SEC Arbitration Shift Is At Odds With Fraud Deterrence

By **Lauren Ormsbee and Jacqueline Lacovara** (October 6, 2025)

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On Sept. 17, the U.S. Securities and Exchange Commission issued a policy statement on a 3-1 vote, not subject to any public notice and comment, that greenlighted the inclusion of mandatory issuer-investor arbitration provisions in initial public offering registration statements, provided that the issuer adequately discloses the existence of such a provision.[1]

This abrupt policy change, launched as part of SEC Chair Paul Atkins' push to "make IPOs great again," will not provide this sought-after path to greatness.

Historically opposed by institutional and retail investors, courts, and — until recently — the SEC itself, forced arbitration would be unlikely to cut costs or reduce legal exposure.

It would just take the legal battle private, resulting in a series of costly arbitrations — which could result in greater damages and greater legal fees — while removing the powerful deterrent impact of public lawsuits that have helped make the U.S. securities markets a model of transparency and fairness over the past 90 years.

Forced Arbitration Is Not a Panacea to IPO Decline

While the concept of forced arbitration of issuer-investor securities claims is not entirely new, the SEC's position on them certainly is.

Only one year ago, the SEC affirmed the crucial role played by private enforcement of the federal securities laws in this nation's courts when the commission joined in a pair of amicus briefs before the U.S. Supreme Court explaining that the interest of the U.S. was aligned with "[m]eritorious private securities actions," which "are an essential supplement to criminal prosecutions and civil enforcement actions brought by the Department of Justice and the SEC."[2]

Indeed, former SEC Investor Advocate Rick Fleming commented on forced arbitration of securities suits just a few years ago, stating that "stripping away the right of shareholders to bring a class action lawsuit seems to me draconian and, with respect to promoting capital formation, counterproductive" because the U.S. "regulatory framework assumes that investors themselves will serve an important role in policing the markets."[3]

The SEC's interest in the crucial role of investor protection through private enforcement actions is today diminished in favor of its interest in "making IPOs great again,"[4] despite there being no objective evidence that private enforcement actions have played any role in IPO declines over the past decade.[5]

Much remains to be seen — and legal scholars will no doubt opine in due course — on whether the SEC policy change is legally sound or whether it impermissibly conflicts with the Securities Act, Exchange Act, or state laws, such as Delaware's recent amendment banning forced arbitration.[6]

However, there should be little doubt that if a company successfully goes public after the SEC greenlights a forced arbitration clause, and it is later revealed that the company and its executives misled investors resulting in tens, if not hundreds, of millions of dollars in investor losses, the SEC will be seen to have encouraged shareholders to hand over nearly 100 years of judicial protection and jurisprudence, while gaining nothing of value in return and losing much. That is counter to the public interest, in every sense.

It is critical to note that the grass is not necessarily greener for corporate America. The future, hypothetical public company that chooses to bind its investors to forced arbitration and then violates the securities laws will still face adjudication brought by those damaged investors with the means or incentive to do so.

Large investors will not be defrauded of hundreds of millions of dollars without putting up a fight. However, without the federal class action mechanism that consolidates that fight to one venue on behalf of all injured investors, arbitration all but ensures that the number of separate claims and private arbitration panels could be substantial.

Moreover, arbitrators are not automatically bound by the many procedural roadblocks plaintiffs face in the federal courts, including the Private Securities Litigation Reform Act stay of discovery pending resolution of a motion to dismiss, the heightened pleading standards of the PSLRA and Rule 9 of the Federal Rules of Civil Procedure, or indeed any need to overcome a motion to dismiss at all, and the exacting requirements of class certification as created over decades of heavily contested litigation and U.S. Supreme Court precedent.

Discovery may also vary from arbitration to arbitration, and depositions of high-ranking executives may occur in each arbitration proceeding, raising not only the monetary costs of litigation but also the resource costs.

