeper to the federal courts.\textsuperscript{22}

For over fifty years, since the Supreme Court's decision in \textit{Conley}, courts have interpreted the threshold requirement of the pleading standard liberally,\textsuperscript{23} 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."\textsuperscript{24}

\textsuperscript{20} Compared to pleadings at common law, which served not only notice, but also factual development, winnowing issues and disposing of meritless claims. Christopher M. Fairman, \textit{The Myth of Notice Pleading}, 45 \textit{Ariz. L. Rev.} 987, 990 n. 17 (2003)
\textsuperscript{21} Fed. R. Civ. P. 12(b)(6)
\textsuperscript{22} For exceptions to the rule see, Fed. R. Civ. P. 9(b), which requires that "the circumstances constituting fraud or mistake shall be stated with particularity". \textit{See also} Private Securities Litigation Reform Act (PSLRA) of 1995, 15 U.S.C. § 78u-4(b)(2) (requiring that the plaintiff "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"). For the interpretation of "strong inference" see \textit{Tellabs v. Makor}, 127 S. Ct. 2499 (2007). See Richard L. Marcus, \textit{The Revival of Fact Pleading Under the Federal Rules of Civil Procedure}, 86 \textit{Colum. L. Rev.} 433, 435 (1986) (Claiming, long before \textit{Twombly}, that "Not only has pleading practice survived, but fact pleading, the bete 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").
\textsuperscript{23} See \textit{e.g.}, Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 168 (1993) (stressing the "liberal system of ‘notice pleading’ set up by the Federal rules."); Swierkiewicz v. Sorema, N.A., \textit{supra}, note 19, 514 (2002) (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.').
\textsuperscript{24} Conley, 355, U.S. at 45-46. See however, Christopher Fairman, \textit{Heightened Pleading}, 81 \textit{Tex. L. Rev.}, 551, 553-54 (2001) (claiming 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 hurdles creates classes of disfavored cases and denies plaintiffs determination on the merits - a substantive effect masked as procedural. In the process, the trans-substantive nature of the rules is eroded; the procedure of procedure is ignored.").
The rationale behind the liberal construction 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." The application of a liberal pleading standard ensured that the notice was sufficient to prevent surprise from the defendant, and relied on summary judgment to bar frivolous claims from reaching trial. Under the liberal pleading standard most complaints had passed the pleading threshold.

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. The Court repudiated Conley’s liberal “no set of facts” pleading standard and ordered the dismissal of the case. It stated that the pleading standard requires the plaintiff to allege facts that suggest “plausibly” 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.” Following this standard, a plaintiff may no longer state a general description of her claim and await pre-trial discovery to reveal the necessary evidence to support her allegations. Stating a claim "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not suffice." Relying on the pitfalls of costly discovery, the Court stated that since “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.

Some commentators hoped that the Twombly pleading standard would be confined to antitrust cases. However, this hope was unfulfilled in Iqbal, which

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25 Conley, 355 U.S. at 48
28 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 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. 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 determine whether a plaintiff has any evidence to back up what is in the complaint.").
29 Twombly, 127 S. Ct. at 1965.
30 Twombly, 127 S. Ct. at 1965.
31 Id. at 1968.
asserted that the heightened pleading standard applies trans-substantively to all civil actions, irrespective of their specific particularities. Thus, the debate over the aggregate implications of the Twombly pleading standard has been intensified after Iqbal. Some commentators have argued that the decisions are not revolutionary, but rather consistent with the Supreme Court’s prior notice-pleading approach, while others have defended the decisions as setting the correct pleading standard. However, the vast majority of commentators have strongly criticized Twombly’s standard as being a radical departure from prior policy, and as having devastating consequences on plaintiffs’ access to the courts.

61, 64 (2007) (arguing that “[t]here is no reason to confine the logic of [Twombly’s] decision to antitrust cases”).

