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Exploratory Meeting

Resolution of Corporate Governance Related Disputes

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Exploratory Meeting on Resolution of Corporate Governance Related Disputes Stockholm, 20 March 2006 – Synthesis Note

Introduction

On 20 March 2006 the OECD together with the Stockholm Center for Commercial Law, and with the support of the Government of Japan, organised the 'Exploratory Meeting on Corporate Governance Related Dispute Resolution'. The meeting brought together 25 experts from around the world, representing both OECD and non-OECD countries, public and private sector, as well as (non governmental) international organisations. The meeting was organised to explore the policy options, including the trade-offs, for policymakers in non-OECD countries who will have to design a dispute resolution framework for corporate governance related disputes in listed companies. Identifying and comparing the merits of different dispute resolution options in the areas of company law and corporate governance beyond the traditional mainstream judiciary system is one way of doing this. The need for non-traditional (or specialised) means of dispute resolution and interpretation has also announced itself with the emergence of various types of corporate governance codes, whose "ownership" and enforcement may sometimes be unclear. Fundamental questions regarding these sources of corporate governance regulation remains: what happens if they are being breached by market parties? Is (or should) there (be) a body that takes care thereof? What judicial redress have shareholders in such case? The meeting focused on two alternative mechanisms, i.e. (i) specialised courts, and (ii) arbitration.

One of the reasons why the topic has become more important today is the rise of shareholder activism. In particular institutional shareholders are now common all over the world; often they represent individuals whose pensions and savings amongst other depend on structural corporate governance reforms. That is the reason why there is a need to consider the regulatory framework regarding this topic. In the search for better regulation, rather than more regulation, the prevailing question from an economic perspective should be who should bear the costs. From a legal perspective other considerations may play a role.

In the morning sessions first the topic of specialised courts was introduced by representatives from two jurisdictions having successful specialized enterprise courts, i.e. Delaware with its Chancery Court and the Netherlands with its Enterprise Chamber. Subsequently arbitration as a means of resolving corporate governance related disputes was discussed by representatives from the international organizations setting the standards and framework on this specific topic, i.e. UNCITRAL and the ICC. Participants engaged in a true debate on the pros and cons of both specialised courts and arbitration, but also discussed alternatives beyond the two mechanisms. They explored for example the role of mediation and moreover the media in corporate governance related dispute resolution.

1. Session 1: Setting the scope of the topic; Corporate Governance and Dispute Resolution – a Public Policy Perspective

1.1 Background

The Programme was originally designed as a response to the OECD's Regional Corporate Governance Roundtables (which bring together (mostly) non-OECD countries) that underscored the central role of enforcement in corporate governance. Participants in Roundtable discussions have emphasized that although much has been achieved in raising awareness and in putting in place improved rules and procedures, real progress remains frustrated by poor regulatory and judicial enforcement.

1.2 Beyond Arbitration

Research has concluded that also other dispute resolution methods than arbitration can be effective and that arbitration sometimes can have certain disadvantages, in particular the fact that arbitration is contractual in nature. Arbitration in company law disputes therefore requires parties to the arbitration to have signed up for arbitration in advance. This also explains why disputes involving joint venture agreements and closed companies are more suitable for arbitration than those involving listed companies. Therefore in considering the different policy options for corporate governance and alternative dispute resolution it may be fruitful to include, but not limit, the analysis to arbitration. In particular the role of specialised company (or business) courts should be considered as a means of establishing a well functioning corporate governance system. Also in an era with a growing amount of national corporate governance codes it will be important to understand the remit, role and judicial powers of various "committees", "panels" and "chambers" monitoring interpretation and compliance with these codes.

1.3 Categories of Disputes and Qualities of Dispute Resolution Mechanisms

Dispute resolution in corporate governance is an element of corporate governance enforcement and thus fits in the 2004 OECD Principles. The focus of the meeting has been on corporate governance related disputes between shareholders on the one side and other corporate bodies (e.g. boards) and stakeholders (including creditors) on the other side.

