January 16, 2018

The Honorable Jay Clayton
Chair
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chairman Clayton:

Last month, the Wall Street Journal reported that Hal Scott, who owns a trust with shares in Johnson & Johnson, is pushing a proposal that would deprive J&J investors of their right to pursue their claims in court when they believe they have been defrauded by the company. Scott's move is designed to force the Commission to reconsider the question of whether public companies can legally adopt forced shareholder arbitration clauses.[1] The 56 under-signed organizations and individuals are writing on behalf of middle income, working Americans who turn to our nation's capital markets to save for retirement and other long-term goals to urge you to grant J&J the no action relief it is seeking and to reaffirm the Commission's long-held position that forced arbitration clauses are illegal under the federal securities laws.[2]

The small investors whose interests we represent are the primary, and often unknowing, beneficiaries of a system that allows shareholders to band together to enforce securities law violations through private class action lawsuits. If Scott were to prevail, these small investors wouldn't just lose their right to bring their claims in court, they would lose their ability to bring their claims at all. Indeed, without the ability to share the costs of litigation through class actions, only the largest institutional investors would have the means to pursue shareholder claims in arbitration, and some of the most serious and complex frauds would be difficult if not impossible to pursue even for them.

In short, Scott's reported claim that "mandatory arbitration wouldn't dilute shareholders' rights, and would only affect where a dispute is heard, and not whether shareholders can mount a claim" is clearly false. At best, Scott's preferred approach would create a system of haves and have nots, in which only the largest of institutional investors are able to seek compensation for their losses from securities fraud, likely at the expense of small investors who were similarly harmed but unable to seek recovery. At worst, it would eliminate this vital deterrent to financial fraud entirely, doing untold harm to the integrity of U.S. capital markets. For these reasons, a broad coalition of investor advocates have previously written to you urging you to preserve defrauded investors' access to the courts.[3]

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[1] Dave Michaels, "Johnson & Johnson Drafted Into Fight Over Shareholder Lawsuits," The Wall Street Journal, Dec. 13, 2018, https://on.wsj.com/2EAZGnY.
[2] Barbara Roper and Micah Hauptman, A Settled Matter: Mandatory Shareholder Arbitration is Against the Law and the Public Interest, Consumer Federation of America, Aug. 21, 2018, https://bit.ly/2UQNkx9.
[3] Letter from 133 organizations and individuals to SEC Chairman Jay Clayton, August 21, 2018 https://bit.ly/2rK3Kdr.

As you know, SEC officials of both parties going back many decades have recognized that private litigation plays a vital role in compensating the victims of fraud and supplementing the SEC's own enforcement efforts. Former SEC Chairman Richard Breeden summed up the importance of the issue well when he stated that private lawsuits "are instrumental in recompensing investors who are cheated through the issuance of false and misleading information or by other means." If defrauded investors weren't able to hold wrongdoers accountable, he added, "investors would be far less willing to participate in our securities markets. This would limit the most important source, and raise the costs, of new capital for all American businesses."[4] As former SEC Chairmen William Donaldson and Arthur Levitt and former Commissioner Harvey Goldschmid wrote in a joint amicus brief, "Private cases, so long as they are well-grounded, are an important enforcement mechanism supplementing the SEC in the policing of our markets. Most often, the larger the frauds, the greater investors must rely on private cases to recover their losses."[5]

We recognize that you have previously stated that you did not wish to bring the issue of mandatory shareholder arbitration before the Commission,[6] but Scott has forced it upon you. The ideal outcome for investors would be for the staff to grant Johnson & Johnson's request to exclude the proposal from its proxy ballot on the grounds that it would violate federal securities laws, as they have done on several occasions in the past.[7] However, past statements by the division director, William Hinman, suggest that the Commission staff may have pre-judged the issue in favor of permitting forced arbitration.[8] That renders all the more important your pledge that any decision to change the Commission's long-standing policy would be made at the Commission level and only after an open and deliberative process.[9] Failure to grant Johnson & Johnson the no action relief it has requested in a timely manner would in itself constitute a significant change in policy without the deliberative process you have pledged to undertake.