35 See, e.g., Douglas G. Smith, The Twombly Revolution? 36 PEP 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.”).

36 See e.g. Robert G. Bone, Twombly, Pleading Rules, and the Regulation of Court Access, 94 IOWA L. REV. 873, 875 (2009) (arguing that “Many judges and academic commentators read the decision as overturning fifty years of generous notice pleading practice.”); Note, Pleading Standards, 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.”); A. Benjamin Spencer, Plausibility Pleading, 49 B. C. L. REV. 431, 432 (2008) (arguing that Twombly is “quite at odds with the Court’s position heretofore” and a “clear break from the Court’s previous embrace of notice pleading” and adding at 37 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, 277 (2008) (arguing that Twombly represents “a substantial change to the pleading standard that had traditionally applied in federal court”); 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, 1261 (2008) (criticizing Twombly for ignoring “information asymmetries”); Scot Dodson, Pleading Standards After Bell Atlantic Corp. V. Twombly, 93 VA. L. REV. IN BRIEF, 135, 138 (“Clearly, Conley’s "no set of facts" language is dead.”); Brian Thomas Fitzsimmons, 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, 206 (2008) (suggesting that the Supreme Court’s decision should be set aside); Randy Picker, Twombly, Leegin, and the Reshaping of Antitrust, 2007 SUP. CT. REV. 161, 177 (arguing that "Twombly shrinks the domain of private plaintiffs.")
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 accessing the courts, even if they should have been allowed to be heard. Conversely, the application of the pleading standard that applied before *Twombly*, and which we call in this Essay the *pre-Twombly* standard, might allow claims in court, even if they should have been barred from being heard.

Focusing on the *Twombly* standard, we argue that some instances in which the application of the standard would perform inadequate screening can be remedied. 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. 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, by eliminating strategic opportunistic behavior, by affecting the incentives of the parties to comply with their contractual obligations and the substantive rules applicable to their legal relationship and by enabling parties to signal to their counterparts information which is held exclusively by them.

Hence, we propose a novel approach for addressing the question 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 the proportion of cases where it would have been chosen by contracting parties. As we show, even if aggregatively, over all contracts, 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 and lesser problems in implementing such modification.

The Essay proceeds as follows. Section I 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. The Section also explains why the *Twombly* standard cannot be modified by the litigants after the dispute arises. Section II features the advantages of pre-dispute modifications of the *Twombly* standard. It examines how such modifications can correct screening inadequacies, maximize the parties' joint contractual surplus and allow them to signal their private information and sort among prospective counterparts based on their private information at the time of contracting. Section III explains the alternative ways for contractually modifying the
Twombly standard. It examines the costs of such modifications and concludes that since 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.

I. SCREENING UNDER THE TWOMBLY PLEADING STANDARD

Access to the courts is not without limits. Screening mechanisms enable the courts to draw the line between suits that should proceed to trial and be decided 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 interests of the claimant to have her day in court and those of the defendant not to be harassed in defending meritless suits. Screening mechanisms purport to enable access to justice to claimants, while at the same time to protect defendants as well as the judicial system from undue costs and burdens.

The available screening mechanisms at the pre-trial stage include Rule 11 requirement that attorneys would certify the propriety of any pleadings, motions and other papers they sign, Rule 12(b)(6) dismissal for failure to state a claim upon which relief can be granted, Rule 16 which allows the court to eliminate frivolous claims, and Rule 56's Summary Judgment motion. The purpose of each of these mechanisms is to distinguish between meritorious suits that should be heard and decided by the jury and frivolous suits that are filed by opportunistic claimants for the mere intention of extracting nuisance settlements from defendants, and as such should not be allowed to proceed to trial. 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 as it operates before discovery. If it is adequately applied, it has the potential to screen frivolous suits most effectively.

38 Robert G. Bone, Twombly, Pleading Rules, and the Regulation of Court Access, 94 IOWA L. REV. 873, 909 (2009) (“[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.”); 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, 1217 (2008) (Claiming that the judicial system 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, out not to have been welcomed in the first place.”).
40 Rule 12(b)(6) has been termed “the most promising new tool” in the regulation of cases at the pleading stage. See, 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.
Like the underlying notion of any procedural rule, the basic premise of the pleading standard is to balance the interests of the adversary litigants by ensuring fairness and efficiency in the resolution of their dispute. However, as the standard is transsubstantive and applies uniformly to all types of civil suits, regardless of their specific characteristics or merit, there might be instances in which its application would frustrate the fragile balance between the litigants’ interests, thereby rendering it inadequate.

Since 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 over a claimant who wishes to have her day in court. Similarly, a court’s rejection of a motion to dismiss might have adverse consequences over a defendant who would have to incur the high costs of discovery before he can move for a summary judgment. Thus, while in most cases a pleading standard may effectively screen cases, there are cases in which its application might not do so. In the sections that follow we explain these inadequacies, and discuss their effects 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,” the new standard, requires the
plaintiff to allege facts that renders the liability asserted “plausible” sufficient to “raise a right to relief above the speculative level”, that make it plausible that she is entitled to relief.

