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DIVIDED SEC CLEARS WAY FOR MANDATORY ARBITRATION CLAUSES IN COMPANY GOVERNANCE DOCUMENTS

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TAKEAWAYS FOR COMPANIES TO CONSIDER

WHAT HAPPENED

On September 17, 2025, without seeking public comment, the SEC approved two controversial items in a 3-1 vote:

- A policy statement that the inclusion of a mandatory arbitration provision in governance documents will not affect an SEC staff decision to accelerate the effectiveness of a registration statement under the Securities Act.
  - Previously, according to conventional wisdom, the staff would not accelerate IPOs when governance documents required an investor or shareholder to arbitrate its claims arising under the federal securities laws with the issuer of the securities.
- Amending Rule 431 of SEC Rules of Practice so that a single Commissioner or any aggrieved person will no longer have the ability to require the SEC to review the declaration of effectiveness of a registration statement under the Securities Act.

The majority disclaimed any view on the acceptability of mandatory shareholder arbitration, taking the position that the SEC should defer to state corporate laws and the market. However, Chairman Atkins did applaud the decision as "among the first steps of my goal to make IPOs great again." By contrast, the dissent viewed the decision as "depriv[ing] shareholders of fundamental rights, fundamental choice, and . . . [flying] in the face of market integrity, fairness and efficiency."

The policy statement and Rule 431 amendments will be effective upon publication in the Federal Register.

TAKEAWAYS

The effect of the policy statement is to remove an obstacle to public companies' adopting mandatory shareholder arbitration in governance documents. The decision represents a sharp turn in policy views from past Commissions.

Advocates believe such arbitration clauses may reduce litigation exposure, including by preventing class actions lawsuits in court.

Now that the SEC has opened the way, many public companies may consider adopting such provisions. Before doing that, they should consider:

- ***Monitoring developments.*** As with other controversial topics, it may be uncertain how many companies are prepared to adopt such provisions, whether unilaterally or with shareholder votes, or the pace of acceptance. Some companies may want others to act first to gauge the reaction of investors, shareholders, and others.
  - It may take time to evaluate the medium to longer-term implications given the stakes involved.
- ***Governing state law.*** Delaware law may prohibit inclusion of mandatory arbitration. But other states may take different approaches.
  - New amendments to the Delaware General Corporate Law recently took effect barring any charter or bylaw provision that denies access to at least one court within Delaware with jurisdiction to consider claims that relate to the business or affairs of the company or the rights or powers of the company, its shareholders, directors or officers.
- ***Investor response.*** Many investors, including the Council of Institutional Investors and CalPERS have expressed strong opposition to the inclusion of mandatory arbitration provisions. In 2020, only 2.4% of shareholders supported a stockholder bylaw proposal to require arbitration of shareholder claims, indicating that the largest shareholders, including T. Rowe Price and Vanguard, opposed the proposal, as did management.
  - Adoption might trigger the interest of activists, potentially leading to proxy contests or other actions challenging management and the board.
  - It may be uncertain how investors respond to IPOs that include such provisions, including any effect on pricing or interest.
- ***Proxy advisor reaction.*** Glass Lewis may recommend voting against the governance chair or the entire committee when governance documents require arbitration of shareholder claims. ISS has not published its policy, but based on analogous topics such as dual class structures, rights plans and exclusive forum provisions that specify a particular local state court (or specific federal court), it is possible ISS will take a similar position.

