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SEC chair not eager to take action on unequal stock schemes, IPO arbitration

The SEC Chair said his agency has limited resources and because of that he was hesitant to commit to actions on topics of interest to the institutional investors.

Dietrich Knauth | 14 Mar 2018

The chair of the **Securities and Exchange Commission** expressed reluctance to take additional action on dual-class stock structures and arbitration clauses in companies' initial public offerings.

Jay Clayton, speaking at the **Council of Institutional Investors**' spring conference in Washington, D.C. on March 12, said that his agency has limited resources, and that he was hesitant to commit to game-changing actions on topics of interest to the institutional investors in attendance.

Unequal voting stock

One topic which has discussed frequently at the conference was dual-class capitalization structures, in which some classes of stock carry more voting weight than others. The issue has been more hotly debated by investors since the 2017 IPO of **Snap**, the maker of *SnapChat*, which sold shares of common stock that conferred no voting rights at all. SEC commissioner **Robert Jackson, Jr.** said in February that such structures were

undemocratic, and called for listing standards addressing the use of perpetual dual-class stock that can be passed down to heirs without any diminishing of voting power. Clayton, however, was more circumspect when asked about dual-class shares at the CII event.

"I'm not putting this at the front of the agenda for something we should weigh in on," Clayton said.

Clayton said that the "one share, one vote" model is not the only model of governance for successful public companies, although extreme examples like Snap were cause for concern.

"Where you draw the lines, and whether that's something that should be done by the SEC or by the stock exchanges or some other authority – or by people with a great deal of capital to put to work in the markets – is a question worthy of debate," Clayton said. "But from my own perspective, I'm not an absolutist on either end."

The moderator interviewing Clayton, former SEC Chair **Elisse Walters**, agreed with that position.

"I do think that some modified voting structures can work, but the extreme ones really bother me, and the ones that go on in perpetuity, forever, are a little bit like a dictator ship, and that bothers me too," Walters said. "I do think that there is something in between, and frankly, I don't think it's something the Commission should muck around in directly. Talking to the exchanges about listing standards is different."

Shareholder lawsuits or mandatory arbitration?

Clayton also declined to take a firm position on arbitration clauses in companies' initial public offering documents, another issue of concern to CII members. Mandatory arbitration was the subject of controversy during **Carlyle**'s 2012 IPO, when it initially included such a provision before dropping it in response to pressure from shareholder activists and the SEC.

CII members have expressed concern about clauses that require arbitration to settle shareholder disputes and accusations of fraud, rather than class action lawsuits. Those worries were exacerbated by SEC

commissioner **Michael Piwowar**'s comments indicating support for shareholder arbitration provisions in corporate charters, made during a 2017 speech to the Heritage Foundation.

Clayton said he wasn't anxious to weigh in on the topic, but that he would try to address it fairly if it came before the SEC.

"Because it is an emotionally charged issue, and one that would take a lot of time and a lot of commission bandwidth, as I said, I'm not anxious to take up this issue at this time," Clayton said. "This is a big deal. So I'll do it right, if I do it. I don't want to do it! I have other things I want to do. But it's not my choice. If someone wants us to decide it, there's not much I can do about it. If it comes before us, I will do it in a fair way."

Clayton did not, however, reassure a questioner who asked if the SEC would go through a formal rulemaking process, with a public period, before changing the SEC's longstanding policy that mandatory arbitration in IPO documents violates the anti-waiver provisions of the federal securities law.

"I am not going to commit to a particular process, but what I am going to commit to is not doing anything like this in haste, or without input from all interested constituents," Clayton said.

Company efforts to block shareholder proposals

CII members also expressed concern about SEC guidance, released in November, on the rules that allow company boards to exclude shareholder proposals from proxy statements if they deal with the company's "ordinary business" or if they don't have sufficient "economic relevance." Institutional investors often use shareholder proposals to pressure companies on environmental, social, and governance issues, and one CII member asked whether SEC's new guidance was too deferential to company boards.

"My short answer is no, but I think that you can assess that over the next shareholder proposal period, and I'm sure you will tell us if you think the pendulum has shifted," Clayton said.

The SEC has thus far supported at least one company's effort to block a shareholder proposal on "economic relevance" grounds since the new guidance was issued. In February, the SEC allowed **Dunkin' Brands Group** to exclude a proposal that would have required the board to assess the environmental impacts of continuing to use its branding on K-Cup coffee pods.

Clayton said he was supportive of the change in SEC guidance, which nowrequires SEC staff to include a discussion of a company board's analysis before deciding whether a proposal met one of the exclusion criteria. Considering input from boards, who are more familiar than SEC staff about issues of "ordinary business" and "economic relevance," should make for more thorough determinations, Clayton said.

"I think it's good to hear from the directors what they think," Clayton said.

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