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Improving Board Accountability by Deployment of Industrial Arbitration In Resolving Shareholder Grievances: Concise Review of Practices from Advanced Corporate Governance Countries

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Abstract

It is not debatable that interpersonal harmony enhances superlative progress in organizations that have adopted the corporate governance model as their operational benchmark. This also holds true in situations where dispute settlement procedures are already defined before grievances arise. In corporate governance organizations that utilize various forms of dispute settlement mechanisms, it was found that such mechanism as industrial arbitration is clearly provided for in their operational by-laws or constitution. Thus, under this model, the procedures for activating arbitration panel proceedings are provided for in the Regulations or Rules that are incidental to the by-laws of the corporation. This proposed models for African businesses can enhance service delivery by reducing or even eliminating the time and cost of litigation. It is therefore imperative to posit that corporations that apply ICD such as industrial arbitration had been known to survive massive competitions due to well articulated corporate governance practices. This approach also appeals to African businesses that are faced with various forms of shareholders and investments challenges that affects their capacity to remain sustainable. Thus, adopting this model of internal dispute resolution by way of industrial arbitration guarantees increasing corporate efficiency, high productivity and significant profitability.

Keywords: *industrial arbitration, intra-corporate dispute, fiduciary contractarianism, internal conflict resolution, quasi-contract, asymmetrical arbitration, financialization, derivative and multiparty arbitration*

1. Introduction

As corporate governance takes center stage in the support of the growth of modern businesses, there is the crucial need for consideration of the provisions of law and corporate regulations in respect of dispute resolution and crisis management within an organizational framework. This need is necessitated by the corporate policy of increasing profitability by increasing efficiency of services and products delivery. Thus, quality services and products delivery lie at the heart of modern business survival and these businesses must be strategically positioned to surpass competitions and hostile business environments.

One proven way to achieve these great feats is to ensure that aggrieved members of the company utilize internal industrial arbitration measures in their bid to resolve internal disputes among themselves and their corporations, keeping in mind that competition in some cases are fueled by grievances that results divisions and setting up same business in same location. This paper is an attempt to conduct a concise review or uncover some of the practices of intra-corporate dispute arbitration as applicable in countries with appropriate legislations and advanced applications of industrial arbitration practices. The paper is with specific reference to internal corporate disputes among shareholders and perhaps stakeholders. The paper commences with shareholder focused internal corporate disputes identification and the capability of resolution by privately initiated arbitration hearing or proceedings. The impacts of this resolution on the corporate governance of the organization is of major concern and should properly be addressed.

2. Issues in Arbitration Driven Contracts

The structural basis of intra-corporate dispute arbitration (ICD) which is referred to in this paper as an industrial form of arbitration as applicable under common law and viewed within the confines and meaning of autochthonous laws in the sense that it delivers a level of autonomy to the arbitration panel to assume jurisdiction

once the parties have accepted to be bound by its findings and awards. It should be noted that arbitration panels carry on their responsibility under conventionally accepted procedures and rules of proceedings (Coffee, 1986). In this vein, a comparative analysis of this view indicate that this approach is limited in application given the fact that in some advanced industrial arbitration jurisdictions such as Singapore, Japan and Germany corporate organizations are not perceived to purely run on the basis of contracts (Kraakman, *et al*, 2004). This to a large extent is at variance with what obtains in the UK and most common law countries.

Thus, under this approach, corporate organizations are viewed as purely business entities that maintain some fiduciary relationships among its shareholders and partners on one hand and between the shareholders and the organization on the other hand. This explanation is further brought to limelight in the works of Moor (2014) where the author argued that the widespread existence of mandatory rules within the UK corporate governance system represents a major empirical aberration to contractarianism's flexible, private-ordering paradigm of law". Although this view sprang from practices in the UK corporate regime environments, suffice to say that as world capital for financial services, it is well assumed that policies operational in the UK could be well accepted as standard in the rest of the world. This opinion accounts for why large corporate organizations and firms prefer to travel from their host countries to enter into contractual agreements in London.

