TOOLKIT 4

Resolving Corporate Governance Disputes

VOLUME 1 : RATIONALE

Global Corporate Governance Forum

IFC International Finance Corporation
World Bank Group

Corporate governance disputes involve corporate authority and its exercise. Such disputes frequently involve the corporation's shareholders, board directors, and senior executives. These disputes constitute a category of their own, one that differs from labor, commercial, consumer, or other disputes involving the corporation.

Although they are less common for well-governed companies, most companies will experience a corporate governance dispute.

To ensure that corporate governance disputes are properly prevented or efficiently resolved, this module helps users identify the different kinds of corporate governance disputes and the context in which they may arise.

THIS MODULE REVIEWS

- Corporate governance disputes
- Other disputes involving companies
- Different kinds of corporate governance disputes
- How corporate governance disputes affect different types of companies
- Contexts in which a corporate governance dispute may emerge

MODULE 1
WHAT ARE CORPORATE GOVERNANCE DISPUTES?

DISPUTES AFFECTING CORPORATE AUTHORITY

Corporate governance is "the system by which companies are directed and controlled."[1] It involves the balance of powers among three key corporate constituencies: the board of directors, which is charged with monitoring, overseeing, and guiding the company; the shareholders, who invest their funds in the company's shares and, therefore, have the right to elect and possibly dismiss directors; and, the company's management, whom the board hires to run the company on a day-to-day basis. By law, boards have the ultimate responsibility for the company's affairs, hiring and giving direction to management and representing shareholders' interests. Thus, the board sits at the center of the company's governance structure.

INTERACTION AMONG THE MAIN GOVERNING BODIES OF A COMPANY

SOURCE: Adapted from IFC Pakistan Corporate Governance Project 2007.

The elected board is the company's principal governing body. The board appoints management, led by the CEO, but it retains ultimate responsibility for protecting the company's integrity and its shareholders' investment.

In addition to the board, shareholders, and management, a corporation has many other constituencies, or "stakeholders," who are important to the company's operation. These stakeholders may include employees, suppliers, creditors, financial institutions, communities, and even publicly regulated agencies.

Defining Corporate Governance Disputes

Corporate governance disputes involve corporate authority and its exercise. Governance disputes involve the board's powers and actions, or its failure or refusal to act. These conflicts may arise between the board and its shareholders, or between directors and executive management. They may also involve issues among the directors themselves and between the board and other stakeholders. A governance dispute implicates the board in one way or another as a party, or as an active participant, and requires the directors' concurrence to resolve the conflict.

Corporate governance disputes emerge in many different ways. Common disputes include:

- ***Disagreements between the company's shareholders and the company or its board.*** A shareholder or a group of shareholders claims that their rights as shareholders have been violated or that their shares' value has declined.

- ***Disputes between the board and the CEO and/or senior management.*** The board hires the CEO and empowers him or her to manage the company. The board may question the CEO's performance or otherwise be dissatisfied with her or him. The CEO

may be concerned about the board's decision-making process. Both situations can create a poisoned atmosphere in which the company's productivity and value could be impaired.

- ***Disputes among board directors.*** These may include the chairman, the CEO, and all other executive and non-executive directors.
- ***Disputes between the board and employees' representatives.*** In such countries as Germany or Slovenia, where employees have a voice on the company's supervisory board, the differing concerns and views of labor and management can play out in the boardroom and, sometimes, spill into the media.
- ***Disputes between the board and communities and/or social activists.*** Other constituencies' disagreements with the company may become matters in which the board itself becomes involved. Questions regarding social policies, the environment, and sustainability become governance issues when these issues are directed at the company through either the proxy voting process or a demand for board action.

Differentiating Corporate Governance Disputes

To better understand what corporate governance disputes are, it is helpful to distinguish them from other types of disputes that may involve a company. For example, a dispute over a contract, a labor claim, or a commercial matter involves the company as an entity but does not pertain to its governance. These disputes are typically part of doing business, and it is generally up to management to resolve them. As part of its oversight and monitoring functions, the board is typically informed about significant litigation that may affect the company's reputation, operations, and finances. In addition, it is appropriate for the board to assure itself that the company has dispute resolution policies and mechanisms available to mitigate disruptions and limit expenses resulting from these disputes. But routine business or commercial matters are handled by management; the board does not take direct action in resolving them.

TO LEARN MORE ABOUT THE BOARD'S ROLE IN ADOPTING CORPORATE DISPUTE RESOLUTION POLICIES, SEE VOLUME 2 MODULE 1.

EXAMPLE

Common Corporate Governance Disputes
Brazil

On June 18, 2008, the Brazilian Institute of Corporate Governance (IBGC) organized a discussion forum on corporate governance and alternative dispute resolution.

Forty-six participants — consisting of lawyers, company directors, shareholders, consultants, academics, and two journalists — were given a questionnaire about the nature of corporate governance disputes. The questionnaire listed 10 types of disputes and provided space for comments. Participants were asked to mark the four most frequently occurring disputes based on their individual experiences.

Here are the results:

TYPES OF DISPUTES	OCCURRED
RELATED-PARTY TRANSACTIONS	61%
INVESTMENT DECISIONS	55%
RIGHTS OF MINORITY SHAREHOLDERS	52%
MANAGEMENT PERFORMANCE	52%
MERGER AND ACQUISITIONS DECISIONS	45%
NOMINATION/APPOINTMENT OF DIRECTORS AND OFFICERS	42%
DIVIDEND DECISIONS	36%
FINANCIAL RESTRUCTURING AND TURNAROUNDS	24%
REMUNERATION OF DIRECTORS AND OFFICERS	21%
OTHER (BUSINESS STRATEGY, CONFLICTS OF AGENCY)	12%
APPROVAL OF ANNUAL ACCOUNTS AND FINANCIAL STATEMENTS	0%

COMMENT

Since 2008, IBGC has used this questionnaire in some of its training programs, and every time, participants selected "related-party transactions" as the main cause for governance disputes.

SOURCE: IBCG.

GLOSSARY

Corporate Governance Disputes

- Corporate governance disputes involve corporate authority and its exercise.
- Parties to a corporate governance dispute may include the company's shareholders, its board members, and senior executives. Other stakeholders who challenge the company's governance, ethics, or strategy may also be involved.
- Corporate governance disputes typically require the board's attention, regardless of whether the board or individual directors are a direct party to the dispute.

Other Corporate Disputes

Corporate governance disputes differ from other disputes that a company may face. Here are some comparisons:

- **Commercial disputes** arise from the conduct of business. They involve such external stakeholders as clients, consumers, and suppliers. Thus, they represent a wide spectrum of issues. In all of these, something has gone wrong, at least in one party's view, during the normal course of business. The dispute may be over any number of issues — price, quality, contract terms, and payment, for example. Essentially, commercial disputes involve problems in which one or more parties claim that business transactions have gone awry. The board's role may involve ensuring that appropriate dispute resolution procedures are in place, but these types of disputes will typically be handled by management.
- **Financial disputes** can sometimes be viewed as a subset of commercial disputes. However, these disputes involve funds required for capital investment or business operations. They may involve such matters as rights and obligations under debt financings, collection of funds that are claimed, or other matters dealing with the debt portion of the company's financial structure.
- **Securities disputes.** Many disputes arise from the public trading of securities, such as stocks or bonds. In these disputes, one party claims, for example, that a rule has been violated, in the sale, purchase, or exchange of securities. Securities disputes may involve the parties who facilitate these transactions, such as stock exchanges or brokerages. Some securities disputes — where shareholder rights may have been violated — may also be governance disputes.
- **Labor disputes.** This category involves controversies between a corporation and its employees, or among a company's employees. Employment or labor disputes can typically involve disagreements over wages, benefits, or scope of work issues. Disputes between an employee and supervisor are another example. Employment disputes also can revolve around working conditions, such as safety matters, hours of service, and unethical or inappropriate practices (e.g., employment of children, discrimination, and harassment). Here, again, the board's role may involve ensuring that appropriate policies and procedures are in place, leaving management to handle the dispute.
- **Regulatory disputes.** Governments impose regulations and restrictions on companies and their operations. Companies or their executives often disagree with the regulatory agency's interpretation of its own regulations or with the application of those regulations to the company. These disputes involve the company and relevant regulatory agencies.

As a general rule, close scrutiny should be given to the parties' identity and the nature of the dispute to distinguish corporate governance disputes from other corporate disputes. For example, a dispute may arise between the board and management over a contract for services or goods that was awarded in violation of the company's policy on related-party transactions. This would be regarded as a corporate governance dispute. In contrast, if a dispute erupts between management and a supplier over the terms of the aforementioned contract, it would typically be a commercial dispute. ■

DISPUTES AFFECTING ALL TYPES OF COMPANIES

One can better understand the nature of corporate governance disputes and how these disputes can affect all types of companies by reviewing some basics about a corporation's organization. Corporate structures vary widely, but every corporate enterprise involves at least three core requirements: capital, labor, and leadership. Leadership is further divided between those who participate in the company's governance (directors) and those who are directly involved in supervising employees and producing goods and services (managers). The relationships and interactions involving these three business elements can be a fertile ground for disputes.

Theoretically, a corporation has perpetual life. This means that the corporation continues operating even when those who founded it, or work in it, are no longer involved. During its existence, the corporation will evolve, and many aspects of its governance will change, too, including its shareholders, management, and directors. What began as a small family business, or as a "dot com" start-up, may eventually become a large company whose shares trade on a stock exchange.

The enormous variety of corporations, coupled with different legal or cultural norms, can result in many situations in which governance disputes may erupt. Those involved in governance issues — directors, senior management, investors, and other stakeholders — should be cognizant of the kinds of disputes that can arise as the company's business, ownership base, and capital structure evolve.

Small Companies

In a small company owned by a single person, that person can fill all three core functions required to run a business — providing capital, leading/managing the business, and working to produce goods and/or services. That scenario becomes more complicated if the company's founders include several people who, along with running the business, must manage their relationships with one another. In other words, even in a small, closely held company, disputes can arise within the small group that owns and controls the business.

As the company grows, different people or institutions assume these roles. Capital may come from people or institutions that invest funds in exchange for equity ownership. It may also come from lenders — banks and other financial institutions.

Regardless of funding sources, shareholders elect the board's directors. The directors, in turn, hire the company's executive management, which is responsible for hiring labor and running the business. As the business expands, the composition of shareholders can easily become more diverse, often changing regularly — sometimes daily — through trading on an exchange, sales between individuals, and inheritance.

Management can change rapidly, too, as the business evolves. The founders who held executive positions may no longer work directly in the business. Their shares may become diluted when the company issues more shares to raise capital. As a result, they may no longer

QUOTE

Conflict in Family Firms

"Conflicts within family firms have a special character. In most cases, what is involved is not merely a difference of opinion about business policy but issues within the family and its history. The way in which conflicts are addressed in the family also has an impact on family firm conflicts. If there is little dialogue and consultation within the family, that will generally also be the case within the family firm."

JOZEF LIEVENS
PARTNER, EUBELIUS LAW FIRM
MEMBER OF THE FORUM'S PRIVATE SECTOR ADVISORY GROUP

SOURCE: Jozef Lievens. "Collaborative Conflict Resolution — the 'Harvard Approach' Applied to Family Business." 2002 working paper provided by the author to the GCGF.

EXAMPLE

Family Firm Dispute
India: Reliance Industries

Dhirubhai Hirachand Ambani founded Reliance Industries in 1966 to import polyester yarn and export spices. In 1977, he took the company public, and its turnover soared to $10 billion yearly by 2002 as the business expanded into petrochemicals, textiles, crude oil and gas production, and polyester and polymer products. Reliance Industries became one of India's most powerful non-state holding companies.

When Dhirubhai died in July 2002, the Ambani family was in control of 46.76 percent of the company. Yet the founder left no succession plan to determine the company's leadership. He left no will, either, meaning the business had to be shared with his two sons, two married sisters, and his wife. Neither the mother nor the two sisters expressed any interest in managing the business.

Dhirubhai's two sons — Mukesh Ambani, who earned an M.B.A. from Stanford University, and Anil Ambani, a graduate of the Wharton School — formally took the group's reins after their father's death. Rivalry for control between the two quickly emerged, resulting in an intense family feud that attracted media attention and worried investors.

On July 27, 2004, the feud was brought to a head when Reliance's directors approved a proposal to give Mukesh Ambani power to overrule Anil Ambani's decisions.

"The core of the differences, however, is said to be that Mukesh Ambani wants to take a larger control of Reliance Industries and its subsidiaries," the *New York Times* reported. "The fissures between the brothers, apparently, extend beyond the control of the Reliance group. Mukesh Ambani is said to be unhappy over Anil's recent plunge into politics and his nomination as a Member of Parliament."

On November 16, the rift spilled into the public arena. Mukesh Ambani told a journalist in Mumbai that there were "ownership issues" inside Reliance. The news prompted the biggest drop — a 3.4-percent decline — in Reliance shares in three months on November 19, the day the comments were widely circulated in newspapers.

On November 25, six of 14 directors of Reliance Energy quit without giving a reason. Reliance Energy's shares fell 6 percent, their biggest drop in six months.

In December, Anil questioned the company's decision to consider a share-buyback program, stating he was neither informed nor consulted on the issue, according to the *Times of India.* That public dispute added to the volatility of share prices for Reliance Industries, which lagged in performance behind those of the company's competitors.

In June 2005, the Ambani brothers agreed to split the $20-billion business and, thereby, end their ownership feud. Mukesh retained control of refining, oil, gas exploration, and chemicals, while Anil took cellphones, power, and financial services. The news caused shares in Reliance to hit record levels. "The trench war is finally over," one investor said. "I'm sure the stock will run up. It's positive for the shareholders and the stock market that the deal has been inked."

The calm was broken in February 2006, when Anil disputed the terms of a gas supply agreement with Mukesh, accusing Mukesh and his group of acting in an "arbitrary, non-transparent and unfair manner." The dispute headed to the courts in India.

Additional tensions surfaced in May 2008 when Anil's company, Reliance Communications Ltd., was in buyout talks with the MTN Group, South Africa's largest mobile phone network operator. Mukesh claimed he had first rights of refusal to purchase a controlling stake in Reliance Communications Ltd.

In January 2009, the Bombay High Court temporarily lifted a ban on the sale of natural gas, allowing Mukesh to tap the gas reserves.

COMMENT

This situation illustrates the problems that arise where there is no clear succession plan, and how family disputes, grounded in emotion and differences in business outlook, can undermine a publicly traded company. As reported (April 27, 2005) by the *International Herald Tribune,* "The brothers' feud at Reliance underscores how shareholder interests can suffer when family members cannot resolve fundamental problems." The long-running dispute between the brothers demonstrates how protracted conflicts can continue to emerge over new issues that draw from the tensions of earlier hostilities. The unresolved disputes affected share prices.

