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Exploratory Meeting

Resolution of Corporate Governance Related Disputes

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The OECD's Work Programme on Corporate Governance and Dispute Resolution

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Corporate governance is fairly new as a public policy area, and experience with how to best design, implement and evaluate the regulatory framework is still limited. This also applies to corporate governance related dispute resolution. Corporate governance related dispute resolution covers those disputes that involve shareholders on the one hand, and the various company organs – typically the board and the executive management – on the other hand. Policymakers should consider what market participants request from dispute resolution mechanisms. Moreover, policymakers need information about the available range of different dispute resolution mechanisms, their respective pros and cons, and how they can complement each other in serving market participants. There is a demand from policymakers for a perspective on rules and practices, for them to understand the relative costs and benefits of different policy options, as well as to identify, assess, promote or re-direct existing policies in the field of corporate governance related dispute resolution.

Introduction

When the OECD Principles of Corporate Governance were revised in 2004, a new chapter on the structure and quality of the regulatory framework was added. An important reason for introducing this chapter was to stress the need for effective enforcement, which increasingly is seen as an important element for a well-functioning corporate governance system. A crucial prerequisite for successful civil enforcement is the availability of efficient mechanisms for dispute resolution, be it through the regular court system, specialised courts, mediation, panel rulings or arbitration. (Administrative enforcement, in particular, by securities regulators, and criminal enforcement are also important elements of enforcement in the area of corporate governance, but usually less so in the field of dispute resolution.) The preferred form of dispute resolution will depend on a variety of factors, including the character of the dispute, the parties involved and the importance that the parties attach to issues such as speed, cost and transparency.

Civil Enforcement – Context

Participants in the debate on corporate governance generally agree that enforcement is a crucial component of good corporate governance. Research on the external factors conductive to good governance (implementation, policy approach, enforcement culture, quality of courts) is growing fast worldwide. There are substantial variations in enforcement practices and the rules designed to enforce governance measures across countries. Effectiveness in enforcement tends to vary depending on: (1) ownership structure; (2) management entrenchment; (3) legal infrastructure. There are a number of challenges in evaluating the enforcement and dispute resolution environment:

1. A well developed corporate governance system does not necessarily ensure effective enforcement;
2. There may be a number of regulatory institutions necessary to ensure effective enforcement; and
3. An effective enforcement regime needs to facilitate civil actions by shareholders, supported by an adequate legal infrastructure that supplies sufficient incentives for parties to bring civil actions.

In relation to enforcement the OECD Principles state that "*The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.*"

The annotations to this principle point out that, " *...a distinction can usefully be made between ex-ante and ex-post shareholder rights. Ex-ante rights are, for example, pre-emptive rights and qualified majorities for certain decisions. Ex-post rights allow the seeking of redress once rights have been violated. In*

jurisdictions where the enforcement of the legal and regulatory framework is weak, some countries have found it desirable to strengthen the ex-ante rights of shareholders such as by low share ownership thresholds for placing items on the agenda of the shareholders meeting or by requiring a supermajority of shareholders for certain important decisions.

One of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members. Experience has shown that an important determinant of the degree to which shareholder rights are protected is whether effective methods exist to obtain redress for grievances at a reasonable cost and without excessive delay. The confidence of minority investors is enhanced when the legal system provides mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated. The provision of such enforcement mechanisms is a key responsibility of legislators and regulators."

"There is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. [...] In the end, a balance must be struck between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation. Many countries have found that alternative adjudication procedures, such as administrative hearings or arbitration procedures organised by the securities regulators or other regulatory bodies, are an efficient method for dispute settlement, at least at the first instance level."

The discussion about effective enforcement and efficient means of dispute resolution has been particularly prominent in the Regional Corporate Governance Roundtables that the OECD organises around the world with the support of the World Bank Group and the Global Corporate Governance Forum. The prime task of the Regional Roundtables is to raise awareness, provide an exchange of experiences and to formulate concrete policy recommendations for reform. Based on these discussions it appears that regarding civil enforcement in non-OECD countries there is a particular need to address some key institutional weaknesses, i.e.:

(i) an insufficient number of judges,
(ii) a judiciary lacking the necessary skills, and
(iii) the need for more expeditious decision taking by judges.