The foregoing implies that the argument as to the viability of shareholders' fiduciary contractarianism among themselves as an attempt to positively position the incursion of corporate rules into contractual realities, begs the question as to when such should be considered appropriate under the theory and practice of freedom of choice as a core foundational doctrine of the privity of contracts. Hence, should public imposed corporate rules be used as the only basis for intra-shareholder participation in their organizations? In response to this poser, this paper is of the view that it is the incursions of these assumed and imposed standard rules that create room for disputes and disagreements that necessitate the deployment of industrial arbitration within a corporation's shareholdership. It should further be noted that although these rules are thought of as being consistent with corporate rules of choices and selections, under UK applicable laws, such claim of consistency constitute more or less, a quasi-contractual view that do not seem to be appropriate, given practical realities as there are evidence of contradictions that makes them unreliable.

In the forgoing regard, a modern assessment of a corporation's status indicate that a company is the focal point of contractual ties. This implies that an organizational constitutional framework must necessarily provide the means of a legally enforceable internal dispute arbitration clauses that can enhance smooth operations of the organization. This view is the lifeline of the success of the organization. Thus, treating the company's constitution, which includes an arbitration clause and thus forms the basis of the organization's corporate arbitration procedure for internal conflict resolution. This view was further supported and adopted in the European Court of Justice case of *Powell Duffryn Plc v. Petereit* and was relied on in the appeal case of *Kleinwort Benson Ltd v. Glasgow District Council, 1997***.** In the Kleinwort appeal, the United Kingdom House of Lords while interpreting sections 1 and 2 of the Civil Jurisdiction and Judgements Act 1982 which incorporates the European Courts Judgements Convention (Brussels) 1968 into the laws of the United Kingdom, held that although Article 2 and Article 5(1) of the Civil Jurisdiction and Judgements Act 1982, are distinct, Art. 2 provides that a person domiciled in any part of the United Kingdom can be sued in the courts of that part of the United Kingdom; it also went on to state under Art. 5(1) that a person can also be sued in courts of other parts of the United Kingdom if it is for the purposes of performance of obligations under a contract.

The import of the foregoing analysis in respect of this paper is anchored on the position of the House of Lords in *Kleinwort Benson case* where the Court affirmed that the independent or autonomous concept of the convention or contract under which parties entered into a transaction should be the basis of adjudication and not the national law of the contracting state. In the words of Lord Goff of Chieveley who read the lead judgement:

> "*It was held in the MARTIN PETERS CASE that membership of an association creates between the members close links of the same kind as those which are created between the parties to a contract, and that the obligations between them may be regarded as contractual for the purposes of Article 5(1). This was on the basis that the concept of "matters relating to contract" should be regarded as an independent or autonomous concept, to be interpreted by reference chiefly to the system and objectives of the Convention, and not by reference simply to the national law of the relevant Contracting State.*

An extension of this argument to the United States will clearly show a more restrictive treatment in terms of offshore investments that were contracted outside of the United States and in different currency. In support of this view, the United States Supreme Court case of *Morrison v. National Australia Bank* found that section 10(b) of the Exchange Act does not support an action from an Australian claimant who transacted with a United States corporation outside of the United States under a foreign currency. This decision is a substantial protection for United States corporations who sell their shares in foreign lands using the currencies of those foreign countries. The question arising from the *Morrison* judgement to the United States courts is, what if the transaction was carried out in United States dollar currency but on foreign soil? This study is of the opinion that if this issue is not well clarified, then rouge corporations can set up in the United States and proceed to sell their shares outside of the country and be protected by United States law provided their securities are not listed on United States exchange.

From the view point of this discussion and the American approach as opined by Ravanides (2008) and further argued by Scot and Silverman (2013), does not appear to encourage some types of offshore investments by shielding United States corporations with cross boarder outlets from class litigations if they are not listed on the United States exchange. In order to solve this problem, if the corporations maintain bye-laws that provides for mandatory arbitration within its shareholders and between shareholders and the corporation, then issues of loss of investments arising from limitations in national laws would be out of the question. Further, it should be noted that under such condition, the company and its members are partners that are in a type of fiduciary trust relationship that makes it incumbent on them to resolve their issues internally or at most by an arbitration panel.