SOURCE: Saritha Rai, "A Family Rift Roils the Market in India," New York Times, *November 23, 2004. Available at: http://query.nytimes.com/gst/fullpage.html?res=9B0CE7D7163EF930A15752C1A9629C8B63. Abhay Singh and Ravil Shirodkar, "Indians Await Peace at Reliance."* International Herald Tribune, *April 27, 2005. Available at: http://www.iht.com/articles/2005/04/26/bloomberg/sxreliance.php. Ravil Shirodkar, "Reliance Shares Hit Record on Accord,"* International Herald Tribune. *June 21, 2005. Available at: http://www.iht.com/articles/2005/06/20/bloomberg/sxreliance.php."Face-off: Ambani Brothers Trade Fresh Barbs,"* Times of India. *February 5, 2006. Available at: http://timesofindia.indiatimes.com/articleshow/msid-1401519,prtpage-1.cms. Associated Press, "India's Ambani Brothers' Feud over Reliance Communications' Talks with South Africa's MTN."* International Herald Tribune, *June 17, 2008. Available at: http://www.iht.com/articles/ap/2008/06/17/business/AS-FIN-India-Reliance-MTN.php. Archana Chaudhary, "Indian Court Lifts Ban on Reliance's Gas Field Sales,"* Bloomberg, *January 30, 2009. Available at: http://www.bloomberg.com/apps/news?pid=20601091&sid=a13q.Oi0MQ9Y&refer=india.*

own a controlling share of the stock, losing their ability to determine which directors are elected.

With expansion comes the need, typically, to hire more people and to differentiate job responsibilities, including a separation of management from employees. While the employees may own stock, they typically do not own enough shares to control a board election.

In summary, as the business grows, the separation widens between ownership and governance, on the one hand, and between ownership and the management of the business, on the other. The increasing complexity and differentiation of functions can easily trigger disagreements and disputes.

Joint Venture Companies

A joint venture represents a strategic alliance between investors with complementary strengths. Invariably, the parties' ownership and control rights to a joint venture company are subject matter for corporate governance disputes. Disputes can erupt at the board over the strategic direction for the joint venture company. For example, a local joint venture's expansion into another market can threaten or bring more competition to one of its co-venturers that has a presence in that market, thereby leading to a split board. In situations where no single co-venturer has a simple majority on the board, such disputes, unless resolved properly, can sometimes lead to deadlocks.

Family Firms

Family-owned and -operated businesses are very common. The family itself provides a defined social structure, which can translate into a successful organization for a business. However, families are not simply groups of people who band together to conduct a business. They are bound to one another through emotional, social, economic, and legal relationships, which have the added overlay of cultural imperatives. Hence, governance disputes may result from familial clashes and vice versa. The factors that make family relationships strong and lasting can translate into a healthy governance structure. By the same token, factors that result in rancor or mistrust in the family can produce dysfunctional governance.

For example, as one generation retires or dies, the next generation must assume their predecessors' roles. This often triggers many issues. Do all family members wish to work in the business? Are all family members equally qualified, and do all family members work equally hard? How will succession be determined — by line of descent, age, gender, or non-familial criteria? Will rivalries and jealousies among family members play out in the governance of the business? These and other related issues can form the basis for bitter disputes if there is no process for resolution.

In a family-owned business, disputes initially would have been settled by the authority of the founder. However, as one generation succeeds the next, ties among family members tend to weaken. For example, the founder's authority over his children may be stronger than the relationships among the siblings who inherit the business. The next generation of the family may involve cousins, whose own ties may be substantially weaker than those of parent-child or sibling-sibling. Share ownership can become more fragmented over generations as each family member divides his or her shares among his or her children. Cousins do not respond to the authority of a patriarch or matriarch as their children would do. The jealousies that stem from sibling rivalries can translate into deeply emotional disputes over the course of the business.

EXAMPLE

Family Firm Dispute
Brazil

When the company's founder died, it was like opening a Pandora's Box. He had developed a market-leading, world-class company, and left it with a professional management structure and a shareholders' agreement, which included an arbitration clause. That failed, however, to prevent conflicts among the heirs. The founder's two sons soon engaged in a fierce judicial battle, which has lasted for more than three years. One brother is a big spender, whose top priority is to control the company and finance his lavish lifestyle. The other has large cash reserves, refuses to negotiate, and favors adjudication. They only speak to each other through their lawyers. The board consists of six non-executive directors, who were relatively successful in shielding the company from the conflict's effects but didn't stay neutral. The board's meetings became a fighting arena where lawyers set most of the strategy. The judiciary has been ineffective because judges often prefer a "Solomonic Justice" to balance the involved parties' interests instead of making decisions to help the company. The almost-ruined brother eventually escalated the conflict by seeking help from a "white knight," who proved instead to be a "knight of darkness" because of his shady methods. Prospects worsened for the shareholders and the company. The stakes got higher and the company began suffering as the dispute expanded to involve other stakeholders and attracted media attention.

COMMENT

The lack of succession planning is a common source of major disputes in family firms worldwide. Family business members often delay the process of succession planning for several reasons that are often influenced by the cultural context. In some cases, leaders find it difficult to let go. In others, succession discussions are postponed because of the fear that decisions could create conflicts and provoke criticism. In some cultures, it is furthermore difficult or uncomfortable to discuss a leader's retirement or death. Yet without proper succession planning, firms are left vulnerable after their leaders' retirement or death. This can lead to bitter and embarrassing disputes that can harm the company's reputation and performance.

SOURCE: Leonardo Viegas, Director, IBGC; Member, Forum's Private Sector Advisory Group

Independent or non-executive directors are often appointed to the board of family firms with the expectation that they will help resolve disputes among family board members. Yet, the appointed directors are not always prepared for that role and can find it disconcerting and challenging to handle those disputes and remain "neutral" as the dispute(s) unfold(s).

TO REVIEW THE SKILLS REQUIRED FOR CORPORATE GOVERNANCE DISPUTE RESOLUTION, SEE VOLUME 3 MODULE 1.

State-Owned Companies

For some companies, the government of the country in which the business is located may be a significant shareholder. In such situations, disputes can go beyond business issues and involve politics or public policy. In countries where public policy shifts from government ownership and industry control to privatization, the change in governance structure, the composition of the controlling group, and the company's perceived objectives can all become fertile ground for disputes.

Listed Companies

But what happens when the small, closely held business — family-owned or otherwise — prospers and grows? As the number of shareholders expands, only a few of them will sit on the board and participate in the company's governance. It is likely that no single individual or family member will own a controlling share of the company's stock. Capital requirements, or the lure of greater wealth for shareholders, may result in the company "going public." The company and/or its shareholders may sell shares to the public to raise capital. Since the company's shares will trade on public exchanges, the composition of the shareholders may change daily.

Shareholders often are institutions such as pension funds, insurance companies, foundations, venture capital funds, private equity funds, mutual funds, and hedge funds. A corporation may begin life with capital from an institutional source, and that institution may be one of the shareholders — or, perhaps, a controlling shareholder.

Once a company goes public, the people who become shareholders do so for their own financial investment

EXAMPLE

State-Owned Company Dispute
Bulgaria: E.ON Bulgaria

When the state of Bulgaria owned one-third of the regional utility company E.ON Bulgaria between 2003 and 2005, the government's relationship with the foreign owner grew increasingly strained. In 2005, Bulgaria's Economy Minister Petar Dimitrov raised questions about the owners' management in handling a sale of two power distributors in Gorna Oriahovitsa and Varna to Germany's E.ON. He also questioned the lack of dividend distributions that should have occurred when the sale was completed. The sale was initially drafted in late 2004 with an April 30, 2005 deadline. If concluded by that deadline, the 2004 dividend would be distributed proportionally to shareholders based on their equity holdings. E.ON Bulgaria did complete the sale in early 2004 but did not pay the dividend promised under the sales agreement. High restructuring costs in the two years prior to the utility's sale and booming construction caused demand for electricity to soar. The company maintained that the dividends were to be plowed into necessary investments to modernize the transmission grid, countering charges that the dividends were being expatriated.

COMMENT

In partially state-owned enterprises or partially privatized companies, disputes can easily erupt between private and public shareholders over the company's short-term strategic goals. The state as shareholder may have public policy expectations that are neither a priority nor a concern for the company. Whether state-owned or not, a board should act in the best interests of the company and all its shareholders. Yet, state representatives can find it difficult to ignore political and societal pressures that may conflict with the company's best interests.

SOURCE: "Bulgaria: Raps Power Distributors for Dividend Non-payment," Dnevnik, *August 9, 2007.*

objectives. Emotional ties do not enter the picture for shareholders, who may not have any direct relationship with the company's board or management. Thus, the company's ownership may gradually become divorced from control of its board and management. However, should these shareholders become dissatisfied with the company's direction or performance, they may seek to influence its governance.

The company may grow through mergers, acquisitions, or global expansion. Its culture may change. These developments, in turn, may bring in new directors and senior managers who have no experience working together.

As the company grows and changes, the possibilities for disputes increase exponentially. Tensions may arise among the directors. Companies founded by families may have directors, executives, or significant shareholders who are the founder's descendants. Or some directors may have developed emotional ties to the company. This emotional overlay can easily clash with the perspective of investors or directors who may be motivated by their own financial objectives.

Shareholders and directors with a long-term view of the company may accept lower financial returns in the short run to strengthen the company's future. Other shareholders or directors may favor short-term gains. Disputes around these and other strategic issues may emerge among shareholders or with the company's board. Unresolved, such disputes can reach a point where the disgruntled shareholders seek to replace some or a majority of the directors, exercising their power through voting rights that come with their stock. ■

EXAMPLE

Corporate Strategy Disputes

United States - UAE: Sonus Networks vs. Legatum Capital

Sonus and its largest shareholder, Legatum Capital of Dubai, are in talks to address several disputes.

In a June 18, 2008 statement, Legatum Capital of Dubai, which is said to hold 25 percent of Sonus Networks Inc., raised several issues and said it would withhold its votes for those directors standing for election to the board at the June 20 annual meeting. It said the company's stock price was sitting near a five-year low and complained that the three directors in question "have presided over years of poor operational performance," the "company lacks transparency" and "its board...is unresponsive to shareholder concerns."

Two days later, Sonus responded that it was disappointed with Legatum's statement and needed to know more about Legatum's structure. Sonus said its business touches on national-security telecommunications infrastructure in the United States. It was unclear who, via Legatum, hold Sonus stock.

At the annual meeting, shareholders elected the three directors including Chairman and CEO Hassan M. Ahmed. Legatum withheld its vote. Afterwards, Sonus said it was willing to discuss naming a Legatum representative to the board, after a review of that person by the board's nominating committee and subject to the two sides signing a standstill accord.

In mid-May 2009, the company named Richard N. Nottenburg as president and chief executive. He succeeded Ahmed, who continued as chairman.

COMMENT

This cross-border corporate governance dispute illustrates conflicting views over the company's strategy. While the dominant minority shareholder's priority is to seek greater involvement and better returns, one board's priority has been the preservation of national security interests.

SOURCE: Robert Daniel "Sonus in Talks to Address Legatum's Concerns." MarketWatch*, June 23, 2008. Available at: http://www.marketwatch.com/story/sonus-networks-uae-investor-in-talks-to-resolve-dispute.*

DISPUTES AFFECTING INTERNAL AND EXTERNAL CONSTITUENCIES

Most companies are likely to experience corporate governance disputes at some point. These disputes can fall into two broad categories: internal and external corporate governance disputes.

Internal governance disputes occur within the company, especially among directors or between directors and senior management. Such disputes often have their source in the relationship between the CEO and the chairman and/or other executive and non-executive directors.

External governance disputes involve constituencies that are outside the company — mainly shareholders. For example, dissident or dominant shareholders may see a change in the company's policies or in the board's composition. In some cases, other stakeholders, such as employees or communities, may have grievances that they want the board, rather than management, to resolve.

Internal disputes are obviously the most disruptive to board decision-making, but shareholder disputes are increasingly troubling directors. Unresolved, internal and external corporate governance disputes can impair the board's ability to function and improve the company's performance.

TO REVIEW THE IMPACT OF CORPORATE GOVERNANCE DISPUTES, SEE VOLUME 1 MODULE 2.

Internal Disputes

As boards generally operate out of the public's view, there is little empirical data related to internal disputes. Yet anecdotal evidence of board disputes that became public indicates that boards do not always function smoothly, that they sometimes experience discord and strife.

In the United States, listed companies must disclose the details of internal disputes involving directors when a director resigns or refuses to stand for re-election due to disagreements involving the company's operations, policies or practices.[2]

Boardroom disputes often reveal serious issues facing the firm. The revelation of these problems, in turn, can lead to large declines in share value, trigger changes in top management, and disrupt the board's work.

Boardroom disputes can be classified into three broad categories:

- Board processes
- Agency problems
- Corporate strategy

EXAMPLE

Board Composition Dispute
United States: Phoenix Timber Corporation

In 1985, a group of minority shareholders, led by board member Michael Hermann, sought to appoint three independent directors. The board's chairman then, Dennis Cook, wanted to keep executive members on the board. Hermann argued that the existing structure was counter-productive and lacked both innovation and team spirit due to intense competition internally. In a very stormy meeting, both sides claimed to represent the former CEO's legacy. Hermann's request was neither heard nor followed; the board structure remained the same. The board's instability nevertheless continued and led to poor corporate performance. Phoenix had to announce a substantial loss for that year. This, in turn, led to the resignation of several directors, including its chairman, in the year following the dispute.

COMMENT

Conflict within a board can erupt to the point where the board becomes paralyzed and ineffective. Unresolved boardroom disputes can lead to poor corporate performance.

SOURCE: R. Reuben, Corporate Governance: A Practical Guide for Dispute Resolution Professionals. *Washington, D.C.: American Bar Association, 2005.*

EXAMPLE

Disputes Leading to Director Resignations
United States

This table provides a classification of 168 disputes into four categories based on the main issue cited by resigning directors: agency problems, board processes, corporate strategy, and miscellaneous disputes. Dispute episodes are identified from SEC 8-K filings made between 1995 and 2006 that contain an *Exhibit 17* (director's resignation letter) citing disagreement.

CATEGORY OF DISPUTE	EXAMPLES OF ISSUES CITED	FREQUENCY
Board Processes	• Special board meetings were called on short notice regarding important matters • Directors were given insufficient information on financials and operations • Resigner was forced to vote upon unfamiliar matters without adequate board discussion • No review of corporate disclosures and executive employment contracts • Company made inappropriate use of resigner's name as signatory in 10-K filing • Dispute over money (cash or stock) owed to resigner • Directors and officers insurance coverage not renewed	65
Agency Problems	• Management seems to pursue its own interests, unconstrained by the board of directors • Excessive option grant to the CEO • Board decisions regarding management personnel that failed to protect shareholders' interests • Disagreement with adoption of shareholder rights plan • Calls for resignation of CEO/Chairman were ignored • Board's governance practices, especially CEO compensation and succession • CEO used pseudonym to post misleading messages on Internet stock message boards	42
Corporate Strategy and Financial Policy	• Disagreement over the company's direction • Company has moved away from its R&D focus, to the shareholders' detriment • Lack of clarity in business, marketing, and financial plans • Disagreement with management over how to restore the company to profitability • Board rejected takeover offer that would have added to shareholder value • Inadequate terms of private offer • Company is undercapitalized and, therefore, unable to deliver on long-term plans • Resigner disagrees with company's decision to enter into $15-million credit facility	43
Miscellaneous Issues	• Workplace environment was counterproductive • Management did not foster diversity in the workplace • CEO withheld wages from line employees • Payroll taxes were delinquent • Unspecified disagreement with the company's operations, policies, and practices	18

SOURCE: Anup Agrawal and Mark. A Chen. July 2008. "Boardroom Brawls: An Empirical Analysis of Disputes involving Directors." University of Alabama and Georgia State University. Working paper. Available at: http://papers.ssrn.com.

