The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

March 16, 2018

Dear Chairman Clayton,

We write on behalf of Public Citizen, a non-profit membership organization with more than 400,000 members and supporters nationwide, and Better Markets, a non-profit, non-partisan, and independent organization that promotes the public interest in the financial markets. We are greatly distressed by recent remarks from a sitting Commissioner and from the Director of Corporation Finance inviting companies considering going public to essentially challenge the U.S. Securities and Exchange Commission (SEC or Commission) to allow companies to include forced arbitration provisions in initial public offering (IPO) documents.[1] As organizations committed to protecting investors, we write to strongly urge that you reject any such proposals.

We were pleased to hear your comments at a recent Senate Banking Committee hearing that forcing investors into mandatory arbitration is not on your priority list, but we are alarmed at the continuing, seemingly concerted, efforts by others within and outside of the agency that aim to gut essential investor protection rights. This letter will detail some of our views on the matter, and urge you not to go down in history as the Chairman who, instead of empowering and protecting investors, stripped them of their right to seek redress in court by forcing them into mandatory arbitration.

Such proposals are indefensible on legal and policy grounds: They would deprive shareholders of the only realistic means of redress for fraud and manipulation; remove an

[1]Bloomberg, "SEC Weighs a Big Gift to Companies: Blocking Investor Lawsuits" (Jan. 26, 2018), *available at* https://www.bloomberg.com/news/articles/2018-01-26/trump-s-sec-mulls-big-gift-to-companies-blocking-investor-suits.

important deterrent against corporate misconduct; restrict the flow of information to the SEC and other regulators about market-wide abuses; and conflict with the clear intent of Congress and the courts.

I. Forced Arbitration Prevents Individuals from Accessing Justice

Last August, Public Citizen wrote to you expressing concern over comments by Commissioner Michael Piwowar suggesting that he was in favor of allowing companies to include forced arbitration provisions in IPO documents.[2] Forced arbitration clauses, which use fine-print "take-it-or-leave it" agreements to abolish investors' fundamental rights and remedies, have become ubiquitous in such varied settings as agreements governing bank accounts, student loans, cell phones, employment, and even nursing home admissions. These clauses deprive people of their day in court when they are harmed by violations of the law, no matter how widespread or egregious the misconduct may be. Instead, people are forced into biased, secretive arbitration proceedings with little right to appeal if arbitrators ignore the facts or law. When forced arbitration clauses are combined with class action bans, neither judges nor arbitrators can assess or remedy the full scope of wrongdoing that affects multiple victims.

The bottom line is that for most investors, their rights under federal securities laws can only be vindicated by banding together because of the expense and complexity that bringing an individual securities action entails. The SEC must not allow the use of such agreements to infect the IPO process in the way they have infiltrated most financial services agreements.

II. Investors Play an Indispensable Role in Securities Enforcement

We further believe that taking such a step would be contrary to legislative intent and judicial and SEC interpretation of the laws that govern the agency. Congress and the federal courts have acknowledged that investors play a critical role in policing the marketplace to ensure that public companies play by the rules. In passing the Private Securities Litigation Reform Act, Congress chose to improve the class action process, not ban it, and in doing so, acknowledged the importance of private enforcement to protect market forces and investors.[3] The U.S. Supreme Court has supported this common sense policy, saying that "implied private actions provide 'a most effective weapon in the enforcement' of the securities law and 'are a necessary supplement to Commission action.'"[4] And a federal circuit court summarized the role of class actions under

[2] Letter from Lisa Gilbert and Remington A. Gregg to Hon. Jay Clayton, U.S. Securities and Exchange Commission (Aug. 11, 2017), *available at* https://www.citizen.org/system/files/case_documents/letter_to_sec_on_piwowar_comments.pdf.

[3] H.R. Conf. Rep. No. 369, 104th Cong., 1st Sess. (1995) ("[P]rivate lawsuits promote public and global confidence in our capital markets and help deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.").

[4] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985) *quoting* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).

the securities laws well: "Class actions are a particularly appropriate and desirable means to resolve claims based on the securities laws, 'since the effectiveness of the securities laws may depend in large measure on the application of the class action device.'"[5]

Investors play an important complementary role to government enforcement, and they must be maximally empowered to protect themselves and help punish wrongdoing and deter future fraud. The SEC employs 4,600 individuals to oversee:

- approximately $72 trillion in securities trading each year;
- disclosures of 8,100 public companies; and
- the activities of 26,000 registered entities.[6]

These are huge responsibilities that make it impossible for SEC enforcement staff to police the marketplace alone.

Rick Fleming, the SEC Investor Advocate, recently remarked that "our regulatory framework assumes that investors themselves will serve an important role in policing the markets" and "have typically borne a large share of the responsibility of policing the markets and rooting out misconduct."[7] Not only do private lawsuits complement government enforcement, but at least one empirical study has shown that private lawsuits have provided "*greater deterrence* against more serious securities law violations" than SEC enforcement actions.[8] And according to Commissioner Robert Jackson, "roughly sixty cents of every dollar returned to investors in corporate-fraud cases came through private rather than SEC settlements."[9] The rights of investors to help police misconduct are even more important when the government is prevented from taking action.[10] Finally, settling disputes in open court not only holds wrongdoers accountable, but "tells the public that we take corporate fraud seriously—and sends a signal to insiders, the bar, and investors, that being unfaithful to investors doesn't pay."[11]

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[5] Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir. 1985) (quoting Kahan v. Rosenstiel, 424 F.2d 161, 169 (3d Cir. 1969)).

