Some Critical Observations on the Italian Regulation of Company Arbitration

Valerio Sangiovanni
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I. ADVANTAGES AND DISADVANTAGES OF COMPANY ARBITRATION

In Italy there has recently been an important reform of corporate law. One of the major innovations of this reform has been the introduction of special rules concerning civil litigation involving companies: Legislative Decree No. 5/2003.¹

Disputes involving companies are normally tried before a judge. However, the reform also allows company litigation to be decided by arbitrators, and a form of arbitration proceedings specifically for companies has been established by Legislative Decree No. 5/2003.² Before this reform there had been no specific

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regulation in Italy for company arbitration (*arbitrato societario*), and the express regulation has reduced legal uncertainty. The opportunity to choose between court proceedings and arbitration creates a conflict between these two methods of resolving controversies. Standard litigation tends to last many years in Italy, and this inefficiency may have the effect of driving companies towards arbitration.

The intention of the Italian legislature was to place more emphasis on arbitration as a way of resolving controversies, and certainly arbitration does seem to offer some advantages compared with standard litigation. However, a distinction should be made between regular arbitration (whose regulation is contained in the Italian Code of Civil Procedure, *codice di procedura civile*) and corporate arbitration: the advantages of ordinary arbitration are not necessarily the same as the benefits of corporate arbitration.3

One advantage of arbitration is considered to be the ability of the parties to choose the members of the arbitral tribunal. According to Article 809(2) of the Code of Civil Procedure, the arbitration agreement must either appoint, *i.e.*, name, the arbitrators or define the number of arbitrators and the method of their appointment.4 This advantage does not apply to company arbitration. Article 34(2) of Legislative Decree No. 5/2003 states that the arbitration clause shall set out the number and the modalities of appointment of the arbitrators. “Number and modalities of appointment” is something different from “appointment.” The law goes on to state that the arbitration clause must in any case confer the power to appoint the arbitrators on a person outside the company. The parties cannot therefore directly appoint the arbitrators. The certificate of incorporation can only identify the designator. It will then be for the designator to appoint the arbitrators. The advantage of arbitration – that the parties are free to choose the arbitrators – is therefore not applicable, or at least less applicable, to company arbitration in Italy. Members can choose the appointing authority (and consequently they enjoy a certain freedom), but this freedom is not as broad as to include the ability to name the arbitrators.

Moreover, the notion that the parties cannot choose the judge in a civil proceeding is not completely accurate. The general principle is that such power

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3 Regarding the recent reform of traditional arbitration in Italy see, *La Riforma della Disciplina dell’Arbitrato* (Elio Fazzalari ed., 2006).

cannot be created by agreement of the parties (Art. 6 of the Code of Civil Procedure). But Article 6 makes an exception in certain cases. In particular the geographic jurisdiction can be specified by means of an agreement between the parties (Art. 28 of the Code of Civil Procedure). If the parties to an agreement decide, for example, that the judges in Milan shall have jurisdiction instead of the judges in Rome, the parties exercise a certain indirect influence on the identity of the judge: no judge in Rome will be entitled to decide the controversy; only a judge established in Milan will be entitled to decide. In this way, the parties can, although only in some cases, derogate from the “natural” competence of the judges and consequently exercise a certain indirect influence on the choice of the judge.

Another apparent advantage in arbitration is the ability of the parties to choose an arbitrator who has particular expertise in a certain field. This argument has limited validity. The argument can apply if a lawyer with a specific competence is appointed arbitrator. But the argument can apply only to a certain extent when a person other than a lawyer is appointed arbitrator. It may happen for certain highly technical controversies that it is convenient to appoint, for example, a chemist or an engineer as an arbitrator. However, a chemist or an engineer will have little, if any, knowledge of the law. To manage arbitration proceedings and to draft an arbitration award, expertise in chemistry and engineering is of no help. This problem could be overcome through the appointment of an arbitral tribunal instead of a single arbitrator. Thus, a team could be built in which different competencies are represented. But the claimed advantage of particular technical competence of the arbitrators is overstated. It could also be construed as disrespectful to judges, by the suggestion that arbitrators are more efficient adjudicators than judges. Arbitration, however, is not fundamentally better than court-rendered justice. The qualities of the individual determine whether an arbitrator or a judge performs well.