Any such change would raise numerous issues that demand the kind of careful deliberation you have promised. The question of whether forced arbitration is permitted is just the first of many

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[4] SEC Chairman Richard Breeden, Private Litigation under the Federal Securities Laws, Hearings before the Senate Securities Subcommittee (1993) https://bit.ly/2Miptpg.
[5] SEC Chairman William Donaldson, Chairman Arthur Levitt (D), Commissioner Harvey Goldschmid, Brief Amici Curiae of Former SEC Commissioners, Stoneridge Investment Partners, LLC v. Scientific-Atlantic, Inc, 552 U.S. 148 (2008) https://bit.ly/2nEFozM.
[6] See, e.g., Letter from SEC Chairman Jay Clayton to Rep. Carolyn Maloney et al, Apr. 24, 2018 ("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.")
[7] See, A Settled Matter at 15-19, discussing five separate instances in which the SEC has either refused to accelerate IPO filings for companies seeking to include mandatory arbitration clauses (Franklin First Financial Corp. in 1988 and The Carlyle Group LP in 2012) or granted no action relief, like that currently being requested by Johnson & Johnson, to permit companies to exclude mandatory arbitration proxy proposals (Alaska Air Group, Inc. in 2008 and Gannett Co., Inc. and Pfizer Inc., during the 2011-12 proxy season).
[8] Susan Antilla, Will Shareholders Lose the Right to Sue Over Corporate Fraud?, The Intercept, Aug. 21, 2018, https://bit.ly/2GlcSz2.
[9] Letter to Rep. Carolyn Maloney et al ("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.")

issues the Commission would need to decide if it went down this path.[10] For example, if a forced arbitration clause were adopted by an already public company, such as Johnson & Johnson, what would be the effect on investors who bought their shares before the severe limitations in their rights for recovery were adopted? Would investors have adequate notice of the change? If the change impacted the stock price, would that change create any liability risks? If a company were to adopt a mandatory arbitration clause, and then engage in arbitration, how could this impact its disclosure processes? For example, would the existence of the arbitration itself create material, non-public information? And if it could, how would that be managed? These issues may quickly become remarkably complex, as some key shareholders bringing claims would have greater information than others. The Commission cannot reasonably change its long-standing policy regarding forced arbitration without careful consideration of these and a host of other complex issues raised by such a change.

Since news first emerged that some within the Commission were pushing for a change in Commission policy on forced shareholder arbitration,[11] a number of parties have weighed in in opposition to such a change. These have included Members of Congress, State Treasurers of both parties, the nation's leading securities law professors, institutional investors, and our own broad array of pro-investor organizations. Despite their disparate backgrounds and viewpoints, these individuals and organizations have shared a common message: private class action lawsuits provide an essential supplement to the Commission's own enforcement actions. By threatening that dual system of public and private enforcement, forced shareholder arbitration would weaken deterrence and undermine market integrity. That would be bad for investors, bad for the markets, and bad for the economy as a whole. We therefore look forward to working with you and your fellow commissioners to ensure that this important element of the investor protection arsenal is preserved.

Respectfully submitted,

AFL-CIO
Alaska Public Interest Research Group
Alliance for Justice
American Association for Justice
American Federation of State, County and Municipal Employees (AFSCME)
Americans for Financial Reform Education Fund
Arkansans Against Abusive Payday Lending
Better Markets
Center for American Progress
Center for Justice & Democracy
Center for Responsible Lending
Colorado AFL-CIO
Communications Workers of America (CWA)
Congregation of Sisters of St. Agnes

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[10] See, A Settled Matter, at 48-49 for a more detailed discussion of the issues that could arise if a public company were to adopt a forced arbitration clause through a bylaw change.

[11] Benjamin Bain, SEC Weighs a Big Gift to Companies: Blocking Investor Lawsuits, Bloomberg, Jan. 26, 2018, https://bloom.bg/2BvUfAL.

Consumer Action
Consumer Assistance Council, Inc.
Consumer Attorneys of California
Consumer Federation of America
Consumer Federation of California
Consumer Watchdog
Consumers for Auto Reliability and Safety
The D.C. Consumer Rights Coalition
Demand Progress Education Fund
Economic Policy Institute
Essential Information
Fund Democracy
The Impact Fund
International Brotherhood of Teamsters
International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW)
Bevis Longstreth, Retired partner, Debevoise & Plimpton; former Commissioner, SEC
Montana Organizing Project
Mountain State Justice
National Association of Consumer Advocates
National Consumers League
National Employment Lawyers Association
National Employment Law Project
National Latino Farmers & Ranchers Trade Association
New Jersey Citizen Action
The One Less Foundation
Reverend Chester Payne
Priests of the Sacred Heart, US Province
Protect All Children's Environment
Public Citizen
Public Justice
SafeWork Washington
Service Employees International Union (SEIU)
Sisters of St. Francis of Philadelphia
Texas Watch
Lynn Turner, former SEC Chief Accountant
United Auto Workers
U.S. PIRG
Virginia Citizens Consumer Council
Virginia Organizing
Woodstock Institute
Workplace Fairness
YWCA of the University of Illinois