[6] *Examining the SEC's Agenda, Operations, and Budget*, House of Representatives Financial Services Committee, 115th Congress, 2nd Sess. (2017) (statement of Jay Clayton, Chairman), *available at* https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget.

[7] Rick Fleming, SEC Investor Advocate, Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders (Feb. 24, 2018), *available at* https://www.sec.gov/news/speech/fleming-sec-speaks-mandatory-arbitration.

[8] Stephen Choi & Adam Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* 36 (Law & Economics Working Papers, Art. 55, 2012) (emphasis added), *available at* https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1168&context=law_econ_current.

[9] Robert J. Jackson, Jr., SEC Commissioner, Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration (Feb. 26, 2018), *available at* https://www.sec.gov/news/speech/jackson-shareholders-conversation-about-mandatory-arbitration-022618.

[10] *See* Kokesh v. SEC, 137 S. Ct. 1365 (2017) (finding that "[d]isgorgement, as it applied in SEC enforcement proceedings," operated as a penalty and therefore was barred by statute of limitations).

[11] Jackson, *supra* note 9.

Thus, it is clear that private lawsuits play an indispensable role in policing misconduct, deterring bad actors, and returning ill-gotten corporate gains to investors. Allowing companies to force investors into arbitration would sideline them from carrying out their indispensable role as a complementary enforcement mechanism.

III. Prohibiting Forced Arbitration Provisions is Well Within the Commission's Legal Authority

The Commission is well within its legal authority to prohibit public companies from forcing investors into arbitration. The Securities Act of 1933 and the Securities Exchange Act of 1934 ('34 Act) include anti-waiver provisions that nullify a contract that seeks to waive compliance with those laws,[12] and the SEC has a mandate to protect investors against "manipulative and deceptive" practices.[13] In addition, the Supreme Court has recognized that the Commission has authority under the statutes to regulate the use of arbitration to ensure that it does not prevent the vindication of investors' rights.[14] Forcing investors into a system that would prevent the class remedies that are essential to effective enforcement of investors' rights is in our view clearly manipulative.

Even where the SEC has allowed the use of arbitration under the securities laws, most notably in the FINRA rules authorizing the use of customer arbitration agreements by broker-dealers, it has acted to ensure that the availability of class actions in court is not impaired,[15] and has used its authority to shine greater transparency on the arbitration process in the expungement context.[16]

In addition, allowing companies to force investors into arbitration is contrary to the agency's previous interpretation of the law. In 2012, the private equity firm Carlyle Group indicated its intention to insert forced arbitration clauses and class action bans into its IPO agreements. After receiving feedback from the SEC, Carlyle dropped the provision. Around the same time, the Commission sided with Pfizer against its shareholders who sought to include an arbitration clause in proxy materials that were to be distributed by the company.[17]

Finally, allowing issuers to avoid accountability under the securities laws by using arbitration clauses to squelch securities class actions would not only be unprecedented, but also

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[12] *See* 15 U.S.C. §§ 77n, 78cc ("Waiver Provisions").
[13] 15 U.S.C. § 78j.
[14] Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 238 (1987).
[15] *See* Charles Schwab & Co. v. FINRA, 861 F. Supp. 2d 1063, 1068–69 (N.D. Cal. 2012).
[16] *See* FINRA Regulatory Notice on Expungement of Customer Dispute Information (Dec. 6, 2017), *available at*http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf; *see also* Letter from Susan Harley and Remington A. Gregg to Marcia E. Asquith, FINRA (Feb. 5, 2018) (on file with authors).
[17] *See generally* Pfizer Inc., SEC No-Action Letter, 2012 WL 587597.

counter to the trend of congressional intentions and actions, including the Dodd-Frank Wall Street Reform and Consumer Protection Act[18] and the Private Securities Litigation Reform Act.[19]

IV. Conclusion

Many organizations oppose allowing corporate actors to sneak forced arbitration clauses into IPO documents. Among them is the Council of Institutional Investors, which recently wrote to the Commission, stating that forced arbitration represents a "potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business."[20]

If the Commission takes its role to protect investors seriously, and we believe it does, it can only come to the conclusion that forced arbitration clauses are a grave threat to investors' ability to assist the government in policing the marketplace, rooting out misconduct, and deterring bad actors. We would welcome the opportunity to meet with you to discuss these important issues, and if you have any questions in the meantime, please contact Remington A. Gregg (Public Citizen) at remington.gregg@citizen.org and Lev Bagramian (Better Markets) at lbagramian@bettermarkets.com.

Sincerely,

Robert Weissman
President
Public Citizen

Dennis Kelleher
President and Chief Executive Officer
Better Markets

Cc:
Honorable Kara M. Stein
Honorable Michael S. Piwowar
Honorable Robert J. Jackson, Jr
Honorable Hester M. Peirce

[18] Included in the Dodd-Frank Act were amendments to Section 15 of the'34 Act and Section 205 of the Investment Advisors Act of 1940 ("40 Act"), which give the SEC the authority to ban forced arbitration clauses and class action waivers used by broker-dealers and investment advisers.

[19] Codified at 15 U.S.C. § 78u-4.

[20] Letter from Jeffrey P. Mahoney to William H. Hinman, Director, Division of Corporate Finance (Jan. 29, 2018), *available at* https://www.cii.org/files/issues_and_advocacy/correspondence/2018/January%2029%202018%20letter%20to%20Mr_%20Hinman%20on%20forced%20arbitration%20(final).pdf.

Mr. Rick Fleming, Investor Advocate
Mr. William H. Hinman, Director, Division of Corporation Finance