Written Testimony of

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on

Putting Investors First: Reviewing Proposals to Hold Executives Accountable

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Good afternoon Chair Maloney, Ranking Member Huizenga, and Members of the Subcommittee:

Thank you for inviting me to testify before you. My name is Remington A. Gregg, and I am counsel for civil justice and consumer rights at Public Citizen. Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent the public interest through legislative and administrative advocacy, litigation, research, and public education on a broad range of issues including ensuring access to justice for all people. Pertinent to this hearing, Public Citizen has had a long interest in holding corporate bad actors accountable by reining in corporate misconduct, ensuring transparent corporate policies, safeguarding whistleblowers from retaliation for exposing wrongdoing, and stopping the insidious practice of forced arbitration. While my testimony will identify several issues where Public Citizen believes Congress can act to put investors first while holding corporate executives accountable, my testimony's main focus is on why Congress should ban corporate wrongdoers from forcing investors into pre-dispute binding arbitration (commonly known as forced arbitration).

I. PROTECTING EVERYDAY INVESTORS FROM FORCED ARBITRATION

1. Forced arbitration is an inherently unfair practice

Forced arbitration clauses and bans on class actions (forced arbitration clauses) use fine-print "take-it-or-leave it" agreements to abolish investors' fundamental rights and remedies. Forced arbitration clauses have become ubiquitous in such varied settings as agreements governing bank accounts, student loans, cell phones, employment, and even nursing home admissions. These clauses deprive people of their day in court when they are harmed by violations of the law, no matter how widespread or egregious the misconduct may be. The contracts that contain forced arbitration clauses are written by corporate entities, so it is unsurprising that its terms are generally corporate friendly. Arbitration provisions generally:

- Limit the type of damages that a person can receive, such as punitive or compensatory damages;
- Prohibit individuals from banding together in a class or collective action, which may be the only realistic avenue for bringing small claims;
- Limit discovery and other attempts to obtain evidence;
    - A Public Citizen report details that "54 percent of arbitration clauses discussed discovery or evidentiary standards, in most instances to 'alert consumers that

discovery may be limited and evidentiary standards may be relaxed by comparison to litigation'";[1]

- Include arbitration fees that are "are dramatically higher than court costs"[2] and may include a "loser pays" provision which creates a significant disincentive for an individual to bring a claim for fear that they will be on the hook for all fees if they do not prevail.

Justice Hugo Black summed up the unfairness of arbitration well:

> "For the individual, whether his case is settled by a professional arbitrator or tried by a jury can make a crucial difference. Arbitration differs from judicial proceedings in many ways: arbitration carries no right to a jury trial as guaranteed by the Seventh Amendment; arbitrators need not be instructed in the law; they are not bound by rules of evidence; they need not give reasons for their awards; witnesses need not be sworn; the record of proceedings need not be complete; and judicial review, it has been held, is extremely limited."[3]

If a worker, consumer, or small business brings a claim in arbitration and loses—and the odds are very likely that they will—an arbitrator's decision is given "limited judicial review."[4] Rather, "[u]nder the [Federal Arbitration Act], courts may vacate an arbitrator's decision 'only in very unusual circumstances.'"[5] These circumstances include:

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[6]

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[1] Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration* 38 (2008), *available at* https://www.citizen.org/sites/default/files/arbitrationdebatetrapfinal.pdf.
[2] *Id.* at 39.
[3] Republic Steel Corp. v. Maddox, 379 U.S. 650, 664 (1965) (Black, J., dissenting).
[4] Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064, 2068 (2013).
[5] *Id.* (*quoting* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 942 (1995)).
[6] 9 U.S.C. § 10 (2012).

Forcing everyday investors into arbitration would deprive them not only of basic procedural rights that they are normally guaranteed in neutral, open court, but would all but prevent them from exercising their rights to appeal if they believe the arbitrator erred.

2. **Forcing all investors into individual arbitration would effectively prevent them from holding corporate wrongdoers accountable**

Thus, it is clear that workers, consumers, and small businesses are often at a disadvantage in arbitration. If everyday investors were forced into individual arbitration, they would be at a greater disadvantage because individual investors often lack the ability to bring complex securities claims on their own. "Class actions," however, "are a particularly appropriate and desirable means to resolve claims based on the securities laws, 'since the effectiveness of the securities laws may depend in large measure on the application of the class action device.'"[7] That is because federal securities law is complex. It often requires significant discovery, reliance on expert witnesses, and specialized counsel. Therefore, joining together in a class action may be the only feasible way for everyday investors to vindicate their rights against a corporate wrongdoer that has cheated them.

If everyday investors were forced to agree to arbitrate their claims individually, it would mean that many could never effectively vindicate their rights against a corporate wrongdoer.

Moreover, forcing all investors into arbitration is contrary to federal securities law because it would force them to give up their ability to vindicate their rights under the law. The Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) includes so-called "anti-waiver" provisions that nullify a contract that seeks to waive compliance with those laws.[8] The statutes state in near-similar fashion that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance [with the statute] shall be void." In addition, the Supreme Court has recognized that "barring waiver of a judicial forum" to protect investors is permissible, but that it is possible "only where arbitration is inadequate to protect the substantive rights at issue."[9] Forcing investors into a system that would prevent them from exercising class remedies, which is a critical tool for effectively enforcing their rights, would effectively prohibit an investor from vindicating their rights.