A further touted advantage of arbitration is its speed. In practice, arbitration is usually faster than court proceedings. There are many reasons for this. Arbitration is less formal than a full trial. In addition, the organization of public justice in Italy is not particularly efficient. The speed advantage is an argument for the superiority of arbitration. However, this does not change the heart of the matter, i.e. the slow pace of public justice. Arbitration alone cannot resolve the problem of the inefficiency of public justice.

The speediness of arbitration may, of course, be a significant factor for corporations, for which litigation can be an obstacle to the efficient functioning of their enterprises. A single controversy can have the effect of blocking the business relations between two companies, with loss, damage, inconvenience and expense
An efficient mechanism for resolving controversies allows business relations to recover speedily and facilitates the creation of wealth. A system that is able to resolve business disputes quickly may benefit the entire economy.

Another advantage of arbitration is that controversies can be kept private, in contrast to civil trials, which, in Italy, are public (Art. 128 of the Code of Civil Procedure). In certain cases the result may even be published in the press, and where publication of the decision contributes to reparation of the damage, the judge can, at the request of the interested party, order that the decision be published in one or more journals (Art. 120 of the Code of Civil Procedure). In specific situations, the private nature of arbitration can be a significant benefit for the parties. But in this context some distinctions are necessary. First, confidentiality depends on the agreement of the parties. Where the parties have coinciding interests, arbitration proceedings can take place without any publicity. For various reasons, however, one of the parties may be interested in disclosing the existence of the controversy. Moreover, any common interest in favor of secrecy that exists at the beginning of the proceedings can later disappear. Second, the arbitration award does not necessarily put an end to the controversy. Under Italian law an arbitration award may be challenged on various grounds (Art. 827(1) of the Code of Civil Procedure). If one of the parties challenges the award, there will be a trial before a judge and confidentiality can no longer be maintained. In the case of company arbitration, there is even a provision that obliges disclosure of the existence of the controversy. Article 35, paragraph 5-bis, of Legislative Decree No. 5/2003 states that any order of the arbitrators suspending a members’ meeting must be registered in the register of enterprises.

**II. TYPES OF ENTITIES COVERED BY COMPANY ARBITRATION**

According to Article 34(1) of Legislative Decree No. 5/2003, the certificates of incorporation of companies may provide that some or all disputes among members (soci) or between members and the company must be decided by arbitration. This provision concerns the arbitration clauses contained in the certificates of incorporation of “companies.” It makes no distinction between partnerships (società di persone) and corporations (società di capitali).

Under Italian law generally the following types of partnership are provided for: the informal partnership (società semplice), the ordinary partnership (società in nome collettivo) and the limited partnership (società in accomandita semplice). In addition, there are three types of corporations: the limited liability company

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(società a responsabilità limitata), the joint-stock-company (società per azioni) and the partnership limited by shares (società in accomandita per azioni).

A number of judicial decisions have addressed the question of the scope of the new company arbitration statute. A court in Udine found that company arbitration applies to all types of companies, including partnerships.6 A court in Trento decided that the new regulation is applicable to partnerships.7 According to the Trento court, even irregular companies (società di fatto) fall within the scope of company arbitration. This follows a previous decision of the same Trento court to the effect that the new regulation applies to partnerships.8

Legislative Decree No. 5/2003 was based on Law No. 366/2001. This statute allowed the government to enact provisions regarding company arbitration with reference to the articles of “commercial companies.” But one type of company, the informal partnership, cannot have – under Italian law – a commercial purpose (Art. 2249(1) of the Italian Civil Code). Moreover, in an informal partnership the partnership agreement is not subject to any special form, unless a special form is required by the nature of the goods contributed (Art. 2251 of the Civil Code). Thus, a written agreement is not necessary. Yet without a written partnership agreement there cannot be an arbitration clause under the new company arbitration statute. If, however, the partnership agreement is in written form, then an arbitration clause can be contained therein. According to Article 34(6) of Legislative Decree No. 5/2003, the modifications of the certificate of incorporation – introducing or eliminating arbitration clauses – must be approved by members representing at least two-thirds of the equity. This provision is intended to protect minorities. The legislature considered any change from state court proceedings to arbitration (or, in the other direction, from arbitration to state court proceedings) potentially dangerous. For this reason, a super-majority is required. But in the informal partnership the certificate of incorporation can be modified only with the consent of all members (Art. 2252 of the Civil Code). The informal partnership typically has few members, who have a personal relationship, and it is for this reason that amendments to the certificate of incorporation require the consent of all involved in the partnership. But this is only a general principle. In company arbitration there appears to be an exception to this rule: for the

