ARBITRATION OF CORPORATE DISPUTES AND LISTED COMPANIES

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AGENDA

- Corporate arbitration and listed companies: **is it different?** and why?

- What is the current legal framework on the use of corporate arbitration in listed companies, at national and international level?

- In a policy perspective, what measures can be adopted to mitigate the fundamental risks that the use arbitration in listed companies may cause and to exploit the opportunities it offers?
DEFINITION

Corporate Arbitration → arbitration for the resolution of intra-corporate disputes

- corporate arbitration normally rests on an arbitration clause contained in the company by-laws
- corporate arbitration concerns disputes involving shareholders and other company’s organs (i.e. challenging the validity of general meeting decisions; disputes between shareholders and boards on mismanagement of the company and directors’ liability)
  ✓ these disputes concern shareholders in their special status deriving from being member of the company
  ✓ these disputes are different, and raise different problems, from other contractual claims also involving shareholders but in a different capacity, such as those disputes arising out from shareholders’ agreements

Listed companies → in a broad sense, companies who raise capital in the public market and whose shares are publicly traded
CORPORATE ARBITRATION AND LISTED COMPANIES
IS IT DIFFERENT?

Corporate arbitration raises some fundamental issues

- whether and in what way the clause which is in the by-laws of a company is binding on all shareholders, as well as on members of the organs of the company
- which disputes may be decided by arbitration (subject-matter arbitrability)
- whether, and in what way, all interested parties may be informed and may participate in arbitration proceedings
- what is the scope of application of the arbitral decision

Do these issues change, and if so how, when a listed company is involved?
Are there other issues to consider?
Arbitration of company law disputes is commonplace in many jurisdictions **BUT** arbitration of company law disputes involving publicly traded companies faces more hurdles

Main concerns:

- **minority shareholders protection**, especially retail shareholders
  - consent to arbitrate
  - costs of arbitration
- the **adequacy of arbitration** for complex disputes involving a potential high number of shareholders
  - how to ensure that all interested parties can be involved
Consent to arbitrate

- the consensual/contractual basis for arbitration may require that a potentially very large number and geographically dispersed shareholders would have to individually consent to the arbitration clause.
- if it is unlikely that all shareholders in a widely held listed company will consent to the clause on individual basis or join an arbitral proceedings, questions may arise as to the validity (and the scope of application) of the arbitration clause and of the final award.

Costs of arbitration

- the potential high costs of arbitration may be considered as an obstacle to access to justice for retail shareholders.

Highly dispersed shareholdings may put in question the adequacy of arbitration for complex cases.

- multiple parties/multiple claims.
CORPORATE ARBITRATION AND LISTED COMPANIES
WHY IT MATTERS?

Beside the hurdles, there are also reasons to support the use of arbitration for intra-corporate disputes in listed companies:

- to **enhance the effectiveness of private enforcement** of corporate law and corporate governance framework → weak regulatory and judicial enforcement, especially in emerging markets, undermines shareholders’ rights and discourage investment

- many **features of arbitration** may prove **friendlier for investors**, especially foreign ones, which may be more willing to resort to “private judges” instead of the national judicial system:
  - control over the expertise of the arbitrator which are appointed by the parties
  - more expedite decision process
  - flexibility of the proceedings and more likely to reach a settlement
  - confidentiality of the proceedings
  - impartiality and independence from the State

→ **arbitration** may play an important **role** in **increasing investment** offering an alternative to traditional judicial enforcement
CORPORATE ARBITRATION - THE LEGAL FRAMEWORK

Only a few jurisdictions have special rules on corporate arbitration:

- **Italy** enacted a quite comprehensive regime on corporate arbitration in 2003 and addressed many of the main problems it faced in the practice, such as
  - the possibility to provide for an arbitration clause in the bylaws and the quorum required for the decision
  - mechanism to appoint the arbitral tribunal
  - rules on joinder of other shareholders
  - rules on the disclosure of the request for arbitration

- **specific rules** allowing for the provision of a clause of arbitration in corporate bylaws are also provided by Spanish law and Brazilian law

- a specific regime has been recently adopted in Russia

- other countries do not have special rules but generally admit the use of arbitration in corporate disputes under specific conditions or limits set forth by court decisions
As to corporate arbitration for listed companies