Even where the SEC has allowed the use of arbitration under the securities laws, it has acted to ensure that the availability of class actions in court is not impaired.[10] Most notably regarding Financial Industry Regulatory Authority (FINRA) rules authorizing the use of customer arbitration agreements by broker-dealers, critically, the courts have protected the right of investors to bring

[7] Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir. 1985) (*quoting* Kahan v. Rosenstiel, 424 F.2d 161, 169 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970)).
[8] *See* 15 U.S.C. §§ 77n, 78cc ("Waiver Provisions").
[9] Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 230 (1987).
[10] *See* Charles Schwab & Co. Inc. v. FINRA Inc., 861 F. Supp. 2d 1063, 1068–69 (N.D. Cal. 2012).

their claims as a class. For its part, FINRA, a self-regulating entity authorized by Congress to police the broker-dealer industry, has sought to shine greater transparency on the individual arbitration process in the expungement context.[11] Nevertheless, the FINRA process is far from perfect. According to its 2018 statistics, claimants were only awarded damages in 40% of cases, a decline over the last three years.[12] And there is concern that a significant number of investors are unable to collect their unpaid arbitration awards. It is for that reason that last Congress, Sen. Elizabeth Warren (D-MA) introduced, and Sen. John Kennedy (R-LA) co-sponsored, the Compensation for Cheated Investors Act (S. 2499), which would require FINRA to use its existing authority to compensate investors who never received their just arbitration award.[13] Thus, it hardly seems useful to place a large swath of everyday investors bringing complex claims into a system that already has significant flaws.

3. Private enforcement actions are a powerful and "indispensable" complementary tool to public sector enforcement

Congress and the federal courts have acknowledged that investors play a critical role in policing the marketplace to ensure that public companies play by the rules. Allowing everyday investors the opportunity to bring claims as a class is a powerful complementary tool to public enforcement of the nation's securities laws because private lawsuits play an indispensable role in policing misconduct, deterring bad actors, and returning ill-gotten corporate gains to investors. The conference report for the Private Securities Litigation Reform Act of 1995 (PSLRA) noted that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs."[14] Notably, in passing the PSLRA and the Securities Litigation Uniform Standards Act of 1998 (SLURA), which gives the federal courts almost exclusive jurisdiction for securities class actions, Congress

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[11] *See Regulatory Notice: Expungement of Customer Dispute Information*, FINRA (Dec. 6, 2017),http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf; *see also* Letter from Susan Harley, Pub. Citizen, Deputy Dir., Cong. Watch, and Remington A. Gregg, Pub. Citizen, Counsel for Civil Justice and Consumer Rights, to Marcia E. Asquith, FINRA, Exec. Vice President, Bd. and External Relations (Feb. 5, 2018) (on file with authors).

[12] *Dispute Resolution Statistics*, FINRA, https://w https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics ww.finra.org/arbitration-and-mediation/dispute-resolution-statistics (last visited Mar. 29, 2019).

[13] *Kennedy Joins Warren on Legislation to Compensate Investors Cheated by Brokers and Dealers*, ELIZABETH WARREN NEWSROOM (May 16, 2018), https://www.warren.senate.gov/newsroom/press-releases/kennedy-joins-warren-on-legislation-to-compensate-investors-cheated-by-brokers-and-dealers; *see also Compensation for Cheated Investors Act Summary*, https://www.warren.senate.gov/imo/media/doc/2018.3.6%20Compensation%20for%20Cheated%20Investors%20Act%20One%20Pager.pdf (last visited Mar. 29, 2019) (noting that "According to a December 2015 report by FINRA's Dispute Resolution Task Force, investors were unable to collect more than $62 million in unpaid arbitration awards in 2013 alone.").

[14] H.R. Rep. 104-369, at 31 (1995) (Conf. Rep.).

chose to make changes to the class action process, not ban it. In doing so, this body acknowledged the importance of private enforcement to protect market forces and investors.[15]

The U.S. Supreme Court has supported this commonsense policy, saying that "implied private actions provide 'a most effective weapon in the enforcement' of the securities law and 'are a necessary supplement to Commission action.'"[16] The indispensable role that private enforcement plays in policing wrongdoers is a bipartisan-held principle. Former SEC Chairmen William Donaldson and Arthur Levitt, Jr., and former Commissioner Harvey Goldschmid, who were nominated to serve by presidents of both political parties, clearly stated in an *amicus curiae* brief the importance of private enforcement. They said:

> "Investors must rely primarily on private actions to recover when defrauded. The SEC's disgorgement and civil money penalty powers, although enhanced by the Sarbanes-Oxley Act, are limited, and will generally cover only a fraction of the damage done to investors by serious securities fraud. Moreover, the SEC with limited resources cannot possibly undertake to bring actions in every one or even most of the financial fraud cases that have proliferated over the past few years. …Private cases, so long as they are well grounded, are an important enforcement mechanism supplementing the SEC in the policing of our markets."[17]

And then-commissioner Luis A. Aguilar said: "[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 to complement and complete the Commission's efforts."[18]

4. **Private enforcement not only provides complementary enforcement of federal securities laws, but provides significantly more relief to everyday investors**

In 2012, The Carlyle Group sought to include a forced arbitration clause in their revised draft registration statement. The attempt (which is explained further below) was unsuccessful. In response to Carlyle's request, 29 law professors voiced strong opposition to then-SEC Chair Mary Jo White, saying that forcing investors into arbitration was inconsistent with the anti-waiver provisions in the Securities and Exchange Acts. They said that allowing everyday investors to bring forward their claim in a neutral, open court was important because it "is essential to maintaining the integrity of our nation's financial markets that investors and shareholders have

