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The Potential Impact of Mandatory Arbitration Provisions on Securities Claims

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On Sept. 17, 2025, following a 3-1 vote, the United States Securities and Exchange Commission (SEC) issued a new policy statement (https://bit.ly/3VKCIAH) announcing its position that the presence of a mandatory arbitration provision in a company's governing documents (e.g. charter or bylaws) will not prevent it from accelerating the effectiveness of the company's registration statement, changing its long-held view ("Policy Statement").

The SEC's policy change opens the door to the potential for mandatory arbitration of federal securities and other stockholder claims, which raises important considerations for new and current issuers. This article discusses (1) the SEC's policy change and reasoning behind it, (2) the impact of state law forum requirements, and (3) the implications for the future of federal securities claims.

SEC PERMITS MANDATORY ARBITRATION PROVISIONS

In the Policy Statement, the SEC provided its view that mandatory arbitration provisions for stockholder claims, including federal securities claims, do not conflict with the federal securities laws, including the Securities Act of 1933 and the Exchange Act of 1934. Previously, the SEC had taken the position that it would not declare a registration statement for an IPO effective if it contained a mandatory arbitration provision, which the SEC applied to all issuers.

This long-held view was predicated, in part, on the understanding that the anti-waiver provisions of the federal securities laws (Sections 14 and 29(a) of the '33 and '34 Acts, respectively) required access to a judicial forum, thus prohibiting issuer-investor mandatory arbitration provisions. However, the SEC recently re-examined this position after considering the Supreme Court's jurisprudence and other case-law developments involving the intersection of the Federal Arbitration Act (the "FAA") and other federal statutes.

The SEC explained that the FAA established a "liberal federal policy favoring arbitration agreements" and the Supreme Court has held that for federal statutes enacted thereafter — such the securities laws — to override the FAA, there must be a "clearly expressed congressional intention." Epic Systems Corp. v. Lewis, 584 U.S. 497, 510 (2018).

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After reviewing relevant precedent, the SEC concluded that neither the anti-waiver provisions nor any other provision of the federal securities statutes displaces the primacy of the FAA in the context of issuer-investor mandatory arbitration provisions.

The SEC also dismissed concerns that its new policy could potentially impede the ability of investors to bring private actions to recover for violations of the federal securities laws, including by foreclosing class-wide proceedings.

The Policy Statement notes that the federal securities statutes do not guarantee access to affordable litigation or a right to class actions. Accordingly, the SEC concluded that "the potential for an issuer-investor mandatory arbitration provision to diminish, or even eliminate, the economic incentive for some investors to bring private claims under the federal securities laws is not a sufficient basis to conclude that the federal securities statutes displace the [FAA's] mandate."

Finally, the SEC provided that the positions in the Policy Statement are not limited to new issuers but rather extend to current Exchange Act reporting issuers that may amend their governing documents to adopt mandatory arbitration provisions.

IMPACT OF STATE LAW FORUM REQUIREMENTS AND FEDERAL PREEMPTION

While the Policy Statement changes the SEC's position on arbitration clauses in governing documents, a potential impediment to issuers implementing these provisions is whether it is permitted by state law. The Policy Statement does not take a position on this issue.

States have taken different positions on whether a company can include a mandatory arbitration provision in its governing documents. For example, Delaware — the most popular state for incorporation — recently amended Section 115 of its General Corporation Law to require that stockholders be permitted to bring claims, including federal securities claims, "in at least 1 court in this State."

Texas and Nevada — two other popular states of incorporation — do not appear to impose such a restriction on issuers. Section 2.115(b) of Texas' Business Organizations Code provides that companies "may require" that claims be brought only in a Texas court, but leaves open the ability of issuers to choose arbitration as a forum over a Texas court. Likewise, Nevada's statutory scheme provides issuers with flexibility in choosing their preferred forum, including, presumably, arbitration. As such, issuers incorporated in these states could choose to adopt a provision requiring that stockholder claims, including federal securities claims, be subject to mandatory arbitration.

The differences between these states and Delaware could provide another reason for Delaware companies to consider relocating, adding fuel to the so-called DExit movement.