When the plaintiff possesses the information necessary to assert the facts in order to meet the burden of the “plausibility” threshold, the Twombly standard is adequate. The plaintiff would have no trouble in presenting sufficient evidence to support her assertions that she is entitled to relief. In such a case, the balance between the opposing interests of the litigants would 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 who fears having to bear the high costs of discovery, would be barred from pursuing it to discovery. The requirement from the claimant 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 stage of pre-trial. Since 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 prevent the defendant from having to go through extensive discovery and incur high costs. Thus, the Twombly pleading standard serves as an efficient screening mechanism of frivolous suits.

The situation is different where the plaintiff has a meritorious claim but does not possess the necessary facts to pass the Twombly threshold. This situation is characterized by information asymmetry at the pre-filing stage. It is often the case that a defendant possesses exclusive possession of relevant information and evidence critical to the claim. When the information is in the defendant’s sole custody, the plaintiff would not be able to assert facts that she cannot obtain.

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43 Twombly, 127 S. Ct. 1955 at 1974,
44 Id. at 1965.
45 Id. at 1959.
46 Robert G. Bone, Twombly, Pleading Rules, and the Regulation of Court Access, 94 IOWA L. REV. 873, 909 (2009) (“[S]tricter pleading treats plaintiffs who do not have access to information less favorably than plaintiffs who do have access.”).
47 Bone, id at 884 (“[E]nhancing the pleading burden risks screening meritorious suits.”).
48 See, e.g. Spencer, id. at 488 (stressing that by imposing the Twombly standard, the court makes it possible “that valid claims that could have found support through discovery never make it into the system.”). Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2512 n.9 (2007) (“Any heightened pleading rule… could have the effect of preventing a plaintiff from getting discovery on claim that might have gone to a jury, had discovery occurred and yielded substantial evidence.”).
49 Randal C. Picker, Twombly Leegin, and the Reshaping of Antitrust, 2007 SUP. CT. REV. 161, 164, (“Plaintiffs will often have much less information about possible liability than defendants.”)
prior to discovery. In this case, the *Twombly* standard might bar the plaintiff from pursuing her claim in court, even if it has merits. Thus, when the information needed is privately held by the defendant, and the plaintiff cannot access it with reasonable investigation, then under the *Twombly* standard her lawsuit would be dismissed. An application of this standard in such cases would therefore result in the dismissal of claims that should have proceeded to discovery.

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. Clearly, 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. 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. However in the cases where the *Twombly* standard would perform proper screening, the *pre-Twombly* standard failed. When the defendant did not hold any private information, the liberal pleading standard allowed the plaintiff to proceed with a lawsuit and extract a positive settlement from the defendant, even if he knew it was frivolous.

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50 See, e.g., A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. Rev. 431, 482 (2008) (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.).


52 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. 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. On the notion of “information and belief” See Hartnett, *supra* note 34, at 503-05 (suggesting that “the phrase “upon information and belief” … should be retired.”).

53 Spencer, *Plausibility Pleading*, *supra* note 50, 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.)

B. The Pre-Dispute Implications of Inadequate Screening

Like the implications of any procedural rule, those of Rule 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 and a suit is filed. Since the parties expect any future dispute to be litigated according to the rules of procedure, these rules affect the probable outcome that litigation would generate, and as a consequence, also the parties’ pre-dispute behavior. They affect the parties’ incentives to comply with substantive law as well as to engage in a dispute, to bring a suit or to refrain from doing so, to invest in the litigation and to consider the possibility of a prospective settlement.

Similarly, any screening mechanism may engender incentive effects on the parties’ behavior before and after a dispute arises. A screening mechanism would affect the parties’ decisions whether to comply with substantive law, and in case a dispute arises, whether to engage in litigation or to 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 - where a plaintiff with a meritorious claim lacks the factual assertions necessary to pass the pleading threshold because that information is privately held by the defendant. In such cases, a prospective defendant who knows that he will have exclusive possession of the relevant information, and that the claimant will not be able to get hold of this information prior to discovery, might reduce his level of care and have weaker incentives to satisfy his legal duties since 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 the case of a medical negligence case. A prospective defendant who knows that he will have sole knowledge of information and control of evidence about his level of care prior to the dispute will abstain from taking care, since a prospective claimant will not be able to pursue a claim against him without obtaining the necessary information through discovery. Since taking care is costly, and since the expected sanction for not taking care is low due to the high probability of early dismissal, a prospective defendant would prefer not to take due care.