[15] *Id.* ("[P]rivate lawsuits promote public and global confidence in our capital markets and help deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.").
[16] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985) (*quoting* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964)).
[17] Brief for Former SEC Commissioners et al. as Amici Curiae Supporting Respondents at 7-8, Stoneridge Inv. Partners, LCC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2007) (No. 06-43).
[18] *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court*, U.S. SECURITIES AND EXCHANGE COMMISSION (Apr. 11, 2012), https://www.sec.gov/news/public-statement/2012-spch041112laahtm.

access to the courts to resolve claims under the federal securities laws."[19] They argued that access to the courts ensures "independence and transparency" in the capital markets. Moreover, they asserted the importance that private litigation has on "advanc[ing] the development of the federal securities law." It is worth reemphasizing this last point. Arbitration hearings are held in secret. Oftentimes, the contract that the workers, consumers, or small businesses signed that forced them into arbitration prohibits them from disclosing the contents of the proceeding, and an arbitrator is not required to issue a written decision. As a result, arbitration is neither "an equivalent medium for meaningful oversight of the rights of investors and shareholders"[20] nor the proper venue to ensure meaningful interpretation and development of federal securities laws.

Instead, forcing investors into arbitration would "fundamentally alter investor confidence in the corporate form."[21] Forcing everyday investors into arbitration would alter the corporate form in several ways. First, the public would have less confidence that the market was being policed for wrongdoing. The SEC employs 4,600 individuals. This workforce is less than those serving in the military marching bands and roughly a third the size of the Los Angeles Police Department, yet these individuals oversee:

- approximately $72 trillion in securities trading each year;
- disclosures of 8,100 public companies; and
- the activities of 26,000 registered entities.[22]

It is implausible to believe that the agency would be able to police the markets robustly in a way that gives the public confidence that their savings was being closely guarded if the only "cop" on the beat was an extremely under resourced agency.

Second, private enforcement actions recover significantly more ill-gotten gains from corporate wrongdoers than SEC enforcement. Rick Fleming, the SEC Investor Advocate, recently remarked that "our regulatory framework assumes that investors themselves will serve an important role in policing the markets" and "have typically borne a large share of the responsibility of policing the markets and rooting out misconduct."[23] Not only do private

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[19] Letter from 29 law professors to Mary Jo White, Chair, U.S. Securities and Exchange Commission (Oct. 30, 2013), *available at* https://law.duke.edu/sites/default/files/centers/gfmc/session_2/4_letter_to_sec_re_arbitration_bylaws-10-30-2013.pdf.

[20] *Id*.

[21] *Id*.

[22] *Testimony on Examining the SEC's Agenda, Operation, and Budget Before the Comm. on Fin. Serv.U.S. House of Representatives*, U.S. SECURITIES AND EXCHANGE COMMISSION (Oct. 4, 2017), https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget (statement of Jay Clayton, Chairman).

[23] Rick Fleming, SEC Investor Advocate, Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders (Feb. 24, 2018), *available at* https://www.sec.gov/news/speech/fleming-sec-speaks-mandatory-arbitration.

lawsuits complement government enforcement, but at least one empirical study has shown that private lawsuits have provided "*greater deterrence* against more serious securities law violations" than SEC enforcement actions.[24] And according to Commissioner Robert Jackson, "roughly sixty cents of every dollar returned to investors in corporate-fraud cases came through private rather than SEC settlements."[25]

Third, the rights of investors to help police misconduct are even more important when the government is prevented from taking action.[26] Finally, settling disputes in open court not only holds wrongdoers accountable, but "tells the public that we take corporate fraud seriously—and sends a signal to insiders, the bar, and investors, that being unfaithful to investors doesn't pay."[27]

Private lawsuits play an indispensable role in policing misconduct, deterring bad actors, and returning ill-gotten corporate gains to investors. Allowing companies to force investors into arbitration would sideline them from carrying out their indispensable role as a complementary enforcement mechanism.

5. Congress must take action to protect investors

The SEC has been asked on several occasions to allow forced arbitration clauses to be included in corporate governance documents. Each time, the company has asked the SEC to issue a "no-action" letter stating that the SEC would take no enforcement action if the company resisted the proposal.[28] On two occasions, the SEC refused to accelerate the IPO filings of those companies, Franklin First Financial Corp. and The Carlyle Group, after they indicated a desire to include forced arbitration clauses in their governance documents. Both companies subsequently did not move forward with placing forced arbitration clauses in their documents. Up until this time, the SEC—with overwhelming concurrence from academics, consumer advocates, and institutional investors—has asserted that forcing investors into arbitration would be contrary to federal securities laws.

