UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

April 24, 2018

The Honorable Carolyn B. Maloney
U.S. House of Representatives
2308 Rayburn House Office Building
Washington, DC 20515

Dear Representative Maloney:

Thank you for your March 12, 2018 letter regarding the ability of companies to require shareholders to arbitrate claims against them under the federal securities laws.

This matter is complex. It involves our securities laws, matters of other federal and state law, an array of market participants and activities, as well as matters of U.S. jurisdiction. It also involves many public policy considerations. Further, this issue has come before the Commission in a variety of ways and contexts and may do so in the future. Views of market participants on this issue, particularly in the case of an initial public offering (IPO) of a U.S. company, are deeply held and, in many cases, divergent. In response to the recent heightened interest from Congress and others relating to the inclusion of mandatory arbitration provisions in the charters or bylaws of U.S. companies contemplating an IPO, I have (1) made several statements[1] and (2) more recently, asked the Division of Corporation Finance (the Division) to review how this issue has arisen in the past, and may arise in the future, in connection with filings made by companies with the Division.

A summary provided by the Division of its prior approach to this issue, as well as how the Division would expect to proceed if the issue were presented in the context of an IPO of a U.S. company, is below. The summary reflects the Division's view that should a U.S. company pursue a registered IPO with a mandatory arbitration clause in its governing documents, the decision about whether to declare the filing effective should be made by the Commission, not the Division by delegated authority. I agree with the Division's view on process and, in particular, that this would be a decision for the Commission. Although I have made several prior statements on this issue, for reasons of clarity and completeness, I summarize my perspective on the issue below.

As a threshold matter, and recognizing the complexity and importance of this issue, I reiterate my personal view that any analysis of this issue or decision making by the Commission in the context of a registered IPO by a U.S. public company should be conducted in a measured and deliberative manner.

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[1] *See, e.g.*, Remarks before the SEC Investor Advisory Committee (March 8, 2018), *available at* https://www.sec.gov/news/public-statement/statement-clayton-2018-3-8.

The federal securities laws provide a basis for private rights of action by investors in the event of material misstatements as part of securities offerings. There is a long history of claims of this type being brought against U.S. publicly traded companies in our federal and state courts, including as class actions. The Division's summary notes that, in the case of foreign private issuers that have conducted registered offerings in the United States and U.S. companies that are not listed, direct and indirect limitations on such actions have been prevalent for many years. In addition, and beginning several years prior to my arrival at the Commission, certain U.S. companies conducting exempt Regulation A offerings have included mandatory arbitration clauses in their governing documents or subscription agreements. The Division's summary discusses these and other matters in more detail.

It is my view that if we are presented with this issue in the context of a registered IPO of a U.S. company, I would expect that any decision would involve Commission action (and not be made through delegated authority) and that the Commission would give the issue full consideration in a measured and deliberative manner. Such a review would take into account various considerations, including developments in applicable law and any other relevant considerations. I have reiterated these views and sought to appropriately frame this issue and my preference for such a process in my public statements.

These statements have not only addressed my perspective on the appropriate procedure for analyzing this matter but also its relative priority. With respect to priority, generally speaking, my view is that the Commission should allocate its limited rulemaking and other related resources to a portfolio of matters that (1) present currently pressing and significant issues for investors and our markets, (2) are central to our mission, (3) are ripe for consideration, and/or (4) are addressable through a reasonable share of Commission and staff time. To me, such matters currently include, among others and in no particular order, (1) standards of conduct for investment professionals, (2) Congressionally-mandated rulemaking, (3) the regulation of investment products, including ETFs, (4) the impact of distributed ledger technology (including cryptocurrencies and ICOs), (5) FinTech developments, (6) the elimination of burdensome regulations that do not enhance investor protection or market integrity with an eye toward facilitating capital formation, (7) an examination of equity and fixed income market structure, and (8) of course, inevitable issues that we have not yet identified but will emerge as pressing.

