

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION— House FSC Democrats urge Clayton to uphold investor suits in face of calls for mandatory arbitration, \(Mar. 13, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

A letter signed by all 26 Democratic members of the House Financial Services Committee urged SEC Chairman Jay Clayton to maintain the SEC's current policy of allowing investor class action law suits and to avoid upending this policy by letting companies force investors to arbitrate claims. Representative Carolyn Maloney (D-NY), ranking member of the House FSC's Subcommittee on Capital Markets, Securities, and Investment, led the representatives in [calling](#) for the SEC to retain its existing policy.

Anti-waiver provisions. The Democrats' letter cited the anti-waiver provisions in federal securities laws and the Supreme Court's recognition of private suits under the antifraud provisions of federal securities laws as reasons to continue to bar mandatory arbitration of investor claims. Moreover, the letter noted the primacy of investor law suits as an alternative to government intervention as stated in the [conference report](#) for the Private Securities Litigation Reform Act, which referred to such suits as an "indispensable tool."

As further support for allowing investor suits, the representatives noted that SEC staff told Gannett Co., Inc. in February 2012 that it could [exclude](#) a shareholder proposal from its proxy materials that had called on the company to amend its bylaws to implement forced arbitration of certain claims. Gannett had argued that the proposal, among other things, asked the company to violate federal law such that exclusion of the shareholder proposal would be warranted under Exchange Act Rule 14a-8(i)(2).

"Forcing shareholders to individually arbitrate their Federal securities claims, however, would effectively eliminate private securities litigation as a meaningful supplement to Commission enforcement of the securities laws, thereby undermining the comprehensive scheme of enforcement that Congress envisioned," said the representatives.

Is SEC considering forced arbitration? Chairman Clayton has said on multiple occasions that allowing companies to adopt mandatory arbitration clauses is not a high priority for him. In a tense exchange with Sen. Elizabeth Warren (D-Mass) before the Senate Banking Committee in early February, Clayton said "I'm not anxious to see a change in this area."

Clayton had prefaced his reply by saying that he did not want to "prejudge" the issue should it come before the Commission; he also said he could not "dictate" whether the arbitration clause issue came before the Commission. Moreover, Clayton emphasized that mandatory arbitration was not on his list of areas where the SEC can do better.

Senator Warren ended her questioning of Clayton about the arbitration issue by noting it is the SEC's mission to protect investors: "I cannot think of anything that would do more harm to investors than saying they have to pre-waive their rights to sue in a class action when that company cheats them."

More recently, Clayton addressed the mandatory arbitration issue in a [Q&A session](#) with former SEC Chairman Harvey Pitt during the Practising Law Institute's annual SEC Speaks conference in late February. Clayton told Pitt that the arbitration issue was not on the SEC's agenda and he reiterated that he was not eager to deal with the issue.

SEC Investor Advocate Rick Fleming, [speaking](#) at the same PLI conference, acknowledged that there are some arguments for arbitration (e.g. lowering the cost of going public to encourage more IPOs) and the "messy" state

of the applicable law, but he nevertheless urged caution about letting companies go forward with mandatory arbitration clauses, which he described as "draconian" and "counterproductive" to capital formation. He cited the SEC's authorities to slow the registration process under Securities Act Section 8(a) and provisions in both the Securities Act (Section 14) and the Exchange Act (Section 29(a)) that void terms that require the waiver of compliance with applicable securities laws.

According to Fleming, mandatory arbitration could upset the balance between the SEC's enforcement authorities and private law suits, both of which seek to hold companies accountable, but in different ways (e.g., disgorgement versus full restitution). Fleming also said mandatory arbitration could result in expanded SEC authorities to police companies or spur private market solutions, such as index providers barring companies that require arbitration from appearing in stock indices.

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