However, the SEC's stance could change. After public statements from then-Commissioner Michael Piwowar and current Commissioner Hester Peirce that they would be willing to overturn

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[24] Stephen Choi & Adam Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* 36 (Law & Economics Working Papers, No. 55, 2012) (emphasis added), *available at* https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1168&context=law_econ_current.
[25] Robert J. Jackson, Jr., SEC Commissioner, Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration (Feb. 26, 2018), *available at* https://www.sec.gov/news/speech/jackson-shareholders-conversation-about-mandatory-arbitration-022618.
[26] *See* Kokesh v. S.E.C., 137 S. Ct. 1635, 1645 (2017) (finding that "[d]isgorgement, as it is applied in SEC enforcement proceedings," operated as a penalty and therefore was barred by statute of limitations).
[27] Jackson, *supra* note 23.
[28] *See* Barbara Roper & Micah Hauptman, *A Settled Matter: Mandatory Shareholder Arbitration is Against the Law and the Public Interest*, 17-19 (2018), *available at* https://consumerfed.org/wp-content/uploads/2018/08/cfa-mandatory-shareholder-arbitration-white-paper.pdf

longstanding SEC policy, last December, a trustee of The Doris Behr 2012 Irrevocable Trust sought to include a forced arbitration clause in Johnson & Johnson's proxy materials. In February 2019, Chairman Jay Clayton announced that SEC staff "would not recommend enforcement action [against Johnson & Johnson] should the company decide to exclude the proposal on the grounds that it would violate New Jersey state law."[29] To be clear, Chairman Clayton left the door wide open for shareholders to take another bite at the apple and force the SEC to re-examine whether including a forced arbitration provision in corporate governance documents would violate federal law. Last month, The Doris Behr 2012 Irrevocable Trust sued Johnson & Johnson seeking declaratory relief that the company violated the federal securities laws by failing to include a forced arbitration clause proposal in its proxy materials and injunctive relief requiring the company to: (1) "issue supplementary proxy materials that include the Trust's proposal;" (2) "announce" that the Trust's proposal is legal under federal and state laws, and (3) prevent "Johnson & Johnson from excluding proposals of this sort from future proxy materials."[30] Even if the court denies the Trust's prayers for relief, this issue—and the danger that it poses to everyday investors and their savings—will not go away until Congress acts.

Investors' rights will only be truly protected if Congress passes the Investor Choice Act, which has been introduced in three previous Congresses. This legislation would amend federal securities laws to prohibit issuers, brokers, dealers, or investment advisers from the use of pre-dispute arbitration agreements. The bill would not prohibit investors from choosing to arbitrate *post-dispute*; this decision would remain up to the investor. But everyday investors who are relying on brokers, dealers, and investment advisors to safeguard their life savings would be able to choose the forum that is right for them if they are wronged by those they entrust with their hard-earned savings.

Many organizations oppose allowing corporate actors to sneak forced arbitration clauses into IPO documents. Among them is the Council of Institutional Investors, which recently wrote to the Commission, stating that forced arbitration represents a "potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business."[31] More broadly, Public Citizen, along with almost 90 consumer, worker rights, and civil rights organizations supported the recent introduction of the Fair Arbitration Injustice Repeal (FAIR) Act, which would prohibit the use of forced arbitration in

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[29] *See Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions*, U.S. SECURITIES AND EXCHANGE COMMISSION (Feb. 11, 2019), https://www.sec.gov/news/public-statement/clayton-statement-mandatory-arbitration-bylaw-provisions (statement of Jay Clayton, Chairman); *see also* Letter from Gurbir S. Grewal, N.J. Attorney Gen., to Jay Clayton et al., Chair, U.S. Sec. and Exch. Comm'n (Jan. 29, 2019), *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/dorisbehrjohnson022219-14a8.pdf.

[30] Complaint against Johnson & Johnson, The Doris Behr 2012 Irrevocable Trust v. Johnson & Johnson, No. 3:2019-cv-08828 (D. N.J. Mar. 21, 2019).

[31] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to William H. Hinman, Director, Div. of Corporate Finance (Jan. 29, 2018), *available at* https://www.cii.org/files/issues_and_advocacy/correspondence/2018/January%2029%202018%20letter%20to%20Mr_%20Hinman%20on%20forced%20arbitration%20(final).pdf.

consumer, civil rights, employment, or antitrust disputes. And according to a national survey, 84 percent of the public supports federal legislation that ends the practice of forcing consumers and workers into arbitration. Republicans support the legislation more than Democrats (87% to 83%).[32]

II. PROTECTING EVERYDAY INVESTORS FROM INSIDER TRADING

Illegal insider trading undermines the integrity of financial markets. When corporate insiders and others who wrongfully obtain inside information trade on it, they engage in theft. Insider trading is akin to an owner selling a car that the person knows is defective for an inflated price. More broadly, illegal insider trading contributes to income inequality because senior management profits at the expense of everyday investors outside of elite circles.

Currently, the law governing illegal insider trading lacks definition. This has forced the SEC and the Department of Justice (DOJ) to rely on general anti-fraud statutes and decades of case law subject to interpretation by judges. Under current SEC interpretations, illegal insider trading is "buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security."[33] For nearly fifty years, federal prosecutors who have brought criminal insider trading charges under Section 10(b) of the Exchange Act and the SEC's implementing rule governing the law, Rule 10b-5, and more recently, litigation has focused on a personal benefit test.[34]

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[32] Guy Molyneux & Geoff Garin, *Nat'l Survey on Required Arbitration*, HART RESEARCH ASSOC. (Feb. 28, 2019), https://www.justice.org/sites/default/files/2.28.19%20Hart%20poll%20memo.pdf.

[33] *Fast Answers: Insider Trading*, SECURITIES AND EXCHANGE COMMISSION, https://www.investor.gov/additional-resources/general-resources/glossary/insider-trading (last visited Mar. 27, 2019).