- some countries express expressly forbid it → it is the case of Russia and Italy
- some of them implicitly allow it → it is the case of Sweden where a provision of the companies act determines who should bear the cost of arbitration when a publicly traded company is involved
- one of them, Brazil acknowledges a primary role to arbitration in the corporate governance of listed companies → under the rule of the Stock Exchange in San Paolo, companies whose shares are listed in the Novo Mercado Segment are required to introduce an arbitration clause in their statutes, mandating arbitration of intra-corporate disputes to the Market Arbitration Panel created by the stock exchange
- the OECD Corporate Affairs Division has dealt with the arbitration and corporate governance issue, both for close companies and publicly traded companies, as a vehicle for enhancing shareholder protection and encouraging foreign investors → Vienna meeting (2003); Stockholm meeting (2006); Regional Roundtables
CORPORATE ARBITRATION AND LISTED COMPANIES
A POLICY PERSPECTIVE

In a policy perspective, the **most important shortcomings** of the use of corporate arbitration in listed companies could be addressed by developing a **sound legal framework** and adopting **appropriate measures** to counterbalance the difficulties and provide for adequate safeguards.

**Two main issues** should be addressed:

- **minority shareholders protection**
  - shareholders’ consent
  - costs of arbitration

- **the adequacy of arbitration**
  - dispersed shareholdings and complexity of the dispute
MINORITY SHAREHOLDERS PROTECTION

As to shareholders’ consent,

- it should be expressly made clear that individual consent is not needed once the arbitral clause is inserted in the company by-laws and that the clause is binding on all shareholders, present and future

- definition of a qualified quorum for a legitimate decision by the general meeting to insert such a clause in the by-laws

- ensuring an exit right to shareholders not agreeing with the general meeting resolution should be considered

- adequate disclosure of the arbitration clause should be ensured for instance by including the information in the corporate governance statement of the company
MINORITY SHAREHOLDERS PROTECTION

As to the costs of arbitration,

- resorting to institutional arbitration could be recommended
  - arbitral institution normally provides for predetermined scales of fees for arbitrators, thus helping in quantifying and limiting the expenses

- costs could be partially, and under determined circumstances, charged to the company
  - i.e. under the Swedish Companies Act, where the company is a public company, in the event of an arbitration, the company shall be responsible for the compensation to the arbitrators

- under certain conditions, resorting to third party funding could be taken into consideration
  - the issue is to be further investigated since there are serious concerns when third party funding refers to arbitration: for instance, as to the impartiality and independence of arbitrators, the risks of conflict of interests, the disclosure of confidential information
ADEQUACY OF ARBITRATION

In order to ensure that a potential high number of parties can be involved in the proceedings, a sound legal framework should provide for

- **joinder** of multiple parties to arbitration
  - an adequate disclosure should be ensured, at least for the request for arbitration, in order to have other shareholders and interested parties informed of the pending arbitration: i.e. disclosure in the business register
  - is it enough for listed companies? Is it an information to be disclosed to the market? Under which conditions? Here there might be a tension between the confidentiality of arbitration and the transparency requested to listed companies

- **consolidation** of claims

- **class arbitration**
  - although the recent debate in the US underlines how corporate arbitration might be appealing for companies as a mean to avoid class litigation

→ **institutional arbitration** could be recommended
  - arbitral institutions’ rules of procedure could properly address the issue and help arbitrators dealing with this complexity
CROSS-BORDER DIMENSION

What happens when the dispute has a cross-border dimension and more jurisdictions are involved → for instance when shares are traded in a regulated market in a country different from the one of incorporation of the company

✓ this situation may give rise to a conflict of laws which may affect the validity and the enforcement of the arbitration clause and engender multiple legal action (i.e. Petrobras litigation case)

In addition, arbitral awards are to be performed voluntarily by the parties otherwise they can be enforced by appealing to a State court

✓ the issue is covered by the New York Convention on the recognition and enforcement of arbitral awards, which is widely accepted; however, its success may be conditioned by how national courts are set up to interpret and apply the Convention itself

→ Therefore a sound legal framework should also encompass the need for a certain convergence at international level