Issues discussed included the spectrum of judicial redress possibilities, the categories of disputes as well as the qualities of the dispute resolution mechanism sought for in case of corporate governance related disputes. Further issues include the costs versus benefits consideration, the problem of lawmakers also being law enforcers and the fact that a corporate governance *problem* is not the same as a corporate governance *dispute.* In order to assess the wide variety on possible alternatives presenters and discussants were invited from different legal traditions (Anglo-Saxon versus civil law) and different jurisdictions, both from OECD and non-OECD countries, as well as from different international institutions.

2. Session II: Corporate Governance and Dispute Resolution - the role of specialised courts in settling corporate governance disputes

2.1 The Chancery Court of Delaware

The first presentation was about the role of specialized courts in resolving corporate governance disputes in the United States and the European Union and primarily dealt with three issues: (i) the historical experience of the Delaware Chancery Court in dealing with corporate governance related issues and the wide impact of its decisions within the US and beyond, (ii) developments within the EU regarding specialized courts, and (iii) the possible lessons to be learned by EU policymakers from the Delaware and Netherlands' experiences with specialized courts. The presentation also addressed some of the recent high profile decisions, such as the Disney case and the Hollinger case. As a concluding remark it was stressed that the ability to make quick decisions and to to express its reasoning in appellate quality opinions are the key qualities of the Delaware Chancery Court. The two reasons why it can do so are: (a) its limited jurisdiction leads to a relative lower case load than other courts, and (b) the culture or 'esprit de corps' of opining in an expedited manner.

2.2 The Netherlands' Enterprise Chamber (Ondernemingskamer)

Subsequently the role and functioning of the Netherlands' equivalent of the Delaware Chancery Court, i.e. the Enterprise Chamber, was discussed. Three questions were dealt with, (i) which corporate governance cases are assigned to the Enterprise Chamber? (ii) why has the Enterprise Chamber become so popular?, and (iii) how did the Enterprise Chamber help develop the Dutch corporate governance policy framework? The presentation underlined the reasons for the success of the Enterprise Chamber (such as expedience and less formalism), however, also reference was made to the threat that specialization of courts may seclude them from society and developments in other areas of law.

2.3 Observations

In immediate response to the two presentations participants raised several relevant considerations. Experiences from Russia and Ukraine show that procedural rules still often prevail. The judiciary still works very formalistic. Although there is a tendency to specialisation within courts, there is not yet a focus on corporate governance related disputes in either Russia or Ukraine, but indeed a related topic such as tax is now specifically being focused on by courts. In relation thereto it was mentioned that there is a risk for transition economies when focusing on specialized courts since this may shift attention away from other, probably bigger, problems such as corruption. Also within such transition economies special interest groups may have too big an influence on specialised judges which may increase the threat of corruption. Moreover it was mentioned that transition economies have to address the question of what to spend their limited resources on. Therefore there will be a need to further explain the incentives for, and benefits of, setting up specialized courts. A comment was also made on Japan where some district courts allot certain types of cases to specialized divisions within the courts, which might be an example of *de facto* specialized courts as opposed to statutory specialized courts. Moreover it was stated that transition economies will likely have some difficulty in justifying a separate specialised court to deal with corporate governance disputes; however, these countries might benefit from the establishment of a commercial division of the general courts in the major commercial centres. Such special division could timely handle commercial matters important to that locality including corporate governance disputes.

3. Session III: Corporate Governance and Dispute Resolution – the role of arbitration in settling corporate governance disputes

3.1 UNCITRAL

The role of United Nations Commission on International Trade Law (UNCITRAL) in the area of arbitration was the next topic of a presentation. UNCITRAL is well known for the model arbitration law and standards it develops in different areas of law. Active participation of the private sector is characteristic of the work of UNCITRAL. Standards developed by UNCITRAL are non-binding.

In itself it is not clear whether corporate governance fits in the mandate of UNCITRAL. If UNCITRAL would embark on a corporate governance effort on dispute resolution, its previous work should be considered, in particular the 1958 New York Convention and the 1961 European Arbitration Convention. Moreover the 1976 Arbitration Rules have proven to be useful since a number of arbitration centers around the world function on the basis of these rules.