Again, the pre-Twombly pleading standard might also have adverse pre-dispute implications. In the medical negligence example, under the pre-Twombly standard, prospective defendants might have expected opportunistic claimants to file suits irrespective of the merits of their claims. Since defendants would have to incur the high costs of discovery before being able to move for summary judgment, this would imply higher costs of medical service, and lower incentives for taking proper care. 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, which allows the litigants to enter procedural stipulations. For example, they may consent to waive the right to a jury trial, to agree on the extent of discovery proceedings or to the taking of depositions, and to forgo their right of appeal. Litigants would agree to make procedural arrangements if they would reduce their litigation expenditures, lower their risks and would not adversely affect the expected outcome. Thus, by customizing their litigation procedures

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59 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.”).


61 Fed. R. Civ. P., 29. See also, Jay E. Grenig, Stipulations Regarding Discovery Procedure, 21 AM. J. TRIAL ADVOC. 547 (1998);


64 See 73 Am. Jur. 2d Stipulations, §15.
to their specific needs, the adversaries can improve the efficiency and the justice of their individual proceedings.  

Litigants would agree to enter procedural arrangements when such arrangements best suit 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, they would not agree on it. This situation is characterized by the paradigm of a Zero-Sum Game. A zero-sum game (also called a strictly competitive game) is defined as a strategic situation in which one party's gain implies the other party's loss. Clearly, in a zero-sum game litigants are not likely to enter any procedural stipulation.  

Even if a litigant were 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, since this gain equals her adversary's loss, he 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 claimant in order to pass the Twombly standard. After the dispute arises, the defendant has no interest in agreeing to supply the claimant with the relevant information to substantiate her allegations. Thus, the defendant is unlikely to agree to the pre-Twombly standard under which the claimant 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. Since the plaintiff's and the defendant's interests stand in direct conflict, no arrangement to opt out of the Twombly pleading standard is feasible.  

To conclude, the Twombly pleading standard may serve as a just and efficient screening mechanism in many cases. However, since 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 and evidence that are essential to establish  

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66 See R. Duncan Luce and Howard Raiffa, Games and Decisions 158 (1958); Ariel Rubinstein and Martin J. Osborne, Game Theory 21 (2006).
his liability. Such inefficiencies would be pronounced both after the dispute and before it.

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

II. THE OPPORTUNITIES OF CONTRACTING AROUND TWOMBLY

In the previous section we showed how the Twombly pleading standard might induce inappropriate screening, as it might bar justified lawsuits in case the defendant holds private information necessary for the plaintiff to cross the pleading threshold. 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 section 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. 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. We show that the parties can overcome the zero-sum problem ingrained in pleading standards, and that they can address any pre-dispute inefficiencies caused by inappropriate screening. We further explore additional benefits that the contracting parties can realize by agreeing to adopt the pre-Twombly standard. We demonstrate how any such pre-dispute stipulation can curtail strategic opportunism and efficiently structure the parties’ primary behavior. In addition we show how a pre-Twombly stipulation enables the parties to signal information they possess exclusively at the contracting stage and to sort among prospective counterparts based on their private information.

67 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 Bruce Hay, Procedural Justice, supra note 56. See also Keith N. Hylton, Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis, 8 SUP. CT. ECON. REV. 209 (2002)
Pre-dispute procedural stipulations are not foreign to contracts. Contracting parties often agree to adopt forum selection clauses, choice of law clauses, appointment of service agent or waiver of notice altogether, limitation period, or waiver of the right to a trial by jury. There are also examples of contracts that modify 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, while others include asymmetric clauses that enable the party

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69 See e.g., Bremen v. Zapata Off-Shore Co, 407 U.S. 1, 9-10 (1972) (holding the prima facie validity of forum selection clauses at 10).

70 See, RESTATEMENT (SECOND) OF CONFLICT OF LAWS 186-87 (1988) (stating that, with few exceptions, the law chosen to govern by the parties is the law that will be applied); Uniform Commercial Code §1-301; See also, Dykes v. DePuy, Inc., 140 F.3d 31, 39 (1st Cir. 1998) (“upholding choice of law agreement 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)).

71 See, e.g., Nat’l Equip. Rental v. Szukhent, 375 U.S. 311, 315-16 (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 Insurance Association, 48 F.R.D. 15, 26 (E.D. Tenn. 1969) (citing Szukhent). See also Barker v. Greenstreet Financial, L.P., 823 So. 2d 195, 196 (Fla. 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 FRCP provide for waiver of service of process and direct mailing of the complaint. See, Fed. R. Civ. P. 4(d).