Further, it has become necessary that legislative empowerment is required to drive this process. This account for the reason behind Spanish and Italian legislative inputs that requires the incorporation of arbitration clauses into statutes of companies. Accordingly, the Spanish Arbitration Law 2011, provides that corporate organizations are empowered to institute arbitration proceedings for its internal disputes by providing a clause in its constitution, statutes or by-laws that directs disputants to proceed on arbitration provided two-third of its members reflecting its corporate capital have agreed to it. Italy on its part has similar provision which restricted the decision to one-third the capital voting strength of the corporation. In the case of Spain, where there seem not to be an agreement, then a resort to an arbitral institution is required Warwas (2020). This is the essence of the corporate partnership pronounced upon by the European Court of Justice in the *Powell Duffryn [1992]* case.

It should be noted that under the provisions discussed above, shareholders that have access to the organization's statutes or by-laws are bound by such arbitration clause in the document. This position has long been established in the cases of *Eley v Positive Government Security Life Assurance Co Ltd (1876)* and *Hickman v Kent or Romney Marsh Sheepbreeders' Association*. The implication of this point is that would-be shareholders are by law required to seek guidance from professionals and possibly access the various establishment documents of the organization before investing their funds. In addition, under the United Kingdom law, while directors cannot rely on arbitration clause to defeat an action against their conducts, the court has approved of the shareholders to bring derivative actions against the organization. This was addressed in the case of *Battie v. E&F Beattie Ltd* and does not imply that the directors are not privy to the statute of the company, but that no part of the statute should be allowed to shield them when then they err or commit corporate fraud against the shareholders.

3. Nature of Organizational Statutes and Corporate By-Laws

It is important to note that under the UK Companies Act 2006, directors of companies are required to conform to the provisions of their statutes, since it provides the procedures for their appointment and removal and further regulate their conducts while in the service of the organization. Thus, a quasi-contract is created by statute and this contract have been pronounced by the English Courts as binding on all that are privy or connected to the transactions of the company by reason of the company's statutes or by-laws since it has binding effects on the stakeholders (Moore, 2014).

Given the position of law in respect of arbitrability of a statute, it is important to note that while most arbitration laws make provision for corporate or industrial arbitration, the members of the panel must not necessarily be members of the organization. For instance, the United Kingdom Companies Act, 2006 provides that that persons who are not privy to the constituent statute of the company cannot be allowed to rely on the statute. This novel

approach does not affect external arbitrators whom the Act referred to as outsiders who can be engaged by an amendment under s. 737 of the Act which requires that the Secretary of State can introduce an amendment to that section where it is designed to serve a worthy purpose. The implication of this is that arbitrators can be engaged to carry on with their service under legal approval.

As a follow up, it should be noted that arbitration clauses are not meant for employees, creditors (to enforce loan commitments), suppliers, etc. These group of persons cannot compel the organization to proceed to arbitration, since they are not privy to the statute of the organization and are not allowed to exploit the provisions of the statute to arbitrate on their disagreements with the corporation. This also go to the auditor who has the responsibility for maintain the records of the organization. The auditor cannot utilize the arbitration clause to settle disputes where such arise in course of his work, except he comes under the provision for outside party. The organization statute can also stipulate the range of rights or privileges that are covered under the arbitration clause.

It should further be noted that in the United States of America for instance, the Courts have always maintained that the founding instruments of corporations including their operational by-laws should indicate the arbitral measures that could be utilized when there is dispute. This is the position in the United States case of *Corvex Management LP v. Commonwealth REIT (2013, Cir. Ct. Balto. City)* where the Court held that shareholders pursuing a hostile seizure of a publicly traded corporation must proceed to arbitration with its board of trustees on the basis of the agreement to arbitrate which they knowingly and willingly entered into. This case being a representation of the attitudes of United States courts in respect of the validity and appropriateness of incorporating arbitration agreement or clauses in the establishment instruments of the organizations. In the instant case, the plaintiff who are shareholders of *Commonwealth REIT* approached the Management and Board of Trustees of their corporation for a possible takeover given their loss of confidence in their management of affairs of the corporation. The trustees referred them to the agreement to arbitrate in situation where disputes arise, as contained in the corporation's by-law. They refused, but rather proceeded to court for a stay and perpetual restraining order against the arbitration proceeding. After taking arguments from both sides, the court found that the plaintiff's argument in respect of lack of consideration in the arbitration agreement as basis for their refusal to proceed on arbitration is not adequate in law to vitiate a validly entered contract to arbitrate. This case like many others is emphatic on the reasonability incidental to the idea to seek solutions to disputes through other interventions outside the Court.

