United Nations Commission on International Trade Law

Experts Group Meeting on Dispute Resolution and Corporate Governance

Wednesday 25th June 2003
UNCITRAL Secretariat, Vienna International Centre
Vienna, Austria

Synthesis Note

SYNTHESIS NOTE

On 25 June 2003, the OECD and UNCITRAL convened a senior experts group to discuss dispute resolution and corporate governance.

Executive Summary – Implications from the Experts Meeting

1. ***Arbitration of Company Law Disputes (" ACLD") keenly interests investors in emerging markets.*** OECD Regional Corporate Governance Roundtables have consistently identified poor judicial enforcement as a significant impediment to shareholder protection and foreign direct investment in emerging markets. As a result, ACLD as become the preferred method of dispute resolution for OECD member-country equity investors in many emerging markets, such as Russia and China.

2. ***Structured dialogue on ACLD will promote investment and economic development.*** National approaches differ on the extent to which they permit ACLD. While most countries permit it, a number of emerging-market countries continue to resist final and binding resolution of company-law matters outside of national courts. At the same time, there is considerable international divergence on specific issues central to corporate governance. Such issues include: (i) the arbitrability of shareholder appraisal rights, derivative actions and class actions; (ii) the authority of arbitrators to apply interim measures (such as an order to produce documents or to pay a preliminary award); and (iii) and the ability of claimants to join officers and directors in arbitral proceedings.

For emerging-market countries with weak court enforcement, structured dialogue can encourage adoption of a base level of ACLD that helps attract and retain foreign investment. For countries with effective court systems, structured dialogue can raise awareness of policy options that improve ALCD. Additionally, such dialogue also enables policy makers to identify and assess important ACLD trends. In some cases, policy makers may wish to accelerate or broaden these trends. In other cases, horizontal policy issues (see below) may suggest that such trends are potentially harmful and should therefore be re-directed or curtailed.

3. ACLD raises a number of horizontal policy questions. In many countries, the arbitrability of matters involving officers and directors raises issues under labour law. Arbitration of appraisal rights, derivative claims and class actions can affect takeover and investment policy. How national courts are set up to interpret and apply the New York Convention has implications for governance and investment flows. Such issues require co-ordinated and holistic consideration by relevant policy communities.

4. ***The principal international instrument promoting ACLD, the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (the "New York Convention"), needs strengthening through greater international policy convergence.*** An ACLD award has little value unless it can be enforced. In this regard, the New York Convention (with over 100 signatories) provides for recognition and enforcement of foreign arbitral awards by national courts unless certain very limited exceptions apply. How these exceptions are interpreted and applied, however, varies widely. Expansive interpretations arising from ignorance, bias, or corruption on the part of national courts often result in the setting aside of ACLD awards and the effective gutting of treaty and shareholder rights. This situation is particularly acute in emerging markets and has a spill-over effect on market integrity and investment.

5. Policy dialogue should begin with a comparative overview of ACLD and development of an analytical framework for assessing interpretation and application of the New York Convention. Developing policy options and, as appropriate, promoting policy convergence, begin with an understanding of current practices. From this understanding, policy options can be classified and their relative costs and benefits explored. Instruments, such as a common analytical framework for assessing implementation and enforcement, can also be devised and tested. The OECD's existing program of work provides for such efforts. The program contemplates an international conference to be organized in partnership with UNCITRAL in mid 2004 to present research on current practice and analytical frameworks, and to discuss policy implications.

Overview of Expert Discussions:

The conclusions of discussions were as follows:

A. Corporate Governance

1. ACLD is commonplace in many jurisdictions.
2. Procedural and technical requirements can represent a trap for the unwary.
3. Notwithstanding a clear trend favouring ACLD, its acceptance varies across countries.
4. ACLD involving publicly traded companies presents far more problems than ACLD involving privately held companies.
5. Notwithstanding the legal, policy and practical difficulties, a nascent trend supports wider ACLD involving public companies and their shareholders.