Companies curious about forced arbitration have in the past sought refuge in class actions as a method of resolution when they were unable to bear the expense of thousands of individual arbitrations.[7]

As Fleming cautioned in 2018, "for those of you who advise companies that may be curious about adopting forced arbitration clauses, I encourage you to talk to them about the downsides and the likely resistance they would encounter from investors and their advocates."[8]

The Purpose of the Securities Act Is to Protect Investors

It is notable the SEC does not claim that forced arbitration provisions are actually in the public interest, stating only that it now takes the self-limiting stance that "the existence of such a provision is not within the ambit of appropriate considerations" when greenlighting an IPO.

However, there is a dissonance between that stance and the reason why Congress enacted Section 11 of the Securities Act of 1933: to protect investors by compelling issuers and their insiders to, according to the act, "provide full and fair disclosure ... and to prevent frauds."[9]

Indeed, the Supreme Court has long affirmed that a fundamental purpose of the Securities Act is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry," as the court put it in its 1963 decision in SEC v. Capital Gains Research Bureau.[10]

Through its liability provisions, Section 11 effectuates Congress' determination that those who publicly offer securities bear a "moral responsibility to the public [that] is particularly heavy," as the Supreme Court's 1983 decision in Herman & MacLean v. Huddleston and its 1995 decision in Gustafson v. Alloyd Co. quoted the 73rd Congress as saying.[11]

Courts, including the Supreme Court, have routinely invoked the act's purpose of protecting investors. Indeed, in the 1953 decision in Wilco v. Swan, the Supreme Court concluded that because Congress "enacted the Securities Act to protect the rights of investors ... the intention of Congress ... is better carried out by holding invalid" arbitration agreements concerning claims under the act.[12]

The SEC's Decades-Long Resistance to Mandatory Shareholder Arbitration

The SEC, time and time again, has been skeptical about forced arbitration clauses.[13] This skepticism historically resulted in the exclusion of forced arbitration clauses. One of the SEC's primary roles is to approve companies' registration statements enabling them to go public.

Acceleration of a registration statement's effectiveness is essential for the timing of a new issuance. However, in 1990, the SEC refused to accelerate the effectiveness of a registration statement that disclosed a forced arbitration clause.[14] In 2012, the SEC made its stance on forced arbitration provisions even more transparent after Carlyle Group LP, a private equity firm managing $148 billion of assets, removed a provision that would require forced arbitration after the SEC refused to clear the company's IPO filing.[15]

Public Companies and Institutional Investors Alike Have Opposed Forced Arbitration

The SEC has not been alone in its wariness of forced arbitration clauses. The Supreme Court and legal scholars alike have recently noted the serious due process concerns associated with arbitration.[16]

And, on several occasions in recent history, elected officials, public companies, and groups of institutional investors have not only openly criticized forced arbitration systems, but also have petitioned Congress, in a letter to the Committee on the Judiciary and Committee on Banking, Housing & Urban Affairs, to "preserve the ability of investors to access the judicial system for the enforcement and protection of their legal rights."[17]

In a 2013 joint letter to Congress written on behalf of more than 50 institutional investors, the investors explained that forced arbitration clauses are de facto waivers of the right to participate in any collective action — waivers "specifically designed to prevent class actions," which in practice "would prevent class actions like the shareholder action brought against Enron Corporation from ever being brought."[18]

A coalition of state treasurers echoed these concerns in a 2018 letter to then-SEC Chairman Jay Clayton, stating that a forced arbitration clause "helps to keep corporate misconduct and financial fraud secret by preventing such cases from reaching the light of public U.S. courtrooms."[19]

Concerns about investor confidence have prompted public companies to take affirmative steps to exclude forced arbitration agreements in their bylaws.

In 2018, the pharmaceutical behemoth Johnson & Johnson requested that the SEC refrain from seeking enforcement action against it for its decision to exclude from its annual proxy a shareholder proposal that would compel shareholders to submit to arbitration in the event that they seek redress for violations of the federal securities laws.