72 In some jurisdictions parties may limit the time in which actions based on contract may be brought. See e.g. Gifford v. Travelers Protective Association, 153 F.2d 209, 211 (9th Cir. 1946) (upholding six month limitation on bringing claims for benefits under insurance contract); Chilcote v. Blue Cross & Blue Shield United, 841 F. Supp. 877, 879 (E.D. Wis. 1993) (holding the validity of limitation period provided that it is reasonable); Some jurisdictions also recognize the ability to contractually extend the statute of limitations for a reasonable time. See, e.g., Collins v. Environmental Systems, Inc., 3 F.3d 238, 242 (8th Cir. 1993) (applying and then predicting Minnesota law). Others, however, do not allow extension at all. See, e.g., E.L. Burns Co., Inc. v. Cashio, 302 So. 2d 297 (La. 1974) (denying the right to extend the statute of limitations).

73 U.S. Const., Amend. VII. Fed. R. Civ. P. 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. Thorn Rock Realty Co., 46 F.3d 183 (2d Cir. 1995); Leasing Serv. Corp. v. Crane, 804 F.2d 828 (4th Cir. 1986); On jury trial waivers see e.g., Stephen J. Ware, Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights, 67 LAW & CONTEMP. PROB. 167, 169-70 (2004); Chester S. Chuang, Assigning the Burden of Proof in Contractual Jury Waiver Challenges.

74 See, e.g., Asset and Purchase Agreement between The Brown Schools, Inc., and Psychiatric Solutions, Inc. (February 13, 2003), available at cori.missouri.edu/pages/ksearch.htm
who might suffer irreparable harm from breach of contract to seek temporary injunctive relief without the necessity of posting a bond or other security.\footnote{See, e.g., Employment Agreement between Scott Smith and The Amacore Group, Inc, WL Filing 081020286.}

In this section we examine the advantages of pre-dispute contractual stipulations, symmetric and asymmetric, about pleading standards. In Section III we demonstrate how such stipulations may indeed be incorporated into the contract, and we compare the costs of doing so before and after \textit{Twombly}. We show that whereas before \textit{Twombly} modifying the pleading standard was difficult to incorporate into a contract and implement in court, contracting around \textit{Twombly} is easier, and should therefore prove more likely to be applied.

\textbf{A. Symmetric Application of the Pleading Standard}

The main obstacle to agreeing to modify the \textit{Twombly} pleading standard after a dispute arises is the standard’s distributive effect. Any post-dispute agreement would change the likely outcome of the litigation, thus benefiting one litigant at the expense of his adversary. This is not necessarily the case before the dispute arises.

An agreement to opt out of \textit{Twombly} and embrace the \textit{pre-Twombly} standard is more likely at the time of contracting because the parties act behind a ‘veil of ignorance’.\footnote{Generally there are other reasons why procedural stipulations are more likely before the dispute than after it, as the parties enjoy a higher degree of trust and cooperation. See Jeffrey J. Rachlinski, \textit{Gains, Losses, and the Psychology of Litigation}, 70 S CAL L REV 113 (1996); Russell Korobkin and Chris Guthrie, \textit{Psychology, Economics and Settlement: A New Look at the Role of the Lawyer}, 76 TEX L REV 77 (1997); Linda Babcock, et al, \textit{Forming Beliefs about Adjudicated Outcomes: Perceptions of Risk and Reservation Values}, 15 INTL REV L & ECON 289 (1995); Russell Korobkin and Chris Guthrie, \textit{Psychological Barriers to Litigation Settlement: An Experimental Approach}, 93 MICH L REV 107, 129-42 (1994); Peter J. van Koppen, \textit{Risk Taking in Civil Law Negotiations}, 14 L & HUMAN BEH. 151 (1990).} They typically do not know which of the many contingencies that may lead to a dispute might actually materialize. They do not necessarily know who will assume the role of a plaintiff or that of a defendant and which party will be more likely to benefit from a specific pleading standard.\footnote{Procedural arrangements may also affect the risk exposure of the parties. They may either increase that risk or decreases it, depending on the circumstances.}

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 case of disagreement, one partner might hold information and documents (concerning, for example, accounting issues), which the other would not possess. This implies that the \textit{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, since she might not be able to get hold of the information without discovery.

As we already explained, the distributive effects of pleading standards could impede any post-dispute stipulation over pleading standards. After the dispute arises, the defendant would not agree to a pre-

Twombly

standard, since the Twombly standard would enable him to pursue a 12(b)(6) motion to dismiss the lawsuit. However, since at the contracting stage none of the partners knows who will be the one to sue or to be sued, they may prefer to opt for the pre-

Twombly

standard, which does not require high specificity in supporting the allegations pleaded.

