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Commentary: Trump administration could block investor access to courts

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In recent years, forced arbitration clauses have swept the nation, closing the courthouse doors to countless injured and defrauded individuals. In private arbitration, the defendant company typically picks the arbitration tribunal, where plaintiffs lose their ability to obtain important discovery and their right to present their case to a jury of their peers. If plaintiffs receive a bad ruling, they have no right to appeal. Confidential arbitration — unlike trials in open, public courthouses — routinely silences victims, conceals the extent of wrongdoing and allows companies to escape accountability.

The Trump administration is now inviting corporations to impose forced arbitration on investors. These new efforts to block investors from banding together and pursuing remedies for securities fraud in open court threaten the retirement savings of millions of Americans and the integrity of the nation's capital markets. Given these troubling developments, the investment community must rise up and take affirmative action before it is too late.

Why worry now? What's changed?

Historically, the Securities and Exchange Commission has protected investors from the encroachment of mandatory arbitration. The SEC has refused to greenlight initial public offerings where companies insisted on mandatory arbitration bylaws and successfully persuaded companies to eliminate proposals for mandatory arbitration provisions, including in high-profile instances involving The Carlyle Group, Pfizer, Google (now Alphabet Inc.) and Gannett Co.

Under the Trump administration, however, the SEC and Treasury Department have signaled a seismic policy shift. In 2017, SEC Commissioner Michael S. Piwowar made a clear overture for corporations to force investors into mandatory arbitration: "[F]or shareholder lawsuits, companies can come to us to ask for relief to put in mandatory arbitration into their charters. I would encourage companies to come and talk to us about that," Mr. Piwowar said in a July speech to the Heritage Foundation, a conservative public policy group. The Treasury Department followed up with a voluminous report suggesting mandatory arbitration be used to evade shareholder litigation and class actions.

Critical to keep courthouses open to securities claims

Access to the public courthouse has reaped immense benefits for investors. Federal securities class actions have recovered more than $100 billion for defrauded investors within the past 20 years alone, according to Securities Class Action Services data. Through waves of corporate scandal, class actions have secured exponentially greater recoveries for injured investors than government actions and held wrongdoers accountable when government regulators failed to take any action because of lack of resources, interest or expertise.

The return of real money to defrauded investors, no matter the size of their investment, is only possible when investors are able to band together and pursue relief in the courts. Studies show that far fewer claims are pursued when would-be plaintiffs are forced to arbitrate. The average individual retiree, for instance, cannot justify the high costs of arbitration to pursue a securities fraud claim. Institutional investors also would lose out. Taking on the expenses and burdens of go-it-alone arbitration against well-heeled corporations would make economic sense only in the rare mega securities frauds. Even then, institutional investors would be forced to adjudicate their claims piecemeal in a morass of individual pay-as-you-go proceedings, with far fewer legal tools and protections than in court.

Forced arbitration also threatens a crisis of public confidence in our nation's capital markets. Eliminating the majority of securities actions and deciding the few cases that remain individually in closed-door proceedings would only embolden fraudulent conduct and insulate management from accountability. At the same time, the securities laws' ability to compensate victims of fraud and deter future misconduct would suffer greatly.

Plan of engagement: Investors must take action now

Given the extreme swing in the regulatory environment, investors cannot afford to sit on their hands. They must take decisive action to preserve their critical access to the courts. The SEC might act quickly, and investors need to be highly proactive and engaged to resist any regulatory blessing of forced arbitration. The engagement should occur on multiple levels:

1. Investors should directly advocate their positions to lawmakers and regulators. Such advocacy works. In 2015, prominent institutional investors fought back and won a legislative reversal of a Delaware Supreme Court ruling that appeared to endorse one-way fee-shifting bylaws designed to discourage shareholder litigation. The investment community should proactively coordinate its engagement with Congress and the SEC on the importance of keeping the courthouse doors open to investors.
2. Investors should mount a grass-roots campaign that draws upon both shareholder advocacy groups and direct engagement with corporations, using their investment dollars to send the message that they will not surrender their right to the courthouse. This strategy has recently reaped huge benefits in other high-profile campaigns. To address global warming, for example, more than 225 determined institutional investors with more than $26 trillion in assets are directly engaging with the world's largest carbon emitters, and already have persuaded Exxon Mobil Corp., ConocoPhillips Co. and Royal Dutch Shell PLC to develop business plans that better address climate change. Similar grass-roots campaigns and direct engagement with companies regarding basic court access is necessary now.
3. Investors should "vote with their assets." Earlier this year, pressure from the institutional investor community and proxy advisory firms led the top four index fund companies — Standard & Poor's, Dow Jones, MSCI and FTSE Russell — to restrict from their flagship indexes companies that employ multiclass stock structures aimed at entrenching insiders and disenfranchising public investors. The investment community can send a similarly strong message by refusing to invest in companies that seek forced arbitration and class-action bans and by petitioning index providers to exclude those companies from their indexes.

Investors have achieved immense benefits by enforcing the securities laws in public courthouses. Now, a dramatic shift in priorities under the Trump administration threatens to block investors' access to the courts, effectively strip investors of critical protections and foster a crisis of public confidence in our nation's capital markets. The need for decisive and coordinated action by the investment community is urgent. As new calls emerge to cram investors into individual, closed-door arbitration, the investment community must again make its voice heard to preserve its access to the courts.

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