ARBITRATION CLAUSES IN PUBLIC COMPANY CHARTERS: AN EXPANSION OF THE ADR ELYSIAN FIELDS OR A DESCENT INTO HADES?

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ARTICLES

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INTRODUCTION

When, back in the days of gods and heroes, Eris, the ill-natured goddess of discord, was left out of the nuptuals of Peleus and Thetis – the soon-to-be mother of Achilles – because of her quarrelsome manners, she decided to make her absence felt: enraged, she tossed into the feast a golden apple inscribed with the word “kallistei” (“to the fairest”). A heated argument erupted among Hera, Athena and Aphrodite, each claiming the beauty prize for herself, and the Olympians were asked to settle the vexed issue. Zeus decided not to intervene – instead, he nominated the son of the king of Troy, reputed for his honesty, as arbiter. Paris accepted the appointment, but at the hearing on Mount Ida was confronted with irresistible offers from the contestants, each vying for the judge’s favor. Hera pledged wealth and kingship, Athena wisdom and martial renown, yet Aphrodite, unsurprisingly, won by promising him the love of the most beautiful woman on earth, Helen of Sparta. Paris awarded the golden apple to Venus, earning, unluckily for him and his homeland, the enmity of the losing parties.¹

The aftermath of that infamous ruling is well-known: Helen’s abduction led to the Trojan War, which inspired Homer to compose the Iliad. The judgment of Paris, however, is also one of the first accounts of an arbitration proceeding, in the sense of “a method of dispute resolution involving one or more neutral third parties who are usually agreed to by the disputing parties and whose decision is binding”² – albeit one tainted with graft (and lust). Historically speaking, “alternative dispute resolution” (“ADR”) indeed preceded the advent of state-sponsored justice.³ Arbitration was widely used in ancient Greece and Rome⁴ and later in medieval Europe to settle territorial, maritime or commercial differences.⁵

³ See Frances Kellor, American Arbitration, Its History, Functions and Achievements 3 (1948) (“Of all mankind’s adventure in search of peace and justice, arbitration is among the earliest. Long before law was established or courts were organized . . . men had resorted to arbitration for the resolving of discord.”).
⁵ See Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109, 122 n.3 (1924) (“Reference of maritime controversies to arbitration has long been common practice”);
Since those times there has certainly been a lot of water under the keel of arbitration. In the course of the twentieth century, arbitration has evolved from a successful method of pacific resolution of interstate conflicts\(^6\) to a popular mechanism for the settlement of private controversies, erstwhile within the exclusive competence of national judiciaries. The sharp rise in arbitrable subject matters even led to the creation of an international regime for the enforcement of arbitral awards: awards remain the sole product of a conflict resolution system that can be enforced within a network of 142 nations.\(^7\)

In the United States, arbitration ushered in an era of unprecedented expansion after the enactment in 1925 of the Federal Arbitration Act ("FAA"),\(^8\) which uprooted "the old common-law hostility toward arbitration"\(^9\) by explicitly mandating that arbitration agreements be as enforceable as other contracts.\(^10\) The Court’s elevation of the FAA from a procedural statute to a law embodying, in the words of the Supreme Court, a “national policy favoring arbitration” as a matter of substantive federal law,\(^11\) cemented the status of arbitration as a credible alternative to court adjudication; and a series of holdings in the 1980s\(^12\) paved the way for the expansion of arbitration’s reign over almost every field of economic activity. Arbitration has since grown "by leaps and bounds"\(^13\) to encompass labor grievances, civil rights cases, claims brought under the securities, antitrust and anti-racketeering laws, as well as controversies among shareholders of non-public


\(^12\) See infra notes 189-200 and accompanying text.

corporations. Despite scathing criticism, arbitration has become *la mode du jour*, eroding the jurisdiction of national courts.

State-sanctioned justice, nevertheless, retains much-cherished monopolies over classes of disputes deemed too sensitive to hand over to private decision-mak ers. Among these strongholds are internal corporate governance matters, especially differences between public corporations, their shareholders and managers. Even though in many civil-law countries, for much of the nineteenth century, intra-corporate disputes – including those between shareholders of “sociétés anonymes” (i.e., capital-based corporations), public and private – were traditionally subject to a regime of arbitration mandated by law, legislatures later retracted their generosity and re-asserted the adjudicatory power of national courts over such controversies. On this side of the Atlantic, no U.S. court has ever enforced an agreement for the submission of intra-public company controversies to arbitration, and practical efforts to make this happen have been few and far between. Yet already since the late 1980s, sporadic academic duels over the relationship between arbitration and public corporate governance have set the stage for a legal battle now inevitable, as this article shows.

In 1988, John Coffee, Jr. was the first to correlate the substitution of arbitration for derivative litigation with the broader theme of contracting out of default corporate governance norms, a trend spurred by the contractarian perspective on corporate law. Coffee acknowledged the advantages of the arbitral remedy in terms of cost, speed and mainly flexibility, which would allow arbitrators, not subject to standing restrictions, to reach the merits of shareholders’ claims more easily and more often. However, in his view, public derivative or class arbitration was a non-starter, because arbitration was “never designed to substitute for collective proceedings;” plus, concerns would linger over arbitrators’ possible “unconscious predisposition against the plaintiff as . . . usurper of the board’s role,” or the stagnation of corporate case law. Besides, for Coffee, the validity of a charter-based arbitration clause would be less than settled in the context of public companies, where issues of implied-in-fact consent

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15 Among the countries with such a system were France, Spain, Brazil, Argentina and Chile. See OLIVIER CARPRASSE, LES SOCIÉTÉS ET L’ARBITRAGE 145-48 (2002); Siegbert Rippe, *El Arbitraje Como Medio Alternativo de Solución de Controversias Comerciales*, in ASPECTOS ATUAIS DA ARBITRAGEM 371, 374-75 (Adriana Pucci ed., 2001). See also infra note 330.


17 *Id.* at 957-58.

18 *Id.* at 967.

19 *Id.* at 957.
would be more troublesome than in the close corporation setting. Coffee suggested that public corporations be required to establish the public-policy soundness of their charter provisions, by either crafting detailed arbitration clauses or adopting model clauses that would ensure a “quality-constrained” opt-out of statutory remedies.

Also focusing on derivative claims, Richard Shell painstakingly analyzed the legal objections against the enforceability of arbitration clauses implanted in public companies’ governing documents and concluded that arbitration was feasible, inasmuch as there is adequate notice to shareholders. Moreover, he reviewed the policy arguments against a privatized alternative to derivative litigation and, drawing on arbitration’s success in the close company arena, dismissed skepticism about fairness, deterrence and sufficient protection of shareholders’ rights as “unwarranted.” Despite his somehow prophetic caveat that derivative arbitration would “remain the exception rather than the rule,” because of “practical [constraints], as well as transaction cost factors,” Shell anticipated, even encouraged experimentation with novel, non-judicial dispute settlement methods.

Experimentation did occur, but it was short-lived. The first abortive attempt to submit public shareholder claims to arbitration was reported in 1990, when an unnamed Pennsylvania corporation tried to register its initial public stock offering, disclosing the existence in both its charter and bylaws of a provision that would consign to arbitration all disputes, including those giving rise to class actions or derivative claims, between the corporate entity and its shareholders. The attempt was not crowned with success – the Securities and Exchange Commission (“SEC”) declined to accelerate the effectiveness of the registration statement, forcing the company to eliminate the clause from its governing documents. Arbitration, in the SEC’s view, would “weaken[] plaintiffs’ ability to recover for serious violations of the law.”

Defending the SEC’s decision, a SEC staff member cited the inadequacy of the arbitral remedy in protecting “federal statutory and constitutional rights.” This sui generis ban

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20 Id. at 963-64.
21 Id. at 971-72.
22 See Richard Shell, Arbitration and Corporate Governance, 67 N. C. L. REV. 517, 541-60 (1989) [hereinafter Shell]. Shell’s article, as the most thorough presentation of the legal and policy parameters of the issue to date, will resonate throughout this essay.
23 Id. at 565, 560-65, 574.
24 Id. at 572.
25 Id. at 573-75.
26 See Carl Schneider, Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate, 4 INSIGHTS 21 (May 1990).
27 Id. at 28.
persevered, apparently deterring public companies from introducing arbitration in their governance scheme.\(^{29}\)

A revolutionary federal court ruling in 1994 briefly resuscitated the idea of arbitrating intra-public company disputes; yet its momentum evaporated fast. In *In re Salomon Inc. Shareholders’ Derivative Litigation*\(^{30}\) the district court for the Southern District of New York held shareholder derivative claims against directors of a public company arbitrable pursuant to the arbitration provisions in the Constitution and the Listing Rules of the New York Stock Exchange (“NYSE”), by which the company and its directors had agreed to abide. An enforceable arbitration agreement existed, ruled the court, notwithstanding the absence of shareholder consent, because derivative claims by definition belong to the corporation and are asserted on its behalf. *In re Salomon* opened the door a tad to the arbitration of public shareholder derivative claims, but no “new era in intra-corporate dispute resolution”\(^{31}\) ever arrived, because the NYSE not only refused, for the second time,\(^{32}\) the invitation to arbitrate derivative causes of action,\(^{33}\) but also forbade, soon thereafter, the arbitration of class and derivative claims under its auspices.

The subject had fallen into oblivion when the Committee on Capital Markets Regulation (the “Committee”), a private-sector group constituted to study challenges facing the U.S. economy,\(^{35}\) roused it from its lethargic state: the Committee’s Interim Report (the “Report”), discussed below at length, recommended that public company shareholders be permitted recourse to non-

\(^{29}\) Or so rumor has it – this article presents empirical data belying the claim: Tommy Hilfiger Corp., a U.S.-based company, launched its IPO in 1996 despite the arbitration clause in its articles of association. See infra notes 133-35 and accompanying text.


\(^{33}\) *In re Salomon Inc. Shareholders’ Derivative Litigation*, 68 F.3d 554 (2d Cir. 1995).

\(^{34}\) See CODE OF ARBITRATION PROCEDURES FOR CUSTOMER DISPUTES OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY (ex-NASD), Arts. 12204 and 12205, effective as of April 16, 2007, available at http://www.finra.org/web/groups/rules_regs/documents/rule_filing/p018365.pdf: “Class action claims may not be arbitrated” and “Shareholder derivative actions may not be arbitrated,” respectively.

\(^{35}\) The Committee “is an independent and nonpartisan 501(c)(3) research organization dedicated to improving the regulation of U.S. capital markets.” See http://www.capmktsreg.org.
judicial mechanisms for the resolution of intra-corporate differences – such as arbitration or non-jury trials. The recommendation was only one of thirty-two proposals that would strike a better balance between the burdens and benefits of the existing regulatory and litigation framework, restoring the competitiveness of U.S. public equity markets. Yet when the SEC was confirmed to be considering the Report’s suggestions in earnest, the endorsement of a substitute for private court litigation attracted the most coverage and the most venomous attacks by investor rights activists, renewing public interest in a subject few expected to be of any practical significance outside the bounds of academia. Even though no official measures have been so far taken in the direction suggested by the Committee, the Report undeniably stirred, amid much talk of an economic fallout, a passionate debate about the efficacy of the U.S. corporate governance model and its emphasis on shareholder protection.

Heeding the revival of the stormy relationship between arbitration and corporate governance, this article resumes the inquiry into the legal force, under U.S. law as would be applied by U.S. courts, of all-inclusive arbitration agreements in a public company’s constitutional documents, inserted by proper shareholder vote – whether upon or after incorporation, before or following an initial public offering – and commanding the exclusive resolution by arbitration of controversies among shareholders, directors/officers and the corporate entity. The analysis is not confined to the arbitrability of derivative claims premised on fiduciary duty breaches or securities violations – the focal point of prior commentary. Rather, it assumes that the ambit of the arbitration provision would cover the entire web of intra-corporate disputes, including direct claims related to operational issues (e.g., exercise of preemptive or appraisal rights), and vets whether acquisition of an ownership stake in a public company automatically signals adherence to the arbitration agreement in its governing documents.

Puzzling questions about contractual freedom, public policy and the authenticity of consent arise under this hypothesis: would it be fair to bind the average unsuspecting retail investor to some inconspicuous clause in corporate documents that spirit away her right to sue in a “regular” court? Could the issuer ever ensure that the content of its bylaws is adequately brought to the attention of prospective shareholders? An American court has never decided the issues as framed here, but, in light of the remarkable progress made since the Pennsylvania company incident, there is no assurance that the scenario would play out before the SEC the same way as then.

37 See infra note 77.
38 See infra part I.
39 Such a clause was proposed by the Pennsylvania corporation whose offering the SEC refused to register in 1990. See Schneider, supra note 26, at 23.
Indeed, the Interim Report’s sensational proposals and the SEC’s supposed change of heart, the insertion of arbitration clauses in the bylaws of an increasing number of companies trading on U.S. stock markets,\textsuperscript{40} judicial rulings that authorize or do not exclude \textit{a priori} classwide and derivative arbitrations,\textsuperscript{41} and path-breaking arbitration proceedings arising out of foreign issuers’ trading of securities in the U.S.,\textsuperscript{42} all allude to a political and legal environment receptive to pro-ADR litigation reforms. The subject is thus viewed here not in a vacuum, but through the prism of rapid advances in this legal territory – a major difference from previous studies. Arbitration is no longer a mere “legal possibility,”\textsuperscript{43} but literally in the wings for public shareholders.

Part I of this article recounts in detail the domestic developments that have re-ignited a long forgotten controversy, focusing on the Committee’s proposals and the responses thereto. Part II then lays out the findings of the first comprehensive survey on U.S.-exchange-listed public companies with an arbitration clause in their governing documents. Careful research into public filings of U.S.-registered companies reveals traces of a pro-arbitration trend among foreign issuers and a corresponding policy turnaround on behalf of the SEC, both underestimated in the literature.

Against this rich background, Part III scrutinizes the legal underpinnings of arguments for and against the enforceability of arbitration clauses in public company constitutions. Analogizing from the widespread use of ADR techniques in the securities industry, blessed by the Supreme Court, as well as the evolution of the law on the arbitrability of conflicts in close corporations, this section finds legal objections to arbitration wholly unpersuasive. The article’s thesis coincides with the prevailing view among the handful of commentators identified above (Shell and Coffee) and throughout the article – \textit{i.e.}, that modern arbitration law does not bar the enforcement of charter-based clauses as valid arbitration agreements, even without disclosure requirements other than those already in place.

Part IV moves the discourse to the international level and pays due regard to legislative responses to this legal phenomenon in other nations, varying from statutory prohibition (Italy) to a legal obligation to arbitrate all or specific categories of intra-corporate differences, on an exclusive basis or even as a listing condition (Brazil). The comparative analysis teaches useful lessons about the efficiency of granting public companies and their owners wide latitude in the selection of methods of intra-corporate conflict resolution, latitude not inconsistent with the history of the common law.

The final section briefly appraises the overall implications of intra-public company arbitration and, summing up, concludes that there is no reason why

\textsuperscript{40} See infra part II.

\textsuperscript{41} See infra part III.B.3.

\textsuperscript{42} See infra notes 315-22 and accompanying text (discussing the \textit{Harvard v. Surgutneftegaz} class arbitration).

\textsuperscript{43} Shell, \textit{supra} note 22, at 573.
public company stockholders would, from a legal viewpoint, or should, as a matter of policy, be precluded from waiving their right to court adjudication.44

I. MUCH ADO: RECENT U.S. DEVELOPMENTS

When a committee was formed in September 2006 to research the attractiveness of U.S. public capital markets, use of the arbitral remedy beyond the realm of close corporations seemed interred for good in the cemetery of interesting yet impracticable ideas. The Committee’s Interim Report45 proved the impression wrong.

The Committee was set up under the directorship of Harvard Law School professor Hal Scott, as an “independent and bipartisan group” of academic, business, financial and corporate governance leaders, with the challenging mission to study the competitive position of the U.S. public capital markets and propose regulatory and legislative measures to enhance it.46 It is still prominently co-chaired by Glenn Hubbard, Columbia Business School dean, and former Goldman Sachs president, John Thornton.

Despite the lack of official governmental involvement, the Committee’s impartiality was called into question when the Treasury Secretary rushed to praise the venture, a move met with muted suspicion.47 The illustrious membership and its ties with the administration and the business community,48 boded ill, argued many, for investors. Its real motive, they scorned, was to lend a cloak of legitimacy to government initiatives that would slash investor protections enacted in the wake of the corporate scandals; the Wall Street oligarchy, not the U.S. economy, would be the eventual beneficiary.49

44 For the purpose of clarity: “mandatory” is only arbitration required by law. BLACK’S LAW DICTIONARY (8th ed. 2004). Though ubiquitous in arbitration-related writings, the term is avoided here as a misleading qualifier of arbitration conducted pursuant to provisions in bylaws or other contracts. Such arbitration may be “exclusive,” if designated as the parties’ sole choice, but cannot be “mandatory,” unless it stems from legislative coercion, which no U.S. law exerts. Neither is “mandatory” a synonym for “binding” – that arbitral rulings command adherence distinguishes arbitration from mediation.

45 See supra note 36.

46 See supra note 35.

47 See Alan Murray, Panel’s Mission: Easing Capital-Market Rules, WALL ST. J., Sept. 12, 2006, at A2 (claiming that the Committee “clearly has been coordinating its efforts with new Treasure Secretary”).


A month before the publication of the Interim Report, the co-chairs offered a glimpse into the Committee’s deliberations.50 They hailed transparency and robust enforcement as advantages of U.S. markets, but prompted cost-benefit assessments so that over-regulation and unnecessary liability risks do not “inadvertently diminish” these benefits.51

The Interim Report’s findings were along the same lines. The Report alerted policymakers to the flight of global IPOs to Europe and the rising preference for private markets, ominous signs of the declining competitiveness of U.S. equity markets.52 The improved reliability of foreign financial centers is not to account alone for this alarming loss of the U.S. lead in capital markets, noted the Committee. When between 2000 and 2005 the U.S. share of the total funds foreign companies raised through new stock offerings fell from around 50% to about 5%,53 while the number and value of equity issues in U.S. private markets for institutional investors soared,54 there was something rotten in Denmark. The Committee put the blame on the post-Sarbanes-Oxley Act meteoric increase in regulatory compliance costs and liability risks: it found that excessive regulation has generated costs outweighing its admitted benefits and affecting the welfare of shareholders, who are called to pay the price in reduced stock value.55 According to the Report, companies are willing to forego the premium for a U.S. listing in order to avoid costly compliance and the burdens of litigation.56

The Committee specifically adverted to the precipitous rise of securities class action settlement values, which had totaled $3.5 billion in 2005 and on average grew from $13.3 million for the period 1996-2001 to $22.3 million for the period 2002-2005.57 Given the frequency of shareholder lawsuits in the life of a public company, the huge discovery and general litigation costs, and the immeasurably disruptive impact on the company’s operations, it is then no wonder that most firms agree to settle actions early on, regardless of merit.58 Climbing settlement values, in turn, result in higher liability insurance costs, which, like settlement payments, are shouldered by none other than shareholders.59 Public companies, the Report inferred, are trapped in a vicious circle of "pocket-shifting wealth

David Reilly, Street Sleuth: Booming Audit Firms Seek Shield From Suits, WALL ST. J., Nov. 1, 2006, at C1.


51 Id.

52 Interim Report, supra note 36, at 29-38.

53 Id. at 29-34.

54 Id. at 34-38.

55 Id. at 46-50.

56 Id. at 47-48 (“[C]hanges in the U.S. regulatory environment post-SOX decreased the benefit of a U.S. cross-listing, particularly for countries that have good governance standards”).

57 The average settlement in 2005 alone was $71.1 million. Id. at 75.

58 Id. at 75-76.

59 Id. at 78-80.
transfer that compensates no one in any meaningful sense and that incurs substantial wasteful transaction costs. The Committee reiterated that, since class actions do not exist outside the U.S., companies can evade exposure to costly litigation by shunning U.S. markets altogether.

Although it recognized the deterrent value of vigorous enforcement of securities laws against corporate wrongdoing, the Report concluded that the present system is unsustainable. A solution, according to the Report, would be to allow shareholders to seek redress through alternative avenues, including non-jury trials or arbitration, with or without class action waivers. The Committee believed that there would be no obstacle to the enforcement of an arbitration clause in a company’s constitutional documents, other than the SEC’s de facto ban, which the Committee entreated the SEC to lift.

The proposal, strangely, fell short of formally endorsing arbitration as the preferred forum for the resolution of public shareholder disputes. In a nod to shareholders and investor rights advocates, the Committee laid out its recommendations as a question of shareholders’ “right to choose” their remedies. It shrewdly suggested that the SEC not “force shareholders to accept the costs that go with class action securities litigation, . . . where [they] choose to forego these rights.” Allowing shareholders to contract out of wasteful litigation procedures would actually strengthen shareholders’ rights, contended, somewhat counterintuitively, the Committee. More power to the shareholders would ultimately enhance share value.

Touching upon sacrosanct subjects – the impact of post-Enron legislation and shareholder remedies – the Report was set to provoke waves of strong (but predictable) reactions from civil society, the corporate universe and across the political world. Both its recommendations and their premise that the failings of U.S. financial markets were imputable to the asymmetrical regulatory and litigation regime were heavily contested. Former Treasury Secretary Lawrence

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60 Id. at 79.
61 Id. at 71, 77.
62 Id. at 110-11.
63 Id. at 111.
64 Id. at 72, 110-12.
65 Id. at 110.
66 Id. at 109-10.
Summers and New York Governor-Elect Elliot Spitzer condemned the proposals as blatantly “wrong,” while former SEC Chairman (at the time of its 1990 decision to apoplexy anti-arbitration initiatives in the public company sphere) Richard Breeden dismissed them as “elegant whining”;
69 Columbia Law Professor Harvey Goldschmid decried the Interim Report as “unbalanced and unwise.”70

On the other hand, in January 2007 New York Senator Chuck Schumer and New York City Mayor Michael Bloomberg released, amid much fanfare, another report on U.S. capital markets, reinforcing the Committee’s inauspicious forecasts.71 The Bloomberg-Schumer report admonished that an onerous regulatory climate had already taken its toll on the financial services sector and that New York’s status as the world’s financial capital was gravely jeopardized.72

The mayor and senator underscored the need for a balanced legal shakedown to revitalize the ailing American economy and solidify New York’s global preeminence. Among the suggested “near-term national priorities” that would “significantly and immediately” remove impediments to the global competitiveness of U.S. markets,73 was a familiar initiative: litigation reform aimed at discouraging baseless suits and enhancing predictability.74 Arbitration, the report advised, could be the solution: the SEC ought to “revers[e] its historical opposition to the arbitration of disputes between investors and publicly traded companies,” because “arbitration would benefit all parties involved.”75

Such proposals, to put it mildly, did not get a warm reception from either the investor community or Congress. There was, in truth, little need to convince the

72 McKinsey Report, supra note 71, at 72-94.
73 Id. at 96.
74 Id. at 100-04.
75 Id. at 102-03.

public about the economic value or societal benefits of higher shareholder protection, which the Interim Report championed. But the link between shareholder rights and arbitration was a tough sell. The Committee’s overt approval of arbitration was seen as another disguised attempt to insulate boards from liability and curtail enforcement against corporate wrongdoers.76

The last straw came in April 2007, when news surfaced in the Wall Street Journal that the SEC was seriously examining the policy changes recommended by the Committee.77 The article portrayed the arbitration initiative as part of a quid pro quo arrangement that would make more palatable proposals like the one about allowing shareholders to nominate their own directors and reject candidates for board membership, which business groups stubbornly opposed. Echoing popular misconceptions about ADR, the author intimated that consumers may have a reason to worry: arbitration would tilt the balance in favor of corporate boards and, by limiting discovery rights and class actions, threaten “shareholders’ ability to recover money damages or other compensation.”78

After the story came out, sparks started flying over the policy switch considered by the SEC. Eager to strangle the initiative at its birth, Congressman Barney Frank, chairman of the House Financial Services Committee, wrote to the SEC chairman that introduction of arbitration in the public company sphere would represent a “drastic change in shareholder rights” and should not go forward before an exhaustive public debate on the subject.79 He caustically added that arbitration did not provide “a satisfactory framework for redress of consumer actions.”80

Equally vehement was the response of Senators Patrick Leahy and Russ Feingold, chairman and member of the Senate Judiciary Committee respectively, who called attention to the widespread use of “non-voluntary” arbitration agreements in the securities industry. The SEC, the senators suggested, should either impose an outright ban on ADR in securities controversies, especially in the broker-customer context, or require that investors be afforded a “real choice” between litigation and arbitration.81 They insinuated that inclusion of arbitration

80 Id. See also Wall Street Roundup – Lawmaker Opposes Restraints on Suits, L.A. TIMES, Apr. 27, 2007, at C4.
clauses in corporate charters would aggravate the problem. Another senator, Robert Casey, soon joined the effort to extinguish the practice of take-it-or-leave-it arbitration clauses in brokerage contracts, and a movement was born.

