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Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Arbitration Provisions Threaten Market Integrity And Are Contrary To The Federal Securities Laws

Dear Chair White:

We are a group of 29 professors from19 different law schools[1] across the country, each with a specialized focus on and expertise in issues of corporate law or the federal securities laws. Although we hold different views on many aspects of the law in these areas, we are in agreement that the judiciary serves an essential role in the development and enforcement of corporate and securities laws and the protection of investors, and that the judiciary's involvement in the resolution of shareholder disputes is necessary to preserve the integrity of this nation's public financial markets.

We write to bring to the Commission's attention a rapidly developing trend whereby publicly traded businesses, without the approval of their shareholders, are attempting, through broadly written provisions, to limit or eliminate access to state and federal courts for adjudication of a broad range of claims that shareholders may have. We therefore urge the Commission to closely review the potentially harmful impact these practices may have on the historic and important role that private rights of action play in protecting investors, and ultimately to make clear that efforts by corporate boards to eliminate the ability of investors and shareowners to enforce their rights in a public judicial forum is contrary to the federal securities laws.

Background

[1] Each signer does so individually and his or her institutional identification is provided solely for informational purposes and does not reflect the position of an institution.

Recent years have seen substantial increases in state law shareholder litigation relating to corporate transactions, especially mergers and other types of acquisitions.[2] Additionally, more of these cases have been filed outside of Delaware, where almost half of all public corporations in the United States are incorporated, and thus the traditional forum for the resolution of shareholder disputes.[3] In an effort to rein in multi-forum litigation, an increasing number of corporations have adopted bylaws designating an exclusive forum for the resolution of shareholder disputes. As of September 2011, over 300 publicly-traded corporations had adopted such bylaws. (Such provisions, however, are not the focus of this request.)

At the same time, the U.S. Supreme Court has interpreted the scope of the Federal Arbitration Act ("FAA") to allow greater enforcement of arbitration agreements. Notably, in *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011), the Supreme Court held that the FAA requires courts to enforce class-action waivers in arbitration agreements contained in consumer contracts. And more recently in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), the Court held that the FAA requires courts to enforce arbitration provisions that bar class actions with respect to federal claims, as well as state claims.

These two developments have begun to conflate, with publicly-traded businesses purporting to designate arbitration as the exclusive forum for the resolution of *all forms* of shareholder disputes through, *inter alia*, bylaw amendments and registration statements. For example, as the Commission is aware, the Carlyle Group recently attempted in anticipation of its IPO to amend its partnership agreement and registration statement to require the arbitration of all shareholder disputes on an individual basis in anticipation of its IPO; after the Commission objected, the Carlyle Group removed the provision. And, in *Corvex Management L.P. v. Commonwealth REIT*, No. 24-C-13-001111, Baltimore City, Part 23 (May 8, 2013), the trustees of a REIT similarly adopted an extraordinarily-broad arbitration bylaw that purported to require that *all* shareholder disputes be arbitrated. A circuit court for the City of Baltimore enforced the bylaw to require arbitration of a claim that the company's board of directors had breached their fiduciary duties responding to a proxy contest from an activist shareholder. In so doing, the court relied in part on its interpretation of the requirements of the FAA.

As discussed below, the FAA has never been interpreted to require the enforcement of bylaws or similar provisions unilaterally adopted to remove judicial oversight of investor disputes. Although often analogized to "contracts," corporate bylaws – particularly in public

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[2] In 2007, shareholders filed litigation relating to about forty percent of public company mergers. By the first half of 2011, ninety percent of the deals exceeding $100 million were challenged; the number rises to ninety-six percent for deals above $500 million. *See* Joseph A.Grundfest & Kristen A. Savelle, The Brouhaha over Intra-Corporate Forum Selection Provisions: A Legal, Economic, and Political Analysis, 68 Bus. Law. 325, 335 (2013).

[3] Delaware has seen its dominance in the forum of choice for resolving suits against Delaware corporations plummet since 2001, so that the percentage of merger challenges filed exclusively in Delaware reached its lowest point of 30 percent in 2006. There has been no similar change with respect to challenges filed against non-Delaware corporations, which are traditionally brought in the corporation's home state.

corporations that form the basis of the nation's financial markets – are vastly dissimilar to the kind of contractual agreements that have been enforced by courts, including the Supreme Court, under the FAA. We believe that in the absence of a clear Congressional mandate to permit the forced arbitration of shareholder disputes, the Commission should continue to exercise its well-founded and long-held opposition to such provisions as being contrary to the anti-waiver provisions of the securities laws.