The parties’ agreement to a symmetric pre-

Twombly

standard would enable each partner to file a suit in case of a dispute, without being concerned that the information supporting his claim might be in the possession of his counterpart. It would increase the parties’ joint contractual surplus, solidify their mutual trust and strengthen their relationship. Agreeing to such a standard would increase the parties’ incentives to perform their contractual obligations, since each would know that his counterpart would not be barred from filing a suit in case he defaults. At the same time, the parties' future distributive gains and losses from their stipulation would cancel out, as they are equally likely to benefit or to suffer from it.

To sum, 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 realized.

B. Realizing Pre-Dispute Efficiencies

As we showed, 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 do so if it
allows them to realize pre-dispute efficiencies, even if the application of the standard is expected to be asymmetric.

This 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 will not be able to prove the products’ quality unless discovery is undergone. Suppose also that the value of the contract for the chain-store if the products’ quality is high is 100, and the supplier’s cost is 70, whereas if the quality is low, its value 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, opting at the contracting stage for a pre-Twombly standard might be preferred by the parties than sticking with the Twombly standard in case a dispute arises. Although a pre-dispute stipulation for a pre-Twombly standard would have asymmetric implications, since only the supplier is expected to exclusively hold the information needed to assert the chain-store’s allegation in case of a default, 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. Thus, the parties would have no incentive to agree to high quality products, since there would be no way to enforce any contractual obligation on the matter.

Since the parties’ joint surplus of an agreement 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) between them at the time of contracting. As a consequence, the supplier would know that the chain-store’s threat to sue him in case he defaults and provides low quality products is credible. Expecting that, he would therefore provide high quality products, as agreed. Thus, although opting for a pre-Twombly standard may operate against the supplier after the dispute arises, it is in his interest to adopt it at the time of contracting.  

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

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78 Clearly, opting for the pre-Twombly standard would be desirable only if 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.
one party than his counterpart. 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 assumed so far that the parties’ information about future contingencies is symmetric at the time of contracting. This, however, is not always the case. A negotiating party may possess private information which his partner cannot verify prior to contracting.

Take for example a start-up company and a large technology firm who enter a joint venture agreement for the development of a new technological product. The start-up would often hold private information pertaining to the prospects of success of its product. 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 case of failure. The higher the start-up's probability of success, the lower is 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 accessibility to court proceedings. 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 plausibility requirements of the Twombly standard. 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 in order to enable the firm to file a suit and move to discovery in case the start-up breaches the contract.

The start-up can agree in the contract to adopt the pre-Twombly standard. Since the costs of such a stipulation would be higher for a start-up that knows its prospects of success are low than for a start-up whose prospects of success are high, the start-up may use this procedural stipulation to signal to the firm its private information about its prospects of success.

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To make things more concrete, suppose that the probability of success is low, say 0.2, for an average start-up, but that for few start-ups this probability is higher, say 0.7. 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 probability 0.8, whereas the high probability start-up expects to be sued only with probability 0.3. Therefore, the expected costs 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 is filed and it survives a 12(b)(6) motion to dismiss, then the expected costs of agreeing to a low pleading standard are even lower for the high probability start-up, since no 'incriminating' evidence would be uncovered.

Thus, 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 offer. The average start-up would demand a higher minimum premium for this modification, and would therefore decline the firm's offer. Hence, the high probability start-up can signal its private information by agreeing, in addition to a liquidated damages clause, 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. Its aim is to enable efficient signaling. This aim is different from that in the example we gave in the previous section, where the stipulation was used to shape pre-dispute behavior. In our example here, it was 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. Modification of the procedural mechanism was therefore used only to convey pre-contractual information.

To conclude, by agreeing at the contracting stage to a pre-Twombly stipulation contractors are offered the opportunity to signal their private information to their counterparts. Thereby, the modifiable pleading standard

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80 Albert Choi and George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 27 J. LEGAL STUD. 503 (2008), demonstrate how litigation costs can help induce efficient behavior, given possible abuse of the legal system and its inaccuracy. Thus, their argument concerns the necessity of litigation costs to overcome *moral hazard* problems. 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 also Robert Scott and George Triantis, *Anticipating Litigation in Contract Design*, 115 Yale L. J. 814, 863-64 (2006).
serves as a welfare enhancing information revelation mechanism for the contracting parties. This mechanism may be unavailable otherwise.

III. TWOMBY AS A DEFAULT PLEADING STANDARD

So far we showed that by opting for the pre-Twombly standard, contracting parties can resolve inadequate screening and realize pre-dispute and post-dispute gains. In this section 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 contractors to make pre-dispute pleading standard stipulations, and show that such opportunity is easier to implement today than it was in the pre–Twombly era. We show that contracting around the heightened Twombly standard back to the liberal pre-Twombly standard is much easier to negotiate, draft and enforce compared to the reverse modification.