EXAMPLE

Corporate Strategy Dispute
Russia: TNK-BP

James Owen, the chief financial officer of TNK-BP, announced his decision to resign in August 2008. Owen explained why he was leaving his job in a letter to the TNK-BP CEO Robert Dudley and the board. In his opinion, the board's conflict with the shareholders did not allow him to fulfill his duties as a financial director in a transparent, independent way.

After assuming the CFO position in January 2006, Owen became a member of senior management at TNK-BP. He participated regularly in board meetings and was chairman of key corporate governance committees. Prior to this position, he worked for Chevron.

The corporate conflict between the Russian and British shareholders of TNK-BP involved disputes about the company's strategic development and corporate governance. The Russian shareholders insisted on TNK-BP expansion in international markets, even if this competed with BP. They suggested that BP have independent directors on its board to secure parity with the TNK-BP board and its "daughter" companies. The Russians proposed that Dudley be exchanged for an "independent" director.

The Russian shareholders also requested that their British counterparts maintain a balance between the number of foreign and Russian experts working in TNK-BP. British shareholders had already refused these suggestions. As of October 2008, the conflict was pending in the court. Dudley had to leave Russia and continued managing the company from abroad.

COMMENT

This example shows how strategy and governance disagreements can evolve into destructive disputes that may disrupt the board's work, harm the company's reputation, and lead to the resignation of key executives.

SOURCE: RBC News, *"English CFO Resigns."August 4, 2008.*

EXAMPLE

Corporate Merger Dispute
United States: Hewlett-Packard

In 2002, the board became embroiled in a fight over the company's strategy, specifically whether HP should merge with Compaq. Every director supported the merger except for Walter Hewlett, the son of HP co-founder Bill Hewlett. Soon after Hewlett voiced his opposition, the family of David Packard, the other co-founder of HP, announced its support of the Hewlett family's position. Together, the two families owned 18 percent of the outstanding voting shares. The rest of the board was very vocal in supporting the merger; they authorized letters to shareholders that discredited Hewlett's opinion, saying that he was a "musician and academic" and "never worked for the company." Walter Hewlett responded by revealing that the CEOs of the two companies would receive a total compensation package of $115 million if the merger were to be completed. HP management then accused Hewlett of disseminating misinformation about employment terms for senior executives. They also clarified that the then CEO of HP, Carly Fiorina, would only get a sizable compensation package if she remained in her position for three years and delivered a significant increase in the share price. The dispute between Hewlett and the board led to a costly lawsuit. Hewlett was not reappointed as a director on the merged HP-Compaq company, and the company's image was hurt by the media campaign.

COMMENT

This famous dispute shows how sensitive mergers and acquisitions can be, and how easily they can lead to costly disputes. Moreover, this dispute provides insight into how business and personal issues become intertwined as disputes escalate. Such disputes often cannot be contained within the boardroom. The media becomes a battleground for the parties involved.

SOURCE: R. Reuben, Corporate Governance: A Practical Guide for Dispute Resolution Professionals. *Washington, D.C.: American Bar Association, 2005.*

While some dissension in a group may be inevitable, in a corporate environment, certain situations significantly increase the risk that a disagreement will devolve into a dispute. Often, these situations occur during transitions and before or after certain momentous events:

- ***Adopting new strategies.*** When the company needs to change course, directors' opinions may differ or their understandings may vary as to what the new strategy should be.

- ***Mergers and acquisitions.*** A company can undergo tremendous structural and strategic changes during its existence. Mergers and significant acquisitions can alter a company's culture and dynamism, particularly if the company finds itself embarked on a different course from the one before the merger. Not all directors may be comfortable with the changes.

- ***Fundamental change in the corporation.*** Determining the company's ultimate course can exacerbate board tensions. For example, overtures from private equity concerns to buy a company and take it private involve questions about whether the company is to continue in its present form. The possibility of a merger or sale of a substantial part of the company raises profound business issues, but it often has an emotional component.

- ***Transformation from not-for-profit to for-profit company.*** Non-governmental organizations are often inclined to swap the not-for-profit company model with a for-profit one to attract more capital to meet their growth challenges. For example, microfinance institutions are increasingly experiencing such a transformation by establishing themselves as banks to mobilize deposits and diversify their product range. Board disputes at such companies may arise where some board members fear a "mission drift" and want to continue to align the company's social objectives with those of its shareholders to make profits.

- ***Crisis situations.*** Not all directors have the same approach to crisis management. Such situations can easily lead to counter-productive disputes in the boardroom. Whether the crisis is due to alarming financial results, major quality issues with its products or services, a natural disaster, directors' views on how to weather the crisis often diverge. Some board directors tend to want to minimize the problem's impact while others prefer to widely disclose (beyond mandatory disclosure requirements) the problems — even if this may result in a short-term drop in share value.

- ***Post-crisis environments.*** When the company has emerged from a significant crisis — financial, operational, government inquiry, litigation, etc. — the crisis itself may have been the board's unifying element. The immediate objective of surviving the crisis supersedes other goals. Once the crisis is over, the board may find itself without shared goals or strong bonds to unite the directors. As a result, differences may arise regarding corporate strategy and goals.

Board composition changes over time. Some members leave, and new people take their places. These changes don't always go smoothly, especially when they involve either a large number of directors or the appointment of a new CEO or chairman.

FOCUS

Not Every Disagreement Is a Dispute

Discourse and debate are at the heart of the board's work. A significant objective of having a diverse, independent board is to include a broad spectrum of views and ideas in the directors' deliberations. Differing views, perspectives, and ideas foster constructive debate. This brings more information into the decision-making process, challenges assumptions, and sharpens focus. Debate, however, should not be a free-for-all shouting match. Rules and procedures should be established to ensure that the debate is orderly and productive.

- ***Change in board composition.*** Changes in the board's composition that involve a significant number of new directors in a short time can lead to misunderstandings and increase disputes markedly. For example, a merger may involve directors from the acquired company joining the acquirer's board. Or, an entirely new board may be formed, and the directors may not be familiar with one another since they haven't worked together before. Until the group's members have experienced working together, the risk of underlying discord and overt disputes is substantially heightened.

- ***Succession on the board and in management.*** Choosing successors involves agreeing on the company's current and future needs. In turn, these perceptions are related to understandings of long-term strategies. When directors do not agree on these fundamental matters, disagreements and disputes emerge.

- ***New CEO; new chairman.*** When either the CEO or the chairman is new, he or she must simultaneously master his or her new job while developing relationships with the directors. These daunting tasks are rife with possibilities for misunderstanding and poor communication. Trust is imperative for good CEO-Chairman-Board relationships, and anything that impairs building and sustaining that trust presents opportunities for dispute.

- ***Directors nominated by dissident shareholders.*** Once someone is elected to a board, he or she must use his or her best judgment and act only in the interests of the corporation and its shareholders. Thus, directors nominated and elected by dissident shareholders should not simply serve as representatives or mouthpieces for the specific interests and investment strategies of those who nominated and voted for them. However, as a practical matter, when directors nominated by dissident shareholders are elected, they join the board with opinions about the company's focus and direction that likely differ from those of the incumbents. This clash of ideas and vision becomes immediately ripe for disputes.

Other issues with a high risk of dispute involve ongoing irritants to the board's functioning. These include:

GLOSSARY

Dissident Shareholders and Directors

- **Dissident shareholders** oppose a firm's management or management policy. For example, dissident shareholders of Hewlett-Packard opposed that firm's offer to purchase Compaq Computer.
- **Dissident directors** wish to change a firm's policies and generally act in opposition to the other directors' currently held views.

SOURCE: http://financial-dictionary.thefreedictionary.com.

EXAMPLE

Capital Increase Dispute
Kenya: Tsavo Securities Group

In October 2008, Kenya's *Business Daily* reported that disagreements among the directors of the financial advisory and stock brokerage agency, Tsavo Securities Group, have heightened concerns over corporate governance of capital market intermediaries.

Tsavo is the second case in a short span of time where boardroom intrigues have threatened sound management of a securities industry firm. The battles at Tsavo are believed to have been sparked by the company's attempt to raise more capital to finance its expansion through a Sh250-million private placement.

COMMENT

Although most board disputes remain in the boardroom, the media are increasingly reporting on internal corporate governance disputes, which likely tarnish the company's reputation.

SOURCE: Emmanuel Were and Eunice Machuhi, "Boardroom Intrigues Threaten Tsavo Securities." Business Daily, *October 17, 2008. Available at: http://www.bdafrica.com.*

- ***Failure to respect the board's role versus management's role.*** Boards have an oversight and policy role. If directors begin to cross the line and start managing, or if management does not respect the board's role, the company is headed for trouble. Similarly, management may overstep its role, intruding on areas which the board feels are its own. In a two-tier board structure, this would translate as the failure to respect the supervisory board's role versus the management board's role.

- ***Board-CEO difficulties.*** The board depends on the CEO to run the company and develop strategies that the board can scrutinize and adopt. The CEO typically has a dual role — manager and board member. Relationships with the CEO can be fraught with opportunities for dissent.

- ***CEO-Chairman difficulties.*** In companies where the positions of chairman and CEO are separated or in a two-tier board structure, major conflicts can arise between dominant personalities who espouse different visions for the company or who fail to understand the parameters of their different roles.

- ***Dissatisfaction with content and conduct of board meetings.*** Whether the meeting chair is the problem, or whether the board has been using procedures that prevent discussion, dissatisfaction with the meeting itself can become an ongoing irritant.

EXAMPLE

Board versus CEO Dispute
United States

The newly recruited CEO quickly realized that the mid-cap, technology-related company's principal product faced obsolescence. With the help of outside consultants, he developed alternate strategies, one of which the board, after some convincing, adopted. As a first step in executing the new strategy, he acquired another mid-cap company. The strategy paid off: the stock price jumped, Wall Street was happy, and the board's kudos came.

Several months later, the board summoned the CEO, to his chagrin, to a special meeting. At that meeting, the lead director handed him a three-page letter charging him with violating company policy, including breaches of the ethics code. A highly ethical person, the CEO did not believe that he had ever violated the ethics code. The board's action left him without an opportunity to refute charges. Furious, hurt, and embarrassed by what the CEO perceived to be grossly unfair actions by the board and its sudden change in support, he resolved to bide his time, wait until his time-restricted stock vested, and then resign. The dispute with the board was never resolved even though, from the point of view of the overall business, the CEO had driven an effective strategic turnaround. Ultimately, the CEO left the company citing "health reasons."

COMMENT

In this case, tensions had obviously been building between the board and the CEO. The CEO failed to bond with the directors and understand their individual views about the company and its business. The board made no effort to work with the CEO, explain its concerns, and attempt to resolve the problems before they escalated into a confrontation. No director acted as the CEO's mentor.

This case illustrates the potential consequences when virtually no dispute prevention and management techniques are employed. Since communications were ineffective, issues simmered below the surface, and there was no effort at collaborative problem-solving between the board and CEO.

- ***One or more poorly performing directors.*** Being a director involves a great deal of work and responsibility. Directors who do not share the load, or whose performance is lacking, hamper the entire board in accomplishing its objectives.

- ***Potential conflicts of interest.*** When conflicts of interest appear, directors may be pulled in different directions. For example, in a private equity situation where the CEO will be given the opportunity to continue in his or her role after the company is taken over, the CEO's personal interests may be different than those of other shareholders. A CEO, who is also a director and pushes an agenda that benefits himself or herself, can create disagreements and disputes within the boardroom.

- ***Personality clashes.*** Sometimes disputes occur because personalities clash. Two directors may simply dislike one another, and their antipathy can poison the board's atmosphere. Whether directors like one another is not a criterion for board membership. People must put their personal and emotional differences aside when serving together on a board. Disputes between the chairman and the CEO — with one or the other trying to dominate the board — can be especially disruptive to the board's work.

- ***Confrontational directors.*** Periodically, some people serve on boards who are contrarians or who, because of personality or other issues, cannot arrive at a consensus with others when acting as directors. This type of personality creates a constant series of disputes. Sometimes, a director is by temperament a contrarian who makes a point of contesting the prevailing view. In other situations, particularly those involving less experienced directors, the director may not understand that one can argue a case and participate in a debate without adopting a confrontational attitude. Similarly, less experienced directors may initially feel that their status as an independent director requires them to overtly confront management. Being a contrarian and challenging prevailing norms can be healthy and invigorating for a board. However, the challenge for the board is to encourage independent thinking

QUOTE

Board Disputes

"Board disputes usually involve a firm's top management and rarely occur just among outside directors. Moreover, in most cases, these disputes are related to substantial rifts between the views of directors and management regarding board functioning, agency problems, firm strategy, or specific corporate control or financing transactions. This suggests that board disputes are likely the result of power struggles between top management and certain board factions."

ANUP AGRAWAL
PROFESSOR, UNIVERSITY OF ALABAMA

MARK A. CHEN
PROFESSOR, GEORGIA STATE UNIVERSITY

SOURCE: Anup Agrawal and Mark A. Chen, "Boardroom Brawls: An Empirical Analysis of Disputes Involving Directors." July 1, 2008. Third Annual Conference on Empirical Legal Studies Papers. *Available at: http://ssrn.com/abstract=1101035.*

EXAMPLE

Board versus CEO Dispute
United States: Merrill Lynch

Merrill Lynch Chairman and CEO Stan O'Neal came under fire in 2007 when the world's largest brokerage firm announced third-quarter losses of $2.3 billion. Yet it was O'Neal's exploration of merger possibilities with Wachovia — without the board's knowledge and approval — that led to the loss of support of the firm's 11 directors in what was called a corporate mutiny. O'Neal was dismissed in October 2007.

COMMENT
To avoid disputes over the board's role versus that of management, all directors and senior executives must have a clear, common understanding of the board's duties and responsibilities.

SOURCE: NPR, October 30, 2007. Available at: http://www.npr.org/templates/story/story.php?storyId=15768986 .

and debate and to arrive at consensus without the deliberations devolving into internecine disputes.

- ***Adverse regulatory finding.*** Management is charged with running the company in accordance with all applicable legal requirements. If regulatory agencies accuse or determine that the company has violated a regulation, recriminations can start and become a source of dispute.

- ***Executive misconduct.*** When the CEO is accused of misconduct, or if the board believes the CEO has engaged in misconduct, whether true or not, misunderstanding and dispute could arise.

When the circumstances described above occur — or are even suspected — boards should recognize the increased risk of a dispute following shortly thereafter. In such cases, risk-management responsibilities involve recognizing the heightened risk and developing or activating processes and procedures to resolve disagreements before they become disputes, or, if the disputes occur, to bring parties together to develop a consensus.

TO REVIEW PROCESSES AND TECHNIQUES TO PREVENT AND RESOLVE BOARDROOM DISPUTES, SEE VOLUME 2 MODULE 1.