Judicial Review Of Investor and Shareholder Disputes Involving Publicly-Traded Businesses Protects The Integrity of the Nation's Financial Markets

We believe that it is essential to maintaining the integrity of our nation's financial markets that investors and shareholders have access to the courts to resolve claims under the federal securities laws. The federal securities laws provide a range of enforceable rights that protect shareholders and thereby significantly enhance investor confidence in U.S. securities markets. An important component in the investors' faith in the U.S. capital markets is the independence and transparency that has historically accompanied their vindication of the rights and protections accorded them through the courts. For example, private litigation of federal securities claims has significantly advanced the development of the federal securities laws, generating a set of standards regarding corporate disclosure duties that guides corporate action and management behavio. Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder in particular, serve a public purpose by providing a means for private investors to police securities fraud and maintain the integrity of the markets. Similarly, private enforcement of the Exchange Act's proxy rules greatly enhances shareholder participation in the governance of public corporations. These are public rights that are being vindicated and their vindication should happen in a public forum.

Arbitration simply is not an equivalent medium for meaningful oversight of the rights of investors and shareholders. Arbitration proceedings are not public, and arbitration decisions do not require written opinions. In arbitration, there is no requirement that principles of *stare decisis* guide decisions, and arbitrators may or may not have the expertise and experience of a judge. Moreover, arbitrators do not face the same level of review or public accountability as do judges generally. And appeals and other important procedures and safeguards that are available in court are not available in arbitration. In short, forcing investor and shareholder disputes into arbitration would fundamentally alter investor confidence in the corporate form, by eliminating any real ability of shareholders – the owners of publicly traded corporations – to rely on the existence and enforceability of the disclosure obligations to which corporations and their managers are subject.

Forcing Arbitration Of Shareholder Disputes Is Contrary To The Federal Securities Laws

In the absence of any statutory presumption in favor of arbitration, the Commission should continue to regard mandatory arbitration provisions as contrary to the public policy concerns that animate the federal securities laws, and as inconsistent with the "anti-waiver" provisions of Section 29(a) of the Exchange Act ("Section 29(a)") and Section 14 of the Securities Act ("Section 14").

For decades, the Commission has taken the view that public policy concerns weigh heavily against the inclusion of arbitration clauses in the corporate documents of public companies. In 1990, then SEC Assistant General Counsel Thomas L. Riesenberg explained that "it would be contrary to the public interest to require investors who want to participate in the nation's equity markets to waive access to a judicial forum for vindication of federal or state law rights, where such waiver is made through a corporate charter rather than an individual investor's decision."[4] And more recently, Commissioner Luis A. Aguilar observed that "[i]t is unrealistic to expect that the Commission will have the resources to police all securities frauds on its own, and as a result, it is essential that investors be given private rights of action to complement and complete the Commission's efforts."[5]

Concerns that such provisions run afoul of the letter of the securities laws are equally well founded. Congress has recognized investors' right to private enforcement of the securities laws in the Private Securities Litigation Reform Act of 1995 (the "PSLRA") 15 U.S.C. §§ 77z-1 *et seq.* and 78u-4 *et seq*,, which sets forth detailed guidance regarding the role of lead plaintiffs in private class actions to enforce the securities laws. This explicit statutory instruction highlights the key function of federal securities class actions in maintaining the transparency and integrity of the U.S. capital markets. *See* Joint Explanatory Statement of the Committee of Conference on H.R. 1058 at 31, reprinted in 2 U.S.C.C.A.N. 730 (104th Cong., 1 st Sess. 1995).

We believe that by substantially weakening investors' access to the courts, mandatory arbitration clauses run afoul of Sections 14 and 29(a), which provide that "any condition, stipulation, or provision waiving compliance with either Act is void.

The nature of the threat mandatory arbitration provisions pose to investor access to the courts is underlined by the Supreme Court's decision in *Shearson-Am. Exp. Inc.* v. *McMahon*, 482 U.S. 220, 228 (1987). In *McMahon*, the Court concluded that only "where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights," would enforcement of an agreement to arbitrate not constitute a waiver of compliance with any provision of the Exchange Act under Section 29(a). *Id.* at 238. With respect to mandatory arbitration provisions in corporate bylaws the Commission does not have oversight of the type referred to in *McMahon*. The current mandatory arbitration provisions in broker-customer agreements therefore arise from a very different arrangement than that approved by the Supreme Court The extreme feature of mandatory arbitration clauses is not only the absence of Commission oversight but more importantly the absence of any one-on-one interchange from which consent can be said to arise that arbitration will be the exclusive means for resolving any future dispute. Accordingly, mandatory arbitration provisions violate Section 29(a).

For the above reasons, the undersigned professors respectfully request the Commission evaluate the validity of corporate provisions restricting shareholder access to the courts.

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[4] *See* Thomas L. Riesenberg, *Arbitration and Corporate Governance: A Reply to Carl Schneider*, Insights, Aug. 1990, at 2.

[5] Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission, *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court* (Apr. 11, 2012), available at http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1365171490204#.UjhoQuDDlQs

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