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 may not be the standard that most parties would have contracted for if they had a choice,\(^8^1\) it may nevertheless prove preferable for contractors compared with the pre-Twombly standard due to the lower costs of contracting around it.\(^8^2\)

**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 by using one of two possible options. One option is to modify the standard directly, by adopting the pre-Twombly standard. The other option is to waive at the outset the right to file a 12(b)(6) motion in case a suit is filed. Either option would assure the parties that in case a dispute arises none would be barred from pursuing discovery in order to reveal any information necessary to substantiate his allegations.\(^8^3\)

Adopting the pre-Twombly pleading standard directly into a contract can be done using various alternative formulations. The recent proposals in the Senate


\(^8^3\) The parties may apply one-sided modification that would apply only if one of them is to file a lawsuit. Although the implications of such modifications follow 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.
and the House of Representatives provide suggestive language for such provisions. One option would follow the language used in The Notice Pleading Restoration Act of 2009 which 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". 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." Clearly, there are various other possible contractual formulations for implementing the same outcome and elaborating on their exact wording exceeds the scope of this paper. It suffices to note that any of these alternatives would simply opt back to the pre-Twombly legal regime. Consequently, a court implementing it would use the same interpretation of the pleading standard it was using when deciding a 12(b)(6) motion to dismiss before Twombly.

The adoption of a waiver of the right to file a 12(b)(6) motion, either in any future lawsuit or in well pre-defined situations, is much easier to formulate as well as to enforce than the adoption of the pre-Twombly standard. The clear language of such stipulation would avoid interpretation uncertainty by denying the right to file a motion to dismiss, thus limiting the court's discretion to decide whether to enforce the provision or not. Simplicity, however, may come at a cost of over-inclusiveness, as it would leave the plaintiff wide latitude in filing lawsuits, even greater than she had under the pre-Twombly standard.

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86 Furthermore, opting for a pre-Twombly standard might seem less clear and specific than an undertaking not to file a 12(b)(6) motion since some commentators have argued that Twombly did not change any of the Supreme Court's prior notice-pleading threshold. See supra note 34.
87 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 Robert Scott and George Triantis, Anticipating Litigation in Contract Design, 115 Yale L. J. 814 (2006) [hereinafter Scott and Triantis, Anticipating Litigation] 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. See also Albert Choi and George Triantis, Completing Contracts in the Shadow of Costly Verification, 27 J. Legal Stud. 503 (2008) (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 over preferred Bankruptcy procedures).
Like any contractual arrangement, a pre-dispute stipulation to opt out of any pleading standard imposes on the parties bargaining and formation costs. The parties are likely to evaluate these costs against the benefits of such procedures and to decide whether to incorporate them into their contract. Since these costs are borne with certainty at the time of contracting, yet their benefits are uncertain and may be realized only in case a dispute arises, that benefit must be sufficiently large 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 it would have been to affect the reverse modification during the *pre-Twombly* era. If at that time, contracting parties were to adopt a different standard than the standard implemented by the courts, 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 proved cumbersome, thereby increasing the costs of negotiating and drafting that standard.

Moreover, the parties would have had no guarantee how courts would interpret their tailored standard. Being used to apply the *pre-Twombly* standard, courts would have been confronted with enormous difficulties in interpreting and applying the parties' specific standard. As the enormous literature and case studies following *Twombly* demonstrate, even if the standard is set in a court's decision, there are difficulties in interpreting and applying it. An attempt to implement a similar standard set in a contract would have been certainly bound to create enormous interpretational uncertainties.

Finally, and probably most significantly, since a stipulation providing for a tailored heightened pleading standard would have limited the plaintiff's access court and would have raised the concern that it contravenes the drafters' intention to abandon fact pleading, courts would have been likely to not to enforce it. The turmoil following the the Supreme Court's decisions in *Twombly* and *Iqbal* is only suggestive of the harsh implications attributed to any such change.

In comparison to the high costs of agreeing to opt out of the *pre-Twombly* standard, the costs of opting out of *Twombly* are lower, and the likelihood that it would be enforced in court is higher. This is true especially if the parties opt for a waiver of Rule 12(b)(6) motion to dismiss, but also if they opt for the alternative approach of formulating a *pre-Twombly* standard. Drafting such a provision requires the parties to refer back to the publicly known and long practiced formulation in *Conley*. That standard is a minimal one, and thus operates as a natural focal point for the parties to agree on.