In the foregoing regard, it should be noted that the agreement entered into by the members of the corporation to submit to an arbitration limits the questions that can be put to the court to determine. This means that what the court could be invited to determine is the existence of an arbitration agreement. Once the court is able to determine this issue, the United States court lacks further jurisdictional competence to delve into the merits of the matter and must refer the parties to arbitration as provided for in their agreement. In support of this position, the United States case of *Cheek v. United Healthcare, (2003)* have earlier affirm the position that when assessing the enforceability of a valid arbitration agreement, courts are not expected to proceed beyond the details and limits of the arbitration agreement into the main contract that the arbitration is intended to look into and determine.

Further, as provided for in civil procedures, the court is first of all required to determine the identity of the persons who have agreed to arbitrate. Accordingly, and as affirmed in the case of *McCarthy v. Azure, (1st Cir. 1994)*, such identity must not be unclear. In addition, as in the *Corvex Management LP v. Commonwealth REIT* case, nothing stops the shareholders from waiting for the corporation's AGM or any other statutory meetings in order to move a motion to change the provisions of the arbitration agreement which they felt did not accord them sufficient protection. This global practice has been consented to by the Russian Supreme Court (Turkhtanov, 2013) in the 2012 Russian Supreme Arbitrazh Court case which held that an asymmetrical arbitration provision was ineffective in the case of *CJSC Russian Telephone Company v. Sony Ericsson*. As observed from the case the Russian Supreme Arbitrazh Court held that an asymmetrical arbitration provision was ineffective. The agreement between the parties is in relation to product distribution where part of the agreement holds that any disagreements between the parties would be settled through arbitration at the International Chamber of Commerce in London, but that Sony Ericsson would still be free to take any disputes over payment for the products supplied to any court with jurisdiction.

In the foregoing regard, the Russian Supreme Arbitrazh Court held that that this asymmetrical arbitration clause, which gave sole authority to Sonny Ericsson to decide whether to initiate arbitration or litigation, gave Sony Ericsson an undue privileged position and as such was ineffective. The foregoing positions of law in respect of the nature of issues that could be undertaken under industrial arbitration thus indicate that shareholders interests in certain cases may be better protected under well defined internal arbitration measures and processes.

In the foregoing regard, the Russian Supreme Arbitrazh Court held that this asymmetrical arbitration clause, which gave sole authority to Sonny Ericsson to decide whether to initiate arbitration or litigation, gave Sony Ericsson an undue privileged position and as such was ineffective.

4. Corporate Governance and Arbitration

It should be noted that some fundamental theories of corporation rely on the nature of the contracts under which corporate governance is organized in such corporations. Thus, the corporate strategy that utilizes the constitution and by-laws of an organization to regulate or control its internal dynamics and activities is critical to the derivable benefits of arbitration. Thus, modern corporate governance ideologies seek to safeguard shareholders and investors in order to enhance better perception of the public in respect of the corporation's business. In the long run, this attribute increases public trust for the corporation's products or services. Having made this critical point, it is important to note that, the deployment of arbitration as a means of dispute settlement in capital market investments is a clear case of motivation that is intended to strengthen the market. In the arear of capital market investments, for instance, this goal is motivated by the need to strengthen the markets, which in turn provide the businesses with the needed access to investable cash.

Consequently, stakeholders are safeguarded by corporate governance institutions by way of their support towards the financialization of the enterprises with specific interest in their *income stabilization* (Fleur, 2011) and *corporate outlook for high density competitiveness* (Nolan, 2006). Although these views are in themselves not absolute, they represent the approach for most of advanced societies. For instance, in the United States, trust for capital market performance is sustained and corporate governance guaranteed when investors proceed to court for settlement of perceived grievances. Thus, in that jurisdiction, derivative legal proceedings or lawsuits, administrative enquiries and hearings are seen as fundamental to transparent corporate governance and a better way to enforce compliance with corporate agreements (Stefano, 2006). The view of this paper in respect of this point is that the amount of time and resources spent to ascertain the appropriateness of the action or otherwise could be a well off investible resources if internal arbitration is resorted to. This does not mean that all industrial disputes can be settled by arbitration (Coffee, 1988); this imply that litigation has specific role it plays in corporate governance and this role cannot be assigned to arbitration no matter how superlatively empaneled.