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6 Court of Udine, Ordinance of Nov. 4, 2004, LE SOCIETÀ 77 (2005), with comments by Nicola Soldati.
7 Court of Trento, Ordinance of April 8, 2004, GIURISPRUDENZA COMMERCIALE 497 (2006), with comments by Stefano A. Cerrato; Pier Luca Nela, Comment, GIURISPRUDENZA ITALIANA 116 (2005); Claudia Pedrelli, Comment, GIURISPRUDENZA DI MERITO 1699 (2004); Linda M. C. Morellini, Comment, LE SOCIETÀ 996 (2004).
introduction or the elimination of arbitration clauses only a majority (two-thirds of
the equity) is required. If the majority principle is applied to the informal
partnership, the members of this partnership are less protected than pursuant to the
general principle. The outcome would be paradoxical, in that for all amendments
to other clauses of the certificate of incorporation of an informal partnership
unanimity is required, yet for the introduction or the elimination of arbitration
clauses a majority is sufficient. For this delicate decision, a majority (rather than
unanimity) will do.

For these reasons my conclusion is that the informal partnership is excluded
from the application of the new provisions on company arbitration.\footnote{See Also Francesco Paolo Luiso, Commento all’art. 34, in IL NUOVO PROCESO SOCIETARIO 556, 557 (Francesco Paolo Luiso ed., 2006); Pier Luca Nela, Cenni sull’Ambito di Applicazione del Nuovo Arbitrato Endosocietario, GIURISPRUDENZA ITALIANA 117, 117 (2005); Elisa Picaroni, L’Arbitrato nella Riforma Societaria, LE SOCIETÀ 495, 496 (2005); Rinaldo Sali, Arbitrato e Riforma Societaria: la Nuova Clausola Arbitrale, NUOVA GIURISPRUDENZA CIVILE COMMENTATA 114, 116 (2004).}

Irregular companies are characterized by not having written certificates of
incorporation, and it is therefore not possible for these companies to comply with
the rules on corporate arbitration.\footnote{Nela, supra note 9, at 117.}

III. THE EXCLUSION OF COMPANIES THAT USE THE CAPITAL MARKET

As far as corporations are concerned, arbitration clauses are allowed in the
certificates of incorporation of limited liability companies, joint-stock companies
and partnerships limited by shares.

However, it should be noted that not all types of corporations are included in
the current Italian regulation of company arbitration. Company arbitration only
applies to small and medium-sized corporations, since an express exception is
made for those companies that use the “market for risky capital” (mercato del
capitale di rischio).

The definition of such companies is distributed throughout a number of
provisions, both statutes and regulations. According to Article 2325-bis of the
Civil Code, the companies that use the market for risky capital are those
companies with shares listed on regulated markets (mercati regolamentati) or
those with shares diffused among the public “in a considerable way.” This
provision refers to joint stock companies. The rule, on the contrary, does not
concern the limited liability company. In the limited liability company the
holdings cannot be represented by shares (Art. 2468 of the Civil Code). As a
consequence arbitration clauses in the certificates of incorporation of limited
liability companies are allowed.
With specific regard to the joint-stock company, a distinction is made by Article 2325-bis of the Civil Code between two categories of companies: 1) those with shares listed on regulated markets; and 2) those with shares diffused among the public in a considerable way.

But when can shares be considered diffused among the public “in a considerable way?” The answer to this question cannot be found in a statute, but in a regulation. In Italy, regulation of listed companies is the responsibility of the National Commission for Companies and the Exchange (Commissione nazionale per le società e la borsa, “Consob”). Legislative Decree No. 58/1998 regulates listed companies and entrusts the Consob with the power to enact regulations.¹¹ The Consob has enacted a regulation concerning the issuers of financial instruments.¹² Financial instruments can be shares or bonds. Shares are considered as considerably diffused if the company: a) has more than 200 shareholders and b) is not entitled to draft only an abbreviated version of the balance-sheet (Art. 2-bis, para. 1, of regulation No. 11971/1999). Bonds are considered as considerably diffused if the company has a net worth equal to or greater than five million Euros and more than 200 bondholders (Art. 2-bis, para. 4, of Regulation No. 11971/1999).