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88 See supra, note 34.
This implies not only low negotiation and formulation costs, but also low costs of enforcement by the court, and as a consequence - high likelihood that such a stipulation would indeed be enforced. Furthermore, opting out of the Twombly standard provides for a lower access threshold to the courts, and therefore does not imply any constitutional concerns. The high likelihood of enforcement of a pre-Twombly stipulation clearly maximizes the utility from incorporating this standard into the contract, which looms high especially when compared to the low costs of such incorporation.

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 rational advocates the majoritarian standard – the one that most parties would have contracted for if they had a choice. The alternative rational advocates the standard that minimizes the costs of contracting around, implementing and failing to modify the pleading standard. The two rationales do not stand in conflict, since contracting parties must take into account both the costs of modification, and the number of cases where such modification would be called for. We now demonstrate how they should be accounted for in comparing the desirability of the two pleading standards.

As we explained, the Twombly standard would be chosen by contracting parties whenever they expect to hold symmetric information and evidence at the time of the dispute and they expect the plaintiff to opportunistically file a frivolous suit only to impose high discovery costs on the defendant. Conversely, the pre-Twombly standard would be chosen when the parties expect that the prospective defendant would hold private information and evidence, thus preventing the plaintiff from substantiating her claim before full discovery.

Since discovery costs are low, and information is symmetric in most contract cases, it may well be the case that the pre-Twombly standard would

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92 See, e.g., Thomas E. Willging, Donna Stienstra, John Shapard and Dean Miletich, *An Empirical Study of Discovery and Disclosure Practice Under the 1993 Federal Rule amendments*, 39 B.C. L. Rev. 525, 531 (finding that for most cases discovery costs are modest).
have been optimal in most contracts. The Twombly standard may nevertheless prove better for contractors, since its modification is much easier to incorporate into the contract and to enforce in court.

Suppose, for the sake of argument, that contracting parties would prefer the pre-Twombly standard to apply in 90% of the cases, and the Twombly standard only in the remaining 10% of the cases. Suppose also that the expected loss of efficiency due to an inadequate pleading standard, be it the Twombly standard or the pre-Twombly standard, is 100. Finally, suppose that modification costs of the Twombly standard are 10, whereas the pre-Twombly standard is too costly to modify.

Under the pre-Twombly standard the total costs would equal 10 (inefficiency costs of 100 in 10% of the cases). Under the Twombly standard there would be no inefficiency costs, since all contractors that prefer the pre-Twombly standard would contract for it. Yet, each such modification would cost 10. Thus, the total costs of the Twombly standard would equal 9 (modification costs of 10 in 90% 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 modification costs of the Twombly standard were higher, if modification costs 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, the pre-Twombly standard might prove more efficient. On the other hand, an efficiency of Twombly, given its low modifications costs, is that it implements pre-dispute signaling and screening more efficiently than the pre-Twombly standard. This too was not taken into account in the above example.

The literature on substantive defaults has long observed that defaults are 'sticky', and that parties often refrain from contracting around them. In the case

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93 This expected loss takes into account the probability of dispute, the post-dispute and the pre-dispute inefficiencies that would result from the improper standard.
94 In particular, this implies that the costs of modification are higher than 100.
of pleading standards, the stickiness of the *pre-Twombly* standard can be explained by the specific difficulties in formulating a novel alternative standard into the contract and in implementing it in court. In comparison, the *Twombly* standard might prove less sticky, due to the relative simplicity of contracting around it. Since contracting parties who wish to opt out of *Twombly* would contract back to the familiar standard of *Conley*, *Twombly* may prove less 'sticky' than its predecessor. As the example demonstrates, the difference in the alternative standards' 'stickiness' may render *Twombly* preferable in contract cases.

To conclude, 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 view of the possibility of pre-dispute modification of the pleading standard, the costs of modification and of implementing a modified standard should be taken into account. Since the *Twombly* standard is easier to modify than its predecessor, it may prove more efficient in contract cases, even if it would induce inadequate screening in most of those cases, absent modification. Whether it would indeed prove superior depends both on the proportion of contracts that would modify it, and on the costs of such modification and its implementation.

**CONCLUSION**

The debate over *Twombly* and *Iqbal* is premised on the assumption of transsubstantivity of the Federal Rules of Civil Procedure. Thus, it contrasts different views of the overall inefficiencies and injustice created by alternative pleading standards. While any pleading standard might prove just and efficient in the aggregate, it would 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 it. 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 just and efficient irrespective of its screening inadequacies, if these can be corrected by pre-dispute modification.

This essay 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 option, evaluation of the efficiency and justice in cases where the parties have prior contractual relationships must take into account the effects and costs of such pre-dispute procedural modifications.