The Chairwoman of the House Judiciary Subcommittee on Commercial and Administrative Law, Linda Sanchez, for her part, responded by announcing a hearing into the fairness of arbitration agreements in consumer contracts, citing concerns about the mandatory character of these clauses and “the non-public nature of arbitration decisions.” Testifying at the hearing before the Subcommittee on June 12, 2007, Professor David Schwartz of the Wisconsin Law School reiterated the usual objections to arbitrating consumer and employee disputes – innate unfairness due to vast disparities of bargaining power, structural bias in favor of corporate defendants and procedural deficiencies. Corrections to the system were possible, he admitted, but pointless, because they would only make arbitration resemble court-style litigation; consumer disputes should, therefore, be exempted from arbitration altogether.

Not long thereafter, an identical bill was unveiled in both the Senate and the House that would amend the FAA to prohibit explicitly the enforcement of pre-dispute arbitration agreements in connection with consumer, employment, franchise and civil rights disputes. The Arbitration Fairness Act of 2007 (“AFA”), as it was named, would, furthermore, impose a blanket ban on arbitration of claims under statutes intended to protect civil rights or to regulate contracts or “transactions between parties of unequal bargaining power.” Dismissive of past Supreme Court pronouncements, the proposed act would denounce arbitration as non-transparent and “a poor system for safeguarding civil rights and consumer rights.” A similar bill was launched (and never approved) in 2005, but that bill would only nullify arbitration clauses in employment contracts covering statutory claims. The more ambitious 2007 bill aspires to redefine de novo the institution of arbitration, by abrogating long-standing doctrines on the

85 Id. at 22.
87 Id. § 4(4)(b).
88 Id. § 2(6).
division of authority between arbitrators and the courts, and restricting the applicability of the FAA to arbitration agreements between entities of “similar sophistication and bargaining power.” This and the sweeping “unequal bargaining power” clause would outlaw agreements to arbitrate a wide array of statutory claims, including claims under “securities [laws], antitrust [laws], ERISA, certain parts of the Uniform Commercial Code, bankruptcy law, certain parts of admiralty and maritime law, governmental contracts, intellectual property and . . . any statutory dispute between the government and any private litigant.” In a major setback for the securities industry, the bill’s sponsor, Senator Feingold, even vowed expressly to extend its coverage to broker-investor differences. The AFA, thus, would not only affect a wide range of industries, but also, per its vocal and numerous critics, purge the pro-arbitration profile of the U.S. as a frequently designated seat for international arbitrations, thereby keeping considerable business out of the U.S.; nearly double the caseload of federal courts; and even trigger violations of U.S. obligations under international treaties.

90 AFA § 4(4)(c) provides:
[T]he validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.

This provision, if enacted, would rescind, in a single sentence, the separability and Kompetenz Kompetenz doctrines, upending Supreme Court precedent of more than 40 years. See also infra note 241.


95 See Report on the Arbitration Fairness Act, supra note 92, at 5 (noting that the annual caseload of federal courts is 250,000 cases, while the American Arbitration Association alone resolves close to 200,000 disputes per year, most of which will end up in the federal dockets if the AFA becomes law).

96 See Report of the N.Y. State Bar Ass’n, supra note 94, at 7; Sussman, supra note 94, at 483-88.
Although the bill has not yet garnered sizeable support in Congress, it definitely struck a cord with consumer and investor rights defenders. In December 2007, a plethora of consumer rights organizations and other non-governmental groups signed a letter to Senate and House leaders fervently buttressing the Arbitration Fairness Act as an end to “the predatory practice of forcing employees and consumers to sign away their rights.” Civil rights and consumer protection are eviscerated, they emphasized, unless vindicated “in a court of law.” Most notably, in September 2007, Public Citizen, a well-known public interest group, released an eight-month-long survey of almost 34,000 arbitration cases handled by the California-based National Arbitration Forum; the survey substantiated charges of arbitrators’ pro-business prejudice: out of over 19,000 arbitrated credit card disputes, cardholders prevailed in only 4% of them; 28 arbitrators decided 9 out of 10 cases and ruled in favor of businesses 95% of the time. Public Citizen’s report castigated credit card companies for shepherding consumers into a mechanism riddled with favoritism and gross due process violations, and lauded the pending bill as a “common-sense solution.” At the House Subcommittee hearing, on October 25, 2007, Public Citizen representatives cited the survey as strong evidence of the need for legislative intervention. At the same hearing,

97 See Letter in Support of the Arbitration Fairness Act, Dec. 11, 2007, available at http://www.consumerlaw.org/issues/model/content/AFASupportLetter.pdf. Among the co-signers were the Lawyers Committee for Civil Rights Under Law, the Consumer Federation of America, the National Consumer Law Center, the NAACP and the trial lawyers’ American Association for Justice.


100 See Arbitration Trap, supra note 99, at 3.

101 Id.

102 See Testimony of Laura MacCleery, House Judiciary Committee, Subcommittee on Commercial and Administrative Law, Hearing on H.R. 3010 (October 2007), available at http://judiciary.house.gov/hearings/pdfs/MacCleery071025.pdf. By contrast, Professor Peter Rutledge of the Columbus School of Law in Washington attributed companies’ high win rate to the straightforwardness of the cases: most of these disputes were cookie-cutter payment default cases correctly decided in favor of the creditor, he contended, urging Congress not to
acclaimed counsel for investor claimants agreed that securities arbitration fora are in essence “stacked decks[.]” The unsettling case of a rape victim apparently compelled to arbitrate sexual harassment claims against her employer further intensified public rage against arbitration.

At the other end of the spectrum, ADR enthusiasts have proffered arguments in favor of arbitration and its expansion into the public company domain. Jim Copland, of the Manhattan Institute for Policy Research, applauded the proposal to let public shareholders opt for arbitration through bylaws amendments as a “salutary reform” that “makes complete sense,” considering the misgivings of the existing litigation model. Professor Scott, the director of the Capital Markets Committee, concurred that the only parties standing to lose from a shareholder class action reform are plaintiffs’ lawyers who earn handsome fees as a result of rising settlement values. For Scott, optimal deterrence of corporate misconduct is achieved by the prospect of a share price collapse, not by immense settlements, ostensibly paid by the corporate entity; the company’s owners are better positioned to evaluate available remedies and ought to be afforded the freedom to select the dispute resolution method they deem appropriate, including arbitration.

Arbitration proponents, too, offered studies bolstering their claim that arbitration is fair, more expedient and less costly. During congressional hearings, the Securities Industry and Financial Markets Association (“SIFMA”) quoted empirical findings that: thanks to lower pleading thresholds, arbitral fora are be carried away by anecdotal evidence. See Testimony of Peter Rutledge, id., available at http://judiciary.house.gov/hearings/pdf/Rutledge071025.pdf, at 6-7.


104 See Am Assoc. for Justice, Momentum Builds in Congress to End Mandatory Arbitration, 44 TRIAL 12 (Feb. 2008).


106 Id. See also Hal Scott, Let Shareholders Decide How to Resolve Disputes, FINANCIAL TIMES, July 26, 2007, at 11; America Must Act to Renew the Primacy of its Markets, FINANCIAL TIMES, Mar. 12, 2007, at 15.

107 Id.

easier to access than courts; the majority of claimants (66% in 2006) do obtain relief, and securities arbitration, operating under regulatory supervision, is fair and unbiased – the participation of industry arbitrators in panels does not have a discernible impact on claimants’ win rate. These findings, SIFMA reasoned, disprove the tangential data in the Public Citizen report and bear more credible witness to arbitration’s efficiency gains for investors, allowing investors to impose their post-dispute choice of forum on securities firms would be more unfair a system.

Supporters of arbitration certainly face an uphill battle – their voices are lost amidst vociferous criticism. For the first time, however, more than scant thought is given to the possibility of allowing the use of alternative avenues, such as arbitration, for the resolution of differences between public companies and their shareholders. In that sense, the Capital Markets Committee should be credited with breathing new life into a proposal first regarded as doomed, by formally linking it, again for the first time, to the greater enterprise of reinvigorating the U.S. public markets. This association between the employment of arbitration and the global appeal of the American financial system took the argument about ADR’s societal value to a new level – no more that of legality, but that of economic and social policy. The Committee’s Report was the first of its kind to condone arbitration – an institution often synonymous with a threat to consumers’/investors’ rights – as a remedy to the drain of capital out of the U.S. capital markets and a carrot to reclaim a bigger piece of the IPO pie. It has thus spearheaded a strident debate about the role of ADR in economic rescue plans, bridging it with the mainstream conversation about litigation reform and shareholder rights: some studies have corroborated that sanctioning arbitration could substantially reduce liability risks and propel the financial sector; others have refuted these conclusions.

This intensity of activity has, undoubtedly, helped the ADR cause. At least (and at last), intra-public company arbitration is being evaluated on the merits. The stakes for corporate governance are high. But this time, the winds of change are blowing over Washington, strengthened by fears over the consequences of the recent recession. The crucial question is then whether the SEC will disavow the proposed revisions of the litigation model or lay to rest its obscure policy against arbitration clauses in publicly owned company charters. The SEC’s seal of

109 Id. at 31-33 & Appendix C at 63 (20% of all securities arbitration cases are decided on the merits, as opposed to 1.5% of civil litigation cases).
110 Id. at 64 (Appendix D).
111 Id. at 7-15, 34-37, 47 & Appendix G at 67 (between 2005 and 2006, panels including an industry arbitrator found for claimants in more instances than single non-industry arbitrators).
113 White Paper, supra note 108, at 49.
(explicit or indirect) approval is indispensable, because as the supreme market regulator, it has the power to either stifle or foster experimentation with novel initiatives in the conflict resolution field.\footnote{After \textit{Shearson/Am. Express v. McMahon}, 482 U.S. 220 (1997), the SEC has permitted arbitration of investor-broker disputes; yet in 1990, it \textit{de facto} disapproved the inclusion of arbitration clauses in public company charters. \textit{See supra} notes 26-28 and accompanying text.}

Even this question, nevertheless, might be already mooted: there is evidence that for more than a decade the SEC has been turning a blind eye to the arbitration clauses in the governing documents of companies incorporated abroad but listed on American stock exchange markets.\footnote{See \textit{infra} part II, Table A.} With the exception of a single foreign (Chinese) issuer from which the SEC has exacted the commitment to eliminate such a clause from its charter or otherwise amend it so as not to foreclose parallel recourse to the courts,\footnote{See \textit{infra} notes 157-58 and accompanying text.} in all other cases the SEC appears to be affording foreign issuers substantial leeway as to intra-corporate dispute resolution. This policy stands in stunning contrast to its policy vis-à-vis domestic companies – although cracks are observed on that front as well. The next section demonstrates clear signs of porousness in the SEC’s earlier anti-arbitration stance, which raise puzzling questions about differential treatment of foreign capital.

\section*{II. \textit{Tempus Advenit}: The Empirical Data}

This section dispels the myth that arbitration of public company disputes is a far-fetched prospect because of the SEC’s unwavering opposition. A meticulous survey of reports and statements filed with the SEC by U.S.-listed companies over the last twelve years documents timid signs of a novel trend: corporations with equity listings on American stock exchanges no longer hesitate to incorporate in their bylaws or articles of incorporation provisions that mandate resolution by arbitration of intra-corporate controversies. Despite having opted for arbitration, these, mostly foreign, companies have been enjoying full access to U.S. equity markets, whereas the SEC, with few exceptions, has been anything but fiercely defensive of its putative anti-arbitration policy. Richard Shell’s admonition that a fair amount of experimentation with arbitration was likely to take place within public corporations\footnote{\textit{See Shell, supra} note 22, at 573.} is, even at a slow pace, coming true.

The numbers in the tables below substantiate the claim that, when the Report came out in late 2006, the SEC was drifting away from its anti-arbitration policy. Remarkably, between 1996 and 2007, the number of publicly held companies with an arbitration clause in their governing documents more than doubled, from 18 to 40, including one U.S. company, since 2002.\footnote{See \textit{infra} part II, Table A. An arbitration clause was also found in the bylaws of another American issuer, incorporated in the British Virgin Islands but based in the U.S.} More than half (24) of those
companies have a legal obligation, under the laws of their country of incorporation, to channel their intra-corporate differences to arbitration, and nine among those (Brazilian issuers) must even designate arbitration as the exclusive dispute resolution venue.\(^{119}\)

These and other important findings described in this section emanate from an investigation into the SEC filings of companies with equity (not debt) trading on a U.S. stock exchange, irrespective of place of incorporation. The goal was to identify publicly owned companies that, while tendering their shares to American investors, either have (or had, at any point during the investigated time period) an arbitration clause in their constitutional documents, or are (or were) otherwise obliged to arbitrate differences with their shareholders. The survey focuses on these companies because purchasers of a stake therein waive the right to vindicate their claims in court, usually uninformed of the legal significance of their investment and unaware even of the existence of an arbitration clause in the bylaws, due to the impersonal nature of transactions over exchange markets. By contrast, issuers of privately offered securities (like, e.g., JSC Surgutneftegaz\(^{120}\)) are excluded from the survey, because their U.S. shareholders are qualified institutional investors that participate in private offerings presumably mindful of the consequences of their investment decisions, given their superior market knowledge, as well as the systemic differences between private and public markets.\(^{121}\)

Companies incorporated abroad are naturally counted in, as long as they meet two criteria: (1) dispersed ownership that includes a U.S. shareholder base, and (2) insertion of an arbitration clause in their governing documents. Although the majority of foreign securities do not meet listing requirements and thus trade in the over-the-counter market, where dealers negotiate bilaterally with one another,\(^{122}\) the securities laws allow foreign companies access to U.S. public markets as foreign private issuers (“FPIs”), subject to the same obligations as

(through “domestic” under the securities laws and for purposes of this survey); that issuer, however, delisted its securities from the NYSE in 2006. See infra notes 133-35 and accompanying text.

\(^{119}\) See infra Table B.

\(^{120}\) See infra notes 315-22.


\(^{122}\) See Over-The-Counter Market, InvestoPedia, see bbook-webresources at http://www.investopedia.com/terms/o/over-the-countermarket.asp.
U.S.-based issuers, provided that (i) less than 50% of their voting securities are held of record by U.S. residents, and (ii) either the company has its principal administration center or the majority of its assets outside the U.S., or the majority of its executive officers are non-U.S. citizens/residents.123 FPIs can then list their stock on U.S. exchanges directly or in the form of American Depositary Shares (“ADSs”), i.e., U.S. dollar-denominated units of equity ownership each carrying the same rights as a specified number (or a fraction) of the FPI’s shares deposited with a custodian bank in the issuer’s home country.124 ADSs are usually preferred because they offer the advantage of a wider investor base, since FPIs may enter U.S. markets more easily, overcoming various legal and practical barriers – not the least of which are investors’ inhibitions towards “unfamiliar” foreign securities.125

To launch an ADS program in the U.S., however, foreign issuers must comply with U.S. market standards and listing requirements, particularly registration and disclosure provisions – even more so if the ADSs are to trade publicly in a national stock exchange.126 Compliance puts FPIs in a position by all accounts equal to domestic companies. This means that unless ADS-holders are explicitly exempted from the reach of charter-based arbitration clauses, the possibility of arbitration between FPIs and their U.S. stockholders concerning business activities in the U.S. is far from faint.

The fact that FPIs are under the constant glare of financial market regulators also means relentless inspection of the issuer’s finances and internal governance.

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123 See Rule 3b-4(c) under the 1934 Securities Exchange Act [hereinafter Exchange Act], 17 C.F.R. § 240.3b-4(c). The place of incorporation alone does not suffice to justify FPI status, unless accompanied by evidence of real, material ties with the U.S. A company incorporated abroad, but principally based in the U.S. is considered a U.S. issuer. The Tommy Hilfiger Corporation, for example, even though incorporated abroad, would file 10-K (not 20-F) and 10-Q reports. See infra notes 133-35 and accompanying text.

124 See Rule 405 under the 1933 Securities Act [hereinafter Securities Act], 17 C.F.R. § 230.405. ADSs are evidenced by negotiable certificates issued by U.S. depository banks (American Depositary Receipts [“ADRs”]), which trade either in the over-the-counter market, or in an exchange. Despite subtle differences in meaning, the terms “ADSs” and “ADRs” are used interchangeably; here, “ADS” signifies both the tradable receipt and the underlying foreign share, to avoid confusion with “alternative dispute resolution.” See generally International Investing, http://www.sec.gov/investor/ pubs/ininvest.htm.


126 See Sections 5, 6 & 7 of the Securities Act, 15 U. S.C. §§ 77e, f & g (registration of public securities offerings); Sections 12(b), 13 & 15(d) of the Exchange Act, 15 U. S.C. §§ 78(b) (registration of securities to be listed on a national exchange), 78m & 78o (reporting obligations of issuers of publicly registered securities), respectively; Solomon, supra note 125, at 122-28 and 138-45; Foreign Company Listing, see BBook at http://www.foreigncompanylisting.com.
matters, on which FPIs, like domestic issuers, are required to report to the SEC at regular intervals. Registration statements and periodic reports are not hastily approved: an arbitration clause in the charter, or a post-registration amendment of local laws in the FPI’s place of incorporation creating a duty to arbitrate disputes with U.S.-based shareholders, is unlikely to go unnoticed. That FPIs constitute all but one of the U.S.-registered companies whose shareholders have to submit to the authority of an arbitral tribunal, hints at institutional elasticity towards foreign companies’ inclination to opt out of the jurisdiction of U.S. courts, which elasticity has eluded, for the most part, domestic companies, despite the SEC’s (allegedly) impartial oversight of both issuer classes. Intending to reflect this differentiation, the tables below distinguish between FPIs and domestic issuers.

As far as methodology is concerned, the survey is predicated on a diligent review of FPIs’ and domestic issuers’ mainly annual reports (on Forms 20-F and 10-K respectively), aimed at detecting (i) arbitration clauses in articles of incorporation, bylaws or any other document controlling the relationship between the company and its shareholders – such as shareholders’ agreements or, in the case of ADS programs, deposit agreements between FPIs and depository banks – which the issuer must attach as exhibits to its annual reports, or incorporate therein by reference to previous reports, and/or (ii) references, even cursory ones, to a legal obligation, under the (foreign) law of the place of incorporation, to arbitrate intra-company controversies. The research covered a 12-year span, from 1996 to 2007; 1996 was chosen as the year immediately following the conclusion of the seminal In re Salomon Derivative Litigation.

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127 Under the Exchange Act, FPIs must file annual reports on Form 20-F within 6 months after the end of each fiscal year (domestic issuers have 90 days to file 10-K reports). See Section 13 of the Exchange Act, 15 U. S.C. § 78m; Rule 13a-1 under the Exchange Act, 17 C.F.R. § 240.13a-1; 17 C.F.R. § 249.220f (Form 20-F); and Form 20-F, General Instruction A(b), at http://www.sec.gov/about/forms/form20-f.pdf. Although exempt from the obligation to file quarterly reports, FPIs are required to file interim reports on Form 6-K, furnishing information they (i) have to make public pursuant to the law of their domestic jurisdiction, (ii) must file with a stock exchange on which their securities are traded, or (iii) must distribute to their shareholders. See Rule 13a-16 under the Exchange Act, 17 C.F.R. § 240.13a-16; 17 C.F.R. § 249.306 (Form 6-K); Form 6-K, General Instruction B, at http://www.sec.gov/about/forms/form6-k.pdf. The issuer must also provide “full English translation” of any foreign document. Id. General Instruction D. By introducing the 20-F Form in 1979, the SEC intended to impose on FPIs disclosure obligations “somewhat less extensive,” yet “substantially equivalent” to those of domestic issuers. See Rules, Registration and Annual Report Form for Foreign Private Issuers, Exchange Act Release 16371, 44 Fed. Reg. 70,132 (Nov. 29, 1979).


129 The distinction is made because, as detailed infra in Part IV, Chilean FPIs are statutorily obliged to arbitrate intra-corporate disputes; the statutory mandate applies as a default solution, even in the absence of a relevant clause in the bylaws.
with a view to evaluate the impact, if any, of the rulings issued in that case on the SEC’s and general corporate practice. The historical findings are figured in Table A.

Evidence unearthed of an arbitration clause and/or a legal obligation to arbitrate would be further vetted to ascertain, first, whether the clause or the obligation was in effect as of 2007, and, if yes, its exact content, the approximate year of its introduction, the extent of its disclosure in the issuer’s public filings (disclosure as a risk factor/no disclosure), and the mechanics of the arbitration process (forum, place, language, applicable law, panel appointment). Last, we gauged the “size” of foreign issuers’ presence in U.S. markets, by measuring the average percentage of total outstanding stock listed (directly or through ADSs) on American stock exchanges, again on the basis of publicly available information. The results are featured in Tables B and C.

The numbers are telling:

Table A – Historical Data (Number of Publicly Owned Companies Trading in a U.S. Stock Exchange with Arbitration Clauses in Governing Documents, or Under an Obligation to Arbitrate) (1996–2007)

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign Issuers</th>
<th>U.S. Issuers</th>
<th>Total Number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>China Brazil Chile Other Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>2 0 13 2 17 1</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>4 0 16 2 22 1</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>5 0 16 2 23 1</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>5 0 17 2 24 1</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>8 0 17 2 27 1</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>9 0 17 2 28 1</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>10 3 18 3 34 2</td>
<td>36</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>11 3 18 3 35 2</td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>11 5 18 5 39 2</td>
<td>41</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>11 5 18 4 38 2</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>10 8 16 5 39 2</td>
<td>41</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>10 9 15 5 39 1</td>
<td>40</td>
<td></td>
</tr>
</tbody>
</table>

The chart evidences a pattern of steady increase in the number of U.S.-registered companies that have opted for arbitration: this number doubled from 18 in 1996 to 36 in 2002, and, after eight years of unfailing rise, reached its peak in 2004 and again in 2006 at 41 – of which only two issuers were based in the U.S. –
a number since stabilized. Out of the 40 such companies trading in a U.S. exchange market as of December 31, 2007, only the Carolina National Corporation (a South Carolina holding company), was incorporated in the U.S. Even that company was a small business issuer, with limited capitalization and, as conceded in its 2005 Annual Report, “no established trading market” for its shares (and “none expected to develop in the foreseeable future”).\(^{130}\) In addition, while the survey was under way, the company entered into an agreement to merge and deregister its shares in the first quarter of 2008.\(^{131}\) The importance of a single U.S. finding, thus, should not be overestimated.