Some joint stock companies in Italy, therefore, do not fall within the scope of company arbitration. Economically significant enterprises cannot insert an arbitration clause in their certificates of incorporation.

Let us consider why the Italian legislature does not allow large companies to use company arbitration by inserting an arbitration clause in their certificates of incorporation. In economically significant enterprises, the reasons for the investment made by one investor can be completely different from the reasons that have motivated another investor to purchase the shares of the same company. There are two major categories of persons investing in companies that operate on the capital market: large investors and small investors.¹³ Large investors aim to own a majority of the company or at least to control the company. To this end, a massive investment is necessary. Such investors are generally sophisticated.

¹³ About the different approach, preparation and professionality of big and small investors, see Valerio Sangiovanni, Documento d’Offerta Pubblica e Responsabilità Civile nel Nuovo Diritto Tedesco, RIVISTA DI DIRITTO CIVILE 153, 157 (2004).
Shares are bought on regulated markets or, if the shares of the company are not listed, by means of a specific agreement with the seller. In this last case the big investor is usually helped by consultants. Lawyers will try to discover and disclose to the buyer the legal characteristics of the target company and the risks involved in buying into the company. The buyer of a majority shareholding can, after having bought the shares, amend the certificate of incorporation. If, for example, a buyer buys 80 percent of a company, it will be able to amend the articles in order to insert or delete an arbitration clause. As mentioned above, in order to insert or delete an arbitration clause it is necessary to obtain the consent of two-thirds of the capital (Art. 34, para. 6, of Legislative Decree No. 5/2003). Even without reaching on its own this high level of participation of the capital, the buyer of a considerable number of shares may reach an agreement with other shareholders to amend the articles. Big investors generally need less protection than small ones. They have the competence and the means to assert their interests. Small investors are completely different. Their only objective is to make a good investment. First they want to be remunerated through dividends, that will be paid if the company generates earnings. Second, they hope that when they sell their shares, they will receive a higher price than the price they originally paid. The small investor typically buys the shares on regulated markets. It is rare for small investors to buy shares of non-listed companies. That market is less liquid and less transparent than the regulated ones. Small investors cannot acquire the percentage of capital necessary to control the company. With a small holding, they cannot become directors of the company. They do not have the power to amend the articles, and, by and large, they do not investigate all characteristics of the target company before buying the shares. Small investors are unlikely to be aware that the articles of a certain company contain an arbitration clause, and they could become part of an arbitration proceeding without having even known of the existence of an arbitration clause. For the legislature in Rome, this was a risk to be avoided.

According to the reasoning of the Italian lawmakers, the risk of a small investor becoming part of arbitration proceedings without previous awareness of this possibility is lower if the person buys the shares of a small company. Firstly this kind of investment is typical for those who intend to participate actively in the company’s life. Secondly the difficulty of selling the stake (as a consequence of the absence of a liquid market) would induce the buyer to better study the characteristics of the target before buying its shares. For these reasons it should be easier to discover the presence of an arbitration clause. Consequently the person may be able to renounce the purchase. Alternatively, the investor may purchase the shares, but he at least knows in advance that there is an arbitration clause.

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It is arguable that this reasoning is not completely convincing. According to Article 18 of Legislative Decree No. 58/1998, investment services can be carried out only by investment firms and banks, and the fact that there is necessarily an investment broker in the case of listed shares does not reduce investor protection. On the contrary, the protection is all the more. Investment brokers are obliged to observe certain rules of conduct. These duties are detailed in secondary legislation.\textsuperscript{15} They must act with diligence, correctness and transparency in the interest of the clients and for the integrity of the markets. They must obtain information from the clients and always keep the clients adequately informed (Art. 21, para. 1, of Legislative Decree No. 58/1998). Brokers must, in the interest of the investors and for the integrity of the capital market, acquire knowledge of the financial instruments (Art. 26 of Regulation No. 11522/1998). In addition, brokers may not carry out or suggest operations or supply the service of assets administration (\textit{servizio di gestione}) without having first delivered to the investor adequate information on the nature, the risks and the implications of the specific operation or of the service to be performed (Art. 28 of Regulation No. 11522/1998). Investment firms and banks therefore have a duty on the one hand to obtain information from, and on the other hand to give information to, the clients. It seems reasonable that, if there is an arbitration clause in the articles of the issuer, this circumstance shall be disclosed in advance to the potential buyer of the financial instruments. Taking the duties of the investment brokers into consideration, it is simply not the case that the small investor is less protected when he buys the shares of listed companies than when he buys the shares of non-listed companies. In the case of listed companies the client is aided by his investment broker.