External Disputes

Not many years ago, directors rarely had any direct contact with the company's constituencies other than management. The rationale for the board's isolation was simple: To ensure that the company spoke with a single voice, boards left it to management to communicate directly with outside stakeholders, including shareholders. Times have changed. Shareholders are no longer passive. As a result of high-profile scandals and growing mistrust, shareholders are now more actively scrutinizing companies' strategy and performance while increasingly seeking involvement in board matters.

Dominant shareholders (large institutional investors, for example) often loudly express their disagreements with board policies and actions. Increasingly, unhappy shareholders more frequently nominate their own slates of dissident directors when they have failed to resolve their issues with the board. Disputes that go unresolved

EXAMPLE

Corporate Merger Dispute
Germany: Deutsche Telekom and T-Online

The majority of T-Online shareholders had given the go-ahead in April 2005 for the reintegration of the company into Deutsche Telekom, the German telecommunications giant. Yet, Deutsche Telekom could not move forward with its plans to reintegrate its separately listed Internet arm T-Online because several shareholders opposed the offer's terms. T-Online asked the court to allow its merger with Deutsche Telekom to be completed despite objections from dissident shareholders. Yet the court ruled against the merger, and T-Online had to appeal the ruling by the regional court in Darmstadt. A year later in June 2006, the Federal Court of Justice cleared the way for the merger.

COMMENT

This case shows how legal battles related to corporate governance disputes can delay important strategic decisions. Yet, Deutsche Telekom's problems with shareholders did not end there. Some minority shareholders continued to contest the share exchange ratio of the merger, saying it did not reflect the value of T-Online shares. In March 2009, a court ruled the German telecommunications giant must reimburse former T-Online shareholders. The cost could total $252 million. Plaintiffs still consider the figure too low and could file a new complaint with the courts.

SOURCE: Agence France Presse. November 29, 2005.

EXAMPLE

Corporate Strategy Dispute

Canada: Environmental Management Solutions Inc.

In a press release issued on March 3, 2005, the Dissident Shareholders of Environmental Management Solutions Inc. (EMS) announced that they had filed court affidavits designed to ensure that the Special Meeting of EMS shareholders be held as scheduled on March 17, 2005. "The meeting was called because they have completely lost confidence in the current board of directors. The drastic change in the vision, direction and strategy of the company has been disastrous for all shareholders. They believe the current board is attempting to delay the Special Meeting in order to allow time to continue with the strategy of selling off core assets and divisions of EMS.

"The Dissident Shareholders believe that this is the wrong strategy for the company and will only continue the process of eroding shareholder value. On January 20, 2004, the day the current board was announced, EMS's shares traded at $3.60 per share. The share price at close of trading on the Toronto Stock Exchange on March 2, 2005 was $0.78 per share, a reduction of 78 percent.

"The shareholders of EMS must be given the right to elect a slate of directors that will immediately fix the critical financial state of EMS and put appropriate bonding in place so that EMS can bid on significant contracts. Unless the March 17, 2005 meeting proceeds, a new board is elected and appropriate financing is put in place, EMS will lose the opportunity of submitting bids for millions of dollars in contracts and EMS and its shareholders' interests will be further irreparably damaged…

"The Dissident Shareholders believe that EMS's present business model has changed so drastically that it no longer supports the total solutions approach but rather has become an organization with a loss of identity, direction and vision. The Dissident Shareholders believe in the original vision and strategy upon which EMS was founded, to become a national integrated service provider to the environmental remediation industry."

COMMENT

Shareholders including dissident and minority shareholders, are increasingly challenging major board decisions. If shareholders' opinions and questions are not dealt with in a timely, proper manner, disputes are likely to erupt, and, in turn, be disclosed to the media and/or brought to court.

As in this case, the cost of these disputes can be extremely high. The EMS 2005 Annual Report stated: "The former President and CEO, upon his termination, feted a number of suits against the Company and Board of Directors. These costs, along with the associated costs of defending against a dissident shareholder requisition led by the former CEO resulted in restructuring charges and other items of $5.3 million during the twelve months ended December 31,2005 composed of:

- $1.0 million in severance expenses for employees terminated throughout the Company;
- $2.0 million of corporate legal, forensic accounting and consulting charges related to reorganizing the office of the CEO;
- $1.7 million for the settlement of litigation brought about by the former CEO and related parties;
- $0.3 million of premises closure costs and costs to exit leased facilities; and
- $0.3 million in additional costs associated the special shareholders meeting;
- Other costs related to the reorganization of the Western Canadian operations were classified as part of discontinued operations."

Furthermore, the report notes that, "While the possibility of litigation is a risk faced by most companies, EMS spent most of 2005 involved in litigation with various parties associated with former CEO Frank D'Addario that posed a threat to its viability as a business. The uncertainty caused by these legal actions was a barrier to restructuring its long-term loans, arranging for future financing and securing bonding required for it to win significant new contracts. The settlement negotiated in 2005, and completed in the first quarter of 2006, reduces continuing costs and, more importantly, removes significant uncertainty about the future of the Company."

SOURCE: Business Wire, "EMS Dissident Shareholders Seek to Protect Shareholders." Available at: http://www.allbusiness..com/company-activities-management/company-structures-ownership/5029597-1.html. Environmental Management Solutions Inc. Annual Report 2005 Business Wire, March 3, 2005. Available at: http://www.englobecorp.com/pdf/annual-report/2005_Annual_Report.pdf.

EXAMPLE

Financial Disclosure Dispute
Bulgaria: Petrol

In June 2008, bondholders for the Bulgarian fuel retailer Petrol were concerned about the company's failure to disclose its audited, consolidated financial figures for 2007. Petrol had placed a Euro100-million bond offering with an 8.375 percent coupon in October 2006, these bonds traded on the London Stock Exchange.

At that time, the bondholders said the consolidated report was two weeks late and that their requests for information from Petrol went unanswered.

Off the record, company sources blamed the delay in its financial reporting on the sale of 75 Petrol filling stations and a fuel base to local rival Lukoil. The deal apparently triggered the need for corrections in the 2006 and 2007 consolidated reports.

Petrol had already revised upwards 2.3 times its net unconsolidated profit for first quarter 2008 to BGN103.7 million as a result of the Lukoil transaction.

The bondholders also complained that they had not been able to obtain information about plans for spending the proceeds from the Lukoil deal.

A Petrol bondholder revealed that they were very happy with the business model of the fuel retailer and with the amicable resolution of its spat with Lukoil. But the fact that the bond is trading below nominal value is a source of concern, and they would like management to shed light on the company's activities.

Petrol announced that it would invest most of the proceeds in an expansion of its business to quickly offset the loss of market share after the sale of 75 outlets to Lukoil.

However, the sale of a sizeable chunk of assets is a trigger event that could prompt bondholders to seek accelerated repayment of their principal, according to some bondholders.

Under the notes' conditions, Petrol is obliged to invest the proceeds from the sale of Petrol stations in a similar business activity or otherwise seek investors' consent to channel the funds into another business.

Clouds thickened above the Bulgarian fuel distributor after the global rating agency Fitch Ratings on September 30, 2008 placed its solvency and bond ratings on Rating Watch Negative.

The move was triggered by bad corporate management in spending BGN463.5-million of asset sale proceeds on share buybacks in the second quarter 2008 and, other purposes veering off from the business expansion plan laid out to the agency.

The fuel distributor repurchased stocks worth more than BGN90-million to distribute dividends to majority owners at the bondholders' expense, threatening the company's liquidity, Fitch said.

The agency warned that, unless Petrol delivered extra information on the wrongdoings, its rating outlook may be downgraded to negative. Petrol told Fitch that the share buyback is a temporary investment.

COMMENT

This case illustrates a public dispute between corporate bondholders and shareholders that badly reflects on the company and its board. The board is expected to be more transparent about the company's plans and to resolve the dispute to reassure bondholders, reverse the bad rating, and improve its image in the media.

SOURCE: Dnevnik Daily, *June 4, 2008.*

can threaten the company's governance structure and performance.

Several situations in particular can lead to disputes between the board and shareholders. In Finland, for example, the most common dispute is related to the valuation of share prices during a merger or acquisition. It is typically a battle between the majority shareholders, who initiate the transaction, and minority shareholders, who fear they might be sold short. Unresolved, these disputes can lead to high-profile court cases, heighten reputational risk, impair governance, and threaten to change the company's course. Not all shareholders act and think alike. Shareholder disputes involving shareholders can become extremely complex given the with various viewpoints involved.

Matters and areas that are increasingly leading to battles between the board and the company's shareholders include:

- ***Mergers and acquisitions.*** Disputes between shareholders and boards regarding a proposed acquisition or disposal of a substantial part of the company's assets are common.

- ***Takeover procedures.*** Shareholders increasingly scrutinize terms and conditions of a proposed

EXAMPLE

Share Value Dispute
Russia: UTK

In December 2004, despite the independent directors' objections, UTK's board decided to sell 52.5 percent of its shares in Telesot-Alania for $6,196,575. UTK's independent directors believed that this transaction price was below market value based on estimates from rating agencies.

In December 2005, their assessment was confirmed when MTS bought the remaining 47.5 percent of Telesot-Alania from a third party for $32,600,000. The share value of Telesot-Alania was five times higher in December 2005 then in the previous year when the company's controlling stake had been sold.

Under Russian law, although the board assesses the monetary value of assets, that valuation has to be based on fair market value.

On June 21, 2007, the Investor Protection Association, on behalf of UTK minority shareholders, filed a court action against UTK's board for damages suffered by the company.

The minority shareholders argued that the loss of profit due to the sale of undervalued shares in 2004 caused UTK to suffer substantial damages. UTK minority shareholders requested that UTK directors indemnify the company for damages estimated at $8 million.

On August 30, 2007, the Moscow Arbitration Court (Commercial Court) dismissed the case after a first hearing. Dissatisfied with the decision, the Investor Protection Association is continuing to seek redress on behalf of minority shareholders.

COMMENT
Worldwide, minority shareholders are increasingly scrutinizing important decisions made by boards and are demanding action if they feel their rights have not been respected or — as in this case — they believe that the board made a decision that was not in the company's best interest. This example also shows that major disputes may rise among shareholders — especially between controlling shareholders and minority shareholders.

SOURCE: Investor Protection Association, Russia — June 8, 2008.

takeover, including compliance with internal (e.g., articles of association) and/or external (e.g., listing rules, securities legislation) rules.

- ***Share and bond valuation.*** Disputes between shareholders and the board on the share/bond valuation method are increasingly common when there is a compulsory acquisition of the stakes of a small group of shareholders from a joint stock company by means of cash compensation ("squeeze out"). In Germany, for example, a pool of shareholders owning at least 95 percent of a company's shares has the right to squeeze out the remaining minority shareholders by paying them an adequate compensation. The decision to enforce a "squeeze out" must be made by voting at the general meeting. Since the major party already

EXAMPLE

Sustainability Dispute
United States: Exxon Mobil

A group of pension funds and institutional investors accused Exxon Mobil Corp. of failing to act on global warming concerns and demanded a meeting with the company's board over the issue.

Exxon Mobil had long been a target of environmentalists and activists for questioning the science behind global warming.

Demands for the company to do more to address climate change concerns and invest in renewable energy sources gathered momentum in the days ahead of the company's annual meeting, scheduled for May 31, 2006 in Dallas.

The group, comprised of pension fund trustees from eight states and New York City, as well as eight other institutional investors, said they were concerned that Exxon's handling of the climate change issue left it lagging behind its peers, such as BP and Royal Dutch Shell.

"Exxon Mobil is making a massive bet with shareholders' money that the world's addiction to oil will not abate for decades," Connecticut State Treasurer Denise Nappier said in a statement. "As investors, we are concerned that Exxon Mobil is not sufficiently preparing for 'tomorrow's energy' and runs the risk of lagging significantly behind its rivals."

In response, Exxon said it had an ongoing dialogue with the group's members and was setting up a meeting in July 2006 to discuss these issues.

However, the July meeting was only expected to be with Exxon staff, a spokeswoman for the investor group said, noting they were seeking an audience with the company's board.

Exxon released its annual corporate citizenship report, saying it is responding to the climate change issue by improving energy efficiency and cutting greenhouse gas emissions, among other things.

"In part, our position includes the fact that we recognize that the accumulation of greenhouse gases in the Earth's atmosphere poses risks that may prove significant for society and ecosystems," Exxon Mobil said in a statement. "We believe that these risks justify actions now, but the selection of actions must consider the uncertainties that remain."

COMMENT
Shareholders are holding companies accountable to their obligations for sustainable business practices. Engaging in a dialogue, sharing ownership for the issues, and demonstrating commitment in addressing shareholders' concerns are some of the ways in which boards can resolve conflicts.

SOURCE: Reuters, "Investors Attack Exxon on Global Warming." May 19, 2006 Available at: http://www.enn.com/top_stories/article/4288 .

commands the vast majority of votes, this usually is a mere formality. The compensation value is determined by the company's financial situation when the general meeting occurs, the minimum compensation being the share's average price during the past three months.

- ***Lack of disclosure.*** Disputes between shareholders and boards often concern the poor quality of financial disclosure and the lack of nonfinancial disclosure based on best practice and regulations.

- ***Shareholder agreements.*** When acquiring a company's stock, major shareholders increasingly sign a shareholder agreement that describes the company's governance, including bylaws on the sale and purchase of shares, investment policies, etc. Although they can help protect investors, these agreements can also be a fertile ground for disputes.

- ***Non-respect of corporate governance best practices.*** With the adoption worldwide of corporate governance best practice codes and stock exchange listing requirements, shareholders can review the governance of the companies they invest in by accessing the companies' websites and comparing company practices against governance norms. Disputes may arise over the interpretation and implementation of codes and the effective application of the "comply or explain" principle as provided in many corporate governance codes.

- ***Discharge of individual board members/executives.*** Shareholders more actively express their satisfaction or dissatisfaction with board members. Disputes may erupt over the performance of individual board members and/or the alleged mismanagement of a senior executive.

EXAMPLE

Cross-Border Dispute
Malaysia: Nike - Hytex

Nike, Inc. said it has taken steps to correct worker-abuse problems at a factory it uses in Malaysia. The athletic apparel giant said its actions reflect its concern about the country's chronic labor shortage and how it affects factory workers.

Nike alleged abuses at Hytex Integrated Bhd., a Kuala Lumpur-based garment manufacturer that owns a factory producing Nike T-shirts. Nike, which is based in Beaverton, Oregon, said it had completed its initial investigation into "claims of unacceptable living conditions, withholding of worker passports, and garnishing of wages" that began after an Australian television report alleged worker mistreatment at Hytex.

Michael Saw, executive director of Hytex, said the company met with Nike compliance officials to discuss violations of Nike's code of conduct for foreign contract manufacturers, and that Hytex has "rectified" the issues. "We have been working for Nike for the past 15 years," Saw said, maintaining that the allegations of abuses by the Australian reporter were "out of proportion" to the facts.

Nike itself has battled criticism of its labor practices since the 1990s.