Further, as a comparative engagement, it has been observed that the practice in the United States that rely on litigation to resolve internal corporate governance issues that are likely arbitrable disputes are not applied in that manner in the United Kingdom. However, this approach is changing in the United Kingdom as reported by Croftand and Vandevelde (2016) who opined that more investors are now willing to fund collective legal actions in the United Kingdom. In such circumstances as in the United States, litigations are used to demand accountability from the operators of corporations while in the UK, they are likely to resort to arbitration in order to settle the disputes internally under Take Over Panel arrangements (Armour, 2007). In line with this no-litigation practice in the United Kingdom, Financial Services Ombudsman is approached when disputes arise between retail investors and securities brokers. Additionally, under the London Stock Exchange regulations, disputes between traders over securities are settled through internal complaint processes and sometimes arbitration rather than resort to litigation in court.

As have been observed, the United Kingdom system differs from the US litigation-based corporate governance in terms of these conflict resolution procedures, particularly the Takeover Law Panel and the compounding soft law approach to corporate governance. The United Kingdom does not view the court as the key venue for the offering of investor protection and restitution. In this regard, the United Kingdom corporate governance framework of employing a non-judicial method to enforce governance rules is in tandem with ICD arbitration as

a framework for safeguarding investors. In view of this point, a school of thought have maintained that resort to arbitration rather than the Courts delegalizes the practice of corporate governance (Shell, 1989).

5. Authority of the Court and the Limits of Arbitral Award

We note that there are provisions of law under which Courts are allowed to make various orders and grant reliefs or remedies. In this regard, arbitration is not prohibited by the any provision of law that empowers a court to adjudicate and make findings. This position is in view of the judgement of the English Court of Appeal in the case of *Fulham Football Club (1987) Ltd v Richards [2011]*. Thus, arbitration does not negate or usurp the roles of the Courts in terms of making awards that guarantees and assures the recipients of their equitable remedies. In the foregoing regard, this constitutional and statutory role of the Court can be used against an arbitral award that affect the rights of third parties, especially where such third parties were not parties to the arbitral proceedings. For example, no arbitral award against a creditor will be binding in arbitral proceedings that result the dissolution of a company.

However, this view is not a suggestion that limits the applicability of arbitration in most of an organization's affairs. Consequently, arbitration should be allowed even if some remedies can have an impact on third parties due to the nature of the transaction, especially where awards for different remedies or claims can be made. This approach was ably dealt with in the case of *ACD Tridon Inc v. Tridon Australia Pty Ltd [2002]*; where the Court held that a winding up order also has the potentials of affecting third parties outside the intended public policy considerations.

As could be observed, minority shareholders in some jurisdictions have been prevented from seeking legal remedies on the ground that they do not have the statutory *locus standi* to bring such action in court against the board of directors, who are regarded as the company's fiduciaries. This historical limitation has consequently prevented minority and individual shareholders from seeking judicial reliefs. Under the corporate internal arbitration agreement, these persons that have been secluded from the benefits of justice are allowed to vent their grievances at the arbitration panel proceedings.

In the foregoing regard, it can be said that the substantive and procedural laws, which considers the corporation or firm to be the proper party that can initiate legal actions that can hold the board accountable, is the major issue in respect of this imposed limitation. Thus, arbitration proceedings must be required to be conducted under strict provisions of the company by-laws or statute. This means that areas that are not arbitrable must be identified in the by-law. This crate more openness for choice making during investment in such corporation. For instance, the company's by-law can stipulate that shareholders can bring derivative law suits against the corporation where there is an absolute need for such action. Based on this provision, an arbitral panel or tribunal would have the authority to provide remedy, since they have the authority to do so; any action commenced from court in respect of issues provided for arbitrative hearing in the by-laws will go to a nullity since arbitration is the first port of call. Secondly, the implication of this provision is that the arbitrators will also have the legal mandate or authority to grant reliefs that remedies the grievance since those reliefs are within the provided items for arbitration.