The specific challenge with corporate governance related disputes is the question of arbitrability. Why are such disputes often not readily arbitrable? The Model Law might need to be amended (in

order to broaden its scope) to facilitate the specific needs for corporate governance related dispute resolution. UNCITRAL may wish to play a more important role on specialized courts by developing guidance on this topic for its member countries.

3.2 ICC International Court of Arbitration

The ICC International Court of Arbitration subseqeuntly first addressed the issue of why parties are interested in private dispute resolution instead of genuine courts. Some of the arguments include: (i) impartiality and neutrality; (ii) speed; although arbitration tends to become more lengthy, the limited number of instances before a final opinion is granted, remains a strong advantage; (iii) costs (control over fees); (iv) confidentiality; (v) flexibility of proceedings (in particular the informality and scope); and (vi) the opportunity for parties to appoint the arbitrators. The enforcement of arbitration awards often remains a challenge.

The ICC is a not for profit organization set up to promote international trade. Over the past five years 20% of company law related disputes settled within the ICC context concerned corporate governance related disputes. Example cases include (i) valuation of shares; (ii) disputes between shareholders; (iii) remuneration of boards; (iv) bankruptcy related disputes; (v) shareholder participation in decision making processes; and (vi) takeovers.

Alternatives to arbitration may be: (i) specialized dispute boards, (ii) expert appointments, or (iii) alternative dispute resolution such as pre-arbitration referee decisions. In the end arbitration leads to a binding decision as opposed to some of the aforementioned alternatives. It should be noted that there is also a distinction between institutional and *ad hoc* arbitration. Institutional arbitration is perceived as giving parties more guarantees, in particular in the field of confidential treatment of disclosed information. Fraudulent schemes are in general easier to detect in institutional arbitration than in *ad hoc* arbitration. In each form transparency of proceedings is of the essence.

Finally, the issue of multiparty arbitration was addressed. This has shown still to be a challenge: how to arbitrate in case of multiple parties; in this context reference was made to the recent adoption of arbitration by Shell in its articles of association as the exclusive dispute resolution mechanism. It was mentioned that in cases such as the Shell example one will also have to deal with how various jurisdictions treat articles of association of a company; is it a binding compact only on incorporators or is it binding on all original plus any new shareholders by transfer of title? Or is there another treatment in a particular jurisdiction.

3.3 Observations

Participants noted that arbitrability of corporate governance related disputes remains the key challenge. In particular how to obtain an arbitration agreement in case of a corporate governance related dispute seems to be difficult. It appears that for example either in Japan or East-Asia no corporate governance related dispute, or notable one, at least, has until now been decided upon by arbitration. Indeed arbitration may only succeed in case parties already agreed thereto prior to the rise of a corporate governance dispute. In practice this prior agreement still remains a problem; also because of poor drafting of arbitration clauses, as experience from the Stockholm Arbitration Centre has shown.

Recently some interesting concepts in the field of arbitration have been developed. In the US the concept of class action in arbitration is now introduced; moreover interim measures during the arbitration proceedings are also being developed by the ICC in order to make the arbitration

process more attractive. In general it should be noted that although arbitration is rapid, it is not rapid enough at the outset of a case; in courts judges are ready to start proceedings while in arbitration the proceedings leading to the actual arbitration often take a lot of time. Arbitration institutes should acknowledge this issue and find a solution. In this context reference was made to the Canadian example where some courts are designed to specifically facilitate rapid decision making by the judiciary.

On a fundamental note it was mentioned that in particular developing countries should address the issue of arbitrability in their statute in order to secure that arbitration indeed is permitted as a means of private dispute resolution.

In relation to the procedural difficulties accompanying arbitration reference was made to mediation as a potential alternative. It was stated that although the average length of ICC arbitration is about two years, mediation until now has proven to be in (the ICC) practice a very complex process. Although in particular share valuation is becoming more often a topic submitted to binding expert advice as alternative to arbitration.

In conclusion it was stated that the issue of arbitrability of corporate governance related disputes should be a topic for UNCITRAL to elaborate on.