COMMENT

Investors and stakeholders are increasingly pressuring companies to adhere to practices that ensure employees worldwide have humane working conditions. As a result, CSR and governance policies adopted by international companies can result in disputes with their subsidiaries or suppliers. These cross-border disputes can be further complicated by differences in laws, social mores, judicial processes, and corporate governance practices.

SOURCE: The Wall Street Journal Asia. *August 4, 2008.*

- ***Nomination/appointment of board members.*** Disputes can easily emerge among majority and minority (or dissident) shareholders and between shareholders and the board over the nomination or appointment of board members and senior executives, as well as over the nomination criteria.

- ***Remuneration/bonuses of board members and senior executives.*** Disagreement over the remuneration and/or bonuses of board members and senior executives, as well as with the board's compensation policies is, effectively, a disagreement with the board's performance as overseer of the company's management. If the board's compensation decisions are rejected, directors suffer public embarrassment, and it becomes clear that the board and the shareholders, whose interests the board represents, are not in alignment. "Say on pay," in which shareholders express their approval or disapproval of senior executive compensation, is a sensitive, highly publicized issue that can trigger disputes.

  In jurisdictions where "say on pay" is not required, the question as to whether the board should adopt this practice can itself be contentious.

- ***Corporate social responsibility.*** Social and ethical issues involving the company's broader range of stakeholders are increasingly becoming an issue for shareholders, especially institutions that invest across borders. Disputes may arise over shareholders' concerns about employment policies and/or the company's interaction with the communities or even the countries in which it does business.

- ***Sustainability.*** As the world increasingly focuses on matters involving sustainability, questions arise about the company's long-range future and the strategies that will increase the company's value while working to protect the environment and operate in a sustainable manner.

- ***Cross-border operations.*** Globalization and cross-border trade increase a company's risks that social, political, and cultural differences can create deep rifts between the company and its external constituencies. Reputational and operational risks can increase dramatically.

When a company's business crosses national borders, or when shareholders and directors come from different countries or cultures, the potential for a dispute increases. Different perspectives may exist as to a company's purpose and whether that purpose involves creating wealth for the company and its shareholders, or whether the company exists principally to perform a certain public function. For example, in some countries, the primary purpose of utility companies, such as electric or water companies, is serving the public good. Directors and shareholders from different national or cultural perspectives may view the same company's principal purpose as creating shareholder value as measured in financial terms. Thus, different national, political, or cultural perspectives can result in decision-makers using various criteria to shape their view and decide their vote. These different perspectives can become the basis for severe disputes deeply rooted in cultural values and perceived national or political interests.

Other issues involving culture and national law or policy can easily exist in the ethics arena, or in situations in which the policy of one country differs from that of another. Global companies may have conflicting laws and different ethical mandates to address. ■

Endnotes

1 This definition of corporate governance was provided by Sir Adrian Cadbury in 1992 in the *Report on Financial Aspects of Corporate Governance in the United Kingdom.* London: Gee and Company. Available at: http://www.ecgi.org/codes/documents/cadbury.pdf.

2 Anup Agrawal and Mark. A Chen. July 2008. "Boardroom Brawls: An Empirical Analysis of Disputes involving Directors." University of Alabama and Georgia State University. Working paper. Available at: http://ssrn.com/abstract=1101035.

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Companies, their boards, investors, and other key stakeholders need to care about corporate governance disputes because once they arise, they can harm the company. Left unchecked, corporate governance disputes can have a highly negative impact on the company's reputation, operations, and performance and thereby lead to a loss in shareholder value and market standing.

Although the court is the traditional way of resolving disputes in many jurisdictions, the impact of litigation for corporate governance disputes can be highly counter-productive. The proceedings can inflame the dispute, increase its cost, damage the company's reputation, and delay the resolution of strategic issues. Moreover, corporate governance disputes often lack the legal basis to be tried in court, or are premised more on personal issues and/or business judgment than on legal principles.

THIS MODULE REVIEWS

- **Impact of corporate governance disputes on the company's reputation, operations, performance, and shareholder value**
- **Impediments and limits of litigating corporate governance disputes**
- **Need to effectively deal with corporate governance disputes**

MODULE 2
WHY CARE ABOUT CORPORATE GOVERNANCE DISPUTES?

DISPUTES PUTTING THE COMPANY AT RISK

In the boardroom, disagreements are often unavoidable — especially when the board is composed of independent-minded, skilled, and outspoken directors. This is not a bad thing. There should be debate in the boardroom, and decisions should result from a process in which directors consider all reasonably available information. A board that never argues or disagrees is most likely to be an inactive, passive, or inattentive board — in other words, an ineffective board that is neither fulfilling its oversight function nor carrying out its duty of care.

EXAMPLE

The Need for Disagreement in Boardrooms
United States: General Motors

Twentieth Century business guru Alfred Sloan (1875-1966), who was General Motors chairman from 1937 to 1956, stressed the importance of boardroom debate by summing up the end of a GM executive meeting as follows:

"Gentlemen, I take it we are all in complete agreement on the decision here," he said. Everyone nodded their heads in agreement. "Then," he added, "I propose we postpone further discussion of this matter until the next meeting to give ourselves time to develop disagreement, and perhaps gain some understanding of what the decision is all about."

COMMENT
Boards should discuss and debate strategic decisions. Disagreements are not disputes, but left unspoken, they may become disputes.

SOURCE: The Economist, *"Guru: Alfred Sloan." January 30, 2009. Available at: http://www.economist.com/business/management/displaystory.cfm?story_id=13047099.*

Shareholder activism, or the ability of shareholders to assert their power as the company's owners to influence its behavior, is a positive trend. Shareholders who scrutinize a company's performance and question its strategic decisions are part of a healthy corporate governance system that helps protect shareholder rights and keeps board members and senior executives alert.

Yet, if boardroom disagreements and/or shareholder conflicts are not dealt with properly, they can devolve into acrimonious disputes that undermine a company's operation and performance. Left unchecked and unattended, these disputes escalate quickly into public matters that can have severe, long-term consequences for the company and its key stakeholders.

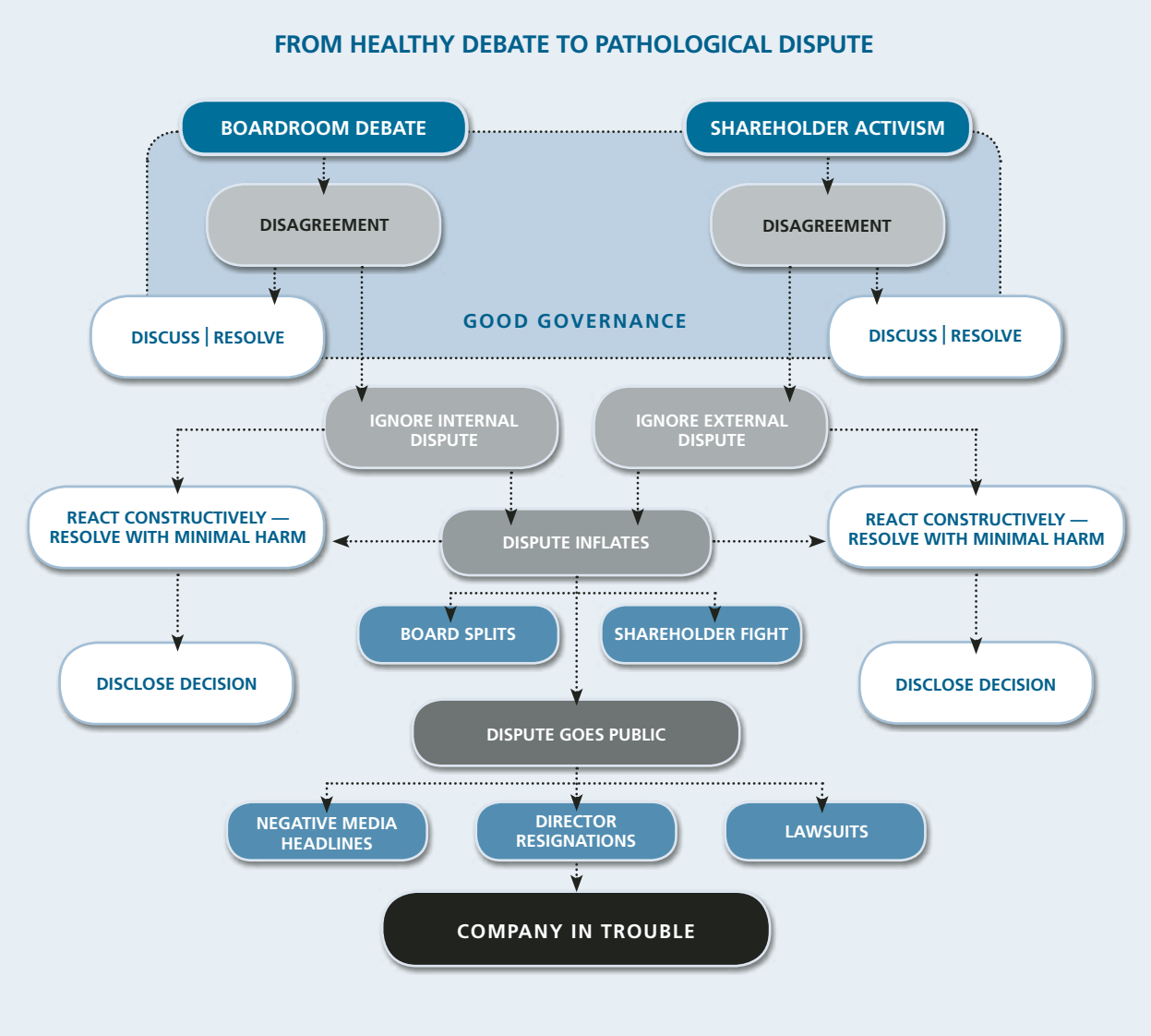
When disputes become public and are discussed in the press or trigger litigation, they indicate an important failure of governance. They demonstrate a mismanagement of conflicts within the board or between the company and its stakeholders — mainly its shareholders, but sometimes also its suppliers, clients, creditors, and the communities in which the company operates. Corporate governance disputes reflect the inability of executive managers or directors to address major strategy issues and conflicts.

TO FIND OUT MORE ABOUT INTERNAL AND EXTERNAL CORPORATE GOVERNANCE DISPUTES, SEE VOLUME 1 MODULE 1.

Corporate governance disputes undermine confidence in the company and harm its competitive position. External and internal corporate governance disputes can impair a firm's ability to prosper and grow. Unless resolved quickly, and especially if they become the subject of a lawsuit and media headlines, governance disputes can weaken the capital markets' confidence in a company, threatening its ability to attract capital and retain investors.

The full implications of disputes generally do not become clear until the dispute becomes public. In most cases, the dispute becomes "toxic" as soon as news organizations and/or bloggers report information about it. The company's reputation is immediately affected, creating doubts for shareholders and other stakeholders (e.g., potential investors, clients, and vendors). Investors may want to sell their shares. Credit agencies may revise their ratings downwards. Creditors and suppliers may turn less flexible in the business terms that they are willing to accept. Employees may start questioning their employer's future; the most capable ones may leave to work for better-run companies. In short, the company may come under tremendous pressure to resolve the conflict and restore its share value, as the ongoing dispute plays out in public.

The media can be a critical element in a dispute's unfolding. While shareholders and stakeholders have a right to be informed about ongoing disputes, senior management or the board must ensure that the supply of information is properly managed if they don't want the situation to spin out of control. The media are often used as a tool by parties to a dispute, dissident board members, and shareholders to raise awareness and pressure the other party(ies) or the company into addressing the dispute and finding a solution. This is especially true when large corporations are involved, or there are social and ethical issues. Boards must be able to communicate effectively and in a timely manner with the media at all times, but especially when the company faces a crisis or is entangled in a dispute.



FOCUS

Impact of Corporate Governance Disputes

Although a company may be doing well, corporate governance disputes that are left unchecked and unresolved can have the following negative impacts on the company:

LEVEL 1

- Divert boardroom resources
- Disrupt board's work
- Obstruct company's operations
- Delay major strategic decisions

LEVEL 2

- Undermine company's reputation
- Reduce market share
- Deter investors
- Cause share value to fall
- Divert corporate financial resources
- Divert corporate human resources
- Weaken internal and external stakeholder trust
- Prompt resignation of board members and senior executives

LEVEL 3

- Impair growth
- Increase governance costs
- Entail high litigation costs
- Cause a breakdown in stakeholder relations
- Affect corporate results

PRACTICE

Cost of Corporate Governance Disputes

All companies suffer negative consequences from corporate governance disputes. The actual impact can be difficult to measure. In most cases, the impact is underestimated and only takes into account the direct cost of the dispute, if quantifiable, and the associated legal fees — especially if the dispute goes to trial. When assessing a dispute's impact, the following factors should be considered:

- Cost of the dispute in relation to the value of the matter in dispute
- Number of staff members involved in dealing with the dispute
- Amount of staff time involved in dealing with the dispute
- Degree of satisfaction with the dispute's outcome
- Level of recovery from the dispute
- Incidence of destruction in business relationships
- Incidence of director and / or senior executive resignations
- Incidence of loss of shareholders
- Incidence of loss of business opportunities
- Number of corporate strategic decisions delayed
- Amount of goodwill or reputation lost
- Amount of negative media coverage
- Other?

FOCUS

Corporate Governance Disputes and the Media

If unresolved and left to fester without being addressed quickly and effectively, the dispute will attract media coverage. Given the proliferation of communications technologies, major corporate governance disputes do not remain hidden for long.

Information can be leaked anonymously or voluntarily disclosed to the media by:

- Party(ies) to the dispute (e.g., shareholder, director, senior executive)
- Whistleblower (e.g., employee, creditor, client)
- The company (e.g., official declaration to the press)
- Stakeholders, including dissident shareholders
- Lawsuit (e.g., public filings)

Reasons for media disclosure include:

- Strengthen a party's position
- Attract attention to the dispute
- Act for the common good
- File a lawsuit
- Silence rumors

Benefits of media disclosure include:

- Informing shareholders and stakeholders
- Generating pressure to resolve the dispute
- Containing and squashing rumors

Risks of media disclosure include:

- Creating partial, imbalanced information on the dispute
- Increasing rumors
- Escalating the dispute (e.g., the media becomes a battleground for the dispute)
- Creating public embarrassment

EXAMPLE

Publicized Boardroom Dispute
Australia: National Australia Bank

In late 2003, to prepare for his succession, Charles Allen, chairman of the National Australia Bank, sought to promote one of his directors, Graham Kraehe, to the position of deputy chairman. Eight out of nine directors agreed with this choice. Some analysts believe that the longest serving director, Catherine Walter, voiced her opposition because she coveted the chairmanship herself. The board decided to postpone its decision rather then to appear split.

In February 2004, Allen and the Bank's managing director, Frank Cicutto, resigned in the face of a major foreign-exchange trading scandal. This time, Graham Kraehe was unanimously voted in as the bank's new chairman.

Yet although Catherine Walter, who chaired the board's audit committee, volunteered to oversee the PricewaterhouseCoopers-led investigation into the AUD360-million trading loss, the board gave the task to Kraehe, who was also the head of the risk committee. Outsider's believe that this decision triggered the collision between two high-profile directors, disrupting the board's collegiality.