The other 39 companies in the table are mostly Chilean (15), Chinese (10), or Brazilian (9), with five companies hailing from Colombia, Mexico, Russia, the British Virgin Islands and England and Wales (prominently, Royal Dutch Shell, Europe’s largest energy group, with official residence in the Netherlands).\(^{132}\)

Prior to 2007, ten companies were found to have had an arbitration clause in their charter or bylaws while maintaining, for any period of time, an active float of stock in the U.S.: one Spanish (until 2004), one Chinese, one Brazilian, one Peruvian, five Chilean and one incorporated in the British Virgin Islands, but in effect, based in the U.S., and hence counted as a U.S. issuer. The latter was the Tommy Hilfiger Corporation, parent of Tommy Hilfiger U.S.A.,\(^{133}\) the iconic American fashion house, which until its buy-out by a Dutch private equity firm in 2005 and deregistration from the NYSE,\(^{134}\) was trading (only) in the U.S.


\(^{131}\) See Carolina National Corporation, Inc., Quarterly Report (Form 10-Q), at 11 (Nov. 13, 2007). Delisting has since occurred (see Securities Registration Termination (Form 15-12G) (Mar. 27, 2008)), but, as the survey is premised on reports filed by the end of 2007, Carolina National Corporation is still counted in.


\(^{133}\) Article 24 of the company’s Memorandum of Association (last amended on Mar. 10, 2006) provides that “any difference . . . between the Company . . . and any of the Shareholders . . . touching the true intent and construction . . . of [the] Articles or of the [Business Companies Act of the British Virgin Islands], or otherwise relating to . . . any of the affairs of the Company . . . shall, unless the parties agree . . . to a single arbitrator, be referred to 2 arbitrators to be chosen by each of the parties.” See Tommy Hilfiger Corporation, Current Report (Form 8-K), Ex. 3.1 (Mar. 15, 2006). The clause was not disclosed in the company’s annual reports. See, e.g., Tommy Hilfiger Corporation, Annual Report (Form 10-K) (Nov. 18, 2005) (the last before deregistration).

\(^{134}\) Following its merger with a company controlled by Apax Partners, Tommy Hilfiger Corporation cancelled and delisted its shares in May 2006. See Tommy Hilfiger Corporation, Current Report (Form 8-K), at 2-3 (May 11, 2006); Securities Registration Termination (Form 15-12B) (May 10, 2006). See also A. Yee, Apax Partners Buys
without any apparent objection by the SEC to the sweeping arbitration clause in its charter.\footnote{135}

In any case, it is not comforting that, with the meager exception of two domestic issuers, the U.S.-listed companies detected to have had an arbitration clause in their governing documents have mainly been South American and Chinese FPIs. A closer look at the terms of the arbitration provisions shows that, as the next tables indicate, several aspects of a proceeding conducted under these clauses could be troublesome.

**Table B**  –  Features of Arbitration in Companies Listed on a U.S. Stock Exchange as of August 30, 2007 – I (General Information)

<table>
<thead>
<tr>
<th>Exclusive Character of the Clause</th>
<th>Mandated by Local Law?</th>
<th>Disclosure in SEC Filings (Reports/ Prospectuses)?</th>
<th>Average % of Total Outstanding Share Capital Listed on a U.S. Exchange</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exclusive</td>
<td>Yes</td>
<td>Yes (at least once)</td>
<td></td>
<td>83.78%</td>
</tr>
<tr>
<td>Non-Exclusive</td>
<td>No</td>
<td>As a risk factor</td>
<td></td>
<td>13.52%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>Other Disclosure</td>
<td></td>
<td>–</td>
</tr>
</tbody>
</table>

\footnote{135}{Tommy Hilfiger for $1.6bn, \textsc{Financial Times}, Dec. 23, 2005, at C3; Tommy Hilfiger Retail Investment, \textit{at} \url{http://www.apax.com/en/investments/tommy-hilfiger-corporation.html}.}

This invites the question whether the SEC will be likewise apathetic if the new owners go public again. \footnote{135}{See Lina Saigol & Martin Arnold, \textit{Hilfiger Groomed for Possible IPO}, \textsc{Financial Times}, Oct. 5, 2007, at C9; Martin Arnold, \textit{Hilfiger Pulls IPO Plans}, \textsc{Financial Times}, Jan. 24, 2008, at C5.}
Table C – Features of Arbitration in Companies Listed on a U.S. Stock Exchange as of August 30, 2007 – II (The Content of the Clause)

<table>
<thead>
<tr>
<th></th>
<th>Arbitration Forum</th>
<th>Place of Arbitration/Oral Hearings</th>
<th>Applicable Law</th>
<th>Language of Arbitration</th>
<th>Composition of Tribunal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>U.S.</td>
<td>Non-U.S.</td>
<td>U.S.</td>
<td>Other</td>
<td>TBD</td>
</tr>
<tr>
<td>U.S. Issuers</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>FPIs</td>
<td>1</td>
<td>22</td>
<td>16</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>2</td>
<td>22</td>
<td>16</td>
<td>2</td>
<td>4</td>
</tr>
</tbody>
</table>

These data are revealing. Although all but two FPIs allow shareholders a meaningful role in the appointment of the panel, or incorporate by reference time-honored model rules that safeguard both parties’ procedural rights, only one FPI’s clause designates U.S. law as the applicable law, English as the language and a U.S. city as the place of arbitration. The clause is, oddly, found in the deposit agreement (an equivalent to a shareholders’ agreement) among the issuer (Mechel Steel Group), the depository bank and ADS-holders, binding only ADS-holders, not domestic shareholders.  

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136 Both these companies are Chilean: Madeco, Inc., a manufacturing company whose ADSs represent 5.70% of its share capital, and Embotelladora Andina S.A., a bottling company whose ADSs account for 9.9% of its share capital. Their bylaws provide for the appointment of the single *ex aequo et bono* arbitrator by a civil court seated in Santiago. See Madeco, Inc., Annual Report (Form 20-F), Ex. 1.1 (Bylaws), Article 45 (June 28, 2007); Embotelladora Andina S.A., Annual Report (Form 20-F), Ex. 1.1 (Bylaws), Article 32 (June 29, 2007), incorporating by reference Ex. 1.1 to the 1996 Annual Report (the text also available at http://www.koandina.com/EN/directorio.asp).

137 Section 7.11 of the Deposit Agreement, dated July 27, 2004, provides: Any dispute . . . brought by any party hereto against the Company arising out of or relating to the Shares, the ADSs, the Receipts or this Deposit Agreement, . . . shall be . . . resolved by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association; . . . provided that any dispute . . . based upon the federal securities laws of the United States or the rules and regulations promulgated thereunder may, *but need not*, be submitted to
By contrast, twenty-four of the examined clauses provide that arbitrators do not take into account U.S. law at all, and eleven of these clauses — all adopted by Chilean FPIs — that arbitrators act as \textit{ex aequo et bono} adjudicators, bound only by general principles of fairness and equity.\footnote{See, in general, Leon Trakman, \textit{Ex Aequo et Bono: De-mystifying An Ancient Concept}, University of New South Wales Faculty of Law Research Series, Working Paper 39, available at http://law.bepress.com/unswwps/flrps/art39.} Intriguingly, it is by operation of Chilean corporate law that arbitrators, in these eleven instances, are empowered to decide intra-corporate disputes based on subjective assessments of the equities of each case and practical reasonableness.\footnote{See Article 4(10) of Chilean Corporations Law No. 18,046 (discussed \textit{infra} at IV(C)), compelling public companies to stipulate in their bylaws the “nature of the arbitration” by which intra-corporate disputes will be resolved.} To be sure, there are exceptions to arbitrators’ unfettered authority: the Chilean statute applies in the absence of contrary stipulations in the bylaws, i.e., issuers may exclude arbitrators’ equitable powers, as some companies have done.\footnote{See infra notes 160-61 and accompanying text.} In addition, arbitration is not the exclusive conflict resolution mode — the statute preserves plaintiff shareholders’ parallel right to sue in court, as long as the bylaws provide so.\footnote{See Article 125 of Chilean Corporations Law No. 18,046. In most cases investigated here, Chilean issuers either explicitly recognize claimants’ right to choose between arbitration and litigation or defer to the statute, which makes arbitration optional for claimants.} However, contrary to what a \textit{prima facie} reading of the statute would suggest, issuers have been allowed to foreclose litigation,\footnote{Only Concha y Toro Winery, Inc. expressly excludes recourse to courts, citing a Chilean Supreme Court decision that sanctioned issuers’ right to foreclose litigation. That company was counted among the FPIs designating arbitration as “exclusive” (see table B). See Concha y Toro Winery Inc., Annual Report (Form 20-F), at 7-8 & Ex. 1.1 (Bylaws) (July 2, 2007), incorporating by reference Ex. 1.1 to the 2000 Annual Report (Form 20-F).} and may, in any case, defer to the default statutory provisions, omitting from bylaws any reference to dispute resolution. A Chilean grocery store chain, for instance, was trading in the NYSE from 1997 until 2003, without an arbitration clause in its bylaws, although still subject to the statutory requirement for equitable arbitration.\footnote{Supermercados Unimarc S.A. delisted its ADSs from the NYSE in Sept. 2007. See Supermercados Unimarc S.A., Securities Registration Termination (Form 15F-12B) (Sept. 25, 2007). Filed the same day, this last annual report omits any reference to the arbitration . . . . The place of the arbitration shall be the Borough of Manhattan in the City of New York . . . and the language . . . shall be English. See Mechel OAO, Registration Statement (Form F-6), Ex. 99(1) (Oct. 4, 2004) (emphasis added).} It is then not a dim prospect
that U.S.-based holders of such company’s stock, not versed in the complexities of foreign law, end up enmeshed in *ex aequo et bono* arbitration or, at best, judicial proceedings abroad.

An area of greater concern than applicable law is the disclosure of the chosen dispute resolution method in public filings. Under the securities laws, SEC-registered issuers must enumerate, in public reports, pending arbitration matters as legal contingencies that might have a bearing on their business.\(^{144}\) Contrariwise, there is no obligation to specifically communicate to shareholders and the investing public the existence of an arbitration clause in governing documents, other than by merely attaching these documents to the report.\(^{145}\) Taking advantage of this legislative lacuna, many issuers, inadvertently or not, take the liberty of avoiding statements about arbitration in their reports, or, at best, mention the subject as innocuous “additional information about the company,” likely not to catch the reader’s eye. A total of fifteen companies, in their majority Chilean and Chinese FPIs, including the sole domestic issuer, have elected the first approach (no reference),\(^{146}\) and seventeen the second (some, even slight, disclosure).\(^{147}\)


\(^{144}\) See Item 103 of Regulation S-K, 17 C.F.R. § 229.103 (“Describe briefly any material pending legal proceedings, other than ordinary routine litigation”); Form 20-F, Item 8.A.7 (“Provide information on any legal or arbitration proceedings, . . . which may have, or have had . . . significant effects on the company’s financial position or profitability”), available at http://www.sec.gov/about/forms/form20-f.pdf; Form 10-K, Item 3, http://www.sec.gov/about/forms/form10-k.pdf.

\(^{145}\) Issuers are not required to summarize dispute resolution arrangements as “additional information” in annual reports – either because such information is deemed less material than the balance of power between shareholders and directors, or because it is assumed that intra-corporate controversies are to be litigated. See Form 20-F, Item 10.B, available at http://www.sec.gov/about/forms/form20-f.pdf.

\(^{146}\) These companies are: Homex Development Corp. (Mexico); Bancolombia (Colombia); Yanzhou Coal Mining Co. Ltd., China Eastern Airlines Co. Ltd., China Southern Airlines Co. Ltd., Guangshen Railway Co. Ltd. (China); Provida S.A., Distribucion y Servicio S.A., Madeco S.A., Masisa S.A., Telecommunications Co. of Chile, Embotelladora Andina S.A., Sociedad Quimica y Minera de Chile S.A. and Compania Cervecerias Unidas S.A. (Chile).

\(^{147}\) These companies are: TAM S.A., Empresa Brasileira de Aeronautica S.A., Net Servicios de Comunicaciones S.A., Perdigao S.A., Gol Linhas Aéreas Inteligentes S.A., Brazilian Petroleum Corp., CPFL Energia S.A., Gafisa S.A. (Brazil); Enersis S.A., Empresa Nacional de Electricidad S.A., LAN Airlines S.A., CorpBanca/FI, Banco de Chile, Banco Santander Chile (Chile); China Natural Resources, Inc. (British Virgin Islands); PetroChina Co. Ltd., and Aluminum Corp. of China Ltd., (China). The latter company and CPFL Energia are counted despite the lack of reference to dispute settlement in most recent reports, because of relatively adequate disclosure in prior filings, which might put shareholders on notice. See Aluminum Corp. of China, Annual Report (Form 20-F), at 15 (June 25, 2003); CPFL Energia S.A., Registration Statement (Form F-1), at 23 (Aug. 23, 2004).
Investors in those issuers would in practice have to scroll past the report and read the (entire) bylaws before discovering that by becoming shareholders, they would contract to waive their right to file a claim in court.

Only a modest number of eight, mostly Chinese, FPIs, including Royal Dutch Shell, spell out shareholders’ obligation to arbitrate claims between them or against the company, and expound the specifics of arbitration as a “risk factor” that could influence investment decisions. Even in these cases, though, investors wishing to review the clause themselves do not always have immediate access to the bylaws, as issuers can incorporate them by reference to previous reports. Investors then have to seek the bylaws online or request a hard copy – by no means something the average investor would do.

The lack of an official SEC policy on the disclosure of dispute resolution provisions in issuers’ bylaws becomes more problematic in light of the mandatory character of arbitration for Brazilian and Chilean FPIs. The vague legal framework allows companies to keep the matter under the radar in public filings – eight Chilean companies indeed brush aside any allusion to their duty to arbitrate disputes with shareholders. A bright side may be that under Chilean law claimants retain the right to sue in court, yet nothing in the law or the regulations prevents Brazilian FPIs from consigning dispute resolution to a footnote. In the end, deficient disclosure deprives investors of crucial information about foreign stock.

A glance at typical arbitration clauses adopted by companies from each of the countries most represented in this research (China, Brazil, Chile) is informative.

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148 See China Life Insurance Co. Ltd., Annual Report (Form 20-F), at 23 & 139-40 (Apr. 25, 2008) (stating the “limited” enforceability of shareholders’ rights under the articles of association); Mechel OAO, Annual Report (Form 20-F), at 26 (July 2, 2007) (warning that arbitration might result in an unenforceable award, due to “political resistance to foreign investors” and “corruption” in Russia); China Petroleum & Chemical Corp., Annual Report (Form 20-F), at 11-12 & 75-76 (Articles of Association) (Apr. 13, 2007); Concha y Toro Winery Inc., supra note 142, at 7-8 (noting that “there is doubt as to the ability of ADS-holders to bring actions against the Company or its officers . . . based on U.S. federal securities laws whether in Chilean courts or arbitration proceedings”); Companhia de Saneamento Básico do Estado de São Paulo, Annual Report (Form 20-F), at 18 (“Mandatory arbitration provisions in our by-laws may limit the ability of a holder of our ADSs to enforce liability under U.S. securities laws”) & 103 (July 13, 2007); Sinopec Shanghai Petrochemical Co. Ltd., Annual Report (Form 20-F), at 11 & 71-72 (June 28, 2007); Royal Dutch Shell PLC, Annual Report (Form 20-F), at 14 & 177 (Mar. 17, 2008); and China Telecom Corp. Ltd., Annual Report (Form 20-F), at 14-15 (June 22, 2007).

149 See supra note 147.

150 Even that is not a settled matter, see supra text accompanying note 142. Fortunately, the only Chilean company with an “exclusive” arbitration clause in its bylaws discloses the clause in its annual report and clarifies its exclusive character as a risk factor. Id.
Article 220, for example, of the Articles of Association of the China Petroleum & Chemical Corporation, listed on the NYSE since 2000, reads:  

The Company shall abide by the following principles for dispute resolution:

(1) Whenever any disputes or claims arise between: holders of the Overseas-Listed Foreign-Invested Shares and the Company; holders of the Overseas-Listed Foreign-Invested Shares and the Company’s directors, supervisors, general manager, deputy general managers or other senior officers; or holders of the Overseas-Listed Foreign-Invested Shares and holders of Domestic-Invested Shares, in respect of any rights or obligations arising from these Articles of Association, the Company Law or . . . any other relevant laws and administrative regulations concerning the affairs of the Company, such disputes or claims shall be referred by the relevant parties to arbitration.

Where a dispute or claim of rights referred to in the preceding paragraph is referred to arbitration, the entire claim or dispute must be referred to arbitration, and all persons who have a cause of action based on the same facts giving rise to the dispute or claim or whose participation is necessary for the resolution of such dispute or claim, shall, where such person is the Company, the Company’s shareholders, directors, supervisors, general manager, deputy general managers or other senior officers of the Company, comply with the arbitration. Disputes in respect of the definition of shareholders and disputes in relation to the register of shareholders need not be resolved by arbitration.

(2) A claimant may elect for arbitration to be carried out at either the China International Economic and Trade Arbitration Commission in accordance with its Rules or the Hong Kong International Arbitration Centre in accordance with its Securities Arbitration Rules. Once a claimant refers a dispute or claim to arbitration, the other party must submit to the arbitral body elected by the claimant.

If a claimant elects for arbitration to be carried out at Hong Kong International Arbitration Centre, any party to the dispute or claim may apply for a hearing to take place in Shenzhen.

. . .

(3) If any disputes or claims of rights are settled by way of arbitration in accordance with sub-paragraph (1) of this Article, the laws of the People’s Republic of China shall apply, save as otherwise provided in the laws and administrative regulations.

(4) The award of an arbitral body shall be final and conclusive and binding on all parties. (Emphasis added)

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This provision is reiterated verbatim in the charters of all Chinese FPIs.152 Although this essay does not seek to belittle the standards of justice in foreign countries, nor asserts that American laws should necessarily “govern the destinies of American investors,” 153 a proceeding under the above clause would present undeniable challenges. Aside from the obvious inconvenience of the locus (China or Hong Kong) and the lack of familiarity with the lex causae of arbitration (Chinese law), the sweeping subject matter scope of the clause, embracing “disputes . . . based on any other relevant laws . . . concerning the affairs of the company” (therefore claims under U.S. laws), and its discriminatory application only to conflicts between holders of a specific category of shares (“Overseas-Listed Foreign-Invested Shares”) and the issuer or its directors, could imply intent to siphon claims by ADS-holders to fora that might afford less substantive protection than U.S. courts, even if still fairer than Chinese courts. This impression is reinforced by the extension of the award’s res judicata effect to persons whose claims share the same factual underpinning or “whose participation is necessary for the resolution of [such] dispute.”

Unquestionably, there have lately been positive developments on the shareholder protection front in China: the Company Law was amended in 2005 to introduce shareholders’ right to assert, in derivative capacity, corporate causes of action for breaches of legal or contractual duties to the corporation.154 Yet this does not moot apprehensions about the level of shareholders’ protection under

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152 See China Life Insurance Co. Ltd., supra note 148, Ex. 1.1, Article 203, incorporating by reference Ex. 1.1 to the 2007 Annual Report (May 18, 2007); Yanzhou Coal Mining Co. Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 286 (June 29, 2007); Sinopec Shanghai Petrochemical Co. Ltd., supra note 148, Ex. 1.1, Article 245, incorporating by reference Ex. 1 to the 2001 Annual Report; Aluminum Corp. of China Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 233 (June 20, 2007); China Eastern Airlines Corp. Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 186 (June 28, 2007), incorporating by reference Ex. 1.1 to the 2007 Annual Report (July 7, 2006); China Telecom Corp. Ltd., supra note 148, Ex. 1.1, Article 187; China Southern Airlines Co. Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 305 (June 29, 2007); Guangshen Railway Co. Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 197 (June 28, 2007); and Petro-China Co. Ltd., Annual Report (Form 20-F), Ex. 1.1, Article 181 (May 11, 2007).


154 See, e.g., China Life Insurance Co. Ltd., supra note 148, at 23 & 139-40 (twice admonishing ADS-holders that, although under the amended company law “shareholders . . . may sue directors, supervisors and senior management on behalf of the company,” “no detailed implementation rules or court interpretations have been issued in this regard” and that “class action lawsuits are generally not available”); China Telecom Corp. Ltd., supra note 148, at 14 (pointing out that “because of the limited number of published cases and their non-binding nature, interpretation and enforcement of [economic] laws . . . involve uncertainties.”). See also infra notes 358-59. Even before these legislative reforms, however, Chinese FPIs targeting U.S. investors would offer contractual substitutes for derivative suits. Article 165, e.g., of China Petroleum & Chemical Corp.’s charter recognizes shareholders’ “right to ask the company to commence legal or arbitration proceedings” against directors or managers for breaches of legal or contractual duties. See supra note 148, Article 165.
Chinese law, as interpreted by Chinese judges or arbitrators. It should not be forgotten that the Chinese state regulates the market, while central or local government units are the ultimate controlling shareholders of more than 80% of listed companies. In this situation inheres a conflict of interests, which “shows the politics dimension on China’s corporate governance development.”

The deeply rooted culture of corruption in China, pervading all government branches and “levels of society,” exacerbates fears of pro-government prejudice by arbiters of conflicts involving foreign shareholders of state-owned entities.

In a singular reported instance, the SEC has expressed disquiet about the features of the Chinese corporate arbitration scheme, demanding a change in an FPI’s bylaws that would render arbitration one of the dispute resolution mechanisms available to ADS-holders: China Petroleum & Chemical Corporation admits having undertaken, at the SEC’s request, to “propose an amendment to the articles of association which would permit shareholders to adjudicate disputes arising between our shareholders and us, our directors, or officers by means of judicial proceedings,” “as all applicable laws of [China] and of the . . . Hong Kong shall not prohibit, and to the extent Section 14 under the Securities Act of 1933 so requires.” However, the undertaking has not yet been implemented – without any adverse consequences, like trading suspension, for the company. Moreover, it is the only proof of the SEC exerting active oversight of FPIs’ dispute resolution arrangements; drastic intervention was not a recurring theme in the SEC’s policy. The doubtful “enforceability in [China] of actions to enforce [U.S.] judgments . . . arising out of . . . ownership of . . . shares or ADSs, [or] . . . the civil liability provisions of U.S. federal or state securities laws” further undercuts the value of the concession – even resort to an American court might furnish an ineffective avenue of redress.

155 See Guy Liu & Pei Sun, State-dominated Corporate Governance System in Transition: The Case of China, in HANDBOOK ON INTERNATIONAL CORPORATE GOVERNANCE – COUNTRY ANALYSES 118-19 (Christine Mallin ed., 2006); Liu & Sun, The Class of Shareholdings and Corporate Performance – A Case of State Shareholding Composition in Chinese Publicly-Listed Companies, in 13 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW 46 (2005). Given the state control of public companies, the government would be involved in any dispute between ADS-holders and state-appointed directors; it would be unrealistic to assume that the governmental status of or backing to a disputant would play no role in extra-judicial proceedings conducted in China, under Chinese law.

156 See Zou Keyuan, CHINA’S LEGAL REFORM – TOWARDS THE RULE OF LAW 84 (2006) (stressing that corruption in China is “rampant” and “exceptionally severe” and “laughs at law enforcement”). See also Johnny Cheung, Shortcomings in China’s Corporate Governance Regime, 21 CHINA LAW & PRACTICE 27 (Feb. 2007) (“Another corporate governance problem for big PRC companies . . . is the government trying to exert a strong management influence on them. Many of the senior management . . . see their role as that of keeping the government happy at all costs.”).