That said, the FAA may preempt any state law, such as Delaware's, that prevents arbitration of investor-issuer claims. As the SEC noted in its Policy Statement, the FAA preempts state laws that "target the enforceability of mandatory arbitration agreements either by name or by more subtle methods, such as by 'interfering with fundamental attributes of arbitrations.'"

For example, courts have found preempted state laws that prohibit arbitration of, inter alia, certain franchise and wage collection claims. Indeed, the Supreme Court has held that the FAA preempts "state laws which require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468, 478 (1989).

On the other hand, Section 2 of the FAA includes a narrow "savings clause" that permits arbitration agreements to be declared unenforceable "upon such grounds as exist at law or in equity for the revocation of any contract." In the Policy Statement, the SEC declined to weigh in on if the FAA preempts state law forum provisions.

FUTURE OF FEDERAL SECURITIES CLAIMS

While the impact of the SEC's policy change on federal securities claims remains to be seen, there are a number of considerations issuers should take into account in deciding whether to adopt a mandatory arbitration provision.

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- Views of investors and others. In deciding whether to adopt a mandatory arbitration provision, issuers should consider how investors may react, along with the views of other constituents such as proxy advisory firms and insurance providers. For example, CalPERs (https://bit.ly/48bvBbQ) almost immediately voiced disagreement with the SEC's policy change, and the Council of Institutional Investors (https://bit.ly/48Psneg) has previously opposed the use of arbitration clauses in corporate bylaws. Issuers should also speak to their insurance brokers about the impact on coverage and premiums.
- Litigation over the arbitration provision. Early adopters of investor-issuer arbitration provisions will likely face litigation challenging the validity of such provisions under federal and state law. Despite the SEC's pronouncement that the anti-waiver provisions of the securities laws do not prohibit mandatory arbitration provisions, the SEC's views are not binding on courts, and plaintiffs are likely to argue that such views should not be given great weight after the Supreme Court's decision in Loper Bright Enterprises v. Raimondo, which eliminated Chevron deference. However, even in Loper Bright the Supreme Court held that courts should "go about [their] task" informed by "the agency's body of experience and informed judgment," especially where "it rests on factual premises within the agency's expertise." Plaintiffs will also likely challenge any arbitration provisions under state law, especially in states such as Delaware that appear to prohibit such provisions.
- Arbitration could limit claims. Federal securities claims have traditionally been brought as class actions on behalf of the entire class of purportedly damaged investors. Due to the number of shares outstanding, issuers typically face significant damages exposure. As a result, if a federal securities class action advances past the pleading stage, the issuer may be pressured to settle regardless of the merits of the claim. A mandatory arbitration provision could reduce litigation exposure by requiring investors to bring individual actions instead of class claims. Individual investors may not have suffered enough damages to incentivize them or their attorneys to bring such individual claims, and the claims may not be worth the cost of arbitration.
- Potential for mass arbitrations. To caveat the above point, it is possible that attorneys representing investors could initiate so-called mass arbitration, meaning that they would bring individual arbitrations on behalf of a large pool of investors. These mass arbitrations could result in more investors bringing claims, potentially increasing litigation costs for issuers and leading to conflicting decisions and outcomes. Issuers should weigh these costs against the uniformity and certainty of proceeding in court with a single class action.
- Drafting of arbitration provisions. While arbitration of stockholder claims may lower overall potential exposure, issuers should pay particular attention to the drafting and terms of a mandatory arbitration provision, including in selecting the arbitration provider and in laying out the procedures to be followed. Issuers may want to consider how to ensure that certain protections in the Private Securities Litigation Reform Act of 1995 (the "PSLRA") would continue to apply in arbitration. For example, the PSLRA created an elevated pleading standard for securities fraud claims and automatically stays all discovery unless and until plaintiffs defeat a motion to dismiss. These protections may not automatically apply in arbitration and issuers will want to ensure they do.

CONCLUSION

The SEC's Policy Statement represents a policy change that could have material implications for issuers and investors. Issuers should consider the benefits of implementing a mandatory arbitration provision in their governing documents, while weighing the costs and pitfalls of adopting such a provision especially in a changing legal landscape.

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