Whether or not adherence to business rules is in fact respected by the financial intermediaries is, regrettably, another matter. Recently, Italy has seen a vast number of suits brought against banks by clients alleging violations of the rules governing the conduct of business. Case law shows that financial intermediaries actually tend to be quite reticent with their clients.\textsuperscript{16} In my opinion, Italian laws and regulations already grant sufficient protection to the small investor; it is unfortunate that neither law nor regulation are always respected by the intermediaries.

\textsuperscript{15} Delibera Consob, 1\textdegree{} luglio 1998, n. 11522. Regolamento di attuazione del decreto legislativo 24 febbraio 1998, n. 58, concernente la disciplina degli intermediari.

The Italian legislature excludes companies with listed or diffused shares from the application of company arbitration, the idea being that arbitration offers less protection than the State process and for this reason it must be reserved to those who choose arbitration proceedings deliberately. This argument is not convincing. It is not always the case that arbitration offers fewer guarantees than the State process. Much depends on the type of right one wants to assert. For instance, if a shareholder wants to sue the company as a creditor, it is better to use arbitration, since arbitration is faster than the civil litigation process. Those who are going to obtain a favorable decision prefer a quick proceeding, whereas the counterparties prefer a slow process. A more convincing demonstration that litigation offers more guarantees than arbitration ought to be delivered by lawmakers and researchers.

An additional reason that may have convinced the legislature to exclude companies that use the capital market from the application of the provisions on company arbitration is the fact that small shareholders usually have less power than the other party. The other party might be the company or another shareholder (Art. 34, para. 1, of Legislative Decree No. 5/2003). When two shareholders find themselves before an arbitration tribunal, it is not automatic that one has more power than the other; they may hold the same or a similar percentage of the capital. If the controversy is between a shareholder and the company, it may be that there is a significant difference of power between the two subjects involved: the suit could be initiated by a person with a very little holding. But this imbalance can also exist in small companies: if a shareholder holds five percent and is litigating with a shareholder holding 85 percent, the positions are not well balanced, even if the company is not open to the public. The argument regarding an imbalance of powers is therefore not limited to big companies. But it should be admitted that this problem is particularly relevant in companies with listed or diffused shares. In these companies there are usually few shareholders controlling the company and a large number of shareholders with very few holdings. This possible imbalance has induced the Italian legislature to exclude the possibility of companies with listed or diffused shares to use company arbitration.

There are reasons to doubt that differential treatment between companies with listed or diffused shares and other companies is really justified. The legislature limits private autonomy in respect of big companies that are particularly

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significant for economic value and number of shareholders. 18 One author has pointed out that, paradoxically, it would have been more reasonable to do exactly the contrary, *i.e.* to facilitate company arbitration in those companies that use the capital market. 19 There are arguments in favor of this approach. The financial instruments of listed companies can be sold more easily than the financial instruments of non-listed companies. Both in companies with listed shares and in companies with diffused shares the public is protected by means of specific disclosure requirements imposed by law. 20 With both factors (facility to sell the shares and existence of disclosure requirements) the investor is more protected in big companies than in small ones: an arbitration clause would be less risky in companies with listed or diffused shares. Finally, the time factor must be addressed. Arbitration proceedings are usually faster than litigation. It is therefore possible to come to a solution of the controversy quickly. But this advantage is even more important in companies with listed shares, as uncertainty arising out of the dispute can be reflected in the price of shares. This will generally happen if the controversy concerns shareholders with a significant holding. If the suit is started by a small investor, it will normally not be able to influence the price of the shares. But if a significant controversy is pending, the uncertainty will produce its effects not only on the current shareholders, but also on all potential investors. This can be a good reason to extend company arbitration to listed companies.

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20 One can point, for instance, to the continuous company disclosure requirement (*informazione societaria continua*) pursuant to Arts. 114 and 116-bis of Legislative Decree No. 58/1998. For a study of this matter, see Valerio Sangiovanni, *Ad-Hoc-Publizität und Tatsachenbegriff im Italienischen Recht*, in Zeitschrift für Wirtschafts- und Bankrecht 1594 (2001).