In its no-action letter,[20] Johnson & Johnson articulated its concern that a forced arbitration provision "would be contrary to the public policy interests underlying the federal securities laws and would cause Johnson & Johnson to violate federal law."[21]

Ultimately, the SEC granted Johnson & Johnson's no-action request in 2019, again signaling the commission's low regard for forced arbitration provisions.

Even proposals for forced arbitration that did make their way into an annual shareholder meeting and onto the ballot — an occasion that has only arisen twice — were met with resounding shareholder disapproval. In 2020, for example, fewer than 2.5% of the 213 million Intuit shareholders voted in favor of mandatory shareholder arbitration.[22]

In response, the Secure Our Savings Coalition remarked that "Intuit shareholders sent a resounding message that forced arbitration is bad for investors and bad for markets and efforts to take away shareholder rights are bad for business."[23]

Commissioner Crenshaw Details How Forced Arbitration Harms Market Transparency

It is precisely this well-established, three-decades-long track record of skepticism toward forced arbitration clauses that made the SEC's discussion at its Sept. 17 open meeting so stark in its departure from its historical position.

In his opening remarks, Atkins explained that issuing a policy statement about forced arbitration clauses is "among the first steps of my goal to make IPOs great again."[24]

He further revealed his expectation that there would be "robust public debate" about whether a company should adopt mandatory arbitration provisions, but stated the SEC "will not be part of this debate" because "the Commission is not a merit regulator that decides whether a company's particular method of resolving disputes with its shareholders is 'good' or 'bad.'"[25]

At the same time, however, Atkins seemingly provided a rubber stamp of approval to these provisions when he said the policy statement "provides the Commission's views on whether mandatory provisions are inconsistent with the federal securities laws — and concludes they are not."[26]

Finally, Atkins explained that the policy statement would make clear that the presence of a mandatory arbitration provision will not affect decisions whether to accelerate the effectiveness of a registration statement.

Commissioners Hester Peirce and Mark Uyeda, both of whom voted in favor of the policy statement, kept their comments brief. Peirce shared her view that "if companies opt for mandatory arbitration clauses, investors can decide what to make of them," but "the SEC will not put its thumb on the scale."

Similarly, Uyeda noted that the policy statement both "recognizes that we are not the Securities and Arbitration Commission" and "places focus on the adequacy of disclosure as the central consideration in declaring registration statements effective."

In marked contrast to the comments of her colleagues, Commissioner Caroline Crenshaw — who cast the sole "no" vote against issuance of an official policy statement — expressed her staunch opposition to the policy statement.

She characterized the move as "another way to stack the deck against investors" by "opening the floodgates" to what she believes judges would consider a violation of due process.[27] Crenshaw outlined the practical consequences of issuing the policy statement, all of which reflected the concerns of institutional investors, the former investor advocate, members of Congress, and the Supreme Court.

Among other things, Crenshaw stressed the efficiency of private lawsuits in prosecuting securities fraud, and stated that in 2024 alone, securities class action settlements returned $3.7 billion to harmed investors — whereas SEC enforcement returned only $345 million to investors.

Forced arbitration, which would waive the ability of the vast majority of investors to participate in private class actions, would render the investing public more heavily reliant on an SEC that has shrunk by roughly 16% since the beginning of the fiscal year. In her words, "we are reducing private enforcement mechanisms at the same time as agency resources are shrinking."[28]

Finally, Crenshaw disagreed with the legal analysis in the policy statement, which she stated "does not demand the conclusion that we reach" because "neither the Supreme Court nor Congress has ever adjudged that the FAA requires enforcement of mandatory arbitration provisions tucked away in governance documents of public companies."

She stressed that the SEC does not have a mandate to enforce arbitration provisions, and instead, the Securities and Exchange Commission "should enforce the securities laws, which provide (unequivocally) that any attempt to require a shareholder to waive her rights is void." [29]

What's Next?