158 Id. at 80. There is currently no U.S.-China treaty for the reciprocal recognition of judgments.
Unlike Chinese issuers, South American companies have adopted laconic arbitration agreements raising fewer red flags. Article 32 of LAN Airlines S.A., which launched its ADS facility in 1997, specifies:

Any matter arising among shareholders as such or among them and the company or its managers shall be resolved without form of trial or further remedy by an arbitrator *ex aequo et bono* appointed by mutual consent of the parties involved, and failing consent, by the ordinary courts, in which case the arbitrator shall be a conciliator in regard to procedure and an arbiter in regard to the ruling. The appointment shall fall upon an attorney who is or has been a deputy justice of the Supreme Court of Justice for at least one year. *Notwithstanding the foregoing, the plaintiff in any dispute may remove the hearing thereof from the venue of arbitrators and submit to the decision of the Ordinary Courts.* (Emphasis added)

Two remarks are worthy of note. First, this clause reproduces the statutory mandate for equitable arbitration, to which all but four of the Chilean FPIs in the survey adhere. Under the bylaws of the four companies that digress from the default statutory solution, arbitrators “shall be bound by legal principles,” at least “as to decisions on the merits of the case.” Second, like LAN, all Chilean FPIs secure in their *estatutos* claimant’s elective right to file their claims in Chilean courts instead of an arbitral forum.

Even more terse, the clauses in Brazilian FPIs’ bylaws set forth the particulars of the arbitration process by reference to the Arbitration Regulations of the Sao Paulo Stock Exchange, which assigns most procedural issues to the parties’ agreement. For example, Embraer’s bylaws provide:

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159 See LAN Airlines S.A., Annual Report (Form 20-F), Ex. 1.1 (Bylaws), Article 32 (May 7, 2007).

160 See Telecommunications Co. of Chile, Annual Report (Form 20-F), Ex. 1.1 (*Estatutos*) (Apr. 30, 2008), incorporating by reference Ex. 1.1 to 2006 Annual Report (Form 20-F) (May 15, 2006); CorpBanca/FI, Annual Report (Form 20-F), Ex. 1.1 (*Estatutos Sociales*), Article 37 (June 29, 2007), incorporating by reference Ex. 1.1 to Annual Report (Form 20-F) (Sept. 24, 2004). The solution adopted by Distribución y Servicio S.A. is more perplexing: the arbitrator appointed by consent of the parties will “not [be] bounded by law [and] shall hear the matter without form of trial;” only in the absence of agreement by the parties, will an “arbiter-at-law” be appointed by the civil court. See Annual Report (Form 20-F), Ex. 1.1 (Amended Bylaws), Art. 38 (July 13, 2007), incorporating by reference Ex. 1.1 to Annual Report (Form 20-F) (July 15, 2005).

161 See Bank of Chile, Annual Report (Form 20-F), Ex. 1.1 (*Estatutos*), Article 27 (June 29, 2007). CorpBanca also distinguishes between procedural questions (assigned to the arbitrator’s equitable powers) and merits issues (decided “pursuant to the law”), *supra* note 160.

162 See *supra* note 141. ADS-holders of Mechel OAO may also opt out of arbitration, under the deposit agreement, with respect to federal securities claims. See *supra* note 137.

163 See Empresa Brasileira de Aeronautica S.A., Registration Statement (Form F-4), Ex. 3.2 (Bylaws), Article 57 (Mar. 28, 2007).
Any dispute or controversy related to the construction or application of rules and provisions of the Regulations for Listing in BOVESPA’s Novo Mercado, of these By-Laws, of Law No. 6404, of December 5, 1976, of normative acts issued by Conselho Monetário Nacional, by the Central Bank of Brazil and by CVM, as well as BOVESPA Regulations and other rules applicable to the operation of the capital markets in general, or deriving therefrom, shall be resolved through an arbitration proceeding conducted in accordance with the Regulations of the Chamber of Arbitration of the Market instituted by the BOVESPA.

SOLE PARAGRAPh – The provisions of this Article shall not apply in the event of a dispute or controversy related to or deriving from the common Golden share held by the Federal Government, or concerning its rights and prerogatives, . . . which shall be submitted to the jurisdiction of the Central Courts of . . . Brasília (Federal District).

Similarly, Article IX of the bylaws of Carolina National Corporation, the survey’s single domestic issuer, laid down a bare framework and refers to the American Arbitration Association Rules for the specifics.

Section 1. Any dispute between a shareholder of the Corporation and (1) the Corporation, or (2) any officer of the Corporation, or (3) any other shareholder of the Corporation which arises out of the aggrieved shareholder’s status as a shareholder shall be resolved by binding arbitration held in Columbia, South Carolina pursuant to the rules of the American Arbitration Association.

This provision carried out the explicit authorization in the Articles of Incorporation that the bylaws “may require binding arbitration of disputes arising out of or related to share ownership.” Peculiarly, neither the charter provision nor the arbitration clause in the bylaws was mentioned in the company’s annual filings following the registration statement, even though the bylaws bore a notice to the investors, in all capitals, that “[t]his is a contract subject to arbitration.”

Nonetheless, it is a well-seasoned FPI, Royal Dutch Shell, that has designed the most concise arbitration clause:

Article 152. Arbitration.

Unless article 153 applies: (A) All disputes: (i) between a shareholder . . . and the company and/or its directors arising out of or in connection with these articles or otherwise; and/or (ii) to the fullest extent permitted by law, between the company

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164 See Carolina National Corporation, Inc., Annual Report (Form 10-KSB), Ex. 3.2 (Bylaws) (Mar. 29, 2007), incorporating by reference Ex. 3.2 to Registration Statement By Small Business Issuers (Form SB-2) (Jan. 10, 2002).
165 Id. Ex. 3.1 (Articles of Incorporation), Article G, incorporating by reference Ex. 3.2 to Registration Statement, supra note 164.
166 Id. Ex. 3.2 (Bylaws). Only the initial registration statement advises investors, in a paragraph, that arbitration is “likely to be in the best interests of the Company under most circumstances.” See Registration Statement, supra note 164, at 31.
167 See Royal Dutch Shell PLC, supra note 132.
and any of its directors in their capacities as such or as employees of the company, including all claims made by or on behalf of the company against its directors; and/or (iii) between a shareholder in that shareholder’s capacity as such and the company’s professional service providers; . . . shall be exclusively and finally resolved under the Rules of Arbitration of the International Chamber of Commerce.

(C) The chairman of the tribunal must have at least 20 years experience as a lawyer qualified to practise in a common law jurisdiction . . . and each other arbitrator must have at least 20 years experience as a qualified lawyer.

(D) The place of arbitration shall be The Hague, The Netherlands.

(E) The language of the arbitration shall be English.

(F) These articles constitute a contract between the company and its shareholders and between the company’s shareholders inter se. This article . . . contains or evidences an express submission to arbitration by each shareholder, the company, its directors and professional service providers and such submissions shall be treated as a written arbitration agreement under the Netherlands Arbitration Act, the Arbitration Act 1996 of England and Wales and Article II of the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

(G) Each person to whom this article applies hereby waives, to the fullest extent permitted by law: (i) any right under the laws of any jurisdiction to apply to any court of law or other judicial authority to determine any preliminary point of law, and/or (ii) any right it may otherwise have under the laws of any jurisdiction to appeal or otherwise challenge the award, ruling or decision of the tribunal. . . .

(Emphasis added)

What makes this provision unique is its self-characterization as a “contract between the company and its shareholders,” cognizable under the New York Convention and all national arbitration laws involved; Royal Shell went to great lengths to guard the clause’s legal effectiveness. As an additional precaution, Article 153 judiciously invests English courts with exclusive jurisdiction over “dispute[s] . . . otherwise subject to article 152 . . . if a court in [any] jurisdiction determines that article 152 is invalid or unenforceable in relation to that dispute in that jurisdiction.”168 Last, Article 154 clarifies that the company’s Articles of Association are to be interpreted in accordance with English law, which necessarily applies to arbitrable (or justiciable) disputes arising thereunder and explicitly governs “the submissions to arbitration and written arbitration agreement contained in . . . article . . . 152.”169 Bold enough, Royal Dutch Shell has fully disclosed this elaborate dispute resolution scheme, as nothing less than a “limitation of shareholder remedies”170 – which did not dissuade the SEC from approving, apparently with no vigorous negotiation, Shell’s listing on the NYSE.

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168 Id. Art. 153 (“Exclusive Jurisdiction”).
169 Id. Art. 154 (“General Dispute Resolution Provisions”).
170 See Royal Dutch Shell PLC, Annual Report (Form 20-F), at 14 (Mar. 13, 2007). The most recent annual report, however, describes the dispute resolution provisions as
Summary

The bottom line is that the SEC’s growing acceptance of arbitration of intra-corporate controversies signifies a decisive departure from prior categorical resistance to the practice. The survey belies the claim that arbitration is unlikely to make a foray into the public company sphere. Institutional hostility is receding, whether by reason of apathy, tacit consent or sheer calculation of the financial benefits associated with the uninterrupted flow of foreign capital into U.S. markets.

Admittedly, the clauses investigated above are rather isolated episodes than indices of a general pro-arbitration trend: forty companies are an almost negligible quantity among the thousands trading on American exchange markets. What is more, thirty-nine of them are FPIs that on average have listed a humble 13.52% of their share capital in the U.S., by all means a non-trifling, but not substantial presence in U.S. markets. The survey’s sole American company was trading on NASDAQ as a small business only since 2002 (and even then, on an infrequent basis), before it recently went private.

Absolute sizes notwithstanding, arbitration has gained a strategic foothold in the public company domain and the first arbitration between a U.S.-listed public company and its shareholders is now set to materialize – the question is when, not whether. The now-pending arbitration between a Russian private issuer (Surgutneftegaz) and its U.S.-based ADS-holders has brought investors and the SEC, lawyers and academics, one step away from this formerly distant reality.

simply “determin[ing]” the “ability of shareholders to obtain monetary or other relief.” See supra note 132, at 14. Cf. Registration Statement (Form F-4), at 25-26 (May 18, 2005).

171 See Table B supra. Perhaps safer criteria to gauge an FPI’s U.S. presence would be estimates of the percentage of total shares, or voting securities, held of record or beneficially owned by U.S. residents; or of the percentage of the total number of holders of record or beneficial owners of securities who reside in the U.S. However, determining beneficial share ownership and residency in an era of constant transboundary movements, if not futile, poses insuperable challenges for issuers, let alone outside investigators. The SEC acknowledges the practical difficulties of such inquiry and, although foreign issuers have to look through the veil of “record ownership” of brokers/dealers/depositories, to determine their qualification as FPIs, see Rule 3b-4(c), supra note 123, or justify exemption from registration, see Rule 12g3-2(a), 17 C.F.R. § 240.12g3-2(a), they may “assume that the [beneficial owners] are residents of the jurisdiction in which the nominee [holder of record] has its principal place of business.” See Rule 3b-4(c), Instruction B to paragraph (c)(1), supra note 123. Many FPIs concede that, since most ADSs are held by nominees, the number of record holders “may not be representative” of the actual number of beneficial ADS-holders. See, e.g., Homex Development Corp., Annual Report (Form 20-F), at 49 (July 13, 2007); Bancolombia S.A., Annual Report (Form 20-F), at 188 (May 10, 2007); China Eastern Airlines Corp. Ltd., Annual Report (Form 20-F), at 57 & 62 (June 28, 2007); China Telecom Corp. Ltd., Annual Report (Form 20-F), at 73 (June 22, 2007); China Petroleum & Chemical Corp., supra note 148, at 67.

172 See supra notes 130-31 and accompanying text.

173 See infra notes 315-22 and accompanying text.
It is only regrettable that, as the survey shows, this first public shareholder arbitration will, in all likelihood, be conducted abroad, under foreign law, between an FPI and its U.S.-based ADS-holders. Indeed, the dearth of U.S. issuers that have espoused arbitration – two companies over a 12-year period – contrasts strikingly with the increasing number of their foreign counterparts, which apparently enjoy greater latitude in picking a forum for the resolution of intra-corporate strifes.

The SEC is hard-pressed to justify why, instead of pursuing workable dispute settlement solutions, it has been shortsightedly insisting on a near ban on experimentation with ADR methods for domestic companies, while granting a free pass to FPIs. That many FPIs are required by their local law to arbitrate intra-corporate disputes does not quite absolve the SEC’s responsibility for effective oversight to ensure transparency and procedural fairness. Nor do economic concerns about the appeal of U.S. financial markets to foreign investors warrant double standards. Disparate treatment makes little sense in this area, since arbitration proceedings conducted in the U.S. under U.S. law and under the aegis of a SEC-supervised body (e.g., an arbitration chamber) would unquestionably pose fewer problems than those conducted abroad under foreign law.

Simply put, “if foreign public corporations trading in the United States can arbitrate matters of corporate governance,” American companies “should be afforded the same opportunity.”174 Impartial regulation and close screening of all issuers’ conflict resolution arrangements are preferable, from a policy viewpoint, to the present system of discriminatory prohibitions. This article posits that the ground is fertile for reversal of the SEC’s semi-defunct anti-arbitration policy regarding domestic issuers.

Yet even a policy shift by the SEC would not immunize arbitration agreements in public company charters from legal challenges. The use of such clauses only means that the discussion about their validity will, sooner or later, be transferred to American courtrooms, where American judges will be called to rule on the legal force of contractual experiments, distilling long-standing principles through policy values. The next section predicts that the outcome of this process will probably vindicate Richard Shell and the few others who have asserted the legal feasibility of public shareholder arbitration.

III. THE LEGAL CASE

The legal question at the epicenter of the present analysis is whether a clause in a public corporation’s governing documents would be enforced. Some years ago, the presumption would have been against enforceability, due to the insurmountable “public policy” barrier. Things change, though, and since the beginning of the 1990s – when the SEC refused to accelerate a registration statement on the ground that the arbitration clause would dilute investors’ rights175

174 Sanborn, supra note 31, at 354.
175 See supra notes 26-28.
the climate in the SEC, the business community and academia has become more receptive to proposals like those in the 2006 Interim Report discussed above. With the SEC re-considering its de facto veto of public arbitration, the legal argument in favor of the arbitrability of intra-corporate controversies is almost invincible. The Supreme Court, after all, has interpreted a “federal policy favoring arbitration” in § 2 of the FAA, which places these agreements “upon the same footing as other contracts.” There is no reason why this national policy would not justify the enforcement of arbitration provisions embedded in a public company’s governing documents, when arbitration is the prevalent dispute resolution mode in the securities industry and has been long recognized as a legitimate option for shareholders of non-public companies. The legal case for arbitration in the public company context, firmly anchored in well-entrenched federal doctrine, is, this article maintains, unassailable.

Arbitration agreements were not always the enfant gâté of American jurisprudence. Before the passage of the FAA, they were seen generally as a connivance to oust the courts of their jurisdiction; with few exceptions, courts

176 See supra part II.
178 See H.R. REP. No. 69-96, 1, 2 (1924). It is assumed here that arbitration agreements involving public companies are governed by the FAA – not state arbitration law: publicly held corporations trade on national exchange markets, have nationally and globally dispersed ownership, and clearly engage in interstate and foreign commerce, while transactions giving rise to most shareholder claims involve the use of interstate communication systems. See 9 U. S.C. § 1; Southland, 465 U.S. at 12-13 (recounting that the FAA intended to validate arbitration agreements “contained in contracts involving interstate commerce”) (quoting H.R. REP. No. 68-96, at 1).
180 See infra part III.A.
181 See Home Insurance Co. of New York v. Morse, 87 U.S. 445, 451 (1874); Memphis Trust Co. v. Brown-Ketchum Iron Works, 166 F. 398, 402 (6th Cir. 1909); Atlantic Fruit Co. v. Red Cross Line, 276 F. 319, 321 (S.D.N.Y. 1921), aff’d, 5 F.2d 218 (2d Cir. 1924). The “ouster” doctrine dates back to English common law. See JULIUS COHEN, COMMERCIAL ARBITRATION, 84–102 (1918); Wolaver, supra note 5, at 138-43 (detecting discrepancies in English case law on arbitration, yet concluding, unenthusiastically, that the doctrine that arbitration clauses are freely revocable “is still the law”). See also H.R. REP. No. 68-96, at 1-2 (1924) (“Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. . . . [T]he principle . . . was adopted . . . by the American courts.”).
182 See Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109, 119, 122 (1924) (upholding the constitutionality of the New York arbitration statute providing for specific performance of agreements to arbitrate maritime controversies); U.S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co., 222 F.1d 1006, 1007-08 (1915) (criticizing the practice of not enforcing arbitration contracts as lacking any basis other than “the antiquity of the rule”); Kulukundis
would not compel performance of agreements to arbitrate. In 1925, the FAA repudiated the “ouster-of-jurisdiction” doctrine but courts would paternalistically scrutinize the subject matter of arbitration agreements to ascertain “arbitrability,” i.e., suitability for resolution by arbitration.\footnote{See, e.g., American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) (Sherman Act claims held non-arbitrable); Aimce Wholesale Corp. v. Tomar Prods., Inc., 237 N.E.2d 223, 225 (N.Y.1968) (state antitrust claims held non-arbitrable).} Indicative of this antagonism was the Supreme Court’s refusal, in Wilko v. Swan, to enforce an investor-dealer contract calling for arbitration of securities fraud claims.\footnote{346 U.S. 427 (1953).}

The tide of judicial enmity towards arbitration did not ebb until decades later. Two were the turning points: the first was the Supreme Court’s holding in The Bremen v. Zapata Off-Shore Co. that the forum selection clause in an international vessel-towing contract should be given effect, “absent a strong showing . . . that enforcement would be unreasonable and unjust, or that the clause was invalid for . . . fraud or overreaching,” even if non-U.S. (English) courts were vested with exclusive jurisdiction over contractual differences.\footnote{407 U.S. 1, 15 (1972).} The second was Scherk v. Alberto-Culver Co., where the Supreme Court upheld the validity of the arbitration clause in a business sales contract, reasoning: “An agreement to arbitrate . . . is, in effect, a specialized kind of forum selection clause that posits not only the situs of suit, but also the procedure to be used . . . and [its] invalidation . . . would not only allow respondent to repudiate its solemn promise but would, as well, reflect a ‘parochial concept that all disputes must be resolved under our laws and in our courts.’”\footnote{417 U.S. 506, 519 (1974) (quoting Zapata, 407 U.S. at 9).} The Court sidestepped Wilko v. Swan, by emphasizing the “truly international” character of the Scherk contract;\footnote{Id. at 515.} a forum selection clause was a “precondition to achievement of the orderliness and predictability essential to any international business transaction.”\footnote{Id. at 516.}

It was the Zapata and Scherk decisions that set in motion a dynamic reinterpretation of the FAA which, almost inescapably, produced the pro-arbitration revolution of the 1980s. Soon thereafter, in Moses H. Cone Memorial Hospital v. Mercury Construction Corporation\footnote{460 U.S. 1 (1983).} and Southland Corporation v. Keating, the
Court construed Section 2 of the FAA as a “congressional declaration” of a substantive “policy favoring arbitration,” preemptive of states’ power “to require a judicial forum for the resolution of [any] claims which the contracting parties agreed to resolve by arbitration.”190 Perry v. Thomas invoked the same FAA section to order arbitration of a stockbroker’s claim against his employer for withheld commissions, striking down a state statute under which wage disputes were non-arbitrable.191

The American Express cases administered the coup de grâce to the Wilko doctrine. In Shearson/American Express, Inc. v. McMahon,192 the Court held enforceable the agreement between an investor and his securities broker to resolve by arbitration claims arising under the 1934 Exchange Act; McMahon held federal statutory claims were arbitrable, unless Congress explicitly exempts such claims from arbitration or there exists an “inherent conflict” between arbitration and the specific statute’s underlying purposes.193 Next, in Rodriguez de Quijas v. Shearson/American Express, Inc.,194 another investor-dealer case, the Court upheld agreements to arbitrate claims under § 10(b) of the Exchange Act, Rule 10b-5 and the civil liability provisions of the RICO statute;195 Wilko was unhesitatingly overruled as a vestige of a bygone era.196 No reason existed for excluding securities laws causes of action from otherwise valid arbitration agreements, held the Court in unqualified terms197 – and the same applies with equal force, this essay adds, if the arbitration pact takes the form of a clause in corporate bylaws.

These and other seminal decisions198 – whose enduring authority has been recently re-affirmed by the Supreme Court199 – transformed the legal landscape,


193 Id. at 242.
196 490 U.S. at 484-85 (reasoning that Wilko reflected the “old hostility” to arbitration).
197 Id. at 480.
199 See Preston v. Ferrer, No. 06-1463, slip. op. at 5-6 (U.S. Feb. 20, 2008).
by wholeheartedly embracing private parties’ freedom to entrust the resolution of their controversies to decisionmakers of their picking. As the pro-arbitration euphoria permeated federal case law, a sui generis presumption of arbitrability and validity of arbitration pacts (favor validitatis contractus arbitrationis) began to emerge as a cardinal canon of contract interpretation.\(^{200}\) Courts are now more preoccupied with adequacy of notice and authenticity of party consent than the hemorrhaging of jurisdiction to arbitration.

Consent and notice, not “arbitrability,” should also be the focus of a relevant inquiry into the enforceability of arbitration clauses implanted in a public company’s constitutional documents. The subsections below demonstrate that the long string of pro-arbitration decisions provides ample support for the use of ADR techniques to solve intra-public company controversies. Particularly helpful analogies can be drawn from jurisprudential principles applicable to dispute settlement in other business organizations, like non-public companies.

A. Arbitration and Non-Public Corporations

Early endeavors to introduce arbitration in the context of privately held corporations encountered, unsurprisingly, the same wall of public and institutional resistance that has been plaguing attempts to devise a non-judicial remedy to public shareholder claims. Despite the striking resemblances between closely held corporations (“CHCs”) and partnerships in terms of “integration of ownership and management” and size of shareholder base,\(^ {201}\) and the affinity of CHC charters to private contracts among parties of equal negotiating power, courts were reluctant to permit an ADR expansion into the corporate world.\(^ {202}\)

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\(^{201}\) According to Shell, CHCs represent “the predominant form of corporate enterprise in the United States.” Shell, supra note 22, at 525-28 (citing, inter alia, Frank Easterbrook & Daniel Fischel, Close Corporations and Agency Costs, 38 Stan. L. Rev. 271, 273-77 (1986)). This section draws heavily on Shell’s analysis of the evolution of close corporation law in New York. See Shell, supra note 22, at 528-33; see also Carlos Israel, The Close Corporation and The Law, 33 Cornell L. Q. 488 (1948).

Even after the enactment of New York’s arbitration statute – the first to make performance of arbitration agreements compellable, and the prototype for the FAA\textsuperscript{203} – and the avalanche of state statutes that ensued, courts would defeat attempts to circumvent ordinary judicial processes. One of the rationales was that certain disputes were not justiciable, thus could not be arbitrated either.\textsuperscript{204} Courts would, for example, apply the “board sterilization” doctrine, which forbade governance structures depriving the board of its statutory authority to manage corporate affairs,\textsuperscript{205} to bar arbitration initiated by shareholders seeking to take over the management of the company.\textsuperscript{206}

In other cases, state courts would enjoin arbitration because of the unsuitability of the subject matter for resolution by arbitration, or on public policy grounds. Claims of fiduciary duty breaches were typically deemed beyond the reach of arbitration, either because derivative arbitration would contravene public policy,\textsuperscript{207} or because such disputes were statutory, not “arising out of” the shareholders’ agreement; dissolution disputes also exemplified non-arbitrability.\textsuperscript{208}


\textsuperscript{204} See In re Burkin, 136 N.E.2d 862 (N.Y. 1956) (dispute over removal of shareholder-director held non-arbitrable because was not actionable under New York law); In re Ades, 177 N.Y.S.2d 582, 584 (N.Y. Sup. Ct. 1958) (only state attorney general may remove director); In re Scuderi, 39 N.Y.S.2d 422, 423 (N.Y. Sup. Ct. 1943) (validity of director election under bylaws held non-arbitrable).


\textsuperscript{207} See Pfeiffer v. Berke, 121 N.Y.S.2d 774, 777 (N.Y. Sup. Ct. 1953); Application of Diamond, 80 N.Y.S.2d 465, 467 (N.Y. Sup. Ct. 1948) (“The issues involved in the derivative action are not referable to arbitration under the contract, and . . . [even if they were], they would be unenforceable as against public policy.”), aff’d, 79 N.Y.S.2d 924 (App. Div. 1948).