Insiders surmised that Walter believed the PwC report would be used by Chairman Kraehe to remove her from the board. She questioned PwC's independence, accused the chairman of not sharing information with other directors, and claimed to be the victim of a vendetta. To head off any criticism, the chairman decided to hire PwC's rival, Deloitte, to investigate areas where PwC could be considered to be conflicted. He also hired a law firm to oversee PwC's work

Walter, furthermore, criticized the risk committee, which was set up the previous year but had only met once even though it knew about the financial regulator's concern over the bank's foreign-exchange trading activities.

With tensions running high within the board, Kraehe accused Walter in March of leaking information to the media. Walter retorted that she was sharing information in the best interest

of shareholders, but that she had never divulged confidential information.

In March, when the PwC report was released, Walter had to give up her position as chair of the audit committee. Although the report didn't single out Walter, it did point to all directors by referring to board oversight issues. Fellow audit committee members Kraehe and Ken Moss were promoted.

Walter accepted the board's decision to remove her from the audit committee but expressed concerns over a media campaign waged in an effort to oust her.

The chairman wrote to her on March 18, saying that she had neither his confidence nor that of the other directors. Seven non-executive directors publicly announced their intention of calling an extraordinary general meeting to vote her off the board.

Walter countered that the board had failed to fully investigate the trading scandal and that all the directors should resign when their three-year rolling terms expire, without retirement benefits.

In April, the board announced that it would hold a general meeting of shareholders on May 21 to consider five different resolutions:

- Remove Catherine Walter from the board
- Remove all non-executive directors over time
- Censure the board
- Request a search for a new chair
- Express views as to the re-election of non-executive directors and retirement benefits

Under pressure, Walter and two other directors (including Moss) resigned in early May, and the general meeting was canceled. Chairman Kraeher agreed to step down once Michael Chaney, who was appointed to the board in June, took over as the new chairman in September.

As soon as the appointment of the well-respected Michael Chaney was announced, NAB shares increased by 1.43 percent.

COMMENT

Although the trading scandal triggered this highly publicized dispute, the board became divided because of unresolved issues between the chairman and a dissident director. As a result, the board lost its focus and failed to pull the company out of a major crisis. Entrenched in the dispute, the board in part failed to act in the company's best interests. This example also shows how the media can become an important battleground for internal disputes when issues are not properly handled within the boardroom at an early stage. This can be extremely damaging for the company's reputation and lead to a loss in shareholder confidence.

SOURCE: Sydney Morning Herald Online, *"Heads Roll at NAB over Foreign Exchange Scandal." March 12, 2004. Available at: http://www.smh.com.au/articles/2004/03/12/1078594547046.html. NAB Press Release, "Chairman Outlines Board Renewal Program." April 6, 2004. Available at: http://www.nabgroup.com/0,,46793,00.html.*

Impact of Internal Corporate Governance Disputes

Internal governance disputes are those that arise within the company itself — for example, among directors, or between the board and the CEO. Whether these internal disputes become public, they can impair a board's operation.

A board mired in dispute cannot provide management with the direction it needs for a strategy of long-term, sustainable growth. When governance disputes occur, board and management can lose focus on their roles in creating value for the company and its shareholders. The board's attention and resources are diverted, which can lead the board both to neglect its oversight functions and to freeze decision-making. Chaos and lack of clarity can then spread quickly throughout management ranks. While on the surface, the company's operations may appear to be on track, management's focus and efficiency come into question.

To appreciate the harm that unchecked internal disputes can cause, one must understand how boards can take actions to unite a corporation. Unlike the rest of the corporation, the board's structure does not have a built-in arbiter of disputes.

EXAMPLE

Impact of Corporate Governance Disputes
United Kingdom and the United States: Cadbury Schweppes and Hershey

In 2007, Todd Stitzer, chief executive of Cadbury Schweppes plc in the United Kingdom, met with his counterpart at the U.S.-based Hershey Co., Richard Lenny, to propose the creation of a "global confectionery powerhouse."

Cadbury's strong European market presence would complement Hershey's North American strength, Stilzer suggested. The combined Cadbury-Hershey could use its joint strength to expand into emerging markets, including China and India. Both companies already had existing, successful business partnerships in place. A merger would build on those partnerships' success.

In an initial response to the potential merger, LeRoy Zimmerman, who then served as board chairman of the Milton Hershey School Trust that holds the majority voting rights for Hershey, told *The Wall Street Journal* that the Hershey Trust has "a responsibility to listen to all potential possibilities that might come forward." Yet, he said he had "absolute confidence" in the management team at the time and was unwilling to give up a controlling interest in the company. The trust had previously decided against another sale proposal in 2002 in response to staff protests.

The trust's opposition to a sale eventually led to Lenny's "retirement" and the subsequent departure of eight Hershey directors in October 2007 in what a local newspaper dubbed "the Sunday night massacre."

"Hershey's downward spiral offers an illustration of how a breakdown in communication and trust among a company's main actors — management, the board of directors, and key shareholders — can paralyze an organization and leave it vulnerable," *The Wall Street Journal* observed.

COMMENT

The CEO's dismissal and the departure of all but one director provide a classic example of mistrust and misunderstandings that brewed over a long period of time. Lack of open communication — in this case, management's pursuit of a merger without advising the controlling shareholder — proved disastrous to management, the board, and the merger.

SOURCE: J. Largon, M. Karnitschnig, and J. Lublin, "How Hershey Went Sour," The Wall Street Journal, *February 23, 2008.*

Contrast the board's situation with that of management. Management tends to be organized hierarchically, with the CEO at the top of the company's pyramid. The CEO is the ultimate decision-maker on the management team, and, by his or her authority, he or she can end disputes among subordinates. In contrast, the board is more democratic in its operation. The board acts by taking a formal vote; the results of that vote constitute the board's official action. Each director has the same vote and power. The highest ranking board members — such as the chairman, lead director, or a committee chair — may be in positions to exert greater influence, but none has the authority to single-handedly resolve a dispute among other directors.

Many views may exist among directors. Binding action only results from a vote, which, along with a thorough description of the action, is recorded by the company's secretary and preserved in the company's official minutes.

Director votes are not required to be unanimous, but, as a practical matter, a consensus among directors is desirable. Persistent dissenting votes, or repeatedly delayed voting by the board, signal a lack of consensus. Because directors typically vote on matters that are very important, if not crucial, to the company, continued dissension among the board directors signals to management and the investing public an irreconcilable disagreement about key issues facing the company. In turn, this dissension infects the company and its business. Management becomes uncertain about the direction the board wants to pursue for the company and the performance goals that will be established. When management lacks clear direction, the risks of lackluster performance increase. This sets up a scenario in which the board, or at least a part of it, will always be disappointed with management performance, and management will, in turn, be frustrated in understanding the board's expectations.

Not so long ago, the CEO dominated boards, typically either selecting or approving all its members. The CEO or founder was therefore in a position analogous to his or her role within management. By default, he or she had the authority to cut through disputes and reach conclusions. Today's situation is starkly different in a growing number of countries. More directors are populating boards that are increasingly independent of management; they take their oversight roles seriously, rather than being subservient to the CEO. With the CEO's ability to resolve disputes gone, a vacuum exists, and boards must develop their own mechanisms for recognizing and resolving internal disputes.

EXAMPLE

Impact of Boardroom Disputes on Corporate Value and Performance
United States

In a study of the consequences of boardroom disputes using a data set of internal disputes in publicly traded U.S. companies over 1995-2006, researchers Anup Agrawal and Mark A. Chen reached the following conclusions:

- Stock prices decline significantly (both statistically and economically) upon news of director departure amid dispute. When the resigning director is an insider, the decline is even sharper in magnitude.
- The decline in stock prices is typically greater surrounding disputes related to agency problems, corporate strategy or financial decisions; it is generally more muted for other types of disputes such as those dealing with board processes.
- Companies with boardroom disputes experience poor operating performance in the years surrounding the dispute episode, weak stock price performance during the 12 months both before and after a board director's resignation over the dispute, and a significantly greater incidence of stock market delisting in the post-dispute year.

COMMENT
Director resignations are often a sign of ongoing conflict or disputes within the boardroom. Resignations impact corporate share value, operations, stakeholder relations, and employee morale.

SOURCE: Agrawal and Chen, op. cit.

Ironically, the very characteristics that empower boards and make them effective overseers of the company — independence and diversity — create an environment that is more fertile for misunderstanding, disagreement, and disputes. This new environment raises the risk that board disputes, and their consequent threat to board effectiveness, will increase unless boards develop and adopt processes and procedures for handling disputes.

Similarly, with family firms, the company's founder, in a patriarchal or matriarchal fashion, may have typically selected and approved all the board directors. Given his or her position in the family and his or her role in setting up and growing the company, the founder has the authority to cut through disputes and impose a decision. Yet, once the founder has resigned or passed away, the successor (if they are not the cause of the dispute) no longer has the natural authority and ability to resolve disputes within the board or with family shareholders.

Further, internal governance disputes are between people who will have to continue working closely together. The goal in these situations is for those involved to iron out the subject of their disagreements without impeding their work. It may be desirable for all directors to remain on the board. The CEO may want to continue in office. Therefore, the resolution process must not only be quick and efficient, but it must also leave few, if any, scars. If, as part of the dispute's resolution, an environment is not created in which the parties can work smoothly and amicably together, other problems will soon emerge.

Disputes that result in resignations of board members and senior executives are equally disruptive for the company. They constitute a loss for the company if the resignations had nothing to do with performance, but rather were the result of unresolved internal disputes.

Persistent dissension within the board eventually becomes public knowledge. Lack of a board consensus can poison investors' taste for the company's stock. Lenders may feel their risk of repayment is heightened by the board's lack of consensus. Dissension can also heighten reputational risk. Customers may have concerns about the integrity of the company's products and services in the face of governance conflicts.

Impact of External Corporate Governance Disputes

External disputes involve the board and stakeholders outside the company. Shareholder dissatisfaction, social activist unrest, questions about human relations, and cross-cultural matters can rise to the board level if these issues cannot be resolved by management. External disputes can become public very quickly, leaving the board to carry out resolution in the fishbowl of the public domain.

FOR A MORE DETAILED DESCRIPTION OF EXTERNAL CORPORATE GOVERNANCE DISPUTES, SEE VOLUME 1 MODULE 1.

External disputes can be debilitating for the company. Shareholder dissatisfaction can worry the markets and drive share prices down. The involvement of private equity and sovereign wealth funds can lead to efforts

QUOTE

The Inevitability of Corporate Governance Disputes

"In 1998, private sector players in Uganda came together to set up the Institute of Corporate Governance of Uganda to promote good corporate governance through the propagation of the highest standards of ethical conduct, efficiency, accountability and probity for the benefit of shareholders, workers, consumers, and all stakeholders. It is against this background, and the desire to attain the goals of good corporate governance that one can inevitably expect corporate governance disputes to arise."

JUSTICE GEOFFREY W. M. KIRYABWIRE
COMMERCIAL COURT JUDGE, MINISTRY OF JUSTICE, UGANDA

SOURCE: Geoffrey W. M. Kiryabwire, "Mediation of Corporate Governance Disputes through Court Annexed Mediation." Paper provided by the author to the Forum.

to acquire the company or remove its board. The uncertainty and chaos that these situations bring to the company skews planning, consumes company resources, and disturbs the focus of management and the board.

In earlier eras and in some jurisdictions, shareholder power in publicly traded corporations was dispersed among an enormous base of individual shareholders. These shareholders lacked the cohesiveness and sophistication to challenge the board and management.

EXAMPLE

Shareholders Challenge the Board
Finland: Elisa

In 2007, an Icelandic activist investor, Thor Bjorgolfsson, severely criticized the board and management of Elisa, Finland's oldest telephone company. The dispute involved charges by Bjorgolfsson related to Elisa's structure and direction. Management responded by accusing the dissident investor of having a hidden agenda. A coalition of institutional shareholders, including Bjorgolfsson's Novator Finland that held 20.5 percent of Elisa's stock, succeeded in gaining board approval of a measure that limits Elisa's board to six members and allows the election of four new, shareholder-nominated directors.

COMMENT
Moves by dissident shareholders to change company policies through election campaigns to seat new directors have increased dramatically. The concentrations of large blocs of shares worldwide in institutional funds raise the specter that these disputes and challenges will increase. A contrasting situation is the decision by the New York Times Company's board to meet with dissident shareholders rather than to engage in a fight at the shareholders' meeting. Ultimately, the company and the dissidents resolved their dispute, with the company agreeing to nominate two of the four shareholders proposed by the dissidents.

SOURCE: David Ibson, "Icelanders Turn Up the Heat on Elisa," Financial Times, *December 12, 2007.*

Today, however, the situation is vastly different. Everywhere, institutional investors dominate ownership of public companies. Whether these investors are mutual funds, pension funds, foundations, hedge funds, private equity, or sovereign funds, they represent enormous pools of capital managed by intelligent, sophisticated professionals. Information travels instantaneously over the Internet. In the past, small shareholders could not effectively challenge a company's board. Since they and institutional investors no longer have the same constraints or impediments, their dissents are increasingly targeted at boards.

External governance disputes face a tremendous risk of increasing dramatically. The rise of institutional investors raises the prospect of more confrontations with boards. This risk is further increased through globalization of business, which is broadening companies' contacts with other societies and heightening the risk of cultural and, potentially, political miscues and disputes. Companies are exposed to a wider range of stakeholders than ever before. Previously, a company's relationships with the communities in which it operates were likely to be in the country in which it had headquarters. Nowadays, however, as businesses circle the globe, corporations must interact with people and governments worldwide.

While the precise mechanisms for dispute resolution of external disputes may vary from those that are most effective for internal disputes, governance disputes of all kinds will increase in number and, left unaddressed, will escalate in impact. ■

DISPUTES CALLING FOR OUT-OF-COURT RESOLUTION

Whether in developed or developing countries, the conventional way to settle a dispute is by litigation. Shareholder disputes and, in some cases, disputes that arise in the boardroom can indeed be addressed through litigation. For example, shareholders' actions for monetary claims in mergers and acquisitions may be filed with a court to settle. Using the judicial process can be appropriate in corporate governance disputes in which there is a question regarding the proper application of law and the parties' rights. However, in most cases, courts are not effective arbiters of governance disputes. They expose and accelerate an often irrevocable breakdown in business and sometimes personal relationships.

Litigation typically increases the negative impact of the dispute on the company's performance, reputation, and value. The outcome doesn't necessarily fix the dispute's causes, either. Moreover, the dispute's cost on the company accelerates exponentially, and strategic decisions affecting the company are often delayed. Litigation is neither a fast nor inexpensive process. It can drag on for years. The longer it goes on, the greater the costs in out-of-pocket expenses, management's distraction, consumption of board time, and impairment to strategic and operational decision-making.

QUOTE

Litigation Destroys Relationships

"Business people spend their lives building relationships, but as soon as a dispute arises, if the parties resort to litigation, the adversarial nature of it destroys the relationship. It must be part of a director's duty of acting in the best interest of a company to try and preserve the business relationships.