[34] In Dirks v. S.E.C., 463 U.S. 646, 662 (1983), the Supreme Court held that a breach of duty occurs when, based on objective criteria, "the insider personally will benefit, directly or indirectly, from his disclosure." The Court explained that the relationship between the insider and the tippee involves a quid pro quo. This could either been in the form of money, or friendship. In 2014, the Second Circuit narrowed the definition of a personal benefit. In United States v. Newman, 773 F.3d 438 (2d Cir. 2014), the government charged Todd Newman and Anthony Chiasson with insider trading after material, nonpublic information had been shared with acquaintances, rather than good friends or relatives. These acquaintances later passed the tips along to others who ultimately told Newman and Chiasson. For Newman, the insider initially gave the information to a colleague and fellow alumnus of the same school while receiving casual career advice. In Chiasson's case, the initial tip was given from one acquaintance to another through a church relationship. Each tip eventually reached the defendants, who traded on it and were convicted in December 2012. The Second Circuit voided the convictions. The court argued that the initial exchange of information did not turn on a personal benefit. The court explained that the career advice given between colleagues and a conversation between acquaintances at church acquaintances did not qualify as a personal benefit. While the Supreme Court declined to review *Newman* directly, it did address the general issue in a case from the Ninth Circuit, Salman v. United States,137 S. Ct. 420 (2016). The insider-tipper in *Salman* was an investment banker who gave information to his brother. The investment banker testified that he gave the information to his brother to "fulfill whatever needs he had," along with the knowledge that his brother would trade on it. The brother also passed the information along to another person related to the banker. This person traded on that information and was convicted in the Northern District of California in 2013. The Ninth Circuit affirmed the conviction in an opinion that rejected the Second Circuit's formulation of *Newman*. The Supreme Court then decided to resolve the circuit split in favor of the Ninth Circuit. The Second Circuit's next opportunity to revisit *Newman* came in United States v. Martoma, 894 F.3d 64 (2d Cir. 2018). This year, on January 24, former SAC Capital Advisors portfolio manager Mathew Martoma petitioned the Supreme Court to review his 2014 conviction for insider trading. This conviction

We believe the personal benefit test unjustly limits the boundaries of what should be illegal insider trading. Insiders should not divulge inside information. When a person receives inside information, they should not trade with this knowledge, and each person engaged in such action should be prosecuted. Legislation was previously introduced by Rep. Jim Himes achieves these goals, and Public Citizen strongly supports this bill, which:

- Makes it unlawful for a person to trade on material, nonpublic information when the information was wrongfully obtained, or when the use of such information to make a trade would be deemed wrongful;

- Makes it unlawful for a person who wrongfully obtains material, nonpublic information to communicate that "tip" to another person when it is reasonably foreseeable that the person is likely to trade on that information;

    - The bill defines "wrongful" as information that has been obtained through "theft, bribery, misrepresentation or espionage, a violation of any federal law protecting computer data or the intellectual property or privacy of computer users, conversion, misappropriation or other unauthorized and deceptive taking of such information, or a breach of any fiduciary duty or any other personal or other relationship of trust and confidence."

- Removes the requirement outlined in the *Newman* decision.

- Authorizes the SEC to exempt any person or transaction from liability under this bill at the Commission's discretion.

III. PROTECTING WHISTLEBLOWERS

Dodd-Frank recognized the mistreatment of financial industry whistleblowers and passed strong protections for them into law. The goal was to institutionalize greater accountability by the financial industry and encourage and protect whistleblowing within the financial industry. However, in February 2018, in *Digital Realty Trust, Inc v. Somers,* the U.S. Supreme Court unanimously ruled that employees are only protected from retaliation under Dodd-Frank if they

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stemmed from 2008 activity when Martoma paid a doctor from the University of Michigan for inside information about clinical trial results for an experimental Alzheimer's medication. United States v. Martoma, 894 F.3d 64 (2d Cir. 2018), *petition for cert. filed*, (U.S. Jan. 24, 2019) (No. 18-972). Before the trial results were published, Martoma directed SAC Capital investments in instruments that led to $275 million in gains and losses avoided. The Second Circuit upheld the conviction, holding that the personal benefit requirement was satisfied by Martoma's payments to the doctor. The court attempted to reconcile the *Salman* and *Newman* cases with a further discussion of the personal benefit test.

make a whistleblower disclosure to the SEC; employees are not protected if they only make an internal disclosure.[35] This ruling brings to light a gap in Dodd-Frank that hurts companies and whistleblowers, and Congress should enact legislation to remedy this injustice.

According to a report by the Ethics & Compliance Initiative (ECI, formerly the Ethics Resource Center), 97 percent of employees blow the whistle internally at first.[36] More often than not, they are performing their job and report a perceived error and want to give their superior an opportunity to fix the problem before taking measures outside of the organization. Regardless of the motivation, internal whistleblowing provides a significant opportunity for the company to be informed of the misconduct and to engage in voluntary compliance before the problem escalates. Notably, the business community also supports this procedure of internal notification first since no company wants to be blindsided by accusations of misconduct without first having an opportunity to review the allegations and take corrective action.