It took more than one legislative intervention before courts could overcome their inhibitions and accept arbitrators’ authority to decide management-related disputes, entertain derivative actions alleging fiduciary duty violations, and order dissolution (or mandatory buy-outs). “After nearly [a century] of legal evolution, arbitration is now utilized . . . as a . . . remedy for virtually every kind of corporate dispute.” Acceptance of arbitration has, in fact, been extended to new forms of business organization, like limited liability companies.

It is certainly not by accident that arbitration has thrived in the non-public enterprise setting. As a “less polarizing” process, it seems well-suited to resolve disputes with emotional overtones in a mutually agreeable manner and tailor the solution “to fit the needs of the business and the interests of shareholders.”

209 See Shell, supra note 22, at 529 n.86, 531 n.96.
210 The sterilization doctrine was the first to lose ground in New York case law. See In re Glekel, 281 N.E.2d 171 (N.Y. 1972) (agreement regarding registration of public offering); In re Groval Knitted Fabrics, Inc., 339 N.Y.S.2d 58 (N.Y. Sup. Ct. 1971), aff’d, 31 N.Y.2d 796 (1972) (disputes over termination of salary and minority shareholder freeze-out).
213 See Shell, supra note 22, at 533.
These gains have even prompted proposals to make arbitration compulsory for CHCs that have not opted out of the default statutory mandate.\textsuperscript{216}

This essay does not advocate such innovations in the public company sphere, yet the successful employment of ADR techniques by CHCs should give courts and legislators pause. CHCs are different animals: the market for CHC participations is limited, hence a deadlock may put at risk minority shareholders’ livelihood; above all, CHC charters and shareholders’ agreements are easier to conceptualize as archetypical contracts between parties sitting around a table to negotiate a fair arrangement. However, many ADR advantages – cost-effectiveness, expertise, flexibility of procedures and remedies, and confidentiality – also hold true in the public company context. Deference to shareholders’ freedom of contract, along the lines suggested in the 2006 Interim Report, and use of a streamlined process for the resolution of public shareholder claims could produce similar synergies.

With these thoughts in mind, we now delve into the heart of the legal inquiry.

B. Arbitration and Public Companies

Arbitration is not unheard of in public company land. In the wake of the pro-arbitration revolution in Supreme Court jurisprudence, arbitration has become the staple method for the settlement of differences between securities dealers and their clients, as well as brokerage firms and their employees.\textsuperscript{217} Not rarely, public corporations direct to ADR fora disputes with directors and executives over compensation, non-competition covenants and matters under their employment agreements, including the discharge of fiduciary duties.\textsuperscript{218} Finally, public companies often contract to arbitrate disputes arising out of merger transactions, such as share appraisal claims by aggrieved shareholders.\textsuperscript{219}

The strong presence of arbitration in the contours of public companies deflates public policy objections to the enforceability of charter-based arbitration clauses: arbitration of controversies between public corporations and their stockholders would not imperil core legal values more than arbitration of shareholders’ challenges to a merger or of defrauded investors’ claims against their brokers.

Compatibility with public policy, however, enters the calculus only after the court is satisfied that, first, the litigants have validly consented in writing to arbitrate their disputes; and, second, the dispute \textit{sub judice} falls within the scope of the parties’ agreement. Each part of this three-part inquiry applied by courts to determine the validity of arbitration agreements is here addressed in turn.


\textsuperscript{218} See Sanborn, \textit{supra} note 31, at 350-51 (discussing GAF Corp. v. Werner, 485 N.E.2d 977 (N.Y. 1985)), which held compensation claims by former board chairman arbitrable under his employment agreement, despite a pending derivative action on the same matter).

\textsuperscript{219} See Sanborn, \textit{supra} note 31, at 351-53 (citing various merger agreements).
1. Valid Arbitration Agreement

a. The contractual theory

Charter-based arbitration clauses must, first, qualify under the FAA as “written provision[s]” in a consensual “agreement” to arbitrate future disputes.220 To satisfy this threshold requirement, arbitration proponents most commonly rely on a view of the company’s founding and operational documents as enforceable written contracts, of which arbitration provisions are part.221 The case for the contractual nature of a public (or any) company’s governing documents is indeed strong under the common law, which “clearly considers the corporate charter to be a contract” among the corporation and its shareholders and the shareholders themselves.222 In common-law jurisdictions, and the U.S. in particular, bylaws have been historically construed as a pact between the corporate entity, its owners and managers, regulating the conduct of corporate affairs.223 Corporations are premised on a network of contracts, setting out the rules that govern the relationships among different stakeholders.224

To be sure, charters and bylaws are idiosyncratic contracts. They may, e.g., be amended unilaterally by the board or the majority of shareholders without dissenting minorities being entitled to relief for contractual breach.225 In addition,

221 See Shell, supra note 22, at 543-48 (exploring the contractual nature of corporate charters under common contractual and corporate law theories).
222 Coffee, supra note 16, at 964.
223 See Wylain v. T.R.E. Corp., 412 A.2d 338, 344 (Del. Ch. 1979) (“the corporate charter, is a contract between the state and the corporation . . . between the corporation and its stockholders . . . and between the stockholders inter se”); Cally Jordan & Mike Lubrano, How Effective Are Capital Markets in Exerting Governance on Corporations?, in FINANCIAL SECTOR GOVERNANCE: THE ROLE OF THE PUBLIC AND PRIVATE SECTORS 335 (Robert E. Litan et al., eds., 2002) (noting that “[c]ontracts are at the heart of the corporate entity”); ADOLF BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 129-30 (1933) (“[the charter] was recognized as a ‘contract’ and has been consistently so dealt with in American law”); cf. AUSTRALIAN CORPORATIONS ACT OF 2001, Sec. 140(1) (“A company’s constitution (if any) and any replaceable rules that apply to the company have effect as a contract (a) between the company and each member; and (b) between the company and each director and company secretary; and (c) between a member and each other member; under which each person agrees to observe and perform the constitution and rules so far as they apply to that person.”); UK COMPANIES ACT OF 2006, Sec. 33(1) (“The provisions of a company’s constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions”).
224 See DELAWARE GENERAL CORPORATION LAW, Sec. 242, 8 Del. C. § 242; ARTHUR PINTO & DOUGLAS BRANSON, UNDERSTANDING CORPORATE LAW 115 (1999). Cf. UK COMPANIES ACT OF 2006, Sec. 21(1).
225 See, e.g., REVISED MODEL BUSINESS CORP. ACT, §§ 10.01(b) (“A shareholder . . . does not have a vested property right resulting from any provision in the articles of
they operate as constitutions, to which company owners pledge allegiance upon their induction into the corporate community through the purchase of an ownership stake. The constitutional dimension of corporate governing documents reinforces their enforceability *erga* all company citizens: as the supreme law of the company, they bind investors that decide to acquire stock and, with it, corporate citizenship, much like constitutions are social contracts binding the citizens of a country. In that spirit, arbitration provisions in governing documents of private associations have been regularly upheld against attacks based on lack of individual adherence.  

But contract is the common primary underpinning of corporate and arbitration law and this explains the fundamental importance, in both fields, of transparency: *caveat emptor* is meaningless unless the contractual terms are adequately disclosed, enabling contracting parties to consent knowingly. In the case of intra-corporate arbitration, investors can beware only if they receive sufficient notice of the existence of the arbitration clause in the company’s governing documents.

The need for effective notice is critical, because, in the words of the Supreme Court, “arbitration . . . is a matter of consent, not coercion.” The viability and enforceability of the arbitration agreement, under state law, presupposes genuine consent and thus effective notice. The topic is not purely academic: more than one third of the issuers identified in our survey as having opted for arbitration avoid shedding much light on the subject in SEC filings, whether inadvertently or out of cautiousness for the impact of such disclosure on the marketability of their...
Here lies, therefore, the essence of the legal debate: what “kind” of notice to investors would suffice for a stock purchase to manifest informed intent to adhere to an arbitration agreement inscribed in the bylaws?

Meaningful ways to notify investors of the arbitration clause are not hard to fathom. Public companies could be required by law to describe conflict settlement arrangements in filings with the SEC, for instance, attach special legends on (nowadays rarely used) stock certificates and securities registrars, or register on the website of the exchange market as issuers with an arbitration clause in their bylaws. It is doubtful, however, whether any of these solutions would remedy the problem of deficient notice, or would even be legally necessary. Arbitration clauses have been enforced even when incorporated in a contract by reference to exogenous sources (e.g., rules of an association). State law rules that single out contracts with arbitration clauses, on the other hand, and subject them to more rigorous “conspicuousness” requirements than other contracts have been categorically denounced by the Supreme Court as “inconsonant with, and . . . therefore preempted by” the FAA. Contrary to prior commentary, therefore, this paper argues that exchange-listed companies do furnish adequate notice, by simply complying with their obligation, under the securities laws, to file governing documents with the SEC upon initial registration and every time these documents are amended. No legal requirement can substitute for investors’ astuteness; none can guarantee that share buyers will eventually read the clause and consciously decide to invest irrespective of its existence.

A federal statute or regulation could merely add the proviso that issuers must divulge in detail in annual reports stipulations in bylaws or charters pertaining to the availability of remedies (e.g., class action waivers) or generally the resolution of disputes with their shareholders – whether by arbitration or not. To facilitate investors’ access to the company’s governing documents, all issuers could be required, at a minimum, to attach their charter and bylaws to each annual report filed with the SEC – instead of incorporating them by reference to previous reports – even when no amendment occurred during the past year. Such generally applicable, arbitration-neutral conditions would pass muster under the FAA, which can be superseded by subsequent federal law, and “add a degree of legitimacy to” arbitration. Obviously, issuers who wish to exhaust the chances that the arbitration

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231 Issuers have no legal obligation to disclose dispute resolution arrangements; the SEC apparently takes it for granted that intra-corporate disputes will be submitted to the courts. See supra notes 144-45 and accompanying text.

232 See Shell, supra note 22, at 548; Sanborn, supra note 31, at 360-62.

233 See Cyril Moscow, Arbitration Bylaws to Bar Shareholder Class Actions, 20 Insights 8 (2006) (proposing the creation of “a Nasdaq Web site listing companies who have elected to ‘opt out’ of class action exposure”).


235 See Casarotto, 517 U.S. at 688.

236 See supra notes 126-27.

237 Sanborn, supra note 31, at 360.
provision will be effectively brought to investors’ attention could opt for additional disclosure, as a matter of “self-policing” rather than a strict legal duty. The “more notice and choice given,” the more “attractive” ADR becomes.239

The FAA, of course, does not shield arbitration agreements from garden-variety state contract law challenges – mainly, fraud, duress, and unconscionability.240 Under the separability doctrine, however, such defenses must target the very making of the arbitration agreement itself, not the contract (here, the bylaws or charter) in toto. This is a difficult test to satisfy when shares are purchased in a national exchange market without clause-by-clause negotiations between sellers and purchasers.

Yet exactly the impersonal character of the transaction and investors’ inability to demand individual exemptions from an arbitration provision in the bylaws could give rise to a plausible charge of unconscionability: the vast disparity in bargaining power and the passive nature of stock ownership in a public company, which essentially deprive shareholders of say as to the content of corporate governance documents, could impel an argument that arbitration clauses in charters and bylaws are by nature adhesive242 – especially since shareholders do not sign either.

Certainly, stockowners joining a company before the insertion of an arbitration clause in its governing documents cannot complain of adhesiveness and deficient notice, since they had the opportunity to vote on the adoption of the provision. Dissidents may freely divest their shares in the market; continuous membership in the corporation cannot but imply acceptance of arbitration.

238 Id.
239 Id. at 362.
240 See 9 U.S.C. § 2 (dictating the enforceability of arbitration agreements “save upon such grounds as exist at law or in equity for the revocation of any contract”); Allied-Bruce, 513 U.S. at 281; Rodriguez de Quijas, 490 U.S. at 483-84; McMahon, 482 U.S. at 226.

241 Under this doctrine, which views the arbitration clause as “separable” from the rest of the contract, contractual challenges to the validity of the arbitration agreement cannot succeed, unless they attack the arbitration agreement per se, rather than the contract containing it. See Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440 (2006) (arbitrators are to decide attacks on the validity of the contract as a whole); Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 402 (1967) (“arbitration clauses as a matter of federal law are ‘separable’ from the contracts in which they are embedded”); Moseley v. Electronic & Missile Facilities, Inc., 374 U.S. 167, 171-72 (1983) (holding that “fraud in the procurement of the arbitration contract, like fraud in the procurement of any contract, makes it void”). For a recent discussion of the separability and the concomitant competence-competence doctrines, see William W. Park, Determining an Arbitrator’s Jurisdiction: Timing and Finality in American Law, 8 NEV. L. J. 135 (2007).

A more colorable claim of unconscionability could be raised by investors who consider purchasing a stake in a company that has already opted for arbitration, but the challenge would still probably falter. An unconscionability charge, post-

McMahon, has little chance of succeeding in blocking the enforcement of an arbitration agreement. Courts have repeatedly rejected such complaints by investors seeking relief from arbitration clauses contained in broker-customer contracts, and there is no reason why they would hesitate to apply the same reasoning, should they be presented with an arbitration provision in corporate bylaws – as long as the adoption of that clause does not mask a well-calculated attempt to curtail shareholders’ legal remedies (e.g., by banning class-wide arbitrations).

Moreover, the arbitration clause is no more adhesive than other provisions in corporate governing documents. Striking down an arbitration provision as unconscionable would thus set an alarming precedent, undermining the validity of corporations’ founding acts and bylaws in toto. Unless courts are willing to subvert the entire corporate governance edifice, arbitration clauses in company charters would have little difficulty in qualifying as enforceable contracts: under contract law, adhesiveness and the absence of negotiations on an individual basis do not necessarily subtract from the consensual character and the legal effectiveness of a contract. Articles of incorporation and bylaws are “largely inflexible,” one-sided contracts which putative entrants in the company must take or leave, but still, undoubtedly, consensual. Investors not approving of a company’s governance structure maintain the choice not to join or, if already in,

243 See, e.g., Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988); Rush v. Oppenheimer & Co., 681 F. Supp. 1045 (S.D.N.Y. 1988). Some state courts, on the other hand, remain less hesitant about striking down arbitration clauses in adhesive contracts. See, e.g., Tillman v. Commercial Credit Loans, Inc., 655 S.E.2d 362, 375 (N.C. 2008) (denying enforcement of the arbitration clause contained in a subprime mortgage agreement on unconscionability grounds, “[b]ecause the clause is one-sided, prohibits joinder of claims and class actions, and exposes claimants to prohibitively high costs”). Such state cases, however, are decided under state law, not the FAA (see id. at 369-70), and are still quite infrequent. Id. at 375 (“For the first time in our history, a North Carolina appellate court has found a contract to be unconscionable”) (Newby, J., dissenting). For a discussion of case law on unconscionability in the context of the FAA see Aaron A. P. Bruhl, The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law, 83 N.Y.U. L. REV. 1420 (2008).

244 The validity of class action waivers, combined with arbitration agreements in contracts of adhesion, is a thorny issue, beyond the scope of this article. Suffice it to say that courts have relied on the unconscionability doctrine to strike down such waivers (and the arbitration agreements comprising them) more than a few times. See, e.g., Ingle v. Circuit City Stores, Inc., 328 F.3d 1165 (9th Cir. 2003) (finding the class action waiver in the arbitration agreement “shockingly” one-sided and unconscionable); Ting v. AT&T, 319 F.3d 1126 (9th Cir. 2003) (same); Gentry v. Superior Court of Los Angeles County, 42 Cal. App. 4th 443 (2007); Mandel v. Household Bank, 105 Cal. App. 4th 75 (2003) (holding a class action waiver in an arbitration contract prohibited under California and Nevada law).

245 See Jordan & Lubrano, supra note 223, at 336.
to exit. That no signature is affixed on the text of the bylaws or the charter by each shareholder is legally immaterial. It would be inefficient for a public company to negotiate with each investor over the content of its governing documents, because of the enormous transaction costs involved; in a public stock exchange market, such negotiations would simply be unthinkable.

The existence of an arbitration clause in a company’s charter or bylaws does not warrant subjecting these contracts to higher scrutiny or imposing stricter disclosure requirements than corporate charters or bylaws that do not contain an arbitration clause. The unstated premise of such arguments is that arbitration is inherently unfair or inferior to litigation, a proposition strongly dismissed by the Supreme Court as erroneous.246

b. Foreign issuers and conflict of laws issues.

The above analysis would apply to public companies established under U.S. law. By contrast, if the arbitration clause is found in the constitutional documents of a company incorporated in a foreign land, then U.S. courts requested to enforce the clause would have to apply the New York Convention and determine whether there is “an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them.”247 Since the alleged arbitration agreement would not be “entirely between citizens of the United States,”248 issues of the contractual nature of the charter and enforceability of its provisions would have to be examined, first, through the prism of the New York Convention,249 and, second, according to long-standing U.S. conflict of laws principles, of the law of the company’s place of incorporation or, in the alternative, the law chosen by the parties to govern the company’s charter.250 That the law of the state of incorporation governs questions

246 Compare McDonald v. City of West Branch, Michigan, 466 U.S. 284, 290 (1984) (arbitration “cannot provide an adequate substitute for a judicial proceeding”) with McMahon, 482 U.S. at 227.

247 See New York Convention, supra note 7, Art. II(1) (emphasis added). This threshold is not too high. See, e.g., Bautista v. Star Cruises, 396 F.3d 1289, 1301 (11th Cir. 2005) (holding that the Convention does not impose upon the party seeking arbitration the burden of demonstrating notice or knowledgeable consent, because “[t]o require such an evidentiary showing . . . would be to make an unfounded inference from the terms of the Convention and would be squarely at odds with a court’s limited jurisdictional inquiry, an inquiry colored by a strong preference for arbitration;” the court decided to “abide by the general principle that one who has executed a written contract and is ignorant of its contents cannot set up that ignorance to avoid the obligation absent fraud and misrepresentation”).


249 Article II(2) of the New York Convention, supra note 7, defines “[t]he term ‘agreement in writing’ to include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.”

250 Although quite rare, it is not unprecedented for a company to include a choice-of-law clause in its charter: Article 154(b) of the articles of association of Royal Dutch
pertaining not only to the existence and the dissolution of a foreign corporation, but also to the rights and liabilities of corporate officers and shareholders, and the relations between each other and the corporate entity, is a rule with deep roots in Anglo-American law.251

A U.S. court, therefore, assessing the contractual character and the eventual validity of an arbitration clause in the charter of a Brazilian, Chinese, Chilean or Argentinean company whose ADSs are trading in a U.S. exchange market, would face a relatively easy task: the laws of those countries expressly authorize and, in Brazil’s case, mandate the inclusion in public company charters of arbitration clauses binding on all shareholders, who may, however, in the case of Chile and Argentina, reserve unabridged the right to bring their claims to a court.252 As the majority of the U.S.-listed foreign issuers examined in our Part II survey consists of Brazilian, Chinese and Chilean companies, U.S. courts may soon be called to decide the prima facie validity of charter-based arbitration clauses consistent with the laws of these three countries.

Ascertaining the contractual quality of an arbitration provision implanted in corporate bylaws would only be the first step of a U.S. court’s inquiry into its enforceability: even if construed to fulfill the requirement for “agreements in writing,” arbitration clauses in the founding documents of foreign companies would still be subject to scrutiny under Article II(3) of the New York Convention, which precludes enforcement of arbitration clauses that are “null and void, inoperative or incapable of being performed.”253 Parties keen on avoiding arbitration have used this exception to attack arbitration clauses in international

Shell PLC, for example, designates “the substantive law of England” as the articles’ governing law. See supra note 169.

251 See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 302(2) (concerning “Other Issues with respect to Powers and Liabilities of a Corporation,” i.e., matters involving the “relations inter se of the corporation, its shareholders, directors, officers or agents,” id. cmt. a), 306 (“Liability of Majority Shareholder”), 307 (“Shareholders’ Liability”), 309 (“Directors’ or Officers’ Liability”) (1971); notably, §§ 302, 306 and 309 (yet not 307) include the proviso that “in the unusual case where, with respect to the particular issue, some other state has a more significant relationship” to the parties and the corporation, then “the local law of the other state will be applied.” Among the more recent cases affirming the cardinal principle that the law of the state of incorporation governs intra-corporate affairs and relations among stakeholders, see, inter alia, Nagy v. Riblet Products Corp., 79 F.3d 572, 576 (7th Cir. 1996) (applying this principle to fiduciary duty claims); Central Kansas Credit Union v. Mutual Guar. Corp., 102 F.3d 1097, 1101 (10th Cir. 1996) (recovery of a member’s capital contribution); Fletcher v. Atex, Inc., 68 F.3d 1451, 1456 (2d Cir. 1995) (alter ego and veil-piercing allegations); Solow v. Stone, 994 F. Supp. 173, 177 (S.D.N.Y. 1998), aff’d, 163 F.3d 151 (2d Cir. 1998) (fiduciary duty claims). Cf. Schonfeld v. Hilliard, 62 F. Supp. 2d 1062, 1070 (S.D.N.Y. 1999), aff’d in part and rev’d in part on other grounds, 218 F.3d 164 (2d Cir. 2000) (disregarding the law of the state of incorporation, and applying New York law, the law chosen by the parties to govern the shareholders’ agreement, to shareholder’s fiduciary breach claims).

252 See infra Part IV (sections A, B, and D).

253 See New York Convention, supra note 7, Art. II(3).
agreements on grounds of contractual validity, unconscionability and public policy, i.e., in much the same way as § 2 of the FAA, which allows for ordinary contractual defenses against arbitration agreements\textsuperscript{254} – but, again, to no avail.\textsuperscript{255}

The major problem with Article II(3) is, evidently, its ambiguity: it is not clear to which law a national court would resort to examine the potential “null[ity] and void[ness]” of an international arbitration agreement. Several solutions to this ambiguity have been put forward over the years; most of them converge on the application of the \textit{lex fori}.\textsuperscript{256} It could also be plausibly argued that, if arbitration agreements are to be “placed on the same footing” as other contracts,\textsuperscript{257} conflict of laws rules applicable to all contracts would govern the validity of arbitration pacts under the New York Convention, too. In other words, the law elected by the parties to govern the contract containing the arbitration clause (in our hypothetical, the foreign company’s charter) would prevail over competing legal systems, including the \textit{lex fori}; absent a designation by the parties, the court would apply the contract law of the place/country bearing the closest relationship with the agreement in question.\textsuperscript{258}

U.S. courts, however, have kept away from beaten jurisdictional and doctrinal paths, opting instead for a teleological construction of the Article II(3) exception, consistent with the overall purposes and the spirit of the New York Convention, and unburdened by national parochialism. The prevailing view is that an international arbitration agreement may be declared “null and void” only “(1) when it is subject to an internationally recognized defense such as duress, mistake, fraud, or waiver, or (2) when it contravenes fundamental policies of the forum state.”\textsuperscript{259} Article II(3) is interpreted circumspectly to introduce a narrow exception

\textsuperscript{254} See 9 U.S.C. § 2, supra note 240.

\textsuperscript{255} See, \textit{inter alia}, Rogers v. Royal Caribbean Cruise Line, 547 F.3d 1148, 1157-59 (9th Cir. 2008) (entertaining and rejecting unconscionability and public policy defenses against enforcement of arbitration agreement under the New York Convention); Sandvik v. Advent Int’l Corp., 220 F.3d 99, 105-110 (3d Cir. 2000) (examining and rejecting, under the separability doctrine, a claim of fraud in the execution of an international business sale contract; fraud had been asserted against the enforcement of the arbitration clause contained in the sale contract). See also infra note 259.