These statements have made it clear that I have not formed a definitive view on whether or not mandatory arbitration for shareholder disputes is appropriate in the context of an IPO for a U.S. company. I believe any decision would be facts and circumstances dependent and could inevitably divert a disproportionate share of the Commission's resources from the priorities I noted above. In short, this issue is not a priority for me. Although the issue is not a priority for me, it does not mean that it is not worthwhile to analyze, and I have encouraged those with strong views to support their position with robust, legal and data driven analysis. If this matter does come before the Commission, such analysis will assist the Commission in its deliberative process.

Summary Provided by the Division of Corporation of Finance:

The Division of Corporation Finance (the Division) oversees periodic filings by reporting companies and filings of issuers seeking to raise money in the capital markets through, for example, initial public offerings. The federal securities laws generally focus on requiring companies to provide full and fair disclosure of material information to investors and the Division's oversight of filings is intended to facilitate compliance with those laws.

State laws generally provide the parameters for companies to establish their corporate governance through their organizational documents, such as their charter or bylaws. The Commission does not have rules permitting or prohibiting companies from using arbitration provisions.

The Commission's processes with respect to arbitration provisions have been and may in the future be implicated through the Division's role in overseeing and processing filings by companies. The most often identified channel for this issue to arise is if a U.S. company sought to include a mandatory arbitration provision in its governing documents when it filed an initial registration statement to offer and sell securities publicly. Following is an overview of circumstances in which mandatory arbitration provisions have been and could be present in the governance documents of companies that make filings with the Commission.

Registered Offerings by U.S. Companies

A company may not sell securities in the United States unless (1) it has an effective registration statement on file with the SEC or (2) an exemption from registration is available. Section 8(a) of the Securities Act of 1933 (Securities Act) provides that a registration statement will become effective 20 days after it is filed and authorizes the Commission to accelerate the effective date of a registration statement after taking into account the adequacy of the disclosure and certain other considerations.[2] This authority to accelerate the effective date has been delegated to the Division by the Commission. By statute, registration statements become effective with the passage of time. As a matter of practice, a company will nearly always include in any pre-effective registration statement a legend, referred to as a "delaying amendment," in order to prevent the registration statement from becoming effective automatically following the passage of time and to better control the timing of its offering. During this time, the Division staff may review the filing. In the course of a filing review, Division staff will evaluate the company's disclosure and may issue comments to elicit better compliance with disclosure requirements, and the company will amend its registration statement to address the

[2] In its entirety, Section 8(a) states that "The effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, *and to the public interest and the protection of investors* [emphasis added]."

comments as appropriate. Following this review and comment process, the company submits a request to accelerate the effective date of the registration statement.

When this issue last arose in the context of an initial public offering (IPO) of a U.S. company in 2012, the Division took the position, based on a consideration of relevant federal laws and case law, that it would not use its delegated authority to accelerate the effective date of a U.S. company's registration statement when the company's governing documents contained a mandatory arbitration provision covering disputes arising under federal securities laws. In that context, the Division was unable to conclude that such provisions are consistent with "the public interest and protection of investors" as required by Securities Act Section 8(a) in light of, among other things, the anti-waiver provision in Section 14 of that Act.[3] More specifically, at that time, the Division advised a company that it did not anticipate exercising its delegated authority to accelerate the effective date of the registration statement if such a provision was included in the company's governing documents and that the Commission would need to make any decision on a request for acceleration. In that situation, the company decided not to include the mandatory arbitration provisions in its governing documents in connection with its IPO.

If this issue were to come before the Division in a U.S. company's registration statement for an IPO today, as discussed in more detail below, the Division would not use its delegated authority to accelerate the effective date of the registration statement. Instead, the Division would refer a request for acceleration to the full Commission.

The historical treatment of this issue in other circumstances, such as in the qualification of Regulation A offerings and in the processing of registration statements filed by foreign private issuers, is described below.