Unfortunately, some companies respond to internal disclosures by trying to silence the messenger, rather than heeds their warnings. Take for instance the experience of Wells Fargo whistleblower Jessie Guitron, whose warnings could have prevented the 2016 Wells Fargo banking scandal. Shortly after she began working for Wells Fargo in 2008, Ms. Guitron noticed that her colleagues and she faced a company-mandated quota to sign up new accounts, often with misleading terms that came with large fees and ruined customers' credit. She told CBS News, "I kept complaining and complaining, and nothing ever gets done … I was doing what my conscience was telling me to do. It's fraud. That's what it is." After she reported her concerns to Wells Fargo, she was terminated in 2010 without warning and subsequently blacklisted from the financial industry, according to news reports.[37] Ms. Guitron's experience underscores the significance of protecting whistleblowers who make internal disclosures; otherwise, companies will have an incentive to make an example out of workers who are brave enough to report fraud and other misconduct.

Despite the Supreme Court's decision, it is doubtful that Congress intended to limit whistleblower protections under Dodd-Frank. Indeed, Senator Charles Grassley (R-IA), co-author of the whistleblower provisions of the Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) and co-Chair of the Senate Whistleblower Protection Caucus, asserted in an *amicus curiae* brief in support of the respondent in *Digital Realty Trust, Inc.*:

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[35] 138 S.Ct. 767.

[36] Ethics Resource Center, *Inside the Mind of a Whistleblower: A Supplemental Report of the 2011 Nat'l Business Ethics Survey* 7, 13 (2012), *available at* https://bit.ly/2TFKIjQ.

[37] *Whistleblower: Wells Fargo fraud "could have been stopped,"* CBS NEWS (Aug. 3, 2018), *available at* https://cbsn.ws/2LSCfdU.

> "In Dodd-Frank, Congress sought to enhance the whistleblower protections and reporting provisions of the Sarbanes-Oxley Act, which apply with equal force to internal and external reports. Thus, Dodd-Frank's anti-retaliation provision expressly covers 'disclosures that are required or protected' under Sarbanes-Oxley, the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), and other key federal laws…"[m]any of these disclosures are internal because Congress understood that robust internal reporting can facilitate a culture of voluntary compliance, deter wrongdoing, and protect investors while conserving scarce government resources." [38]

It has long been established in whistleblower protection statutes that employees are protected for making internal disclosures, and there is no reason to maintain this unintended loophole. Public Citizen, in conjunction with the National Employment Lawyers Association and the Government Accountability Project submitted public comments to a related SEC rulemaking proposal that argued that it is more urgent than ever that Congress close this gap, given that Dodd-Frank now requires public companies to maintain internal compliance programs.[39]

Whistleblowers must be protected in the process of making internal disclosures, or employees will be discouraged from sounding the alarm in the first place. We cannot afford to deter would-be whistleblowers since they serve as our eyes and ears to Wall Street abuses. In the current deregulatory climate, whistleblowers are consumers' most effective watchdogs. We urge Congress to pass legislation that would strengthen whistleblower rights by amending the definition of "whistleblower" in Dodd-Frank to clarify that it also applies to internal reporting under the anti-retaliation provision of the law.

IV. HOLDING CORPORATE EXECUTIVES ACCOUNTABLE

In addition to ending forced arbitration, protecting investors from insider trading, and protecting whistleblowers, Public Citizen supports legislation and regulation that ensures corporate executives are accountable to their shareholders, workers, customers, and the public, such as:

- Legislation designed to ensure that the SEC promulgates rules that are mandated by Congress under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). These rules, which include, Sec. 953(a) regarding pay for performance and Sec. 954 regarding claw backs of executive compensation of Dodd-Frank, among others, also require the SEC chair to appear monthly before the House Financial Services Committee to report on progress finalizing these rules.

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[38] Brief for Senator Charles Grassley as Amicus Curiae In Support of Respondent at 2, Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018) (No. 16-1276).

[39] Letter from James H. Kaster, President, National Emp't Lawyers Ass'n, et al. to Emily Pasquinelli, Office of the Whistleblower, Div. of Enforcement, and Brian A. Ochs, Office of the Gen. Counsel, U.S. Securities and Exchange Comm'n (Sept. 18, 2018), *available at* https://bit.ly/2Ujiakm.

- Rulemaking at the SEC requiring public companies to disclose their political spending to shareholders and the public.

- Rulemaking at the SEC that creates a standard set of environmental, social, and governance risk disclosure guidelines for public companies.

1. Implementing Dodd-Frank Section 953 (Executive compensation)

Congress enacted Dodd-Frank as a direct result of the 2008 Wall Street crash and Great Recession. Dangerous compensation plans were at the heart of the global catastrophe. Mortgage brokers won higher fees for selling expensive mortgages. Therefore, they sold mortgages to those who couldn't afford them, which generated fees for the brokers and the investment bankers packaging the mortgage-backed securities. These generated short-term profits that boosted the stock price. In turn, this generated bonuses for senior managers which were paid through stock-based compensation. Congress approved Section 953(a) to provide investors with a means of measuring senior management pay in the context of firm performance.[40] This rule would require companies to clearly and publicly state the nexus between executive compensation and financial performance of the company, thereby giving shareholders the necessary information that they need to assess an executive's compensation. Moreover, it would ensure that shareholders have clear information about how senior executive pay is absorbing increasing percentages of shareholder capital.

Currently, the ability of a shareholder to rein in CEO pay is limited. Shareholders even lack a convenient means of assessing whether management pay accords with performance. Some publicly traded companies do discuss compensation philosophy and offer metrics by which they measure performance, but without a consistent performance standard, it is difficult for investors to assess the validity of compensation levels at a single company or across peers. Together with the SEC's rule on executive pay ratio, which has already been finalized, shareholders will be better equipped to make informed evaluations about executive pay.[41]

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[40] S. Rep. No. 111-176, at 135 (2010), *available at* https://www.govinfo.gov/content/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf.