\textsuperscript{256} See, e.g., Leonard Quigley, \textit{Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards}, 70 \textit{Yale L. J.} 1049, 1064 (1961) (“Presumably, the law specified by the parties in their agreement should govern. Absent such a specification, the forum state might look to its own law and policy, or to the law of the place of execution of the agreement, or to the law of the place where the dispute arose”); Paolo Contini, \textit{International Commercial Arbitration}, 8 \textit{Am. J. Comp. L.} 283, 296 (1959) (suggesting the application of the \textit{lex fori}, including forum choice-of-law principles).

\textsuperscript{257} See H.R. REP. No. 69-96, 1, 2 (1924).

\textsuperscript{258} See \textit{RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 187, 188, 219 (1971)}.

\textsuperscript{259} Rhone Mediterranean Compagnia Francese Di Assicurazioni E Riassicurazioni v. Lauro, 712 F.2d 50, 53 (3d Cir. 1983) (discussed in Case Note, 78 \textit{Am. J. Int’l L.} 217 (1984)). See also Riley v. Kingsley Underwriting Agencies, Ltd., 969 F.2d 953, 959-60
to the presumptive enforceability of arbitration agreements falling within the ambit of the New York Convention. This presumption is almost insurmountable:

Neither the parochial interests of the forum state, nor those of states having more significant relationships with the dispute, should be permitted to supersede that presumption. The policy of the Convention is best served by an approach which leads to upholding agreements to arbitrate.260

This supra-national approach to Article II(3) unquestionably increases the chances that arbitration provisions in foreign companies’ constitutional documents would be judicially enforced in the U.S. Presented with charges of unconscionability or allegations of public policy breaches, U.S. courts would not hesitate to uphold such agreements, perhaps more willingly than similar agreements in the bylaws of domestic companies. And if the foreign company is incorporated under the laws of a country that favors the arbitrability of intra-corporate disputes – as most of the ADS-issuers currently listed on U.S. stock exchanges are261 – the case for arbitrability of intra-corporate disputes is even more solid.262


260 Rhone Mediterranee, 712 F.2d at 54. See also Riley, 969 F.2d at 960 (“[the federal pro-arbitration] policy and the policy of signatory nations to the [New York] Convention . . . presumes the enforceability of arbitration agreements”). This presumption exists because, as the Supreme Court eloquently put it in Scherk:

A parochial refusal by the courts of one country to enforce an international arbitration agreement would . . . invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages. . . . [T]he dicey atmosphere of such a legal no-man’s-land would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements.

Scherk, 417 U.S. at 516-17.

261 See supra Part II, Table A (most ADS-issuers currently trading in the U.S. hail from China, Brazil or Chile).

262 For an in-depth, comparative presentation of the conflict of laws issues relating to the enforcement of an arbitration clause in a public company's charter, from the standpoint of various common-law and other jurisdictions, see Perry Herzfeld, Prudent Anticipation? The Arbitration of Public Company Shareholder Disputes, 24 ARB. INT’L 297 (2008).
Nevertheless, as the next section shows, the use of classic contract law analytical tools may not necessarily be the sole way to resolve the riddle examined in this essay.

c. *In re Salomon*

In 1994, a Manhattan district court called into question the relevance of an analysis evaluating the enforceability of an arbitration clause in a public company’s charter or bylaws from a purely contractual viewpoint. In an unreported decision in *In re Salomon*, Judge Patterson of the Southern District of New York surprisingly ruled, invoking well established corporate law principles, that shareholders of public companies may be forced to arbitrate their claims against corporate executives even in the absence of an arbitration provision in the company’s governing documents.

The judge, in particular, stayed the trial of a shareholder derivative suit against directors and officers of Salomon Brothers and its parent company and, for the first time in American jurisprudence, referred to arbitration claims of fiduciary breaches and securities laws violations asserted against directors of publicly traded companies. The court’s reasoning was stunning: arbitration was compelled on the basis of an arbitration provision in the NYSE constitution and listing rules, by which Salomon Brothers had contracted to abide as a precondition to registration. Since in a derivative suit the corporation is “suing in its own right,” the court held that the dispute arose essentially between the company and its directors, who were “allied members” of the NYSE:

Because Salomon Brothers was a member of the NYSE and the Individual Defendants [i.e., its directors and officers] were allied members and a registered representative [of the NYSE], and because the parties agreed to arbitrate the claims that arise “out of the business of such member, allied member or member organization,” . . . this Court finds that the Individual Defendants and Salomon Brothers agreed to arbitration of the claim brought on behalf of Salomon Brothers.

The court also referred to arbitration claims asserted in a double derivative capacity by shareholders of Salomon Brothers’ parent company, Salomon Inc., against directors of the daughter company. Although not a NYSE member itself, Salomon Inc. was bound by the arbitration provision in the NYSE constitution, because of its congruence with its daughter’s interests. “The fact that Salomon Inc. . . . ha[d] executed no written agreement to abide by the NYSE Constitution and rules does not mean that it may not be required to arbitrate,” wrote the judge. Applying “ordinary contract principles [to] determine who is bound by

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264 *Id.* at *4.
265 *Id.* at *3.
266 *Id.* at *5.
[the arbitration clause],”267 the court concluded that Salomon Inc. “must be bound by [its subsidiary’s] agreement to abide by the arbitration provision in the NYSE Constitution and rules,” as it was “thoroughly enmeshed in the underlying dispute.”268 Having invoked precisely this close relationship between Salomon Inc. and Salomon Brothers to “assert claims in a judicial forum,” held the judge, “Plaintiffs may not now eschew that relationship to avoid arbitration.”269

The follow-up to Judge Patterson’s revolutionary ruling was disappointing: the NYSE Arbitration Department declined jurisdiction over the dispute, remarking the exoticness of derivative litigation to the NYSE arbitration mechanisms and the non-consensual character of the proceeding.270 This phase of the litigation ended ingloriously, when the Second Circuit affirmed the district court’s subsequent refusal to appoint a substitute arbitrator.271

The paramount significance of Judge Patterson’s decision remains, however, undiminished: for the first time a court circumvented the main obstacle to derivative arbitration, i.e., the difficulty in conceptualizing a valid arbitration agreement between the corporation and its shareholders. Reliance on the NYSE constitution and the listing rules per se would suffice to oblige public shareholders to arbitrate claims against corporate executives, if the NYSE had not rushed to amend its constitution to preclude arbitration of derivative causes of action and class disputes.272 That reasoning, in fact, could apply with equal force to domestic and foreign issues.

Even so, the ruling’s moment is not limited to the contours of derivative actions held arbitrable under a provision in the exchange market’s constitution. The Salomon court not only enforced an arbitration clause exogenous to the defendant corporations’ founding documents against non-signatory shareholders, apparently overcoming concerns about consent and notice, but also rejected the contention that derivative suits were unsuitable for arbitration because of the public interest in having such claims resolved by courts.273 The court’s categorical dismissal of public policy arguments and concerns about consent could, then, apply a fortiori in the context of other intra-corporate controversies – e.g. direct actions for dividends – as well as cases arising under the New York Convention, if arbitration is compelled pursuant to an agreement embedded in the (foreign or domestic) company’s own governing documents, to which shareholders have direct access.

267 Id. (internal quotation marks and citations omitted).
268 Id.
269 Id. at *6.
271 Id. at 557-58 (refusing to decide in the abstract “whether shareholder derivative suits are arbitrable”).
272 See supra note 34.
273 1994 WL 533595, at *6-8. The district court acknowledged the soundness of the public policy arguments against the arbitrability of derivative claims, “particularly, as in this case, when the stockholders did not individually sign or approve agreements to arbitrate,” id. at *6, but concluded that the jurisprudence of the Supreme Court on this issue, too, was well-settled. Id. at *8. See also infra notes 306-309 and accompanying text.
2. **Scope**

Recognition of contractual validity is not the end of our legal inquiry. Assuming the validity of the clause, arbitration would only be compelled if the clause engulfs the controversy at bar (*ratione materiae* inquiry), and binds the specific litigants (*ratione personae* inquiry).

As to the subject matter scope of the arbitration agreement, the canon *in dubio pro arbitratione*, a corollary to the federal pro-arbitration policy, serves as the guiding principle. Doubts about the applicability of valid arbitration agreements to a given dispute “should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or a . . . defense to arbitrability,”unos “unless it may be said with positive assurance that the arbitration clause is not susceptible of [such] an interpretation.” Naturally, judicial construction of arbitrators’ competence cannot ignore the wording of the provision, which reflects the parties’ intentions: narrowly phrased clauses encompass disputes “arising out of” the contract containing the clause, broadly worded clauses, by contrast, extend to “any controversy or claim arising out of or relating to” the contract, “whether or not they implicate interpretation or performance of the contract.”

As to the personal reach of the clause, two themes are worthy of further exploration: first, the extent to which the arbitration agreement would bind non-signatories to the bylaws or the charter, such as non-shareholding directors and managers of the company or its parent, second, whether such a provision would

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275 *Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25. See also ACE Capital Re Overseas Ltd. v. Cent. United Life Ins. Co., 307 F.3d 24, 29 (2d Cir. 2002).


278 *Sweet Dreams Unlimited, Inc. v. Dial-A-Mattress Int’l, Ltd.*, 1 F.3d 639, 642 (7th Cir. 1993) (internal citation omitted) (emphasis in original).

279 See *Bridas S.A.P.I.C. v. Gov’t of Turkmenistan*, 345 F.3d 347, 355-56 (5th Cir. 2003) (recognizing six theories as bases for applying an arbitration agreement to non-signatories: incorporation by reference; assumption; agency; veil-piercing/alter ego; equitable estoppel; and third-party beneficiary); *Anthony DiLeo, The Enforceability of Arbitration Agreements By and Against Nonsignatories, 2 J. Am. Arb. 31 (2003); Around the State: Nonsignatory Parties and the Obligation to Arbitrate, 13 *World Arb. & Med. Rep.* 296 (2002); Judicial Decisions: Nonsignatory Compels Arbitration on Estoppel
also cover disputes stemming from circumstances that contest a disputant’s standing as a shareholder and, thus, her ability to invoke the provision at all. Variations are discussed below.

Directors. Even if the arbitration clause encompasses disputes among the corporation, its shareholders and managers, an argument can be made against the applicability of the clause to directors and officers who do not own company stock and thus have not technically adhered to the company’s constitutional documents. The argument is not difficult to counter: intimately enmeshed as they are in the company’s operations more than other corporate actors and charged with protecting shareholders’ interests, directors and officers are bound by the company’s governing documents under basic agency principles, and it would be a travesty to exempt them from the ambit of a charter/bylaw-based arbitration provision. To avoid problems of this nature, however, directors’ and managers’ employment contracts could either include a separate arbitration clause – explicitly covering disputes between them and the company or its shareholders – or incorporate by reference the arbitration agreement in the corporate constitution.

Parent Companies. A more perplexing non-signatory hypothetical would involve claims asserted by a company’s shareholders against the directors of the company’s parent company, i.e., its primary shareholder. The binding nature of the arbitration clause on the parent company itself is not questionable, given the parent’s capacity as shareholder of the daughter and thus signatory to the daughter’s basic documents. The question is whether the daughter’s shareholders would be able to haul to arbitration the parent’s directors, who did


280 Agency is “the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.” See RESTATEMENT (SECOND) OF AGENCY §§ 1(1) & 14C, Comment a (1958) (board of directors resembles both agent and non-agent trustees).

281 See Arnold v. The Arnold Corp.-Printed Communications for Bus., et al., 920 F.2d 1269, 1281-82 (6th Cir. 1990) (holding corporate officers entitled to arbitration as agents of the corporation, because, otherwise, claimants could “nullif[y]” the arbitration agreement by suing non-signatories); Letizia v. Prudential Bache Securities, Inc., 802 F.2d 1185 (9th Cir. 1986) (brokerage firm employees held bound by arbitration clause signed by the firm).

282 See Shell, supra note 22, at 552 (“the binding nature of the corporation’s basic documents on officers and directors is well-settled”) (citing Golden v. Oahe Enter., 240 N.W.2d 102, 108 (S.D. 1976)).

283 The most common scenario in the case law is an arbitration agreement between the daughter company and a third party, invoked by or against the parent company. See Compagnie Noga D’Importation et D’Exportation, S.A. v. Russian Federation, 361 F.3d 676, 683 (2d Cir. 2004); Insituform Technologies, Inc. v. CAT Contracting, Inc., 385 F.3d 1360, 1375 (Fed. Cir. 2004). Westmoreland v. Sadoux, 299 F.3d 462, 467 (5th Cir. 2002); Hill v. Gen. Elec. Power Sys., Inc., 282 F.3d 343, 348 (5th Cir. 2002); MAG Portfolio Consultant, GMBH v. Merlin Biomed Group LLC, 268 F.3d 58 (2d Cir. 2001).
not assent, directly or indirectly, to any provision in an affiliate company’s
governing documents, but who might have taken management decisions adversely
impacting the daughter.

The answer is arguably yes – if the asserted causes of action arise from
breaches of fiduciary duties the parent owes the daughter’s minority shareholders
as a controlling shareholder. As agents of the parent company, the parent’s
directors are subject to the arbitration agreement binding their principal with
respect to its shareholding in an affiliate.284 Conversely, because of the close
parent-daughter association, the parent’s shareholders would also be bound by an
agreement to arbitrate claims brought against the daughter company’s directors
and officers in a double derivative capacity, on behalf of the parent – In re
Salomon leaves no doubt about that.285

Shareholder Standing. Claims by shareholders suffering a loss upon entering
or exiting the firm, i.e., before or after they become shareholders, present more
puzzling questions. One can imagine three relevant scenarios: first, where, owing
to management misrepresentations, stockholders are fraudulently induced to sell
their interest in the company at a price lower than the fair market price; second,
where imperfect disclosure prompts investors to buy stock at a price exceeding its
real value; last, a variation of this second scenario – where the stock purchase of
shares is defective, even void, because the purchased shares are issued in violation of
charter or bylaws provisions, e.g., those conferring preemption rights upon current
shareholders. Would the good faith purchaser be then obliged to seek redress in
arbitration, according to the bylaws of a company she never validly joined?

In all hypotheticals, the aggrieved party could be said to lack “shareholder”
status at the time when the complaint would be filed (first scenario) or the cause of
action would arise (second scenario) or at both times (third scenario – since the
purchase would be null ab initio); hence, a mighty argument could be made that the
arbitration clause does not apply. The opposite can also be argued: since the link
between the injured party and the corporation was wrongfully created, lost or never
established as a result of faulty actions by the company’s agents, the controversy
“arises out of” or “relates to” ownership (perfected or attempted) of a company
stake, and thus properly falls within the scope of a broadly worded arbitration
agreement inscribed in the bylaws. The ultimate challenge for courts or tribunals
would be to determine the point in time when shareholder status will be crystallized
for standing purposes. Provided that the parties have not tackled the issue in the
bylaws, options include (1) the filing of the complaint; (2) the occurrence of the
actions complained of; or (3) both.

The last would probably be most desirable. Broadly construing the arbitration
clause as applicable to all disputes between the company and its putative or former
shareholders, would have the advantage of bringing факtually related differences

284 See Pritzker v. Merrill, Lynch, Pierce, Fenner & Smith, 7 F.3d 1110, 1121 (3d Cir.
1993) (compelling arbitration of customers’ claims against both their brokerage firm and
its sister corporation, its employees and agents).
285 See text accompanying notes 266-69 supra.
to the same forum. Although it might be a stretch to allege that aggrieved investors whose participation in the company was either never effected or cancelled retroactively (in the second and third paradigms above) enjoyed shareholder status when suffering the injury, it would not be unreasonable to still interpret the share purchase agreement as an expression of unmistakable intent to abide by the corporation’s governing documents. Whether that intent was irreparably tainted by the defect of the entire transaction would have to be resolved by the decisionmakers. If the defect, though, leaves intact investors’ specific intent to adhere to the arbitration pact, then, under the separability doctrine, the arbitration agreement should stand.\footnote{See Hans Smit, Judicial Review of an Arbitral Finding of Lack of Competence, at 4-8 (on file with the author). The investor disputes discussed here bear a strong resemblance to disputes relating to the dissolution of non-public companies, which, as previously noted, would be arbitrable under the corporate charter, despite their “extra-contractual” nature. See supra note 212.} That intention suffices to establish a valid meeting of the minds required for a binding agreement to arbitrate.

3. The Public Policy Debate

The last – and most vexing – part of the inquiry into the enforceability of charter/bylaws-based arbitration agreements turns to public policy concerns and other constraints on the enforcement of the arbitration clause, exogenous to the clause itself. “Like any statutory directive, the [FAA’s] mandate may be overridden by a contrary congressional command.”\footnote{Shearson/Am. Exp. v. McMahon, 82 U.S. 220, 226 (1987).} Congressional intent to carve out particular classes of disputes from the FAA’s scope and render them non-arbitrable could thus preclude enforcement of any arbitration agreement with respect to those matters. Such intent may be discerned from (1) the text of a statute; (2) its legislative history; or, importantly, (3) the finding of “an inherent conflict between arbitration and the statute’s underlying purposes.”\footnote{Id. at 227.} Since there are currently no statutes explicitly or implicitly excluding the arbitration of matters involving the relationship between public companies and their shareholders, the question in the case of intra-corporate arbitration would be whether policies underpinning other statutory schemes clash with and prevail over the FAA’s favor arbitration.

The relevant inquiry would not differ substantially if the arbitration agreement were included in the charter of a foreign corporation: as noted above, public policy challenges have been leveled against international arbitration agreements under Article II(3) of the New York Convention.\footnote{See supra note 255.} The “null and void” language in that article would be triggered by allegations that enforcement of an arbitration agreement
agreement in a foreign issuer’s constitution “contravenes fundamental policies of the forum nation.” The “fundamental policies” test is a rough equivalent of the “inherent conflict” test applied under the FAA: the question in both cases is whether a compelling policy imperative would require the resolution of certain categories of disputes by judges, not arbitrators.

In the good old Wilko era, courts would not hesitate to detect policy conflicts as a last line of defense against the shift of statutory causes of action to arbitration. Claims asserted under the antitrust or securities laws, RICO, and other “sensitive” statutes were held inappropriate for private adjudication, because of “the pervasive public interest in [the] enforcement” of statutes embodying vital values. A jurisprudential “Chinese wall” would shield courts’ exclusive competence to decide “mandatory” law claims.

Despite Wilko’s fall, similar judicial skepticism over arbitration could derail attempts by public company shareholders and boards to insert an arbitration clause.

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290 See supra note 259 and accompanying text.
295 See American Safety Equipment, 391 F.2d at 826-27 (holding antitrust claims non-arbitrable, because of the plaintiff’s role as “private attorney-general who protects the public’s interest”); Cobb, 488 F.3d at 47. According to Robert Pitofsky, antitrust claims were particularly unfit for arbitration because of the (then) unavailability of treble damages in arbitration, which would impair the role of private attorneys general in antitrust enforcement. See Robert Pitofsky, Arbitration and Antitrust Enforcement, 44 N.Y.U. L. REV. 1072 (1969). See also Lee Loevinger, Antitrust Issues as Subjects of Arbitration, 44 N.Y.U. L. REV. 1085 (1969). Commenting on the then well-entrenched judicial reluctance to the arbitration of antitrust claims, Judge Feinberg pointedly wrote “[s]ince judges are human beings – I trust there is majority support for that proposition – they are understandably not anxious to turn over the power to decide to a person who is not a judge and perhaps not a lawyer.” Wilfred Feinberg, Arbitration and Antitrust – An Introduction, 44 N.Y.U. L. REV. 1070 (1969).
provision in the company’s governing documents and entrust intra-corporate disputes to private decisionmakers. The societal value of certain procedural mechanisms like class actions, and the unique institutional role of corporate law remedies like derivative suits, could be invoked to justify the categorical exclusion of corporate causes of action from the spectrum of arbitrable subject matters.

That corporate law disputes arise primarily under state law would be fatal to such public policy challenges. As the FAA’s federal pro-arbitration policy preempts contrary state policies, absent a federal statute reflecting clear congressional intent to refute the arbitrability of intra-corporate controversies, arbitration agreements could not be set aside on state policy grounds.

As to those federal statutory claims that could touch upon the relationship of public companies and their shareholders (e.g., antitrust or securities claims) contentions about their inherent non-arbitrability have been rejected by the Supreme Court: the trilogy of Mitsubishi Motors, McMahon, and Rodriguez de Quijas, along with other cases, abolished the judicial monopoly over disputes of supposedly “public” character. The ordre public defense to arbitration is not dead yet, but has been limited to rare instances of explicit or implied congressional intent to exclude arbitration. Since the application of “mandatory” law by arbitrators has so far raised no problems, there is no indication that Wilko is about to be resurrected.

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297 See James D. Cox, The Eighth Abraham L. Pomerantz Lecture: The Social Meaning of Shareholders Suits, 65 BROOKLYN L. REV. 3 (1999). By contrast, the In re Salomon court explicitly rejected public policy challenges to arbitration based on Federal Rule 23.1 (setting forth the procedural requirements for derivative actions) because the Rules “are not statutes enacted by Congress,” thus do not reveal congressional intent to supersede the FAA. In re Salomon, 1994 WL 533595 at *7.

298 Southland, 465 U.S. at 10; Shell, supra note 22, at 539-40.

299 See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 639 n.21 (1985) (“We decline to subvert the spirit of the . . . [New York] Convention by recognizing subject-matter exceptions where Congress has not expressly directed the courts to do so”).

300 See supra note 192.

301 See supra note 194.


303 See William Park, Private Adjudicators and the Public Interest: The Expanding Scope of International Arbitration, 12 BROOK. J. INT’L L. 629 (1986); see also supra notes 287-88.

More recently, two path-breaking cases, *In re Salomon* (of which much has been said above) and *Green Tree Financial Corp. v. Lynn W. Bazzle*,305 have potently retorted to public policy objections to intra-corporate arbitration – the first, by rejecting, and the second, by largely ignoring their rationale. The *In re Salomon* court, in particular, “hit the nail on the head.”306 Despite acknowledging that arbitration of derivative claims “could undermine the deterrent and remedial effectiveness of the shareholders’ derivative action, by . . . depriving shareholders of the right to [jury trial] . . . eroding the scope of judicial review . . . and limiting the . . . right to liberal discovery,”307 the court there ordered arbitration, for want of traces of congressional intent to preclude derivative arbitration. “[T]he Federal Rules of Civil Procedure,” Judge Patterson wrote, “cannot provide a basis for finding agreements to arbitrate . . . derivative suits unenforceable,” because, quite simply, they “are not statutes enacted by Congress.”308 The Supreme Court’s unequivocal denunciation of public policy arguments left the district judge with little choice but to enforce the arbitration clause, lest it “engage in an ‘indefensible brand of judicial activism.’”309

In *Bazzle*, the Court opined on a controversial issue that had previously tormented, and continues to stir controversy, in federal and state courts: the arbitrability of class-wide claims.310 The Court in *Bazzle* finally held that the FAA did not foreclose class arbitration *in principio*, unless the parties explicitly excluded class actions from the reach of their agreement. In a case arising out of a homeowners’ class action against a commercial lender under South Carolina consumer protection law – which state courts had allowed to proceed as an arbitration – a plurality of the High Court ruled that “what kind of arbitration proceeding the parties agreed to” was a question of “contract interpretation,”

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308 Id. at *7.
309 Id. at *8 (quoting *Rodriquez de Quijas*, 490 U.S. at 486) (also noting that “the Court harbored considerable doubt as to the suitability of [derivative] arbitration”).
reserved for “the arbitrator, not the courts.”

Although the Justices bypassed the thorny question of the general compatibility of class actions with arbitration, they intimated that no overriding federal policy would prohibit classwide arbitrations per se: instead of “declaring [class arbitration] unavailable as a matter of law,” the plurality deferred to the parties’ agreement, interpreted under state law, suggesting that class proceedings are “consistent with the FAA.”

Even the dissent aimed its criticism at the technical issue of who should decide arbitrability, conceding that the parties could validly opt for class arbitration.