Other Circumstances

For many years, U.S. and non-U.S. companies have made other types of filings with the Commission that have included mandatory arbitration provisions for shareholder disputes in their governing or offering documents. These circumstances and the relevant considerations are described further below. In these circumstances, the relevant statutes and rules generally require appropriate disclosure regarding material risks to the issuer or of the offering, which would include risks relating to mandatory arbitration provisions and any impact on holders of the offered securities.

- Regulation A: Some companies utilizing the exemption from registration available under Regulation A have included mandatory arbitration clauses in their governing documents or subscription agreements. Under Regulation A, a company may not sell its securities until the Division has qualified its offering statement. In these exempt offerings, neither the federal securities laws nor the Commission's rules require the Division to make the same public interest determination as is required when accelerating the effective date of a registration statement in the context of an IPO.

[3] Section 14 states that "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void."

In 2015, after reviewing the relevant law and regulations, the Commission staff concluded that there would not be grounds to withhold qualification of a Regulation A offering on the basis that the issuer had included a mandatory arbitration provision in its governing documents. Since then, in light of the Commission staff's 2015 determination, certain offerings that have included a mandatory arbitration clause have been qualified under Regulation A, provided that the material risks of such a dispute resolution approach had been disclosed and the issuer otherwise qualified for the exemption.

- Foreign Private Issuers: For many years, a number of foreign companies with securities listed or traded in the United States have included mandatory arbitration and other analogous provisions in their filings. Registration statements of foreign private issuers offering and selling securities in the United States also generally include disclosures regarding limitations investors may face as a result of the issuer's foreign status and home country laws and regulations. These disclosures have typically included a risk factor informing investors that due to jurisdictional issues it may be difficult for them to obtain or enforce judgments or bring original actions, including actions styled as class actions, against the company. In these instances and in situations where mandatory arbitration has been required, either due to local law requirements or otherwise, the Division staff has focused on the disclosure of the material risks related to these limitations and has declared these filings effective.

- Exchange Act Reporting Companies: There are several other ways a company could be in the Securities Exchange Act of 1934 (Exchange Act) reporting regime and have a mandatory arbitration provision in its governing documents. For example, a registration statement for a class of securities pursuant to Exchange Act Section 12(g) becomes effective automatically 60 days after filing. As another example, a public reporting company could amend its bylaws or seek shareholder approval of a charter amendment or to include an arbitration provision (assuming that the applicable state law allows for the enforceability of such a provision)[4]. In any of these situations, the Commission's rules would require appropriate disclosures to investors.

Considerations

Mandatory arbitration clauses involve complexities beyond the Commission and its rules. For example, they raise issues under the state corporate laws under which the issuers are organized. In addition, federal case law regarding mandatory arbitration continues to evolve. Since 2012, when this issue was last presented to the Division in the context of an IPO of a U.S. company, the Supreme Court has affirmed the strong federal interest in promoting the arbitration of claims under federal laws.[5] Over the last several years, commentators have observed that there is uncertainty as to whether the Commission

[4] *See* Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes*, 39 Del. J. of Corp. Law 751, 779-782 (2015) (discusses circumstances where arbitration clauses included in public issuers' filings) ("Allen").
[5] *See, e.g.,* American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013) (holding that, under the Federal Arbitration Act (FAA), courts must "rigorously enforce" arbitration agreements according to their terms unless the FAA's mandate has been "overridden by a contrary congressional command").

would have a basis to deny an acceleration request in these circumstances.[6] If a U.S. company were to file for an IPO with governing documents that included a mandatory arbitration provision, the Commission would need to evaluate the specific facts and circumstances in the context of not just the federal securities laws but also state corporate and other federal law. This is a complex legal and policy issue that requires careful consideration. As such, and as discussed above, if the issue were presented to the Division in the context of an IPO for a U.S. company, the Division would decline to exercise its delegated authority to accelerate the effective date of a registration statement and instead refer the matter to the Commission for its consideration.

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Thank you again for your letter. Please do not hesitate to contact me at (202) 551-2100 or Bryan Wood, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you have any questions or comments.

Sincerely,

Jay Clayton
Chairman

[6] *See, e.g.*, Allen at 778 (fn 141).