4. Session IV: Specialised Courts or Arbitration? Trade-offs for the Resolution of Corporate Governance Related Disputes

4.1 Background

This session dealt with the trade-offs between specialised courts and arbitration for the resolution of corporate governance related disputes. What would be the most effective mechanism to resolve corporate governance related disputes? Identifying the trade-offs can be a useful tool to find an answer. A questionnaire on different categories and qualities of corporate governance related disputes drafted by the OECD Secretariat and circulated among participants prior to the meeting was the focus point for the discussion in this session.

4.2 Introductory Presentations

The afternoon session started with two introductory presentations on the issues set out in the questionnaire. Presenters considered the questionnaire as a good basis for approaching the issues related to the resolution of disputes related to corporate governance and in particular for developing an inventory or toolbox of the different options in this field. As to the role of arbitration and specialised courts, it was stated that they should be seen rather as complimentary than exclusive mechanisms, as each of them had advantages but also disadvantages. Reference was made to the positive experiences with specialist courts or quasi-courts in the field of complex corporate governance issues, such as takeover cases, and to the shortcomings in relation to transparency and creation of case law as regards arbitration proceedings. Moreover it was suggested that in the policy-making process consideration should be given to the substantial differences of purely domestic and cross-border disputes, as well as to the different needs of developed and developing countries. Setting up specific corporate governance panels may be a good alternative to each of arbitration and specialised courts, bringing together the goods of each of these mechanisms; such dedicated body might well serve effectively the purpose, which in the end should be the overall driver.

The next presenter stressed that arbitration should not be regarded as a substitute for necessary reforms of the judiciary, which should be an absolute policy priority in particular in emerging markets. Reference was made to some of the supposedly positive characteristics of arbitration (such as speed and the perceived cost-effectiveness), but the numerous shortcomings of arbitration were also stressed, especially in the context of less-developed economies (eg, enforceability of arbitration awards, especially, when the non-prevailing party to a dispute was a state body; multiparty disputes; limited publicity as to bad corporate governance which was crucial for raising awareness on corporate governance issues among small shareholders). A suggestion was then made to have auditors have a prevalent role in the resolution of corporate governance related disputes, especially in the prevention of such disputes in the first place, by auditing companies as to their compliance with corporate governance rules. Such "corporate governance audit" could be carried out by lawyers or any person recognised as having sufficient expertise to do it. It would be best to have the corporate governance audit to be done by someone other than the company's financial auditors as this will secure greater independence and it can be carried out mid-year so the findings can be made in time to be followed up by the financial auditor.

4.3 Observations

In immediate reactions to the two presentations, it was stated that the OECD Corporate Governance Principles represented internationally accepted best practices and were intended to be benchmarks for both developed and developing countries, however, without either restricting the ways and means how adherence to them is achieved and safeguarded or advocating a one-size-fits-all approach. It was also said that businesses in many of the developing countries needed rapid solutions for effective dispute resolution (such as arbitration or specialised courts), since the reform of courts would take many years to come. In relation to arbitration, the problems related to the application or non-application of anti-trust rules in corporate governance related disputes were highlighted. The important role of auditors in preventing litigation was recognised (for example, in Sweden, corporate governance practices are part of a company's audit). However, many participants thought that auditors had only limited competence to solve disputes on an ex-post basis. Furthermore, the controversial role of auditors in recent accounting and auditing scandals was mentioned. Finally, discussants emphasised the importance of the media and institutional investors regarding corporate governance disputes, the former of which should therefore be the focus of educational efforts in this respect.