"Analysts and consultants have found that what stakeholders want from a company after the quality of its products or its services, is to have trust and confidence in the company. As soon as there is a dispute that becomes adversarial, public trust and confidence wanes."

PROFESSOR MERVYN KING, SC
FIRST VICE PRESIDENT, SOUTHERN AFRICAN INSTITUTE OF DIRECTORS
MEMBER, FORUM'S PRIVATE SECTOR ADVISORY GROUP

SOURCE: Directorship Magazine. *2008.*

Cost of Court Litigation

Regardless of the chances of winning or losing a case, where speed and flexibility are at a premium, judicial resolution can be counter-productive for many reasons.

- ***Litigation is slow and cumbersome.*** Corporate governance disputes are time sensitive. They involve matters that require quick resolution because they are integral to how the company conducts its business.

Unless resolved, the board's decision-making stalls. When the board fails to make decisions, management's performance (e.g., performance without clear objectives) will be judged sub-standard. In other words, the enterprise's basic needs to function efficiently can be impaired without a quick resolution. The key to managing corporate governance disputes effectively is to act quickly and assertively — only by doing so can boards address the problem before it becomes insoluble.

Time sensitivity also applies to disputes with outside constituencies. The longer the dispute remains unresolved, the more uncertainty investors face, potentially increasing investment risk and impeding realization of strategic goals. Shareholders must decide whether to keep their investment in the company or to move their capital elsewhere. Shareholders who demand board changes will not wait years until a dispute is resolved. Yet, lawsuits take time, often years, as they wind their way through trials and appeals.

Even the best of rules can prove useless if courts are too slow. Papua New Guinea, the Maldives, and Slovenia, for example, have strong investor protection laws for bringing suits and gathering evidence. But even the simple commercial disputes take too long to resolve — 591, 665, and 1,350 days, respectively, in those three countries.

Moreover, in some countries, the sheer volume of cases makes it impossible for judges to deal with each case thoroughly. In India, for example, case arrears and decade-long legal battles are common. In spite of having about 10,000 courts (not counting tribunals and special courts), India has a serious shortfall of judicial servants. A termination dispute contested until all appeals are exhausted can take up to 20 years for disposal, while writ petitions in High Courts can take between eight and 20 years. About 63 percent of pending civil cases are more than a year old, and 31 percent exceed three years.

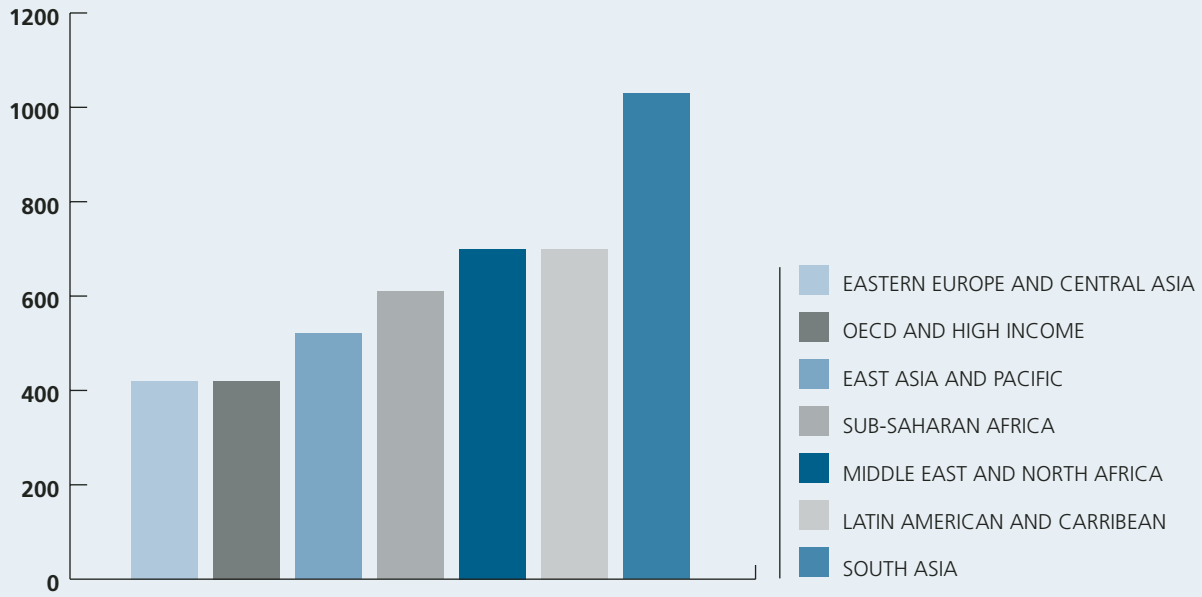
- ***Litigation distracts the board.*** Governance disputes distract boards from their work and delay important, time-sensitive decisions. When these disputes become or threaten to become the subject of litigation, the cost and impact on board operations increases considerably. Not only the progress of the litigation, but also the enormous amounts of time and energy required for preparation, result in a drain on management, whose job it is to operate the business efficiently.

- ***Litigation often lacks a tailored resolution.*** Judges decide facts and apply the law as they understand matters. But a judge may have little or no experience in dealing with a company's particular issues and its governance disputes.

Courts do not always have sufficient staff and expertise to properly understand and litigate the increased number of complicated disputes involving shareholders of listed companies.

- ***Litigation is costly.*** Litigation costs have been increasing exponentially almost everywhere. Unless a company seeks to set an incredibly strong precedent, or a society-wide answer is sought to avert thousands of similar cases, court battles should be avoided and remain an exception.

AVERAGE NUMBER OF DAYS TO ENFORCE A CONTRACT IN 2008



SOURCE: World Bank, Doing Business Database. 2008.

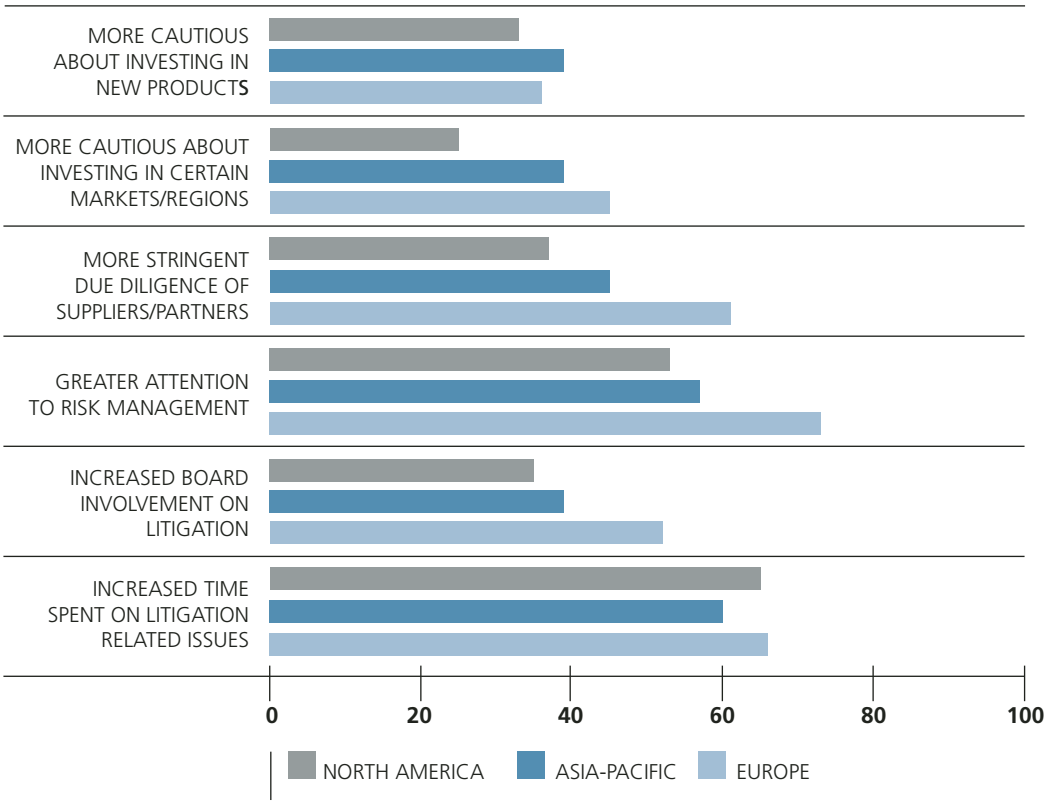
FOCUS

Board Resources Focused on Litigation

A study conducted by Lloyd's, in conjunction with the Economist Intelligence Unit, revealed that "board members are increasingly concerned about the increasing number of corporate litigation cases facing the boards and the escalating cost in mitigating such risks." The report found that, "one in five companies faced lawsuits targeted at individual directors or officers, including non-executive directors with employees and customers being the most likely source."

Boards are increasingly allocating resources to litigation issues, which is pushing up the price of products and services and leading many companies to adopt more cautious business strategies. On average, boards spend 13 percent of their time discussing litigation issues, and directors expect this to increase further over the next three years. There is strong agreement among the 168 board-level executives interviewed for this study that valuable resources are being spent on legal issues that could be deployed elsewhere.

PERCENTAGE OF COMPANIES EXPECTING THE FOLLOWING CHANGES AS A RESULT OF CORPORATE LITIGATION IN THE NEXT THREE YEARS BY REGION (2008-2011)



SOURCE: Lloyd's and Economist Intelligence Unit. 2008. "Directors in the Docks. Is Business Facing a Liability Crisis?" *Available at: http://www.lloyds.com.*

EXAMPLE

Munda Hydro-Power Dam Project Dispute Between Shareholders of Amzo Corporation LLC

AMZO Corporation LLC (AMZO), which is incorporated under Maryland laws, sponsored a multimillion-dollar hydro-power generation project in Pakistan. AMZO first qualified for the project in 2004. After completing a two-year-long feasibility study, AMZO submitted its final report to the federal government in 2006. Amid crucial negotiations with the federal government, a dispute arose between AMZO's two main shareholders. This dispute led to the removal of one major shareholder from the board for his alleged unethical, fraudulent behavior, and his mismanagement of the project company. In retaliation, the ousted director filed a civil suit before a local court, alleging oppression and mismanagement by the majority shareholder. The court prevented the majority shareholder from unlawfully interfering with the sponsor company. Subsequently, the feuding shareholders wrote several letters to the federal government in which they defended their respective actions and posed as AMZO's lawful representatives. As a result of the dispute, the project stopped. Since AMZO failed to resolve the dispute quickly on amicable terms, the federal government reluctantly awarded the project to a public sector utility. As of August 2009, the litigation among the shareholders remains pending in the local courts.

COMMENT

The example demonstrates the negative implications of a fully blown corporate governance dispute.

SOURCE: Pakistan Corporate Governance Project II, IFC Advisory Services for the Middle East and North Africa.

QUOTE

Court Delays in India

"The Indian judicial system is often criticized for slow pace of justice delivery.... Delays in court have always been main concerns for stakeholders. It is also perceived as one of the impediments in attracting foreign direct investment in the country. Lack of suitable infrastructure and inadequate number of judges is cited by the judiciary as one of the main reasons for delays in court."

SUMANT BATRA
SENIOR PARTNER, KESAR DASS B & ASSOCIATES

SOURCE: The Economic Times (New Delhi), "Judiciary Ought to Do Introspection." October 31, 2007.

QUOTE

Cost of Class Action Lawsuits in the United States

"The possibility of being sued for huge sums, while also bearing high costs of legal defense, has brought many companies to a moment of reckoning that mitigates against registering their securities in the United States. The total value of settlements in securities litigation class action lawsuits has continued to increase from $150 million in 1997 to $9.6 billion in 2005. Given the risk and threats to their bottom line, regrettably, foreign companies are simply concluding that it's not worth it to come to our market."

MARSHALL N. CARTER
CHAIRMAN, NYSE GROUP

SOURCE: "America's Capital Markets: Maintaining Our Lead in the 21st Century." Testimony before the Financial Services Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, United States House of Representatives, Washington, D.C., April 26, 2006. Available at: http://www.nyse.com.

EXAMPLE

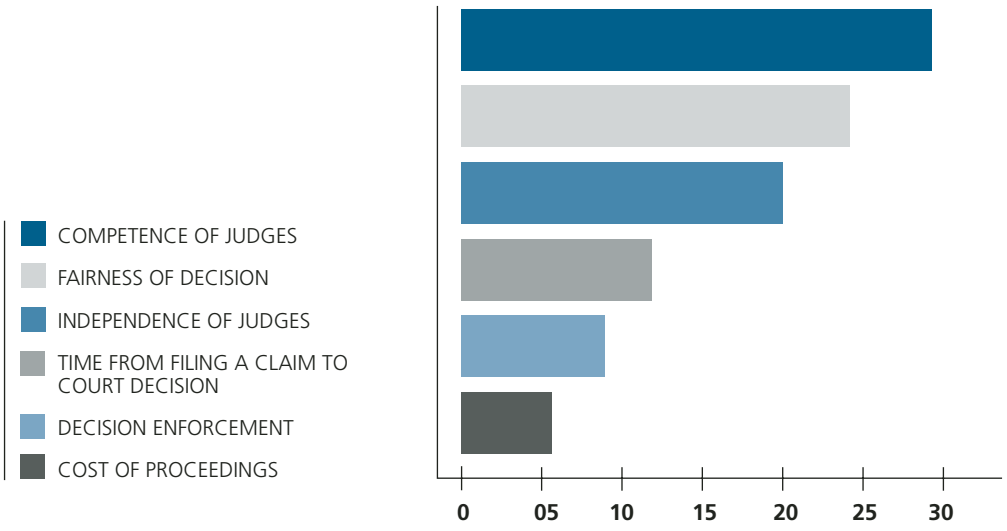
Impact and Perceptions of Corporate Court Proceedings
Ukraine

IFC conducted a comprehensive survey of commercial disputes of business in Ukraine in 2006. A total of 1,210 randomly selected companies were included in the survey.

The findings show that litigation is friendlier to large companies than small ones and that, where trust in the legal system is weak, the competence, fairness, and independence of judges matter more than enforcement and costs:

- Large companies litigate disputes in commercial courts far more often than do medium or small companies: 86 percent of large companies have resolved disputes in court compared to 72 percent of medium-sized companies and 46 percent of small companies.
- The rate of success in court proceedings also varied greatly, correlated to the company's size. Large companies frequently prevailed in court while small companies usually lost.
- Approximately 79 percent of the companies that prevailed in court reported that the court has completely restored their rights. Yet, in relation to their last dispute, companies reported that the court decision was completely enforced in only about 45 percent of the cases. About 37 percent of the cases were not being enforced, and the remaining cases were only partially being enforced. Thus, while respondents may have reported that their rights have been restored, it did not mean that their actual losses were fully compensated.
- When asked to rank the most important attributes of an effective court system, companies stated that the most important factors were the judges' competence, the decision's fairness, and the judges' independence, while efficiency and enforcement were rated lower, and cost was the least important factor.

PERCENTAGE OF COMPANIES SELECTING THE FOLLOWING FACTORS AS THE MOST IMPORTANT FOR COURT EFFECTIVENESS



SOURCE: IFC, Ukraine Commercial Dispute Resolution Study. Researching Commercial Disputes among Ukrainian Companies. *2007. Available at: www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/UkraineADR_2006_Eng.pdf/$FILE/UkraineADR_2006_Eng.pdf.*

While the outcome of litigation is by definition uncertain, going to court involves lawyers, discovery proceedings, and often experts. All are expensive.