B. Arbitral Process and Recognition and Enforcement of ACLD Awards

6. Inadequacy in the national legal infrastructure for arbitration often results more from poor judicial interpretation of laws than problems with the laws themselves.
7. Training and education of judges, particularly in emerging-market countries, is required to realize the potential of the New York Convention in promoting ACLD.
8. Further research on law and practice in the area of corporate governance and arbitration is required.

Expert Discussions

A. Corporate Governance

1. Arbitration of company-law disputes ("ACLD") is commonplace in many jurisdictions.

ACLD has become commonplace in a large number of countries. This situation reflects a 20-30 year trend of increasing acceptability and use of arbitration to resolve disputes involving companies, their shareholders and, in some matters, officers and directors. The trend results from both changes in law and changes in the interpretation of law and international conventions.

Where permitted, ACLD is not all or nothing. Some issues, such as valuation of shares for appraisal-rights purposes, interpretation and application of the subscription agreement, shareholders' rights to information, dividends, and participation in decision-making, better lend themselves to resolution through arbitration than matters such as derivative actions or revival of a company. With respect to remedies, prayers for money damages present fewer complications that requests for injunctive relief. Finally, the inability to join necessary and proper parties, such as officers or directors, or creditors or suppliers, can make ACLD inappropriate or ineffective in particular circumstances.

Where national law permits arbitration of some, but not all, company-law disputes, arbitration rules and procedural law should be integrated so that claimants/plaintiffs do not find themselves trying to sit between two chairs.

2. **Procedural and technical requirements can represent a trap for the unwary.**

In those jurisdictions permitting ACLD, there may remain technical issues that can hinder or prevent arbitration unless certain specific and non-obvious procedures are followed. For example, some arbitrators and courts have held that an arbitration clause within the founding documents of a company does not bind the company because it is not a party to the founding documents. But, this and other "traps for the unwary" should not obscure the larger point that shareholders wishing to have their disputes with each other and the company settled by arbitration may do so, even if these shareholders must be alert to esoteric procedural requirements.

3. **Notwithstanding the clear trend favouring ACLD, its acceptance varies across countries.**

While ACLD may be well-established in certain countries, many others continue to prohibit or to limit it. In some cases, national law either prohibits ACLD or gives national courts substantive review powers over arbitral awards that eliminate the finality of ACLD awards and therefore make ACLD impractical. In other cases, national courts hold that all or many types of company-law disputes are not arbitrable. Such holdings rest, for example, upon: (i) the perceived inherent state interest in interpretation and application of a state's own company law; (ii) the likely intersection of company-law issues with issues arising in areas such as employment, insolvency and tax law, which have a high public-interest component; and/or (iii) concerns over accessibility and due process for natural persons who are parties to the dispute.

4. **ACLD involving publicly traded companies presents far more problems than ACLD involving privately held companies.**

ACLD involving publicly traded companies raises legal, policy and practical concerns that do not obtain with private companies.

With respect to legal concerns, the consensual/contractual basis for arbitration can require that a potentially vast and geographically dispersed group of shareholders give binding consent to ACLD. This group must also receive sufficient notice when ACLD has begun. Typically, public shareholders in developed markets prefer to litigate company-law disputes in national courts rather than to arbitrate such disputes privately. For company managers in developed markets, this situation is usually reversed; the managers 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 forum. In many emerging markets, on the other hand, public 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 of ACLD.

A second set of ACLD issues concerns policy matters. Some policy makers may see a particular value in the judicial enforcement of standards for listed companies. Also, because <u>all</u> public-company shareholders are unlikely to join an arbitral proceeding, questions may arise about the lawfulness of awards, particularly injunctive orders which affect non-parties. Lastly, the liquidity enjoyed by shareholders of public companies may represent an alternative to enforcing legal rights unavailable in the private-company context that makes the case for ACLD less compelling.