In order to accomplish effective law enforcement, the deterrence function of reputational damage for board members and senior management through media coverage is recognised by policymakers to be important. Therefore, and apart from arbitration, specialised courts or mediation, the role of the media also needs to be considered in this context. Through their extensive coverage of law suits brought against management and boards over the past few years, the media in many countries have proven to be very powerful in exercising their deterrence function.

Civil Enforcement – Costs and Benefits

While enforcement can occur via criminal enforcement, administrative enforcement (including regulatory action) or by civil enforcement, the quality of enforcement will depend largely on certain common factors, such as the level of political will, the resources available to prosecute cases, the (level of) incentives and the quality of the legal infrastructure. These different enforcement mechanisms have their respective costs and benefits. When policymakers consider different enforcement mechanisms, a distinction can be made between five main types of costs:

(i) policy design costs,
(ii) policy implementation costs,
(iii) enforcement costs,

(iv) compliance costs, and
(v) disclosure costs.

Regarding the benefits of enforcement mechanisms, a number of factors have to be considered by policymakers in their analysis, such as speed, quality, transparency or predictability.

As regards civil enforcement, different dispute resolution mechanisms have also their own typical costs and benefits. For example, in voluntary dispute resolution mechanisms such as arbitration or mediation the state does not bear surveillance nor investigation costs, only the policy design and implementation costs, and to a limited extent enforcement costs. For companies there are in particular compliance and disclosure costs.

Arbitration of Company Law Disputes

In 2003 the OECD, together with the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC), organised two exploratory meetings in Vienna and Paris on arbitration of company law disputes. The meeting in Vienna focused on arbitration as a specific civil enforcement option. The conclusions can be summarised in five points:

(i) arbitration of company law disputes is commonplace in many jurisdictions;
(ii) procedural and technical requirements can represent a trap for the unwary;
(iii) notwithstanding a clear trend favouring arbitration of company law disputes, its acceptance varies across countries;
(iv) arbitration of company law disputes involving publicly traded companies faces many more hurdles than arbitration of company law disputes involving privately held companies; and
(v) notwithstanding the legal, policy and practical difficulties, a nascent trend supports wider use of arbitration of company law disputes, involving public companies and their shareholders.

The Vienna meeting also noted that the consensual/contractual basis for arbitration may require that a potentially very large and geographically dispersed group of shareholders would have to give binding consent. This group must also receive sufficient notice when the arbitration begins. Typically, shareholders in markets with a well developed, effective and reliable court system therefore prefer to litigate company-law disputes in courts rather than demand private arbitration. For company directors, the position is usually the opposite; the company directors would prefer to arbitrate. This preference on the part of company managers for arbitration can result in consent procedures that may be considered unconscionable because they: (i) are coercive; (ii) represent contracts of adhesion; and/or (iii) entail costs and inconvenience for retail investors or consumer that effectively deny them access to a dispute-resolution mechanism. In markets where the judicial system is less advanced or reliable, on the other hand, shareholders may prefer arbitral proceedings to national courts for reasons of capacity, competence and even-handedness. In such event, it may be sufficient for the company to commit itself to arbitration unilaterally, while providing shareholders with the option of choosing court adjudication.

But arbitration of company law disputes is not only a matter for the parties immediately involved. It can also be seen as a public policy matter where some commentators would argue that traditional judicial enforcement has an intrinsic value. Since it is unlikely that all shareholders in a widely held listed company will join an arbitral proceeding, questions also may arise about the legality of awards, particularly injunctive orders which affect non-parties.

Finally, on a practical level, there may be questions about the adequacy of arbitration for complex cases and the incentives of the plaintiffs' attorneys to pursue claims before an arbitral tribunal.

Beyond Arbitration – Specialised Courts

Research has concluded that also other "alternative" dispute resolution mechanisms than arbitration can be effective and, as set out above, that arbitration sometimes can have certain disadvantages. 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 dispute resolution it may be fruitful to extend the analysis beyond arbitration. In particular the role of specialised company (or business) courts could 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.

Future Work Programme

The OECD's future work on corporate governance and dispute resolution focuses on how various forms of dispute resolution can complement each other in contributing to effective redress and enforcement. The objective is to make an 'inventory' that identifies the merits of various approaches to dispute resolution in corporate governance related disputes. Such an inventory could usefully be complemented by commentaries about applications and practical experiences. The inventory was one of the topics discussed during the recently organised expert meeting on corporate governance related dispute resolution, a summary of which is included in Part II.