6. Multiparty Arbitration: Comparative Assessment

Multiparty arbitration deals with situations where there are more than two parties with varying contending interests in respect of a listed of publicly offered corporation. As should be noted, class action has been used in the United States for a long time with great results. This model of venting mass grievances has been exported to Canada and Australia (Hanotiau, 2004) and a lot of other common law countries. As previously indicated, the corporation's by-law or constitution can provide for resort to class action arbitration for shareholders and individuals who are aggrieved by Board decisions in the same way that class action litigation is conducted. Thus, such a by-law or constitution may contain an arbitration provision that consequently binds all shareholders of the company of all times -past, present, and future. These range of shareholder may have acquired company shares at the time the clause was not contained as a provision in the by-law. Further such provisions may also direct that Regulation or Rules can be developed to undertake the processes of bringing matters to the arbitration of the corporation. Thus, the Rule of Procedure may outline the measures that could be adopted on how shareholders will be notified or invited to participate in the proceedings. The Rule may also provide details as to how Arbitrators are to be sourced, and how they are to conduct the proceedings.

It should be noted that an arbitration clause can only bind shareholders that signs on to it. This means that shareholders that had not joined the corporation when such clause were not in the by-laws or constitution are not bound by such clauses. Further in England there are certain multiparty situations that warrants the combining of claims between former shareholders and current shareholders who lost their investments due to poor management capabilities of the Board (Mulheron, 2011). This means that if for example, the Board refused to declare the corporate health status of the company for shareholders to make decision to trade their shares or not and the corporation enters into financial losses, intra-corporate dispute can result from this negligence. Thus, requiring shareholders to be informed of this development and given the opportunity to get involved in the firm's multiparty arbitration. In this vein, if the by-law or charter of the corporation made provisions for shareholder-company, then invitations can be extended to them to participate. As should be noted, this set of shareholders may start a securities law case against the board at any time due to the nature of their shareholdership in law.

However, another legal issue may come out of this multi-party problem. For instance, the question of the status of a listed business in respect of a legal shareholder who is thus subject to the by-laws of the company? The findings of this paper thus agrees with the views of Gullifer and Payne (2010) that the shareholders that participate in shareholders' meetings and join in the voting process are not always the real or actual owners of the shares. Thus, only the corporations' statutory members, who are the legal owners of the shares, are deemed or seen to be subject to the corporation's by-laws (Yates and Montagu, 2013). This view appears to have limited application as in the United Kingdom shareholders are not allowed to proceed on their organizations under any form of class action, especially where they seek a collective relief; however, in the United States class actions are permitted and they have been seen to be beneficial to small investors if their individual claims can be accumulated resulting significant concern that can guarantee their victory (Scott and Silverman, 2013). In this vein, there is no assumption that shareholders' power to seek redress would be restricted by class action arbitration.

Further, in class action situations as applicable in the United States, shareholders must come to terms in agreement as to the individuals among the aggrieved group that will champion the lawsuit. This is because United States law requires that that there should be a representing party with a clear intention of class action arbitration (Coyle, 2016). It should further be noted that if this clause is not provided for in the arbitration agreement of the corporation's by-law, then there is indication that shareholders can only arbitrate on their individual basis. Consequently, if arbitration will prevent parties from seeking remedies, then a legal or substantive right cannot be surrendered. However, if such a right is procedural, the decision would be left to the parties.

In addition to the foregoing, the United States courts have established by case law that arbitrators can determine on substantive law concerns. Their reasoning is based the need to eliminate unjust prejudice. This effectively means that arbitrators can give remedies that are only covered on their arbitration agreement or clause. Following this position of United States law, if issues of this nature surfaces in the United Kingdom, the United States position may not hold sway if the remedies will affect third parties who are not really parties to the action.

7. Conclusion

The paper has concisely considered the importance of arbitration in issues of corporate governance in firms that are upward looking. This implies that disputants in an organization can proceed to arbitration rather than court if it can be shown their founding instruments and by-laws makes provision for arbitration as a port of first call. The benefits of this proposition for African businesses is that the firm can continuously maintain its focus without being distracted by law suits. Secondly it helps to reduce the frictions and acrimonies that are normally generated by lengthy litigations and same time reduce the occurrence of stiff competition from former friends turned foes. Although it is a comparative treatment, this concise approach has been able to dissect the practice of industrial based arbitration within corporate governance framework. It hoped that if the views expressed here are adapted to corporate governance culture of organizations doing business in Africa, then the same results obtainable from businesses in advanced economies are likely to be recorded.

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