- ***Stock exchange reaction.*** It is possible that the NYSE and/or Nasdaq may develop corporate governance proposals addressing mandatory shareholder arbitration, similar to their qualitative corporate governance standards.
  - Section 6(b) the Exchange Act requires that stock exchange rules be designed to, among other things, "protect investors and the public interest" and avoid "unfair discrimination between customers, issuers, brokers, or dealers."
  - Any new listing rules need to be approved by the SEC.
  - It is uncertain whether stock exchanges may compete for listings by adopting differing policies regarding such provisions.
- ***Potential legal challenges***
  - ***SEC regulatory process.*** The validity of SEC actions often face scrutiny. For example, as discussed below, Commissioner Crenshaw questioned the SEC's failure to follow notice-and-comment rules under the Administrative Procedure Act (APA) with respect to Rule 431 amendments.
  - ***Validity of mandatory arbitration provisions.*** While Supreme Court precedent applying the Federal Arbitration Act (FAA) has allowed mandatory arbitration clauses of federal and state claims including under the securities laws, those decisions have been relied on by contracting parties' agreeing to arbitration, as in customer agreements with securities brokerage firms. While corporate bylaws and charters could possibly serve that function, it may be more difficult to demonstrate this if the provision was unilaterally adopted by the board without a shareholder vote after an IPO. As a result, early adopters may face litigation challenging such provisions.
- ***Cost-benefit considerations.*** It is not clear that corporations would benefit from adopting mandatory arbitration clauses. Some corporate counsel believe that corporations could incur greater litigation cost and risk if shareholders are required to bring individual arbitrations, which could not be litigated and resolved on a classwide basis. For example, in a 2017 post, Mandatory Arbitration of Securities Disclosure Disputes Is a Bad Idea—For Defendants, a securities defense lawyer analyzed numerous potential adverse consequences, concluding:

"These arbitrations would be unmanageable. Each plaintiffs' firm would recruit multiple plaintiffs to initiate one or more arbitrations—resulting in potentially dozens of arbitrations over a disclosure problem. Large firms would initiate arbitrations on behalf of the institutional investors with whom they've forged relationships, as the Reform Act envisioned. Smaller plaintiffs' firms would initiate arbitrations on behalf of groups of retail investors, which have made a comeback in recent years. We often object to lead-plaintiff groups because of the difficulty of dealing with a group of plaintiffs instead of just one. In a world without securities

> class actions, the adversary would be far, far worse—a collection of plaintiffs and plaintiffs' firms with no set of rules for getting along. Securities-disclosure arbitrations would cost multiple times more to defend and resolve."

The Rule 431 amendments may not change traditional practice. Few, if any, examples of SEC reviewing declarations of effectiveness have been reported. Given that the amendments were adopted without notice or comment in conjunction with a contested vote on a controversial topic, the majority may have felt some reason to foreclose the ability of an individual Commissioner to require the SEC to review the issue in a particular case.

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POLICY ON MANDATORY ARBITRATION PROVISIONS

Under the SEC's new policy, the presence of a provision requiring arbitration of investor claims under the federal securities laws will not affect the staff's decision to accelerate the effectiveness of a registration statement. Instead, the staff will focus on the adequacy of disclosures, including disclosure regarding the arbitration provision.

The new policy reflects the majority's conclusion that federal securities statutes do not override the FAA policy favoring arbitration. As a result, the existence of such a provision will not be considered under Section 8(a)'s public interest and investor protection standard for accelerating registration statements.

Background

Since the late 1980's, it has been clear under Supreme Court precedent that claims under the federal securities laws can be subject to mandatory arbitration clauses in contracts. But the SEC has continued to view mandatory arbitration provisions in corporate governance documents as inconsistent with the anti-waiver provisions of federal securities laws, which void any clause that would bind an investor to waive their right to enforce federal securities laws. Although the SEC did not have a formal policy, that position was reflected in numerous settings, including an amicus brief, 14a-8 no-action letters, staff declinations to accelerate registration statements and staff articles in legal publications.

The majority also cited more recent Supreme Court authority rejecting the notion that limiting or foreclosing class actions would be impermissible. The cases are:

- AT&T Mobility LLC v. Concepcion 563 U.S. 333 (2011), which held that the FAA requires court enforcement of class action waivers in arbitration clauses in consumer contracts.
- Am. Express Co. v. Italian Colors Rest. 570 U.S. 228 (2013), which held that the FAA requires courts to enforce arbitration provisions that bar class actions with respect to federal claims, as well as state claims.

Following those decisions, commentators actively debated the legality and merits of mandatory shareholder arbitration by public companies. However, until this month, the SEC declined to reconsider its position.

Rationale for New Policy

According to the SEC policy statement:

- Recent Supreme Court decisions establish that the FAA's policy favoring arbitration prevails over the anti-waiver provisions of federal securities laws.
  - This is because, according to the majority, federal securities laws do not demonstrate a "clearly express congressional intent" to except mandatory shareholder arbitration from the FAA.

  - In order for the FAA to apply, there must be a valid arbitration agreement. However, the SEC does not have authority to decide if any specific document (such as corporate charters or bylaws) is sufficient for purposes of the FAA.