[41] Compelling congressional testimony on the issue addressed in 953(a) came from the Council of Institutional Investors, an amalgam of pension funds and other investors that collectively serve as stewards of some $3 trillion in beneficiary capital. The Senate report references this testimony and in it, the Executive Director of the Council stated: "Of primary concern to the Council is full and clear disclosure of executive pay. As U.S. Supreme Court Justice Louis Brandeis noted, "sunlight is said to be the best of disinfectants." *Other People's Money and How the Bankers Use It*, 92 (1914). Transparency of executive pay enables shareowners to evaluate the performance of the compensation committee and board in setting executive pay, to assess pay-for-performance links and to optimize their role of overseeing executive compensation through such means as proxy voting. *See* Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the S. Subcomm. on Securities, Insurance, and Investment of the Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 9-11 (2009) (testimony of Ann Yerger, Exec. Dir. of the Council) (emphasis added), *available at*

In addition, we believe that a finalized rule—which the agency has taken no action on since the proposal rule was published on April 29, 2015—should require companies to post any financial performance metric they use to determine CEO pay[42] because many companies do not. Where no concrete financial metric is public, we believe that any legislation on executive compensation should require the Commission to require a declaration that end that the company does not bind pay to strict financial metrics. Where firms lack such a consistent metric, shareholders have a right to know.[43]

2. Implementation of Dodd-Frank Section 954 (Executive compensation clawbacks)

We also support legislation that would implement of Section 954, which mandates that the SEC adopt rules requiring all publicly traded companies to adopt a clawback policy. A clawback is where a firm takes money already paid to an employee and clearly serve the interest of shareholders and they should be correspondingly enforced with rigor by corporate boards which serve as fiduciaries for shareholders. Enforcement, however, has been anemic.[44] Congress has attempted to bring rigor to clawback enforcement by federalizing this aspect of corporate governance. The first attempt came through Section 304 of Sarbanes-Oxley. Section 304 requires public company chief executive officers (CEOs) and chief financial officers (CFOs) to disgorge bonuses and other incentive compensation they receive within the 12-month period following the public release of financial information if there is a subsequent restatement of those results.

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https://www.govinfo.gov/content/pkg/CHRG-111shrg55479/pdf/CHRG-111shrg55479.pdf; *see also* S. Rep. No. 111-176, at 135 (2010), *available at* https://www.govinfo.gov/content/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf.

[42] Eleanor Bloxham, The SEC can't stop screwing up, FORTUNE (May 28, 2015), *available at* http://fortune.com/2015/05/28/sec-keeps-screwing-up/.

[43] For example, JP Morgan does not post any clear connection between what the board decided to pay CEO Jamie Dimon and the firm's performance. The board does apparently believe shareholders are interested in the subject enough to devote pages 30 through 44 to this very question. This 15 page discussion includes many charts and numerous normative declarations. However, the board does not provide concrete information that would allow an investor to determine numerically how the CEO's pay was determined. One could not forecast what the CEO would be paid next year based on company financial results. Still, the board would have the company owners understand that the CEO compensation is appropriate. "Mr. Dimon has generated more profit per dollar of compensation paid than other CEO in our financial services peer group." (Such an accomplishment is especially noteworthy given that the firm has more than 240,000 employees who, by extrapolation, apparently generated little or no value as measured by company earnings.) Under the cold lens of professional compensation analysts, however, the board is squandering shareholder money on Dimon. Institutional Shareholder Services, a firm employed by owners of some 20 percent of JP Morgan's outstanding stock, graded Dimon's pay package an "F." The analysts found: "The Company paid more compensation to its named executive officers than the median compensation for a group of companies. . . The CEO was paid more than the median CEO compensation of these peer companies. Overall, the Company paid more than its peers, but performed moderately worse than its peers." ("Proxy Paper: JP Morgan," published by Institutional Shareholder Services. (April 2015)(on file with author).

[44] J. Robert Brown, Jr., *Waiting for Dodd-Frank Clawbacks*, THE RACE TO THE BOTTOM (Sept. 29, 2014), https://www.theracetothebottom.org/rttb/waiting-for-dodd-frank-clawbacks.html?rq=Waiting%20for%20Dodd-Frank%20Clawbacks.

The Sarbanes-Oxley law was written in an earlier time when clawback reform was less necessary. Prior to 2005, only three Fortune 100 companies disclosed clawback policies.[45] Now, most major companies have basic clawback policies (though stronger policies would be preferred), and they have begun adopting them because of the clear need.[46] However, Sarbanes-Oxley provides no enforcement mechanism for shareholders and, as noted above, without disclosure they may not even know that such a policy is in place. Only an active SEC can mandate and enforce such transparent policies. According to Audit Analytics, there have been 700 to 1,500 restatements a year for the last decade.[47] The SEC brought its first clawback case in 2007, five years after enactment of Sarbanes-Oxley. From that time until 2011, the SEC enforced the Sarbanes-Oxley clawback provision only three times.[48] The pace increased to 31 cases through the end of 2013. However, of all of those cases, only eight executives have actually returned pay. A stronger and more robustly enforced policy is clearly needed. [49] [50] In 2012, JP Morgan Chase clawed back certain compensation from three traders involved in the so-called London Whale fraud, but the firm did not detail the amount of the clawback.[51] Walmart reportedly clawed back certain pay, but it was unclear if this was related to the Mexican bribery case.[52] Even in the case of Wells Fargo, shareholders are only informed of those individuals that the firm chooses to publicize.