Since most shareholder claims (derivative or direct) require class proceedings, *Bazzle* removed the last obstacle to intra-public company arbitration. Heeding the ruling, the American Arbitration Association adopted Supplementary Rules for Class Arbitrations to govern proceedings initiated under any agreement not specifically precluding classwide arbitration. In fact, currently pending before the AAA and conducted pursuant to its Supplementary Rules is a shareholders’ class action that arose under circumstances germane to the hypothesis examined here. Harvard College started the class arbitration against JSC Surgutneftegaz, a Russian issuer of privately distributed ADSs, demanding compensation for the issuer’s failure to pay dividends to preferred shareholders. The complaint was filed on behalf of all ADS-holders under an arbitration clause in the deposit agreement between the issuer, the holders and the depository bank.

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313 *Bazzle*, 539 U.S. at 459 (admitting that “the FAA does not prohibit parties from choosing to proceed on a classwide basis”). The dissent in *Bazzle* stated that the courts were to decide “what to submit to arbitrators” in the case of a silent agreement. *Id.* at 456 (citing *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 945 (1995)).


317 Similarly worded to the arbitration clause that gave rise to the Surgutneftegaz arbitration is the clause found in the deposit agreement entered into by the Mechel Steel Group, the Russian issuer of our survey, and the U.S. depository of its U.S.-traded ADSs.
In 2005, Judge Casey of the Southern District of New York rejected Surgutneftegaz’s assertions that the arbitration agreement was unenforceable on public policy grounds, because of international comity and the elemental non-arbitrability of disputes pertaining to internal corporate management.318 In a meticulous opinion, the judge dismissed the notion that “particular areas of law are not arbitrable” absent congressional direction in that regard,319 and held that international comity concerns “counsel in favor of enforcing international arbitration agreements,”320 especially in light of the New York Convention’s broad mandate that arbitration agreements be enforced.

More to the point, however, was the arbitral tribunal’s pioneering (and now confirmed) jurisdictional ruling that the case could proceed as a classwide proceeding, despite – or, probably, because of – the agreement’s silence on the matter.321 Resonating Bazzle, the two-arbitrator majority pointed to the broad ambit of the clause and the explicit submission of securities claims to arbitration. Formal class certification was postponed, but the tribunal intonated that shareholder class actions are not antonymous to international arbitration.322

The appositeness and importance of this ruling cannot be overstated. Surgutneftegaz, unlike the hypothetical examined in this article, is not trading publicly in the U.S., but, after the removal of the most serious public policy barriers, arbitration of disputes between ADS-holders and exchange-listed foreign issuers is only a legal step away. Bazzle and Surgutneftegaz have cleared the way for the enforcement of agreements mandating arbitration of all conceivable intra-corporate causes of action – from classwide derivative actions to direct shareholder claims arising out of internal operations.

* * *

Measured against established jurisprudential benchmarks, objections to the arbitrability of disputes bearing on the relationship between public companies and their shareholders are untenable. The case for the enforcement of arbitration clauses engrafted in corporate constitutions is well-grounded in the “broad principle of enforceability”323 established by the FAA and cemented in the Supreme Court’s jurisprudence. The Court’s ground-breaking 1980s rulings and their progeny militate in favor of the ability of public shareholders to experiment with ADR.

See supra note 137 and accompanying text. It might not be long, therefore, before a Surgutneftegaz-type arbitration scenario plays out in the public company context.

319 Id. at *14 (citing Mitsubishi, 473 U.S. at 639 n.21).
320 Id. at *11 (emphasis on original).
321 Arbitration of Securities Claims Directed to Proceed as a Class Action Based on Deposit Agreement Governing American Depositary Receipts, Sept. 2007 Memorandum, http://www.skadden.com/content%5CPublications%5CPublications1314_0.pdf.
322 Id.
Fueled by a long rejected mistrust of arbitration and resting on the misperception that arbitration poses a grave threat to the rights of parties in a weak negotiating position, the proposed Arbitration Fairness Act would reverse, if enacted, years of precedent and corresponding societal reliance. Fears that a shift to a contract-based system of adjudication would halt the judicial production of binding corporate law norms, or be advantageous to the big guys because of arbitrators’ defiance of “public” law, and overt partiality to corporate insiders, have been negated in fields where arbitration was introduced and corporate law has been no exception.

Interestingly, while public sentiment and the political climate in the U.S. remain inimical to arbitration, developing nations have been eager to board the ADR train in an effort to prove their pro-business credentials. The following section exposes these nations’ responses to the same questions presented here.

IV. LESSONS FROM ABROAD: FOREIGN DEVELOPMENTS

Discussion of public shareholder arbitration in this paper does not take place in a vacuum. The preceding section presented recent legal developments reinforcing the case for the enforcement of arbitration clauses in corporate charters and bylaws, and the survey in Section III documented signs of a trend among mainly foreign public companies to arbitrate differences with their shareholders. Even closer to the point is the legal regime on public shareholder arbitration in jurisdictions from which hail most issuers identified in the survey. Driven by the urge to improve their appeal as hospitable investment destinations, China, Chile and Brazil have subscribed to the scenario hypothesized here, readily validating arbitration agreements in the realm of public companies.

It is not difficult to envision why emerging economies would overlook considerations that have impeded the assimilation of ADR techniques into shareholder-oriented Western corporate governance models. Allowing (China), encouraging (Chile), or even mandating (Brazil) the settlement of intra-company controversies in non-judicial fora is part and parcel of strategies to foster a legal climate attractive to foreign investors seeking an alternative to often discredited national judiciaries.324 The popularity of treaties like the 1958 New York

Convention or the 1965 ICSID Convention among developing nations, and relaxation of domestic norms to allow contractual opt-out of mandatory dispute resolution procedures, are signals of alignment with “superior” Western corporate practices. The arbitration of disputes between public corporations and their often foreign-domiciled shareholders is introduced in emerging economies both as acknowledgement of endemic deficiencies and as a perquisite to investors possibly estranged by the prospect of having their claims decided by a foreign court under foreign law. Brazil, the only country to compel issuers of certain market divisions to arbitrate internal controversies, exemplifies this paradigm.

Legal incentives are, certainly, one part of the story – political instability, lack of regulatory oversight and poor enforcement of contracts and property rights may mar the appeal of a governance regime that allows arbitration as much as a regime that does not. Given the complex interaction between corporate law and economic performance, the following presentation of foreign written laws does not advocate automatic transplantation of foreign governance patterns as a cure to the ills of U.S. public markets.

It is true, however, that overseas developments inevitably resonate within the U.S., where the securities of many foreign issuers are trading. And if other nations have been relatively successful in re-boosting investor confidence by deferring to private parties’ free choices, there is little reason not to take advantage domestically of party autonomy, a bedrock principle of common law, to afford U.S. companies as wide a range of options as foreign issuers enjoy. In that light should be seen the following lay-out of the law on intra-corporate arbitration in Brazil, China, Chile, Argentina and Italy. The first three jurisdictions were selected because 34 out of the 40 U.S.-listed (foreign and domestic) issuers of publicly trading securities with an arbitration clause in their founding documents, as of the conclusion of our survey, are Chinese, Chilean or Brazilian companies; Argentina was selected because of the similarity of its system to that of Chile. Italy, on the other hand, remains the sole Western country to have

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326 Economic studies conducted in the late 1990s, before the modernization of the Brazilian corporate governance regime, revealed that judicial inefficiency inhibited economic growth. See, e.g., Armando C. Pinheiro & Célia Cabral, Credit Markets in Brazil: The Role of Judicial Enforcement and Other Institutions, Inter-American Development Bank, Working Document R-368 (June 1999), available at http://www.iadb.org/res/publications/pubfiles/pubR-368.pdf (finding that the lack of proper judicial enforcement of contract and property rights has a significant negative impact on the ratio of credit to GDP and, thus, on the development of credit markets and economic growth in general).


328 See supra Part II, Table A.
officially addressed and expressly prohibited, by legislation, the enforceability of arbitration agreements in the public company sphere.

A. Brazil

Along with many continental nations, Brazil was an early pioneer of intra-corporate arbitration. Its 1850 Commercial Code would command the compulsory submission to arbitration of all intra-corporate conflicts. That dictate was, however, later declared unconstitutional and after 1867, pre-dispute arbitration agreements were demoted to promissory instruments, lacking binding force. Hostility to arbitration persisted for much of the 20th century, until the tide turned in the mid-1990s. Embracing the tenets of international commerce, Brazil enacted a modern arbitration law that recognized the effectiveness of and provided mechanisms for the enforcement of arbitration agreements, while also removing the requirement that arbitral awards be subject to de novo review on the merits by courts. Upheld as constitutional by the Supremo Tribunal Federal in 2001, the law inaugurated a period of widespread acceptance of arbitration, which led Brazil to join, in 2002, the chorus of adherents to the New York Convention, in a noticeable departure from prior practice. The institutional infrastructure

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329 The comparative presentation in this article is, of course, not exhaustive. For other examples of statutory regulation in this area see Herzfeld, supra note 262, at 302-303 and fns. 39-40 (discussing Section 4 of the Finnish Arbitration Act and Article 581(2) of the recently amended Austrian Code of Civil Procedure).


improved too. In 2001, the Sao Paulo Stock Exchange (“Bovespa”)334 established a center for the administration of commercial arbitration disputes, the Market Arbitration Panel (“CAM”), modeled after the arbitration department of the National Association of Securities Dealers.335

The defining moment came in 2002, when the Law on Corporations was amended to explicitly allow public companies to incorporate arbitration agreements in their bylaws. Article 109 § 3 of the amended Law on Corporations categorically recognizes the validity of arbitration clauses inserted in corporate bylaws:336

The corporation’s bylaws may establish that any disputes between the shareholders and the corporation, or between the majority and minority shareholders may be resolved by arbitration under the terms specified by it.

Not long after the enactment of this provision, the Brazilian SEC (“CVM”)337 and the Brazilian Institute of Corporate Governance, a private market association, invited corporations to circumvent courts as a “good corporate governance practice.”338 Bovespa took the pro-arbitration enthusiasm one step further, by introducing a system of different listing segments for public companies (traditional, Nível 1, Nível 2, Novo Mercado), each corresponding to different governance undertakings, across a scale of voluntary adherence to incrementally


335 See Câmara de Arbitragem do Mercado, Regulamento de Arbitragem, http://www.camaradomercado.com.br/panelregulation.asp (translation). Other organizations (e.g., the Conselho Arbitral de São Paulo, www.caesp.org.br) sprang up to cover the demand for arbitration services.


338 Compare Code of Best Practices of Corporate Governance, Instituto Brasileiro de Governança Corporativa, March 2004, at § 1.9, translated at http://www.ecgi.org/codes/documents/ibgc_may2004.pdf (“Conflicts between owners, or between owners and the company, should preferably be settled by arbitration”) with CVM Recommendations on Corporate Governance, June 2002, Art. III.6, at 7, http://www.cvm.gov.br/ingl/indexing.asp (“The company’s by-laws should establish that divergences between shareholders and the company or between controlling shareholders and minority shareholders will be solved by arbitration.” (Emphasis added.)). Despite the non-binding nature of these recommendations, CVM required public companies to either comply or justify deviations in their public reports. Id. Cf. CVM Instruction 391 of July 16, 2003, Art. 2, §4(IV), at http://www.cvm.gov.br/ingl/indexing.asp (recommending the resolution of investment funds’ internal conflicts under the CAM Arbitration Rules).
stricter governance practices and transparency standards. Admission to Level 2 and Novo Mercado is contingent, inter alia, on the exclusive submission to arbitration, under the CAM rules, of all differences between the company, its shareholders and managers, and Bovespa itself.

These differentiated listing requirements are more rigid than those imposed by law. Compliance is undertaken voluntarily, as a contractual obligation and public statement of adherence to “good” governance practices. Issuers, however, cannot qualify for Level 2 and Novo Mercado listing unless they commit to abide by the respective listing rules and governance standards, which are as binding as the NYSE constitution and listing rules for companies listed thereon. Much like the In re Salomon ruling that a U.S. public company was bound by the arbitration provision in the NYSE constitution, Level 2 and Novo Mercado companies incur an obligation, pursuant to their listing agreement (contrato de participação), to arbitrate disputes with their shareholders under the auspices of CAM. To secure the compulsory character of arbitration, Bovespa regulations further demand that Novo Mercado companies insert an arbitration clause in their bylaws and effectively disclose it to shareholders. As additional precautions, senior managers, members of the fiscal council (a body similar to audit committees) and controlling shareholders must individually assent to the listing agreement and the CAM rules.

In no other country are public companies compelled by law, as a listing condition, to agree to bar shareholders’ access to courts. Yet Brazil’s unrivaled scheme of intra-corporate arbitration has not been without controversy. Although arbitration is widely applauded as efficient, the mandatory bar to litigation has been denounced as waiving constitutional rights without shareholders’ agreement. The prevailing view, though, holds that an

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339 See http://www.bovespa.com.br/Principal.asp (Empresas/ Governança Corporativa/ Comparativo Segmentos) (chart comparing the Bovespa segments, in Portuguese). A fifth division is Bovespa Mais (Bovespa Plus), which also mandates intra-corporate arbitration, but, as part of the BOVESPA Over-The-Counter (i.e., non-public) Market, is not discussed here.


342 See New Market Listing Regulation, supra note 340, Arts. 2.1, 3.1(iv), 6.1.2(ii), 6.4(vii) and 7.2(xvi).

343 Id. Attachments B, C & D, at 27-31; Level 2 Regulation, supra note 340, Attachments B, C & D, at 32-35.

344 See Nelson Eizirik, Some Remarks on Arbitration in Corporate Law, in ARBITRATION LAW OF BRAZIL, supra note 331, App. E-6-11 (proposing the execution of individual instruments of consent by each shareholder, in line with a similar provision of Italian law).
arbitration clause, like all bylaw provisions, binds shareholders whether or not they voted for it; unanimous adoption or individual declarations of consent are not necessary.\textsuperscript{345} There is also consensus that intra-company controversies meet the threshold of arbitrability set forth in the Arbitration Law, i.e., involve “freely disposable property rights.”\textsuperscript{346}

It is early to gauge the success of Brazil’s novel system of differentiated undertakings per market segment in refurbishing the country’s reputation as an investment destination, but what statistics show beyond doubt is the increasing popularity of the upper echelons of the market (Novo Mercado and Level 2), despite – or perhaps because of – the more rigorous obligations and the mandatory arbitration scheme a listing upgrade entails. As of May 2008, 99 companies were listed on the Novo Mercado and 19 on Level 2, up from a total of four listed in both in 2004.\textsuperscript{347}

Rational market players, for sure, do not espouse governance practices, unless these practices could positively affect investors’ perceptions of a company, thus enhancing the company’s prestige and market value. The inclusion of arbitration in the package of corporate law reforms has not tarnished the appeal of a listing in selective market divisions like the Novo Mercado or Level 2. The steep rise in the number of public companies zestfully pursuing a Novo Mercado or Level 2 listing attests to the substantial benefits companies reap by offering investors the advantage of even-handed, specialized dispute resolution mechanisms and depicting themselves as members of a corporate “elite,”\textsuperscript{348} as well as to investors’ responsiveness to improved corporate governance structures.\textsuperscript{349} Onerous though the network of overlapping contractual commitments may be, and despite the inevitable risks a professional, privatized dispute settlement system carries, companies seem willing to subscribe to more stringent governance standards than statutory law requires in exchange for a corporate image investors will reward. In

\textsuperscript{345} See MARCELO VILELA, ARBITRAGEM NO DIREITO SOCIETÁRIO 190-206 (2004).

\textsuperscript{346} See Eizirik, supra note 344, at E-11-14 (defining as arbitrable “everything that can be validly decided by the corporation”).

\textsuperscript{347} Data, per segment and year of listing, are available at http://www.bovespa.com.br/Home/Redirect.asp?end=/Companies/ExecutaAcaoConsultaNivelGovernanca.asp?nivel=nm&idioma=i. Among the Brazilian companies included in our survey (supra part III), five are listed on the Novo Mercado and four on Level 2; all of them disclose in their SEC filings, more or less fully, the obligation to arbitrate (see supra notes 147-48).

\textsuperscript{348} According to Bovespa, companies “complying with Novo Mercado rules should enjoy better stock pricing on the market, and, as a consequence, lower funding costs.” See Bovespa, http://www.bovespa.com.br/indexi.asp (Companies/Corporate Governance/FAQs/No. 10). See also Brazilian Petroleum Corporation, Annual Report (Form 20-F), at 21 (June 30, 2004) (“[T]hese . . . changes better position us to compete in a deregulated market”).

\textsuperscript{349} See Antonio Gledson de Carvalho, Effects of Migration to Special Corporate Governance Levels of BOVESPA, Jan. 2003, at 10, http://www.bovespa.com.br/pdf/usp_ingles.pdf (concluding that “voluntary migration has a positive impact on stock valuation” and “increases the trading volume and liquidity”).
any case, Brazil’s strong institutional preference for arbitration – a sharp contrast to the SEC’s ambivalence – is starting to pay off.\textsuperscript{350}

B. \textit{China}

Intra-corporate arbitration is not unknown in China. Although Chinese publicly owned companies do not bear a legal or contractual duty to arbitrate controversies with their shareholders and managers, Chinese law recognizes arbitration as a legitimate shareholder choice for the resolution of intra-corporate conflicts. Recognition is, however, not universal – Chinese law is much more explicit in its approval of ADR methods in the context of companies trading outside China.

In particular, shortly after the passage of the Arbitration Law in 1994,\textsuperscript{351} the Securities Office of the State Council and the State Commission for Restructuring the Economic System promulgated the “Prerequisite Clauses of the Articles of Association of Companies Seeking a Listing Outside the People’s Republic of China,” which became effective in December 1994.\textsuperscript{352} The regulation requires companies listed abroad to include certain clauses – either verbatim or with discretion as to the content – in their “articles of association” (bylaws). Dispute resolution is a subject companies must \textit{ex lege} address in their bylaws – although shareholders enjoy latitude in selecting the forum and formulating the exact language of the clause. Article 163 of the Prerequisite Clauses reads:\textsuperscript{353}

Disputes between holders of overseas listed foreign shares on the one hand, and the company, or its directors, supervisors, managers or other senior management personnel, or holders of domestic shares on the other, \textit{may be resolved} by methods stipulated by laws and administrative regulations, or \textit{by methods determined by mutual agreement};

and

Claims and disputes involving a company listed in Hong Kong (other than those relating to the share register and the definition of shareholders) \textit{are to be resolved}


\textsuperscript{353} \textit{See Editor’s Notes: The Articles of Association of Companies Seeking a Listing Outside the People’s Republic of China}, 9 \textit{China Law & Practice} 64 (May 1995).
by arbitration; at the option of the claimant, the arbitration body may either be
the China International Economic and Trade Arbitration Commission or the
Hong Kong International Arbitration Center. (Emphasis added)

Not unlike Article 109 of the Brazilian Corporate Law, this provision permits
companies listed on overseas exchange markets to refer intra-corporate
controversies to non-judicial fora, if the parties involved (the company, its
shareholders and managers) agree that arbitration is more suitable than Chinese or
foreign courts. Arbitration is mandatory for companies trading in Hong Kong.\(^{354}\)

Intriguingly, Chinese law affords this open-ended flexibility solely to
companies listed abroad and only in connection with controversies implicating
holders of their overseas shares. The regulation’s silence as to domestic
companies’ ability to contract out of the jurisdiction of Chinese courts leaves them
no room to experiment with ADR. This differentiation between Chinese issuers’
domestic and foreign-listed shares helps explain our survey’s finding of a
disparate treatment by Chinese FPIs of domestic and overseas-based
shareholders: the arbitration provision monotonously repeated in the bylaws of
Chinese FPIs only reaches controversies involving overseas shareholders;
domestic shareholders are exempt.

The dichotomy may reflect Chinese issuers’ efforts to relieve U.S.-based
investors from the pain of asserting their claims before inexperienced Chinese
courts, prone to favor the government in stand-offs with state-controlled
companies.\(^{356}\) This may also be the reason behind regulators’ approval of
arbitration in the context of overseas-listed companies and intention that purely
domestic conflicts be reserved for state courts. The benefit, nevertheless, for
ADS-holders, of an arbitration proceeding conducted in China, possibly under
Chinese law, seems dubious compared to such a proceeding – let alone a trial –
taking place in the U.S., under U.S. law.\(^{357}\)

It is noticeable, in any event, that the Prerequisite Clauses are the single
piece of legislation endorsing party autonomy, even in a limited fashion, in an
otherwise heavily regulated field. When Chinese corporate law was revamped

\(^{354}\) See generally GUANGHUA YU, COMPARATIVE CORPORATE GOVERNANCE IN CHINA:

\(^{355}\) See supra notes 151-52 and accompanying text.

\(^{356}\) See VAI IO LO & XIAOWEN TIAN, LAW & INVESTMENT IN CHINA: THE LEGAL &
BUSINESS ENVIRONMENTS AFTER WTO ACCESSION 316 (2005) (attributing the popularity
of arbitration among foreign investors to two reasons: “First, foreign investors tend to
doubt the quality of Chinese judges . . . Second, the [China International Economic and
Trade Arbitration Commission – “CIETAC”] appears to have more expertise than . . .
local courts.”).

\(^{357}\) Cf. Johnson Tan, A Look at CIETAC: Is it Fair & Efficient?, 17 CHINA LAW &
PRACTICE 24-26 (April 2003) (concluding that “CIETAC [arbitration] certainly has its
shortcomings . . . [Yet] misunderstandings cannot be taken to imply a general inadequacy
of CIETAC itself.”).
in 2005 to comport with common-law corporate governance standards, \textsuperscript{358} fiduciary duties were introduced, shareholders were allowed to bring derivative claims, \textsuperscript{359} but companies were not afforded the liberty to select a dispute resolution forum other than state courts. The Prerequisite Clauses open the door to experimentation with ADR methods, even if only with respect to a well-defined class of disputes.

C. Chile and Argentina

Chilean law stands in the middle between Brazil’s compulsory arbitration scheme and China’s free-choice system. On the one hand, Article 4 of the 1981 Law on Corporations dictates that a company’s founding act necessarily contain a provision describing

- the nature of the arbitration to which will be submitted the differences that arise between the shareholders, in their capacity as such, or between them and the company or its administrators, whether during the life of the corporation or during its liquidation period. If nothing is said, it will be understood that the disputes will be referred to resolution by an arbitrator \textit{ex aequo et bono}. \textsuperscript{360}

Since only the contours (the “nature”) of the arbitration proceeding are left to the discretion of the charter’s drafters, a \textit{prima facie} reading of Article 4 suggests – more formally than Brazilian corporate law – that public and non-public companies alike must refer intra-corporate controversies to arbitration.

The first paragraph of Article 125 (“On Arbitration”), dealing with the nomination of arbitrators, bolsters the impression of a broad-ranging arbitration system. The paragraph reads:

- In the bylaws will be established the method of appointment of the arbitrator or arbitrators that will decide the matters to which refers number 10 of article 4 of the present law. \textsuperscript{361}

The underlying assumption is, again, that companies incur a general duty to submit their disputes to arbitration. That each company may decide for itself how


\textsuperscript{361} Id. Art. 125.
to appoint arbitrators and regulate other procedural matters by no means obviates the requirement that intra-company disputes be settled extra-judicially.