- Under Supreme Court precedent, the FAA is not displaced merely because bilateral arbitration – in contrast to class actions – may undermine the economic incentive to bring private federal securities law claims.
  - According to the SEC, "no provision in the Federal securities statutes 'guarantee[s] an affordable procedural path to the vindication of every claim.'"

- Case law establishes that the SEC obligation to consider "the public interest and the protection of investors" only permits consideration of matters over which it has authority, namely, the adequacy of disclosure of material information, such as mandatory arbitration.

Reasons for Dissent

In Crenshaw's dissent, she described downsides of arbitration for investors:

> "[They] are typically more expensive for individual shareholders; they are not public; they have no juries; they lack consistent procedures; arbitrators are not bound by legal precedent; arbitration precludes collective action among shareholders; there are limited rights of appeal; and, ultimately, there is no assurance that two identical investors would get the same outcome."

She listed practical concerns:

- Small shareholders may be prevented from vindicating rights because of disproportionate costs that would otherwise be shared among large groups in class actions.

- Markets may be under-policed due to the decline in private lawsuits.

- Deterrence may be reduced both because of fewer claims and because arbitration proceedings and awards are non-public, potentially resulting in “more brazen misconduct” and reduced integrity in the markets.

- Market transparency and integrity may suffer when arbitration replaces private litigation. For example:
  - Arbitrators are often not required to follow the law and are not bound by precedent.
  - They need not apply rules of evidence or provide reasoning for their decisions.
  - Discovery and evidence are curbed.
  - Judicial review is limited.

- Allowing companies to mandate arbitration reduces investor choice to litigate in court.

In her view, neither the FAA nor case law requires the SEC to disregard the negative effects of such provisions on investors, citing a 2013 letter to Chair Mary Jo White from 29 law professors (“[T]he FAA has never been interpreted to require the enforcement of bylaws or similar provisions unilaterally adopted to remove judicial oversight of investor disputes”).

She also criticized:

- The SEC’s decision-making process that did not invite input from market participants or study potential costs of the policy change.

- The failure to preserve the SEC’s ability to examine specific language in particular cases that could affect fundamental shareholder rights.

AMENDMENT TO RULES OF PRACTICE

When the SEC acts via delegated authority, any individual Commissioner or any aggrieved person may ask the SEC to review that action. Subject to limited exceptions, a request for review stays the prior action taken by delegated authority until the SEC orders otherwise.

Under amended Rule 431, the declaration of effectiveness of a registration statement (or qualification or post-qualification statements under Regulation A) will be added to the list of exceptions to a stay.

Rationale for Amending Rule

According to the adopting release:

- A stay of effectiveness could fundamentally disrupt the offering and sale process.
  - The amendment will promote capital raising by reducing regulatory uncertainty for companies and underwriters that sold shares.

- Rather than automatically stay delegated actions, it is appropriate that the SEC consider on a case-by-case basis whether to impose a stay when an individual Commissioner or aggrieved person submits a request in such circumstances. Factors could include:
  - The likelihood of inadequate disclosure.

  - Assessing whether harms from potential disclosure failures justify potential disruptive consequences of a stay.

- Safeguards exist:
  - Section 8(b) allows the SEC to issue an order preventing a registration statement from becoming effective.

  - Section 8(d) allows the SEC to issue stop orders.

  - Securities Act Rule 258 allows the Commission to enter an order suspending Regulation A exemption at any time.

Reasons for Dissent

Crenshaw's dissent set forth several criticisms:

- The amended rule may violate Section 4A of the Exchange Act by eliminating the ability of one Commissioner to require SEC review of delegated action in circumstances beyond the two permitted statutory exceptions.

- The failure to follow notice-and-comment procedures may violate the APA because the changes diminish investors' rights to SEC review and, in her view, do not relate solely to internal agency practices.
  - The SEC took the position that "these revisions relate solely to agency organization, procedures, or practice and do not constitute a substantive rule."

- The amendment is bad policy as the SEC will no longer have the ability to review staff acceleration of registration statements before offers and sales are completed.

- The change, along with the policy shift, "tilt[s] the scales and accelerate[s] the adoption of mandatory arbitration clauses by public companies."

RELATED CAPABILITIES

- Securities Litigation and Enforcement

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