Securities Regulation Daily Wrap Up, INITIAL PUBLIC OFFERINGS—SEC's Jackson remains skeptical of mandatory arbitration proposals, (Feb. 27, 2018)

Securities Regulation Daily Wrap Up

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By John M. Jascob, J.D., LL.M.

SEC Commissioner Robert Jackson has expressed continued skepticism about any SEC rule proposals that would permit companies to sell shares in initial public offerings while mandating the arbitration of any shareholder disputes. In remarks before the CECP CEO Investor Forum in New York, Jackson echoed comments he made at his Senate nomination hearing in October, saying that he does not have the sense that we have too much accountability in corporate America today. Accordingly, we should be careful about handcuffing the investors who play such an important role in detecting fraud by forcing them to rely on private arbitration proceedings.

Private shareholders on the beat. Jackson stressed the importance of shareholder suits in policing corporate wrongdoing. The commissioner noted that in 2016, approximately sixty cents of every dollar returned to investors in corporate-fraud cases came through private rather than SEC settlements. In addition, more federal securities-fraud suits were filed in 2017 than in any year since 1995, when Congress passed the Private Securities Litigation Reform Act (PSLRA). At a time when the SEC's enforcement efforts are facing both budgetary constraints and legal limits, such as those imposed by the Supreme Court's *Kokesh* decision, we should hardly be thinking about depriving shareholders of their day in court, Jackson said.

Costs of corporate justice in the dark. Jackson also emphasized the benefits of having these private disputes resolved in public courts. A public hearing gives judges a chance to tell corporate insiders what the law expects of them and sends a signal to insiders, the bar, and investors that being unfaithful to investors doesn't pay. Arbitration proceedings, on the other hand, are usually held behind closed doors, depriving investors of their chance to air their objections and depriving the public of the knowledge of what the law is.

The commissioner acknowledged that lawsuits have their own costs, but noted that steps have already been taken to address those concerns, such as the enactment of the PSLRA and the limitations that the Delaware courts have placed on shareholder litigation. Those steps were the product of careful consideration of the views of the millions of investors, Jackson observed, rather than the result of a one-sided process initiated by corporate lobbyists.

The path ahead. Any policy proposal requiring investors to rely on private arbitration rather than the courts will need to provide rigorous answers to the many legal questions, said Jackson. For example, what would the effect of SEC action in this area be for state law? What would the Delaware courts say about the relationship between forced arbitration and a board's fiduciary duties? And would the SEC's approval of such provisions even be consistent with the federal securities laws?

In addition, the burden of investigating and litigating these cases may fall entirely on the SEC, if shareholders are denied their day in court. Given the sheer scale of private enforcement of the securities laws, Jackson expressed skepticism that the government could ever fully prevent corporate wrongdoing on its own. In order to evaluate proposals like these, therefore, we would need to know what it will cost the markets—and the investors who rely upon them—to face more frequent corporate fraud. "Whatever path we choose, we should choose it in broad daylight," Jackson said.

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