We believe Congress should compel completion of this simple rule, as well as require a monthly progress report from SEC officials at a public hearing.

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[45] Ed DeHaan et al., *Does Voluntary Adoption of Clawback Provision Improve Financial Reporting Quality?*, (Contemporary Accounting Research, Forthcoming,2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2049442.

[46] PricewaterhouseCoopers *Executive Compensation: Clawbacks: 2013 Proxy Disclosure Study*, PRICEWATERHOUSECOOPERS (Apr. 2014), http://www.pwc.com/en_US/us/hr-management/publications/assets/pwc-clawbacks-2013-proxy-disclosure-study.pdf.

[47] Gretchen Morgenson, *Clawbacks? They're Still a Rare Breed*, THE NEW YORK TIMES (Dec. 28, 2013), *available at* http://www.nytimes.com/2013/12/29/business/clawbacks-theyre-still-a-rare-breed.html?pagewanted=all&_r=0.

[48] Wayne M. Carlin, *Another SEC Clawback Settlement*, HARVARD L. SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Dec. 13, 2011), http://blogs.law.harvard.edu/corpgov/2011/12/13/another-sec-clawback-settlement/.

[49] Morgenson, *supra* note 47.

[50] In a recent case involving Babak Yazdani, former CEO of Saba Software Inc., the SEC ordered repayment of $2.5 million following a multi-year fraud that led to an earnings restatement. *See Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C Securities Exchange Act of 1934, Making Findings, and Imposing A Cease-and-Desist Order*, SECURITIES AND EXCHANGE COMM'N. (Sept. 24, 2014), http://www.sec.gov/litigation/admin/2014/34-73201.pdf.

[51] Dan Fitzpatrick, *J.P. Morgan: 'Whale' Clawbacks About Two Years of Compensation*,THE WALL STREET JOURNAL (July 13, 2012), http://www.wsj.com/articles/SB10001424052702303740704577524730994899406.

[52] Letter from UAW Trust and Ill. State Board of Inv. to Walmart S'holders Urging Support for S'holder Proposal on Clawbacks Disclosure (May 22, 2014), *available at* http://www.uawtrust.org/AdminCenter/Library.Files/Media/501/Press%20Releases/2014/14maylettershareholderwmtrecoupdisclosureproposal.pdf).

3. **Corporate political spending disclosure**

Since the U.S. Supreme Court's 2010 *Citizens United* decision, corporations have been allowed to spend unlimited undisclosed amounts of money to influence American elections and policy outcomes. In 2011, a bipartisan committee of law professors filed the first petition requesting a rulemaking at the SEC requiring all public companies to disclose their political expenditures.[53] The petition has garnered a staggering 1.2 million comments[54]—the most in the agency's history. This rulemaking was placed on the agency's agenda in 2013 by the agency's former chair Mary Schapiro, but it was then removed by then-chair Mary Jo White in 2014.

Additional obstruction occurred when conservatives in Congress inserted a policy rider into the past four appropriations bills that prohibited the SEC from finalizing, but not from working on, the rule. Public Citizen urges Congress to remove the policy rider from the budget so that the SEC can continue to work to craft a rule, which should be quickly finalized."

4. **Long-term risk disclosure**

For years, investors have been calling on the SEC to require companies to disclose various types of environmental, social, and governance (ESG) risks, such as climate, human capital management, political spending, tax, human rights, and gender pay ratios. The SEC received more than 26,500 comments in response to its Regulation S-K concept release,[55] the overwhelming majority of which expressed a demand for more and better disclosure in general.[56]

Despite the strong support for the SEC to require these different types of disclosure, the SEC has yet to issue comprehensive, standard guidance for public companies' disclosure of ESG risk.

In 2018, investors representing more than $5 trillion in assets under management submitted a new petition for a rulemaking at the SEC that would create a standard disclosure framework on all ESG issues for public companies.[57] The petition was drafted with the guidance of American securities law experts Professors Cynthia Williams Professor Jill Fisch.

Public Citizen urges the SEC to begin work on this rulemaking and would support legislation from Congress that mandates this rule.

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[53] Lucian A. Bebchuck et al., *Committee on Disclosure of Corporate Political Spending Petition for Rulemaking*, SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2ctSUiS.
[54] *Comments on Rulemaking Petition: Petition to require public companies to disclose to shareholders the use of corporate resources for political activities*, SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2cGUr9G.
[55] *Id.*
[56] Tyler Gellasch, *Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release* 17 (2016), *available at* https://bit.ly/2yoDbfd.
[57] Cynthia A. Williams et al., *Request for rulemaking on environmental, social, and governance (ESG) disclosure*, SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2Pg52qz.

V. CONCLUSION

We are at a moment of reckoning in our society. Workers, consumers, and everyday investors, joined by small businesses, are standing up to corporate behemoths who have historically been able to use their corporate power and money to silence dissent and keep systemic wrongdoing in the shadows. We strongly support access to justice for all people, the ability to bring their claims in open, neutral court, and protections for everyday investors.

Thank you for the opportunity to provide comments and I look forward to your questions.