The SEC's decision to open the door to forced arbitration, and therefore possibly close the courthouse doors to many investors, does not mean that any corporation — or at least any material number of corporations — will actually utilize this tool.

Any company seeking to impose forced arbitration will likely face considerable investor opposition and potential legal challenges and, on a business front, would have to somehow account for the financial risk that should the company run afoul of the securities laws, it would not face litigation in a single forum, but potentially a mass of individual arbitrations, all involving discovery demands and separate arbitration panels, with limited to no rights of appeal. That is bad for the markets, and bad for corporations.

Companies should be wary of adopting forced arbitration. In any event, investors and their advocates have been called to action by this threat to their legal rights, and will no doubt take steps to ensure that corporations do not utilize this ill-advised tool to escape liability.

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[1] Acceleration of Effectiveness of Registration Statements of Issuers with Certain Mandatory Arbitration Provisions, 90 Fed. Reg. 45125 (Sept. 19, 2025) (to be codified at 17 C.F.R. pts. 231 and 241).

[2] Brief for the United States as Amicus Curiae Supporting Respondents, NVIDIA v. Ohman J:or Fonder AB, 604 U.S. 20 (2024) (No. 23-970); see also Brief for the United States as Amicus Curiae Supporting Respondents, Facebook, Inc. v. Amalgamated Bank et al., 604 U.S. 4 (2024) (No. 23-980).

[3] Rick Fleming, Investor Advocate, U.S. Sec. & Exch. Comm'n, Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders (Feb. 24, 2018), https://www.sec.gov/newsroom/speeches-statements/fleming-sec-speaks-mandatory-arbitration.

[4] Paul S. Atkins, Open Meeting Statement on Policy Statement Concerning Mandatory Arbitration and Amendments to Rule 431 of the Commission's Rules of Practice, U.S. Sec. & Exch. Comm'n (Sept. 17, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-091725-open-meeting-statement-policy-statement-concerning-mandatory-arbitration-amendments-rule-431 ("Today's recommendations on mandatory arbitration and rule 431 are among the first steps of my goal to make IPOs great again.").

[5] IPO declines have been attributed to "the changing landscape of the business world," including "the increasing popularity of private markets" and "the volatility and uncertainty of the stock market." See Giri Devanur, The Current IPO Market: Factors in its Decline and Reversing the Trend, FORBES (Feb. 1, 2023), https://www.forbes.com/councils/forbesbusinesscouncil/2023/02/01/the-current-ipo-market-factors-in-its-decline-and-reversing-the-trend/; see also Shreyas Sinha, The Stock Market Is Roaring Back. Why Isn't the IPO Market?, Observer (Sept. 29, 2024), observer.com/2024/09/us-ipo-sluggish-despite-stock-rise/" rel="noopener noreferrer" target="_blank">https://observer.com/2024/09/us-ipo-sluggish-despite-stock-rise/.

[6] See Jessica Corso, Arbitration Clauses Won't Protect IPOs From Investor Suits, Law 360 (Sept. 18, 2025), available at https://www.law360.com/articles/2389941/arbitration-clauses-won-t-protect-ipos-from-in.

[7] See American Ass'n for Justice, Intuit and H&R Block Scammed Taxpayers. Now They're Trying To Scam The Courts (Apr. 15, 2022), https://www.justice.org/resources/research/taxes-and-forced-arbitration-2022.

[8] Rick Fleming, Investor Advocate, U.S. Sec. & Exch. Comm'n, Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders (Feb. 24, 2018), https://www.sec.gov/newsroom/speeches-statements/fleming-sec-speaks-mandatory-arbitration.

[9] Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as 15 U.S.C. §§ 77a-77bbbb).

[10] SEC v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 186 (1963).

[11] Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983); Gustafson v. Alloyd Co., 513 U.S. 561, 581 (1995) (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., at 5 (1933)).