The immediately following paragraph of Article 125, however, illustrates the legislative intent in less ambiguous terms:

The arbitration scheme this law establishes is without prejudice to a claimant’s right, in the event of a conflict, to withdraw her recognition of the arbitrators’ competence and submit to the decision of ordinary courts.\(^{362}\)

This single proviso obviously opens a vast loophole in the otherwise obligatory character of the arbitration scheme, by awarding the party filing the complaint the unique privilege of deciding whether to resort to arbitration or the ordinary judicial process, and then imposing her choice on the other party. Legislators’ intention was clearly to allow shareholders with negligible voting and bargaining power, usually the first to raise a claim against the corporation, to avail themselves of the process that best serves their interests. Under this article, U.S. ADS-holders could elect, should a dispute arise, to file a suit against a Chilean FPI in a U.S. court, possibly under U.S. law.\(^{363}\)

This idiosyncratic regime\(^{364}\) does not, in our mind, lessen companies’ obligation, under Article 4, to include an arbitration clause in their charters and, absent contrary stipulations in the charter, accept the default jurisdiction of one ex aequo et bono arbitrator. Complainants’ ultimate opt-out power does not subtract from the compulsory nature of the process for the respondent, who must act at claimant’s behest. That claimants have the key to the exit door renders arbitration non-exclusive for them, but, contrary to scholarly opinion,\(^{365}\) arbitration remains not facultative; it is just contingent on claimant’s post-dispute consent to arbitrators’ jurisdiction.\(^{366}\)

In fact, the Chilean Supreme Court recently ruled that in certain circumstances, arbitration may be truly mandatory even for claimants. Despite the unqualified language in the second paragraph of Article 125, the Chilean High Court held in 2002 that complainants forfeit their right to sue in court, if the

\(^{362}\) Id.

\(^{363}\) See Coca Cola Embonor S.A., Annual Report (Form 20-F), at 74 (June 30, 2004) (summarizing the legislative regime).


\(^{365}\) See Oscar Torres Zagal, El Arbitraje en la Ley de Sociedades Anónimas Chilena, Centro de Arbitraje y Mediación de Santiago (July 24, 2003), at 4, available at http://www.camsantiago.com/articulos_online_3.htm (arguing that the Chilean arbitration system is “not obligatory or forced”). Zagal juxtaposes Law 18046/2001 to the prior regime of compulsory arbitration under the 1865 Commercial Code. Id. at 7.

\(^{366}\) For this reason, Chilean FPIs are classified in our survey as issuers obliged to submit to arbitration – even if, from the claimant’s perspective, arbitration is not exclusive.
corporate charter does not explicitly preserve it and instead provides only for arbitration. Under the Court’s reading of the law, public companies may foreclose shareholders’ access to courts, by simply omitting any specific reference in the charter to claimants’ statutory right of choice between arbitration and litigation, thus rendering arbitration the exclusive venue for intra-corporate controversies – an irrational outcome that thwarts a diaphanous legislative intent. Even if stare decisis does not exist in Chile’s civil-law system, the Supreme Court’s ruling carries authoritative weight and has been relied on by at least one U.S.-listed FPI to block ADS-holders’ access to American courts.

Another distinctive feature of the Chilean scheme is the default ex aequo et bono character of intra-corporate arbitration, i.e., that disputes are to be settled pursuant to the arbitrator’s subjective assessment of the equities of the case, if companies do not prescribe otherwise in their charters. Apparently seeking to coerce corporate stakeholders to work out their differences in a more cooperative climate, Chilean legislators decided, already in 1981, that corporate law disputes do not need resolution in accordance with the rule of law.

The rationale behind ex aequo et bono adjudication might make sense in the sphere of non-public companies, where venal personal feuds forestall the company’s smooth functioning. A lawless conflict settlement system, however, is incongruous to the complex needs and structures of publicly held corporations, where disputes between shareholders and directors are impersonal and frequently serve as a platform for the development of corporate law. The bizarre prospect of having to subject internal controversies to equitable arbitration would seem to motivate public companies to avert it through charter-based clauses. Our survey indeed identifies U.S.-listed Chilean FPIs that take exception to the default ex aequo et bono solution. Yet this is not always the case: some Chilean FPIs simply rely on the default statutory mandate – as they are entitled to – with no further stipulation in the charter or disclosure in public reports.

Chile’s paradigm was followed by Argentina, which, 20 years after the enactment of Chile’s 1981 Law, established and still has in place a very similar system of mandatory arbitration of disputes between (1) issuers of publicly traded securities and their shareholders; (2) investors and brokers/dealers; and (3)

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368 See PATRICIO AYLWIN, EL JUICIO ARBITRAL 95 (5th ed. 2005), and RICARDO SANDOVAL LÓPEZ, I DERECHO COMERCIAL 569 (5th ed. 2003) (arguing that parties cannot circumvent Article 125(2)). By comparison, no charter provision can preclude arbitration; only claimants’ right to sue in court was held waivable by the Supreme Court.

369 See supra note 142 and accompanying text.

370 See supra note 360.

371 There are four such FPIs; see supra notes 160-61 and accompanying text.

372 See supra text accompanying note 143. All U.S.-listed Chilean FPIs have an arbitration provision in their bylaws.
companies making a public takeover bid and the bid’s addressees. In particular, Article 38 of Legislative Decree 677/22.5.2001 provides:  

[S]elf-regulated entities [i.e., stock exchange markets] shall create a permanent Arbitral Tribunal to which will be submitted on a compulsory basis entities whose shares, negotiable instruments, term and future contracts and options are quoted or traded within the scope of these self-regulated entities, with respect to their relationships with the shareholders and investors. The arbitral jurisdiction will encompass all the actions derived from Law No. 19.550 [of 1984, on Commercial Companies], including actions against resolutions of company organs and liability actions against directors or against other shareholders, as well as actions to nullify clauses of the articles of association or bylaws. In the same fashion [i.e., by establishing a permanent arbitral tribunal] shall proceed the self-regulated entities with respect to disputes that arise between shareholders and investors in relation to the agents [brokers] that operate within their scope of activities, except for disciplinary actions [against these brokers]. In any case, market regulations will have to set aside the right of shareholders and investors enmeshed in controversies with the entity or the broker, to opt to resort to the competent judicial authorities. In those cases that the applicable law mandates the consolidation of pending actions with identical purpose before one single tribunal, the consolidation will take place before the Arbitral Tribunal. Also submitted to the arbitral jurisdiction established in this article the persons who make a public offer of acquisition with respect to the targets of such acquisition offer. (emphasis added)

Like the Chilean system, the arbitration regime under Argentinean law is optional for investors, who reserve the right to sue in court. A crucial difference, however, from the Chilean system, is the establishment of a permanent arbitral tribunal with mandatory (for issuers and corporate entities, yet optional for investors) jurisdiction over intra-corporate disputes. Indeed, a Center of Mediation and Commercial Arbitration was founded in 2005 under the aegis of the Argentine Chamber of Commerce (Centro de Mediación y Arbitraje Comercial de la Cámara Argentina de Comercio).  

In sum, Chile has been an early trailblazer in ADR territory, introducing by law the arbitrability of corporate controversies (with no distinction between public and closely-held companies) already in 1981; Argentina followed suit in 2001. Nonetheless, a potential flaw of Chile’s and Argentina’s hybrid system of semi-mandatory arbitration subject to claimant’s unrestricted election of forum is that it mirrors a less than full adherence to the ADR cause and a belief that shareholders should still have their day in court. Discrepancies between the text of the law and its jurisprudential construction, in the case of Chile, have also generated

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uncertainties in a sensitive area. If an investor-friendly corporate governance system is the goal in these Latin American countries, a less convoluted and ambivalent statutory scheme on dispute resolution would make a difference.

D. Italy

Research revealed Italy as the only country at the other end of the spectrum of legislative responses to intra-corporate arbitration. The sole developed economy so far to have scrupulously regulated the use of ADR techniques in the corporate setting, Italy has contemplated – and dismissed – the possibility that differences between publicly traded companies and their shareholders be steered into arbitral fora. Public companies were thus excluded from the permissive new regime of corporate dispute resolution, enacted as part of a set of brave corporate governance reforms aspiring to amplify party autonomy and incentivize companies towards “agile and rapid” dispute resolution procedures like arbitration.


Chile has recently stepped up efforts to reinforce its pro-arbitration profile, by adopting the UNCITRAL Model Arbitration Law. See Gonzalo Biggs, Breakthrough for International Commercial Arbitration in Chile, 59 J. DISP. RES. 65 (2004). Argentina is still lagging behind in that regard: it has yet to adopt a modern arbitration statute, in line with international standards, see http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html; the current archaic regime still requires the execution of a special post-dispute agreement ratifying the submission of the dispute to arbitration. See Grigera Naón, supra note 375, at 423-24. However, steps have been taken, mainly by courts, in the direction of modernizing the regime. Id. at 437; see also Maria Beatriz Burghetto, Current Status of Arbitration Legislation in Argentina, 21 J. INT’L ARB. 519 (2004).


The first provision in Italian law to introduce Italian companies to the wonderful world of arbitration is Article 34 of Legislative Decree No. 5 of 2003, entitled “Subject and Effect of Dispute Resolution Clauses in Corporate Statutes,” which provides in pertinent part:

The constituting acts of corporations, with the exception of those that resort to markets of capital of risk [i.e., public capital markets] pursuant to article 2325-bis of the civil code, may, by means of dispute resolution clauses, prescribe the submission to arbitrators of certain or all controversies arising between shareholders or between shareholders and the corporation, the object of which are disposable rights related to corporate relations. (emphasis added)

Under the civil code article mentioned in the above provision and its implementing regulation, companies “that resort to markets of capital of risk” are issuers with shares quoted in regulated exchange markets and dispersed among more than 200 non-controlling shareholders. The new law, then, approves arbitration as a legitimate method of corporate dispute resolution, but leaves public companies out of the candy store, disallowing them from experimenting with a potentially more efficient settlement mechanism; in effect, the pro-arbitration regime benefits only closely held corporations.

The public company carve-out has been decried as unjustifiably discriminatory and violative of the law authorizing the reforms, but most

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378 Intra-corporate arbitration was also the subject of a lively academic debate under the Civil Code; however, absent a provision enabling arbitration, there was disagreement as to the arbitrability of corporate causes of action. See Giuseppe Miccolis, Arbitrato e conciliazione nella riforma del processo societario, Mar. 28, 2003, available at http://www.judicium.it/focus/focus_glo.html.


381 The literature on post-reform dispute resolution is vast. See, inter alia, ARBITRATO SOCIETARIO: COMMENTO AL D.LGS. 17 GENNAIO 2003, No. 5 (Federico Carpi ed., 2004); Filippo Danovi, L’arbitrato nella riforma del diritto processuale societario (22.06.2004), http://www.judicium.it/focus/focus_glo.html; Andrea Giardina, L’ambito di applicazione della nuova disciplina dell’arbitrato societario, 12 RIVISTA DELL’ARBITRATO [RIV. ARB.] 233 (2003); Elio Fazzalari, L’arbitrato nella riforma del diritto societario, 11 RIV. ARB. 443 (2002).


commentators discern behind it a well-founded concern about the legal efficacy of a charter-based arbitration clause. It would be impracticable, they contend, to guarantee the consensual character of the arbitration agreement under Italian law, when public shareholders rarely read the company’s governing documents. There is hence academic consensus that even when a company launches an IPO subsequent to the inclusion of an arbitration clause in its charter, the clause would still be ineffective as to its public shareholders, because the company’s new status as a “publicly-trading” company would trigger the absolute ban of the law.

On the contrary, owners of stakes in closely held firms are personally enmeshed in day-to-day operations and would not be justified in ignoring the company’s dispute resolution arrangements. Even these companies, however, are not given a carte blanche. Legislators have taken cautious steps to shield the new system from constitutional challenges for denial of shareholders’ access to justice: modification of the corporate charter to allow for arbitration must be approved by a two-thirds majority of the company’s stock, while absent or dissident shareholders retain the right to claim an exception to arbitration within 90 days. Moreover, the law defines as arbitrable only controversies involving freely “disposable rights,” disputes of a public law nature are unambiguously exempted.

Legislators’ zeal to ensure that small shareholders are not entrapped into waiving their rights without the chance to make a knowledgeable decision has been largely applauded in Italian legal circles. The exclusion of public companies from the new regime is attributed to the inimical incompatibility between public company structures and fundamental principles of arbitration law. Unlike Brazilian or Chinese law, Italian law places a higher value on safeguarding the voluntary nature of arbitration than permitting large companies to settle intra-
corporate differences in a potentially cost-effective, cooperative way. Building a corporate-friendly profile is not as urgent a priority for countries like Italy, as it is for developing markets.

E. Different Strokes for Different Blokes

Agonizing to recast their companies as reliable investment choices, transition economies in Latin America and, to a lesser extent, China have adeptly transformed their legal systems to enhance shareholders’ freedom and, in the same business-friendly spirit, cement a pro-arbitration culture that would increase investors’ options. Arbitration is seen as a tool to restore investor confidence in the country’s potential, by promising legal certainty which local courts often are unable to secure.390

Institutions, nonetheless, are not transferable across boundaries, unless systemic differences and social structures are taken into account. Comparative analysis cannot be reduced to oversimplified suggestions for indiscriminate transplantation of solutions that have “worked” elsewhere. Overlooking market-specific factors, such as corporate ownership patterns and deficient judicial enforcement, can frustrate ambitious reform plans.391 Shareholder class actions, for example, would be an ill fit for emerging economies, due to the lack of infrastructure and experience.392 The method of transplantation also matters: black-letter law interventions would be less successful in common-law countries that share an ingrained antipathy to government-sponsored solutions than in continental legal systems.393 In addition, normative convergence is more enigmatic in the corporate law field, because there is no consensus on what the “best” corporate governance model comprises, or that it can be invented at all.394 Further disputed is the role of the law in such model – the nexus between

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390 Arbitration, e.g., has been introduced in Argentinean law as promoting “trust in a system that guarantees enforcement of the rule of law.” See Decree 677/2001, Preamble, supra note 373. See also Lo & Tian, supra note 356.

391 See Katharina Pistor, Patterns of Legal Change: Shareholder & Creditor Rights in Transition Economies, in Corporate Governance Lessons from Transition Economy Reforms 35, 63 (Merritt Fox & Michael Heller eds., 2006) (concluding that countries implementing gradual “legal and institutional reforms have developed more effective institutions” than those pursuing radical agendas).

392 See STEINBERG, supra note 324, at 266-67 (“opening up the floodgates of litigation . . . sounds like utter nonsense”); Cally & Lubrano, supra note 223, at 355-57.


economic performance and legal norms has not yet been pinpointed to a magic
recipe that could do wonders in all economic systems.\footnote{See Reinier Kraakman et al., The Anatomy of Corporate Law: A Comparative Functional Approach 217-25 (2004) (finding growing commonalities among the principal corporate law systems, but deferring evaluation of this trend until other market factors are measured empirically); John Coffee, Jr., The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications, 93 NW. U. L. REV. 641 (1999); Roberta Romano, A Cautionary Note on Drawing Lessons from Comparative Corporate Law, 102 YALE L. J. 2021, 2025 (1993) (concluding that key factors affecting market performance do not correlate to corporate governance patterns); Bernard Black, Is Corporate Law Trivial?: A Political and Economic Analysis, 84 NW. U. L. REV. 542 (1990); Pistor, supra note 391, at 64 (finding that harmonization of the law on the books does not tell the whole story).}

The U.S., for now, rests assured that its global economic primacy does not warrant mimicking emerging economies’ development strategies – they are simply not in the same boat. Or are they?

The U.S. certainly does not need to prove its pro-investment credentials; its legal and market infrastructures are well-developed. The American economy does not suffer from the systemic flaws and institutional failures that plague emerging markets: a robust regulatory framework, stringent accounting standards and the zealous (perhaps overly so) enforcement of legal norms by courts have been the pylons of a system that supports sophisticated economic intercourse and effervescently and effectively protects investors, even to the detriment of overall economic efficiency.\footnote{A 1997 survey of data from 49 countries concerning the legal protection and enforcement of investors’ rights found that common-law systems tend to protect investors considerably more than civil-law countries, which helps explain the economic success of the common-law business model. See Rafael La Porta, et al., Legal Determinants of External Finance, 52 J. FINANCE 1131 (1997). Cf. Armando C. Pinheiro, Judicial System Performance and Economic Development, available at http://www.bndes.gov.br/conhecimento/ensaios/ensaios2.pdf (Oct. 1996) (assessing the role of well-functioning judicial systems on economic development). See also supra note 326.}

On the other hand, as the present economic crisis deepens, and as the avalanche of high profile reports in recent months persistently point out, America’s public markets are in dire need of refurbishment across the board.\footnote{See supra part I.} If the allegations about investors’ backlash against regulatory inefficiencies and unmanageable liability risks are correct – and there is strong evidence that they are – the hallowed corporate law enforcement framework with the private attorney general at its center, heavily chastised for endogenous flaws,\footnote{See John C. Coffee, The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation, 48 LAW & CONTEMP. PROBLEMS 5 (1985); Roberta Romano, The Shareholder Lawsuit: Litigation Without Foundation, 7 J. L. EC. & ORG’N 55 (1991).} cannot continue being untouchable. Despite varying perceptions about the costs and benefits of corporate litigation,\footnote{Cf. Kraakman, supra note 395, at 208-12.} other countries’ experience could be instructive.
An important lesson can be learned from the synergies produced by the combination of formal legislation and private sector rulemaking to address corporate governance issues. Efforts to improve corporate governance in the transition economies examined above involved legislative or regulatory endorsement of alternatives to formal adjudication. Brazilian law, characteristically, has mixed ad hoc contractual mechanisms (listing agreements, director consent statements) with exchange listing rules, eventually matched by formal legislative directives. Encouraging results from Brazil suggest that regulators and policymakers should heed, not stifle, private initiatives like arbitration and maintain a flexible legal framework, deferential to party autonomy. Even though, in Brazil and other developing economies, private dispute resolution arrangements, in effect, were promoted as substitutes for dysfunctional judicial systems, same spirited initiatives could furnish a remedy to the failings of the U.S. financial markets; in both emerging economies and the U.S., inefficiency – whether due to under-performance or to over-zealous enforcement – undermines further growth. In both cases, then, trial and error might prove a handy compass in discovering cures for the shortcomings of an ineffective conflict management system.

Decentralized rulemaking trends in other jurisdictions should not ring alarm bells in the U.S., where experimentation with corporate structures is anything but incompatible with its legal tradition. Party autonomy and contractual freedom have always been lodestar principles of the common law business model; tailoring flexible rules to industry-specific concerns, the trademark of its success. Governmental imposition of mandatory arbitration on all corporations, public and non-public, would be unwise, even if shareholders' opt-out privileges were intact, in the mold of Chile’s and Argentina’s arbitration schemes. Yet U.S. courts and lawmakers can surely afford to infuse more freedom into corporate law by accommodating public shareholders’ election to shift loyalties from a strained litigation system to streamlined procedures, as proposed in the 2006 Interim Report, without venturing into unchartered territory: there is a huge canvass of

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400 See Cally, supra note 327, at 984 (“Governance mechanisms introduced in multiple guises along a continuum of private and public rule may amplify the prospects of effectiveness”).

401 See Cally & Lubrano, supra note 223, at 357-59.

402 See supra notes 324 and 326 and accompanying text.

403 See Cally & Lubrano, supra note 223, at 351-55. Interestingly, according to Cally, the word “by-law” stems etymologically from “byrlaw,” which meant a local custom or law of a manor or district whereby boundary or trespass disputes were settled without recourse to the public courts of law. See Cally, supra note 327, at 1002 n.56.

404 The argument has been made, however, that in some cases, governmentally imposed arbitration would be constitutional. See Jean Sternlight, In Defense of Mandatory Arbitration (If Imposed on the Company), 8 NEVADA L. J. 82 (2007).

405 See supra part I.
arbitration law to draw on.\textsuperscript{406} Regulatory intransigence is imprudent in the face of mounting pressure for change. The SEC should reconsider its \textit{sui generis} ban on intra-public company arbitration and assume its familiar oversight role, monitoring corporate governance arrangements and certifying the fairness of dispute resolution mechanisms.\textsuperscript{407}

V. CONCLUDING REMARKS: POLICY EVALUATIONS

Disputes among public companies, their shareholders and managers remain one of the last, zealously guarded, bastions of exclusive judicial competence in the United States, mainly because of the SEC’s steadfast refusal to allow the insertion of arbitration clauses into U.S. companies’ governing documents, in the name of ill-perceived notions of fairness and shareholder justice. This single institutional barrier may, however, soon disappear: the 2006 Interim Report challenged conventional wisdom about the costs and benefits of shareholder litigation. The Report presented evidence that neither compensation, nor deterrence – the two rationales for the justification of class and derivative actions – are being substantially promoted; on the contrary, gargantuan, meritless settlements repel investors from investing in public equity markets, making a stop in the U.S. no longer inevitable for businesses in search of capital. In view of these findings and with the sword of recession dangling over its head, the SEC has been forced to revisit its aversion to a remedy long sanctioned in other corporate governance subfields but so far untested in the public company context.

Drawing a link between arbitration and economic performance has come as a shock to many. Challenging populist depictions of arbitration as non-voluntary and unjust for consumers and investors, the Report suggested that arbitration was the antidote to the misgivings of the U.S. financial system. While the fight for foreign investment and capital goes on, this association may prove a catalyst that would allow intra-corporate arbitration to flourish.

The SEC cannot ignore that arbitration, as this article shows, is \textit{ante portas}, with one foot inside the house. For one, a growing number of foreign companies with sweeping arbitration clauses in their bylaws are undauntedly trading on U.S. exchanges, while domestic companies’ attempts to follow suit have fallen below the SEC’s radar. Second, the first class arbitration between a foreign – albeit private – issuer and its U.S.-based shareholders is already occurring on U.S. soil, with one foot inside the house. For one, a growing number of foreign companies with sweeping arbitration clauses in their bylaws are undauntedly trading on U.S. exchanges, while domestic companies’ attempts to follow suit have fallen below the SEC’s radar. Second, the first class arbitration between a foreign – albeit private – issuer and its U.S.-based shareholders is already occurring on U.S. soil.

\textsuperscript{406} Shell estimated that experimentation will and should occur, even if a shift to arbitration would probably be unwise for public companies, due to transactions costs and practical constraints. \textit{Shell, supra} note 22, at 565-73.

based on a clause in the document defining the rights of ADS-holders. Finally, seeking to reinvent their struggling economies, ascending markets recognize the validity of alternative dispute resolution arrangements engrafted in company charters. Arbitration’s march into the realm of public companies is unstoppable, even in the U.S.

The introduction of arbitration would profoundly alter the dynamics of the current corporate accountability model. Shadows over authenticity of consent and acceptance could put a strain on the legal system’s capacity to accommodate novel procedures. However, it needs reminding, arbitration is the genuine offspring of contractual freedom, a bedrock principle of American common law. By disallowing agreements to arbitrate intra-corporate controversies even when approved by shareholders, the SEC is throwing the baby out with the bath water.

This article posits that market regulators cannot afford to make arbitration a scarce commodity for public shareholders who wish to pursue their claims in presumptively more efficient fora. At the very least, there is no reason to keep U.S. public companies on a shorter leash than their foreign counterparts. The mantra about low cost and speed as the ADR benefits par excellence may not always hold true, but empirical evidence suggests that the foreclosure of this dispute resolution avenue would hurt small-time investors and minority shareholders, by barring access to an affordable, specialized mechanism. Arbitration is not lawless, as depicted by its foes. Above all, it is not static: its protean nature allows it to adapt to the special characteristics of different subject matters and metamorphose into a process as fine-tuned as the parties desire. Boisterous criticism aside, recognition of arbitration as a valid intra-corporate dispute resolution method needs to be a salient feature of any litigation reform scheme put forward.

All eyes are now on the SEC: will it decide to finally bow to arbitration’s sirenic appeal, allowing experimentation to occur, or will it be anew consumed with efforts to halt the hemorrhaging of judicial power? Will it step in and regulate the use of ADR techniques in public markets or opt for the perfunctory role of a market bystander? Will the SEC give arbitration a chance? Omens, this time, augur well. Tempora mutantur, et nos mutamur in illis.

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408 See Testimony of Peter Rutledge, supra note 102, at 7-10 and 12-17 (discussing data on employment dispute resolution).
410 Times change and we change with them.