

Arbitrating securities fraud cases: Balancing efficiency with investor rights

The SEC now allows mandatory arbitration in IPOs, reshaping litigation risk for public issuers, raising governance and insurance questions, and making expert, well-structured arbitration crucial for fair, efficient resolution of securities disputes.

By Kennen D. Hagen

The U.S. Securities and Exchange Commission's September 2025 policy shift allowing companies to include mandatory arbitration clauses in their IPO registration statements seeks to redefine the litigation landscape for public issuers. For the first time in decades, the SEC will not block or delay a company's registration statement merely because it requires investors to arbitrate federal securities law claims. SEC Chair Paul Atkins framed this as a deregulatory move to "make IPOs great again," arguing that public markets have been burdened by excessive litigation and compliance costs.

From policy reversal to practical uncertainty

This decision overturns the SEC's long-standing practice — rooted in the view that mandatory arbitration somehow undermines the public interest and investors' ability to vindicate federal rights. Under the new guidance, the SEC's review now focuses solely on the adequacy of a company's disclosures regarding arbitration, rather than on the propriety of the clause itself.

While the move provides regulatory clarity, it stops short of endorsement. The SEC explicitly stated that "nothing in this statement should be understood to express any views on whether arbitration provisions are appropriate or optimal for investors."



Legal and political reactions

The policy has polarized stakeholders. Senators Elizabeth Warren and Jack Reed warned that forcing investors into arbitration "would eliminate a critical tool for accountability" and "hide misconduct behind closed doors." Democratic Commissioner Caroline Crenshaw dissented, cautioning that the change "fails to address numerous legal and economic issues" and risks under-enforcement of securities laws. The public advocacy group Save our Savings Coalition wrote: "the issues in a typical case of financial fraud

are too complex, and the costs of discovery and expert testimony are too high, for these claims to be dealt with effectively through individual arbitration."

Corporate advocates and some market participants, however, argue that arbitration can reduce abusive class actions and align with the Federal Arbitration Act's (FAA) preference for private dispute resolution.

Delaware's restriction will be tested by upcoming IPOs

Despite the SEC's new policy, Delaware law (for the time being)

remains a major barrier. Section 115(c) of the Delaware General Corporation Law prohibits bylaws that force all securities claims into arbitration without allowing access to at least one Delaware court. This effectively bars Delaware-incorporated companies, which represent the majority of U.S. public issuers, from adopting mandatory arbitration clauses for federal securities claims.

As Delaware faces competition from Texas and Nevada, both of which are creating more permissive corporate regimes, a new "race to

the bottom or top” in corporate governance may emerge. The ultimate resolution may depend on whether courts find that the FAA preempts state law restrictions — a question we predict will be tested by IPO filings by the end of October. The ultimate resolution will likely be decided by the Supreme Court, which has recently balanced similar issues in favor of the FAA.

Governance and insurance implications

Boards considering these provisions must weigh governance optics and D&O insurance impacts. While arbitration may reduce claim frequency, it introduces uncertainty for insurers and complex new underwriting considerations. Early adopters should expect heightened scrutiny from proxy advisors who have historically opposed such clauses as limiting shareholder rights.

Arbitration vs. Litigation: The practical trade-off

For companies, arbitration promises speed, confidentiality, and cost control, avoiding the massive costs and disruptions inherent in securities class actions. In reality, arbitration is not without issues:

Arbitration costs can be substantial, especially since issuers typically cover arbitrator and filing fees.

Limited appellate review means limited oversight and potential inconsistency in outcomes.

Limited transparency could fuel investor distrust, as arbitration proceedings are private and do not create binding legal precedent.

Yet most of the potential drawbacks with arbitrating securities fraud cases can be easily addressed by requiring that the selected arbitrators are experienced in securities litigation and by carefully crafting arbitration agreements with the proper procedural architecture.

The expertise of arbitrators is paramount to ensure that proceedings focus on dispositive legal and factual issues, with discovery confined to matters material to resolution. Such discipline minimizes procedural inefficiencies and aligns arbitration with the policy objectives of prompt and equitable adjudication. Former federal district court judges and seasoned securities litigators, who understand the jurisprudential evolution of securities litigation, are best at applying the substantive protections of the securities laws and managing cases efficiently.

Proper procedural architecture

Issuers might want to ensure that their arbitration provisions explicitly incorporate the provisions of the Private Securities Litigation Reform Act (PSLRA) to maintain established securities litigation best practices — such as elevated pleading standard for securities fraud claims and an automatic stay of all discovery unless and until plaintiffs defeat a motion to dismiss. At a minimum, they

should designate arbitral institutions whose procedural rules expressly permit dispositive motions — such as motions to dismiss and other summary mechanisms.

Unfortunately, most legacy arbitration providers are poorly equipped to administer large-scale or “mass arbitration” claims. Legacy arbitration systems were designed to address individualized disputes, and their recent attempts to adapt to mass claims through the creation of “batch” or “bellwether” procedures have proved problematic and unwieldy. These hybrid approaches, while innovative, have been criticized for inconsistency in outcomes and protracted timelines — sometimes extending resolution of thousands of claims to well over a decade.

To overcome the deficiencies of legacy arbitration, a more thoughtful model that enables individualized arbitrations to proceed based on binding decisions that are common to all claimants. Under this framework, inspired by federal MDL, an arbitral panel with demonstrated expertise in securities law would render binding determinations on common issues of fact, law and damages applicable to all claimants. Subsequent individualized adjudications — limited to individual issues (liability or quantum) — could then be arbitrated efficiently, often through the submission of standardized claims forms. The foregoing process can be completed in less than a year.

Key takeaway — expertise is paramount.

The emphasis of the SEC’s policy statement is on the adequacy of the arbitration remedy, and therefore the enforceability of an arbitration provision hinges on the quality of the arbitration remedy provided. Hence, it is vital that any arbitration process be provided by arbitrators with demonstrated expertise in securities litigation who adhere to a process and rules that are fair and equitable to all participants.

Despite differing opinions on the wisdom of arbitrating securities claims, how arbitration is implemented — not whether it exists — will determine whether arbitration fulfills its promise as a streamlined, fair and expert-driven process for prompt resolution of securities disputes.

Kennen D. Hagen is CEO and president of FedArb.



Reprinted with permission from the *Daily Journal*. ©2025 Daily Journal Corporation. All rights reserved. Reprinted by ReprintPros 949-702-5390.

