Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions

Chairman Jay Clayton

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The issue of mandatory arbitration provisions in the bylaws of U.S. publicly-listed companies has garnered a great deal of attention. As I have previously stated, the ability of domestic, publicly-listed companies to require shareholders to arbitrate claims against them arising under the federal securities laws is a complex matter that requires careful consideration.[1]

On various occasions, I have been asked about this issue in the hypothetical context of whether the staff of the Division of Corporation Finance would declare effective the registration statement of a domestic company seeking to include mandatory arbitration provisions in its governing documents at the time of its initial public offering. In response to these inquiries, I stated that, if the issue were to arise in an actual initial public offering of a domestic company, it would not be appropriate for resolution at the staff level but would rather be best addressed in a measured and deliberative manner by the Commission.

The issue has risen again, but it is being presented in a different context. A domestic, publicly-listed company has received a shareholder proposal that would require the company to take steps to adopt mandatory arbitration provisions. The company has asked the staff of the Division of Corporation Finance for informal guidance on whether the company may exclude the proposal from its proxy statement. Specifically, the request seeks the staff's view on whether, under Rule 14a-8(i)(2), the company may omit from its proxy statement a shareholder proposal relating to mandatory arbitration of shareholder claims arising under the federal securities laws. Rule 14a-8(i)(2) permits exclusion of a proposal that, if implemented, would cause the company to violate any state, federal or foreign law to which it is subject. The company has argued that the proposal, if implemented, would result in a violation of both federal and state law.

This is a complex matter under both federal and state law, and it has been interpreted differently by the company (arguing that such a clause would violate both state and federal law) and the proponent (arguing that such a clause would not violate state or federal law). The staff considered in its analysis the arguments made by the company, the proponent and the Attorney General of New Jersey, the state's chief law enforcement officer and legal advisor. The staff issued a response stating that it would not recommend enforcement action should the company decide to exclude the proposal on the grounds that it would violate New Jersey state law. In the context of Rule 14a-8, the staff does not independently adjudicate the legality of any provision of state law, and it is not doing so in this matter. Here, the parties have each asserted different interpretations of state law, neither party has identified New Jersey case law precedent directly on point, and the Attorney General has provided an opinion that implementation of the proposal would violate state law. In light of the submissions, and in particular the letter of the Attorney

General of New Jersey, I believe the approach taken by the staff—to not recommend enforcement action in this complex matter of state law—is appropriate.

The staff of the Division of Corporation Finance explicitly noted that it was not expressing a view as to whether the proposal, if implemented, would cause the company to violate federal law. Since 2012, when this issue was last presented to staff in the Division of Corporation Finance in the context of a shareholder proposal, federal case law regarding mandatory arbitration has continued to evolve. Further, I am not aware of any circumstances where the Commission has weighed in on the legality of mandatory shareholder arbitration in the context of federal securities law. In light of the unsettled and complex nature of this issue, as well as its importance, I agree with the approach taken by the staff to not address the legality of mandatory shareholder arbitration in the context of federal securities laws in this matter, and would expect our staff to take a similar approach if the issue were to arise again. I continue to believe that any SEC policy decision on this subject should be made by the Commission in a measured and deliberative manner.

More generally, it is important to note that the staff's Rule 14a-8 no-action responses reflect only informal views of the staff regarding whether it is appropriate for the Commission to take enforcement action.[2] The views expressed in these responses are not binding on the Commission or other parties, and do not and cannot definitively adjudicate the merits of a company's position with respect to the legality of a shareholder proposal. A court is a more appropriate venue to seek a binding determination of whether a shareholder proposal can be excluded.

[1] For background, see (1) letter to the Honorable Carolyn B. Maloney dated April 28, 2018, available at https://maloney.house.gov/sites/maloney.house.gov/files/MALONEY%20ET%20AL%20-%20FORCED%20ARBITRATION%20-%20ES156546%20Response.pdf; (2) S. Hrg. 115-176, Hearing Before the S. Comm. On Banking, Housing, and Urban Affairs, Feb. 6, 2018, available at Https://www.govinfo.gov/content/pkg/CHRG-115shrg28854/pdf/CHRG-115shrg28854.pdf at 146-151; (3) Remarks before the SEC Investor Advisory Committee (March 8, 2018), available at https://www.sec.gov/news/public-statement/statement-clayton-2018-3-8.

[2] Chairman Jay Clayton, Statement Regarding SEC Staff Views (Sept. 13, 2018), available at https://www.sec.gov/news/public-statement/statement-clayton-091318. See also, Division of Corporation Finance, Informal Procedures Regarding Shareholder Proposals, available at https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8-informal-procedures.htm.