4.4 Questionnaire Outcomes - Categories and Qualities

The OECD gave a brief summary of the responses received to the questionnaire, in which 15 categories of corporate governance related disputes (Categories) and 15 qualities for the resolution of such disputes (Qualities) were set out. Each respondent had given a ranking among Categories and Qualities. The overall results were as follows:

(a) as regards the Categories (see Box 1.), (i) self-interested transactions, (ii) minority-shareholder rights, (iii) takeover procedures, (iv) mismanagement, as well as (v) share valuation and (vi) nomination of board members, were considered as most important;

Box 1. Categories of Corporate Governance Related Disputes

1. *Self-interested transactions*; typical examples include: related party transactions, insider trading, conflicts of interest by board members, executives and senior management
2. *Annual accounts*; typical examples include: disputes between shareholders and the board

and/or auditor over the (withholding of) shareholder approval

3. *Nomination / appointment of board members*; typical examples include: disputes between shareholders and the nomination committee and/or the board over nomination and/or appointment of board members/executives, as well as regarding the criteria for nomination/appointment
4. *Remuneration / bonuses board members*; typical examples include: disputes between shareholders and the remuneration committee and/or the board over remuneration and/or bonuses of board members/executives, as well as regarding the criteria for remuneration/bonuses
5. *Share valuation*; typical examples include: disputes between shareholders and the board and/or auditors on the valuation method in case of (a) squeeze out, and (b) share/bond issues
6. *Takeover procedures*; typical examples include: disputes between shareholders and boards regarding terms and conditions of a proposed takeover, and/or compliance with internal (articles of association) and/or external (listing rules, securities legislation etc.) rules
7. *Disclosure requirements*; typical examples include: disputes between shareholders and boards regarding compliance with (non-) financial disclosure requirements
8. *Corporate control (in M&A transactions)*; typical examples include: disputes between shareholders and boards regarding a proposed acquisition or disposal of a substantial part of the company's assets
9. *Minority shareholders rights*; typical examples include: disputes between majority shareholders and minority shareholders in squeeze out scenarios or on nomination / appointment of board members
10. *Bankruptcy / suspension of payments*; typical examples include: disputes between shareholders and/or bondholders and boards and/or receivers in corporate restructuring
11. *Share / bond issues*; typical examples include: disputes between shareholders / bondholders and boards on dilution issues
12. *Discharge of individual board members / executives*; typical examples include: disputes between shareholders and board members / executives on individual discharge regarding their performance in the past fiscal year
13. *Mismanagement*; typical examples include: disputes between shareholders and boards on supposedly mismanagement of the company
14. *(Non-)compliance with corporate governance codes*; typical examples include: disputes between shareholders and boards on the application of "comply or explain" principles as provided in corporate governance codes
15. *Works' council*; typical examples include: disputes between shareholders / boards and works' councils on the interpretation and applicability of works' council legal corporate governance related rights

Source: OECD 2006

(b) as to the ranking of Qualities (see Box 2.), (i) speed, (ii) quality, (iii) costs, (iv) enforceability and (v) effectiveness, were rated the most relevant by the respondents.

Box 2. Qualities for Corporate Governance Related Disputes Resolution Mechanisms

- Speed
- Quality
- Transparency

- Predictability
- Costs
- Consistency
- Enforceability
- Formalities
- Clarity
- Accessibility
- Legitimacy
- Effectiveness
- Pro active
- Appeal possibilities
- Scope of judgement

Source: OECD 2006

4.5 Tour de Table

In the subsequent *tour de table*, participants had the opportunity to comment the questionnaire as such and to provide the reasoning behind their ranking. More general comments referred to the need for clarification of some of the categories and qualities, the possible adding of further categories and qualities (eg, deterrent effect), and the need for a flexible approach, since ADR mechanisms would not permit a clear-cut categorisation.

It was proposed that the experience gained in ADR in other areas, such as environment, should be taken into account, as well. It was also explained that arbitration was hardly used in Japan, whereas mediation, also by judges, proved very popular in the resolution of commercial disputes. Participants suggested that the assessment of the different dispute resolution mechanisms would have to take into consideration not only the legal framework but also the overall infrastructure in place (eg, efficiency, experience, impartiality, costs). In this respect, shortcomings as to the correct application of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 in a country were considered as having a damaging effect on this country's reputation and business environment, and should be brought to the attention of UNCITRAL. It was moreover discussed in how far the effectiveness of ADR mechanisms in developing countries could depend on the fact whether such a mechanism was demand-driven in that country or not. As to mediation, it was stressed that it could serve as a means for reducing tensions at an early stage and also that it could be particularly suitable for complex disputes.