[12] See Wilko v. Swan, 346 U.S. 427, 438 (1953).

[13] See Steven Davidoff Solomon, Carlyle Readies an Unfriendly I.P.O. for Shareholders, N.Y. Times, Jan. 18, 2012, https://archive.nytimes.com/dealbook.nytimes.com/2012/01/18/carlyle-readies-an-unfriendly-i-p-o-for-shareholders/ (reporting that "[t]raditionally, the S.E.C. has refused to allow I.P.O.'s to go forward with these types of arbitration clauses" and asking "whether the S.E.C. pushes back and once again refuses to allow this clause" in Carlyle's I.P.O. filing request).

[14] Letter from Gannett Co., Inc. to Office of Chief Counsel, Division of Corporation Finance, U.S. Sec. & Exch. Comm'n at 2 (Dec. 27, 2011).

[15] Greg Roumeliotis & Jonathan Stempel, Carlyle Group Drops Controversial Arbitration Requirement for Shareholders, Ins. J. (Feb. 6, 2012), https://www.insurancejournal.com/news/national/2012/02/06/234231.htm.

[16] See Lamps Plus Inc. v. Varela, 587 U.S. 176, 185 (2019) (discussing the "serious due process concerns" in the context of mass arbitration); see also AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 349-350 (2011) (explaining in dicta that it is "odd to think that an arbitrator would be entrusted with ensuring that third parties' due process rights are satisfied"); see generally Richard Frankel, Fighting Mass Arbitration: An Empirical Study of the Corporate Response to Mass Arbitration and Its Implications For the Federal Arbitration Act, 78 Vand. L. Rev. 133 (Jan. 2025) (discussing increasingly complex arbitration procedures).

[17] Letter from Institutional Investors to Committee on the Judiciary and Committee on Banking, Housing & Urban Affairs. (Dec. 17, 2023).

[18] Id.

[19] Joint Letter from State Treasurers to Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n (July 2, 2018).

[20] A no-action letter is a request that the SEC affirm in writing it will not take enforcement action against a company that wishes to exclude a shareholder proposal from its proxy statement. If granted, the no-action letter articulates the SEC's formal recommendation not to take enforcement action against the company for excluding a certain proposal from its proxy statement. SeeLauren A. Ormsbee & Jonathan Gardner, Diminished Proxy Power for U.S. Shareholders Forecasted in Trump's Second Term,IPE (Dec. 20, 2024), https://www.ipe.com/analysis/viewpoint-trumps-sec-pick-points-to-reduced-proxy-power-for-shareholders/10127909.article.

[21] No-Action Letter from Johnson & Johnson to the U.S. Securities and Exchange

Commission (Dec. 11, 2018).

[22] Alison Frankel, Intuit shareholders overwhelmingly reject mandatory arbitration proposal, Reuters (Jan. 28, 2020), https://today.westlaw.com/Document/I5912ed90422411ea82068fd34a36af38/View/FullText.html?transitionType=Default&contextData=(sc.Default)&bhcp=1.

[23] Id.

[24] Paul S. Atkins, Opening Meeting Statement on Policy Statement Concerning Mandatory Arbitration and Amendments to Rule 431 of the Commission's Rules of Practice, U.S. Sec. & Exch. Comm'n (Sept. 17, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-091725-open-meeting-statement-policy-statement-concerning-mandatory-arbitration-amendments-rule-431.

[25] Id.

[26] Id.

[27] Caroline A. Crenshaw, Commissioner, U.S. Sec. & Exch. Comm'n, Mandatory Dis-Agreements: The Commission's Policy of Quietly Shutting the Door on Investors (Sept. 17, 2025), https://www.sec.gov/newsroom/speeches-statements/crenshaw-statement-mandatory-dis-agreements-the-commissions-policy-of-quietly-shutting-the-door-on-investors-091725.

[28] Id.

[29] Id.