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

5. **Notwithstanding the legal, policy and practical difficulties, a nascent trend supports wider ACLD involving public companies and their shareholders.**

A number of company law issues involving listed companies have been held suitable for arbitration. These issues include: executive employment agreements, valuation of shares for appraisal-rights purposes, derivative actions, and permissive indemnification of directors. Recently, in Green Tree Financial Corp. v. Bazzle, 2003 WL 21433403 (U.S.), the United States Supreme Court upheld the arbitrability under U.S. law of a class-action against a commercial lender, and the American Arbitration Association has experience certifying claimant classes for the purposes of multi-party arbitration.

Currently, the Sao Paolo Stock Exchange's Novo Mercado listing rules provide for the arbitration of shareholders disputes, although no ACLD has as yet taken place.

Sweden is among several countries that statutorily provides for arbitration of share value in connection with appraisal rights.

The depth of the trend favouring ACLD involving public companies should not be overstated, though. At present, the United States appears to be at the forefront of ACLD for listed companies. But, aside from Brazil, it is unclear how many other countries permit ACLD to any great degree with respect to listed companies.

B. Arbitral Process and Recognition and Enforcement of ACLD Awards

6. **Inadequacy in the national legal infrastructure for arbitration often results more from poor judicial interpretation of laws than problems with the laws themselves.**

The UNCITRAL Model Law on Arbitration forms the basis for the national arbitration law of approximately 40 countries. In some countries, such as Sweden, the Model Law has been paraphrased, rather than incorporated verbatim, into national law. This situation can generate confusion over the meaning of particular language, as well as result in discrepancies in law and practice among countries that have used the Model Law as a guide.

A larger problem, particularly in emerging-market countries, is a tendency to interpret Model-Law-based provisions of national laws in ways that diverge from established interpretations in developed legal systems. Sometimes these divergences arise from lack of knowledge on the part of local judges regarding such established interpretation. Sometimes divergences arise from a sense of greater obligation to extend court protection to potentially vulnerable persons, and sometimes divergences arise from a desire on the part of the judiciary to preserve its hold on the dispute resolution process.

7. **Training and education of judges, particularly in emerging-market countries, is required to realize the potential of the New York Convention in promoting ACLD.**

The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards has been ratified by over 100 countries. The Convention is structured to provide for national courts to recognize and enforce foreign arbitral awards except in very limited circumstances.

In practice, the judiciaries of several emerging-market countries have interpreted and applied the Convention in ways that greatly expand the circumstances under which recognition and enforcement of a foreign arbitral award may be refused. The result has been frustration of the arbitral process and lack of reciprocity in fulfilment of international obligations under the Convention.

Key issues in deciding to deny recognition and enforcement include: (i) whether a court may review the merits of an arbitral decision if it is based on the substantive law of the country where the court is situated (developed jurisprudence on this point says not); (ii) whether all parties to the arbitration agreement are competent to arbitrate (e.g., in some jurisdictions, companies in bankruptcy may not agree to arbitrate); (iii) whether, under the law of the seat of arbitration and of the place where enforcement is sought, the subject matter of the dispute may be arbitrated (e.g., until 2001, Italian law prohibited arbitration of share-transfer disputes); and (iv) whether enforcement of the award would violate public policy of the place where enforcement is sought (e.g., an award of guardianship over an infant).

As with questions of interpreting national arbitral laws, variances interpretation and application of the Convention can arise from: (i) ignorance of established international jurisprudence; (ii) differing views of the proper roles of the courts vis-à-vis arbitral tribunals; (iii) unwillingness on the part of judges to cede power; and (iv) favouritism due to misplaced patriotism or corruption.

8. **Further research on law and practice in the area of corporate governance and arbitration is required.**

With respect to corporate-governance issues, specific comparative research should be undertaken on topics such as arbitration of appraisal-rights valuations, the joining of officers and directors, derivative-action arbitration and certification of class-action arbitrations.

In addition, an analytical framework should be developed to determine the worldwide spectrum of interpretation and application of the New York Convention.