4.6 A Centralised Specialised EU Corporate Governance Court?

Regarding the idea of establishing a centralised specialised EU court adjudicating corporate governance related disputes (or commercial disputes in general) in all Member States, participants referred to the numerous obstacles in this respect (in particular, different legal systems in Member States, ie common and civil law; conflicting approaches to the legal capacity of companies, ie seat and incorporation theory; and, more generally, the opposition from a number of Member States to further centralisation at EU level). A more viable approach for the time being would therefore be enhanced co-operation and exchange of information between (specialised) courts across Member States.

4.7 The Swedish Securities Council

The role of the Swedish so-called "Securities Council" in relation to the promotion of best practices as to corporate governance issues of listed companies (including takeovers) was explained in more detail. On request by a shareholder or company, this self-regulatory body, established in the 1970ies, issues legally non-binding statements – *ex ante* or *ex post* – as to whether a behaviour could be regarded as being in compliance with best practices of corporate governance, however without giving an interpretation of applicable provisions. The Securities Council is composed of a wide range of experts from different sectors (eg, academia, banks, investment firms, law firms). So far, some 350 written statements, which are public if not requested otherwise, have been issued. A statement would not be given in hypothetical cases and in cases already or likely to be in front of courts. The Council has no sanctioning powers, but has a role supporting the Swedish Financial Regulator in sanctioning unlawful behaviour in relation to takeover procedures. In the more than 20 years of its existence the Council has succeeded in avoiding any conflicts of interests. Finland is currently considering the setting up of a Finnish equivalent of the Securities Council.

4.8 Policy Considerations

With respect to the trade-offs between arbitration and specialised courts, the following policy considerations were considered relevant for a comprehensive assessment:

1. *Speed* of dispute resolution
2. *Impartiality of judges and arbitrators*: here, problems could arise if a company involved in a dispute is a major player in the country
3. *One case – one court*: all integral parts of a dispute should be dealt with by one court, which could pose difficulties in arbitration and specialised-court proceedings, where jurisdiction is usually restricted to specific matters
4. *Flexibility*: arbitration is likely to have more flexible procedures, so that arbitration could lose its appeal the more formalised arbitration procedures become
5. *Costs*: are costs to be borne by the non-prevailing party in all circumstances (eg, in share-redemption actions involving small shareholders)?
6. *Consolidation of actions*: this could be regarded as a major drawback of arbitration proceedings, where parties either have to agree, or bylaws of companies have to provide for the possibility to consolidate similar actions into one single action
7. *Transparency*: in principle, full transparency should be the objective, but a more nuanced approach depending on the subject-matter could be advisable
8. *Evidence*: in this respect, powers of arbitrators would be limited, but this is not necessarily an issue of major relevance for the assessment
9. *Enforcement*: experience would show that in cross-border cases enforcement of arbitration awards was a simpler route
10. *Options*: who should decide on either of the options where to submit the corporate governance related dispute, i.e. to a specialised court or to arbitration?
11. *Settlement of cases*: consideration should be given as to whether courts or arbitration proceedings create opportunities for settling a dispute through mediation or other non-contentious mechanisms
12. *Justice, fairness and predictability*: regarding these criteria, courts might have an advantage

Closing Session; recommendations for next steps

Regarding the follow-up work to this meeting, participants considered further comprehensive analysis of these topics very important, including (i) procedural aspects of ADR mechanisms, (ii)

substantive-law issues of company law, including the issue of arbitrability of corporate governance related disputes, and also (iii) constitutional requirements (eg, as to the insertion of mandatory arbitration clauses for corporate governance related disputes into company statutes). In this respect, the regional OECD corporate governance roundtables would provide a useful source of information and could also serve as a sounding board. The OECD work should ultimately result in an inventory of policy options, based on two legs, i.e. the analytical work, and the collection of data (possibly using the Questionnaire).

Finally, participants of the meeting welcomed that the Global Corporate Governance Forum has been active in the field of mediation and would continue its support of the OECD's work on an inventory and toolbox of flexible (informal) solutions.