

SEC Continues to Grapple with Mandatory Arbitration Hot Potato

WRITTEN BY

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The Securities and Exchange Commission has again had to confront how to react to a mandatory arbitration provision that would have the effect of denying investors the ability to pursue federal securities law claims as a class action in a federal court. Mandatory arbitration provisions are controversial as a policy, legal and political matter and have presented the SEC with challenges. The latest challenge is responding to a no-action request to exclude under Rule 14a-8(i)(2) a shareholder proposal requesting adoption of a mandatory arbitration bylaw. On February 11, 2019, the staff of the Division of Corporation Finance issued a no-action letter to Johnson & Johnson, a New Jersey corporation, approving exclusion of the bylaw proposal based upon the company's position, supported by the Attorney General of New Jersey, that the bylaw would violate state law.^[1] Accompanying release of the no action letter was a statement from Jay Clayton, Chairman of the SEC, explaining that the staff action (i) reflected only informal views of the staff and was not binding on the Commission, (ii) did not address the legality of a mandatory arbitration bylaw as a matter of federal law, and (iii) was not a definitive determination of the legality of the shareholder mandatory arbitration bylaw under state law but rather acceptance of the company's position, especially backed by the opinion of the New Jersey Attorney General.

Previously, the question of a mandatory arbitration bylaw came up in the context of whether the Corp Fin staff would accelerate the effectiveness of a registration statement when the issuer adopted such a bylaw. The question never had to be addressed because the bylaw was rescinded. Chairman Clayton has made clear that should the question of the treatment of a mandatory arbitration bylaw have to be addressed, it would need to be resolved at the Commission level.

Dealing with a mandatory arbitration bylaw presents a difficult question for the SEC because of the conflicting considerations that surround this question. On the one hand, a decision to allow a mandatory arbitration bylaw would, if legal, deprive investors of access to the federal courts and the ability to bring a class action for federal securities law claims as contemplated by the securities laws. In addition, such a bylaw is of doubtful validity as a matter of state law. The Delaware Court of Chancery recently held invalid a bylaw requiring federal securities law claims to be filed in federal court because the bylaw did not involve the "internal affairs" of the corporation and thus was beyond the permissible scope of bylaws.^[2] On the other hand, the Federal Arbitration Act ("FAA"), as interpreted by the U.S. Supreme Court, expresses a strong public policy in favor of arbitration as a remedy and has been held to preempt inconsistent state law and to trump other federal law that does not expressly negate application of the FAA. The relationship of the federal securities laws and the FAA, however, has not yet been determined.

It is clear that the final chapter for mandatory arbitration bylaws has not yet been written. Companies considering

adoption of a mandatory arbitration bylaw should have in mind the current landscape at the SEC and the uncertainties continuing to surround these provisions.

[1] A copy of the no-action letter can be found here: <https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/dorisbehrjohnson021119-14a8.pdf>

[2] See *Sciabacucchi v. Salzberg* 2018 WL 6719718 (Del. Ch. Dec. 19, 2018); see also *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 952 (Del. Ch. 2013)

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