Shareholders ultimately bear the litigation costs involving the company in which they have a stake. Yet, these costs not only have an impact on the company's shareholders but also on its customers. One logical outcome of litigation costs is an increase in prices charged for products and services.

In the United States, the use (or threat) of class action lawsuits, is increasingly used by shareholders as a mechanism to influence companies' governance.[1] In these cases, a shareholder brings a lawsuit against a company and seeks financial compensation on behalf of other shareholders in the same class. Approximately 200 class action lawsuits are filed in federal courts alone each year.[2] However, the costs can be a deterrent for large investors and companies.

Limits of Court Litigation

Judicial resolution of corporate governance disputes may be highly impractical for several reasons:

- ***Weak judicial enforcement.*** Enforcement of good corporate governance practices has always been a key issue of concern in most developing countries. While much has been achieved in raising awareness and improving corporate governance rules and procedures, progress remains constrained by poor regulatory and judicial enforcement. These constraints result from inadequate funding, the lack of trained staff, and systemic corruption. Ownership concentration often remains the most efficient response to weak enforcement of corporate governance rules. Where the court systems are not well-developed, where the judiciary may not understand business and corporate issues, or where they are slow, inefficient, or even corrupt, judicial resolution becomes highly impractical. According to the World Bank's *Doing Business 2008* indicators, Ukraine ranks 46th in terms of contract enforcement. It takes 354 days to resolve a dispute in court, and 30 procedures are needed (from filing a court claim to receiving payment). What these numbers do not reflect is the fact that Ukraine's court system is often a choice of last resort because it is perceived as unreliable and inefficient.

- ***Legal uncertainties.*** When corporate governance disputes arise as a result of cross-border investments, the uncertainty of judicial processes makes court action impractical and more complex. The main legal risks stem from the uncertainty relating to the way in which the court will view and understand the facts, the court's competence with respect to the issue in question, the way in which the court will apply the law to the facts, and the eventual outcome at the appellate level. International treaties have neither solved these issues nor the problem of enforcing judgments across borders.

  Even if a shareholder, for example, obtains a judgment in their country of jurisdiction, he/she may be unable to do anything to enforce the judgment within the country where the company has assets. And even if the shareholder is able to obtain a valid court judgment and to get it enforced, the cost of the necessary procedures, including cross-border legal advice, may exceed the amount that can ultimately be recovered. One important element of the overall cost and decision-making of cross-border investments is therefore generated by the legal uncertainties associated with disputes. Legal uncertainties create a pervasive inhibitor for foreign investments because they are felt by the investor and the company.

- ***Legal vacuum.*** The quality and spirit behind corporate governance standards and principles cannot always be achieved through court activism. Many governance principles and requirements are covered by soft laws and company bylaws. In an area where there is a growing number of national corporate governance codes, monitoring interpretation and compliance cannot be done with traditional court systems. Disputes, therefore, arise over issues that have not been foreseen by laws and regulations or spelled out in contracts, or premised on business issues or individual relationships rather than legal obligations. This is especially true when articulating the concept of fiduciary relationships

between managers and directors as well as those between directors and investors.

In addition, many countries still restrict private lawsuits by investors, relying instead on regulators to police corporate activities. Fines may be imposed as punishments by regulators. Investors are rarely compensated for their investment losses.[3]

Good corporate governance practices are, essential to reducing the likelihood of disputes. Yet disputes remain unavoidable and a fact of corporate life. Everything must be done to minimize the negative impact that disputes have on a company's balance sheet, share value, reputation, operations, and stakeholder relations. Boards must act quickly and efficiently. Investors do not wish to risk their money on a company whose governance will be impaired or simply stalled because the board is mired in internecine squabbling.

In the last few years, much attention has been given to policies, practices, procedures, regulations, and listing rules designed to make boards operate more effectively in the company's and shareholders' best interests. Solid organization is imperative for a board to operate effectively. What can easily be overlooked, however, is that the capstone to good organization is a recognized, effective means of resolving the disagreements and disputes that inevitably emerge when any group of people have differing views. For example, directors who cannot agree on strategy and goals will find their company's stock undervalued when a merger partner emerges, or when another institution wants to buy the company.

Boards need dispute resolution processes that provide solutions quickly, so that they can fulfill their duties to the company and its shareholders. For these reasons, understanding and using techniques and processes that provide a relatively quick resolution and allow directors to focus on the company's operations and its future become very important.


TO REVIEW BOARD DISPUTE RESOLUTION PROCESSES AND TECHNIQUES, SEE VOLUME 2 MODULE 1.

Without alternative mechanisms to deal with corporate governance disputes, more and more companies, boards, and individual directors will be facing high-profile trials that may damage the reputation, performance, and growth opportunities of companies that are otherwise doing well. The key to controlling legal risks is often a question of minimizing the prospects of court litigation. Seeking redress in court should be the parties' recourse, or last resort, only when alternatives fail. ■

Endnotes

1 "Caution — D&Os Working: Reducing Liability Exposure in 2005," National Association of Corporate Directors. (January 3, 2005). In Eric Runesson and Marie-Laurence Guy, *Mediating Corporate Governance Conflicts and Disputes. Focus* Series. Washington, D.C.: Global Corporate Governance Forum, 2007. Available at: http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+Mediation/$FILE/Focus4_Mediation_12.pdf.

2 Cornerstone Research, *Securities Class Action Filings: 2008 Mid-Year Assessment.* Available at: http://securities.stanford.edu/clearinghouse_research/2008_YIR/20080728.pdf.

3 World Bank Group, *Doing Business. Comparing Regulations in 178 Economies.* Washington, D.C.: World Bank Group, 2008. Available at: http://www.doingbusiness.org/documents/subnational/DB08_Subnational_Report_Philippines.pdf.

There are many approaches that a board can select outside of court litigation to resolve corporate governance disputes. Each varies in the process used to reach and then abide by decisions. All, however, share features that encourage constructive problem-solving without incurring the costs — in time, money, and adversarial relations — of court litigation.

This module describes how alternative dispute resolution (ADR) processes and techniques provide avenues for effectively dealing with both internal and external corporate governance disputes. Adroitly implemented, ADR can help find relatively quick and appropriate solutions to all types of corporate governance disputes.

The use of formal ADR processes is especially useful for disputes involving external stakeholders that have matured and in which the parties have squared off on different sides of the dispute. Disputes within the boardroom, however, often do not lend themselves to formal ADR processes. Boards and their directors in that case should consider using ADR techniques as a dispute resolution management tool.

THIS MODULE REVIEWS

- Appeal of out-of-court dispute resolution
- Basic ADR processes
- Benefits and limits of ADR processes

MODULE 3
HOW CAN ALTERNATIVE DISPUTE RESOLUTION HELP?

MORE EFFECTIVE DISPUTE RESOLUTION

Well-governed companies are less likely to have disputes. However, when a dispute arises, the board, investors, and other parties need to have a suitable process and venue to seek redress and resolution to the conflict in a timely, cost-effective manner. Therefore, a good corporate governance framework should have a reliable way of resolving emerging and existing disputes.

The board is responsible for ensuring that any problem is solved as efficiently and expeditiously as possible, and certainly before it can damage the company's brand or reputation.

Benefits of ADR

Traditional dispute resolution mechanisms (which usually include the main court system, specialized courts, and regulatory bodies) are typically costly and slow. In many countries, the quality of law and its enforcement are weak. ADR approaches offer flexible and more efficient options to resolve disputes without recourse to the courts.

ADR mechanisms are typically voluntary and confidential, and each has features that encourage constructive problem-solving without incurring the costs — in time, money, and adversarial relations — of court litigation.

Given these benefits, policy-makers are increasingly encouraging the use of ADR processes. The European Union, for example, adopted in 2008 a directive to foster the use of mediation as a more cost-effective and faster alternative to civil litigation.

TO REVIEW CORPORATE GOVERNANCE DISPUTE RESOLUTION POLICIES, SEE VOLUME 2 MODULE 2.

In countries in which the judicial system is not well-developed, ADR is especially attractive, because it permits the parties to create, in large part, their own justice system. In doing so, together they can pick their own arbitrator, who sits in the position of a judge, or they can choose their own mediator, whose role is not to judge but to help the parties fashion their own solutions. ADR works on the basis of consensual agreement and allows the parties to determine which standards to apply to resolve the disputes.

Companies are increasingly using ADR, particularly negotiation and mediation, to settle disputes outside the courts. In the United States, approximately 800 of the largest companies have pledged to explore ADR before litigation when a dispute arises. In Colombia, out of the 97 companies that have developed their own corporate governance guidelines, 52 have included a dispute resolution clause promoting the use of ADR.

QUOTE

Effective Dispute Resolution

"There is no advantage in having good governance if, when a dispute arises, you haven't got a good method to resolve it. If it would take several years to bring a dispute to trial, it is vital that mediation mechanisms exist to achieve resolution in a kind of timeframe that big business can live with."

MERVYN KING, SC, PROFESSOR
FIRST VICE PRESIDENT, SOUTHERN AFRICAN INSTITUTE OF DIRECTORS
MEMBER, FORUM'S PRIVATE SECTOR ADVISORY GROUP

SOURCE: Institute of Directors, Southern Africa, Bulletin: First Quarter 2007.

GLOSSARY

Alternative Dispute Resolution

"ADR is an amicable dispute resolution procedure based on the goodwill of the parties and the assistance of a neutral third party. It covers various techniques including mediation."

SOURCE: International Chamber of Commerce (ICC). Available at: www.iccwbo.org.

Appropriate Dispute Resolution

The common denominator of all ADR methods is that they are faster, less formal, cheaper, and often less adversarial than a court trial. In recent years, the term "alternative dispute resolution" has begun to lose favor in some circles and ADR has come to mean "appropriate dispute resolution." The point of this semantic change is to emphasize that ADR methods stand on their own as effective ways to resolve disputes and should not be seen simply as alternatives to the courts.

EXAMPLE

Corporate Governance Disputes Settled Through ADR Processes
ICC

From 2001 to 2006, 20 percent of company-law related disputes settled by the Paris-based International Chamber of Commerce (ICC) were corporate governance disputes. Examples include disputes over: share valuation, shareholders' priorities, board remuneration, bankruptcy, shareholder participation in decision-making, and takeovers.

COMMENT
Most mediation and arbitration centers do not have a special category for corporate governance related disputes but they are increasingly receiving requests to handle such disputes.

SOURCE: L. Bouchez and A. Karpf, "Exploratory Meeting on Resolution of Corporate Governance Related Disputes." OECD, Stockholm, March 2006. Available at: http://www.OECD.org.

EXAMPLE

Corporate Governance Dispute without Legal Basis
Bulgaria

According to Bulgarian law, if a shareholder acquires more then 50 percent of a company's voting shares, he/she is obliged to offer to buy the shares of minority shareholders at market value. Until the majority shareholder has made such an offer and it is either accepted or refused, he/she cannot vote during the general meetings.

To avoid becoming a controlling shareholder and complying with this legal provision, the main shareholder of a company issuing and servicing credit cards transferred part of his/her shares to related parties. Owning together more than 50 percent of the shares, the related shareholders changed the board's structure and appointed new directors.

The new board arranged for the transfer of the company's long-term assets of an estimated value of BGN 10 million to another company fully owned by the main shareholder for the symbolic value of BGN 1.

The credit card company was drained of its assets, and its share value plummeted.

Considering that their rights had been violated, minority shareholders filed a claim with the Financial Supervision Commission (FSC). The FSC found that no rules had been formally violated. Minority shareholders sought legal advice to seek redress in court, but were told that this was a case of bad governance and, hence, there was no legal basis for a case.

COMMENT
Some corporate governance disputes cannot be decided in court because they do not involve the violation of any rights according to the existing legislation. Yet, if they become public, these cases can impact a company's reputation and deter investors.

SOURCE: Vassya Prokopieva, Managing Partner, EU&BG Legal Consultants.

Appeal of ADR

Although they have mainly been used for labor, family, and commercial disputes, ADR processes have characteristics that make them particularly attractive in corporate governance disputes.

Corporate governance disputes often deal with dynamic, ongoing situations; the speed and flexibility that ADR provides is particularly helpful in the resolution process. ADR allows the parties to fashion their solutions to their specific business needs. Unlike judicial proceedings, which pass judgment on circumstances that have occurred in the past, ADR solutions can be tailored by the parties to deal with ongoing situations in a manner that allows the parties to continue working together. ADR allows for interim reassessment that otherwise may be hard to achieve once a case comes to trial and battle positions have been drawn.

Moreover, corporate governance disputes do not always involve determination of legal rights and, therefore, do not easily lend themselves to a court's judgment, which applies the law based on a determination of the facts.

The use of formal ADR processes, which provide a structure and a third party to bridge differences, can be especially effective in dealing with external corporate governance disputes, or disputes that involve shareholders and, sometimes, other stakeholders whose contact with the board is situational and not ongoing.

QUOTE

Out-Of-Court Dispute Settlement

"Even if shareholder redress can be sought in court, it may often be in the best interest of both the shareholder and the company to try to mediate and settle the dispute out of court."

LEONARDO VIEGAS
DIRECTOR, BRAZILIAN INSTITUTE OF CORPORATE GOVERNANCE (IBGC)
MEMBER, FORUM'S PRIVATE SECTOR ADVISORY GROUP

More flexibility and caution, nevertheless, needs to be applied when dealing with disputes that take place within the boardroom. Introducing too formal of a resolution process in the boardroom can inflame internal disputes and harden positions, rather than settle them. Activating formal procedures can destroy the collegiality and civility that are essential to the discussion and deliberation processes and to the ongoing working relationship that the directors have. With internal disputes, ADR can play a crucial role by borrowing techniques from both constructive negotiation and mediation. These include: identifying parties' interests; surfacing emotional and factual issues; focusing on long-term objectives; promoting discussion; uncovering information; facilitating collaborative decision-making; and, using a third party when appropriate. These techniques can be adapted for the boardroom.

TO REVIEW THE USE OF DISPUTE RESOLUTION TECHNIQUES IN THE BOARDROOM, SEE VOLUME 2, MODULE 1.

The most common ADR processes are negotiation, mediation, and arbitration, but there are many approaches that fit within each of these broad categories. These can be more or less formal and include panel ruling, mini-trial, facilitation, early neutral evaluation, and collective bargaining.

While negotiation is possibly the most common approach to resolving corporate governance disputes out of the courts, mediation is a more novel approach to dealing with a corporate governance dispute. Arbitration is generally favored as a default alternative to a court trial by many large companies, especially when dealing with cross-border disputes.

Disputants do not have to choose between ADR and litigation. For example, if mediation fails, the parties still have the option to go to court. In several jurisdictions, mediation can occur while a case is pending in court. In such countries as Uganda and Bosnia and Herzegovina, the legal system even provides for court-referred mediation where the judge requests the parties to try to mediate the dispute; only if the mediation process is unsuccessful will the case be tried in court.

Use of ADR

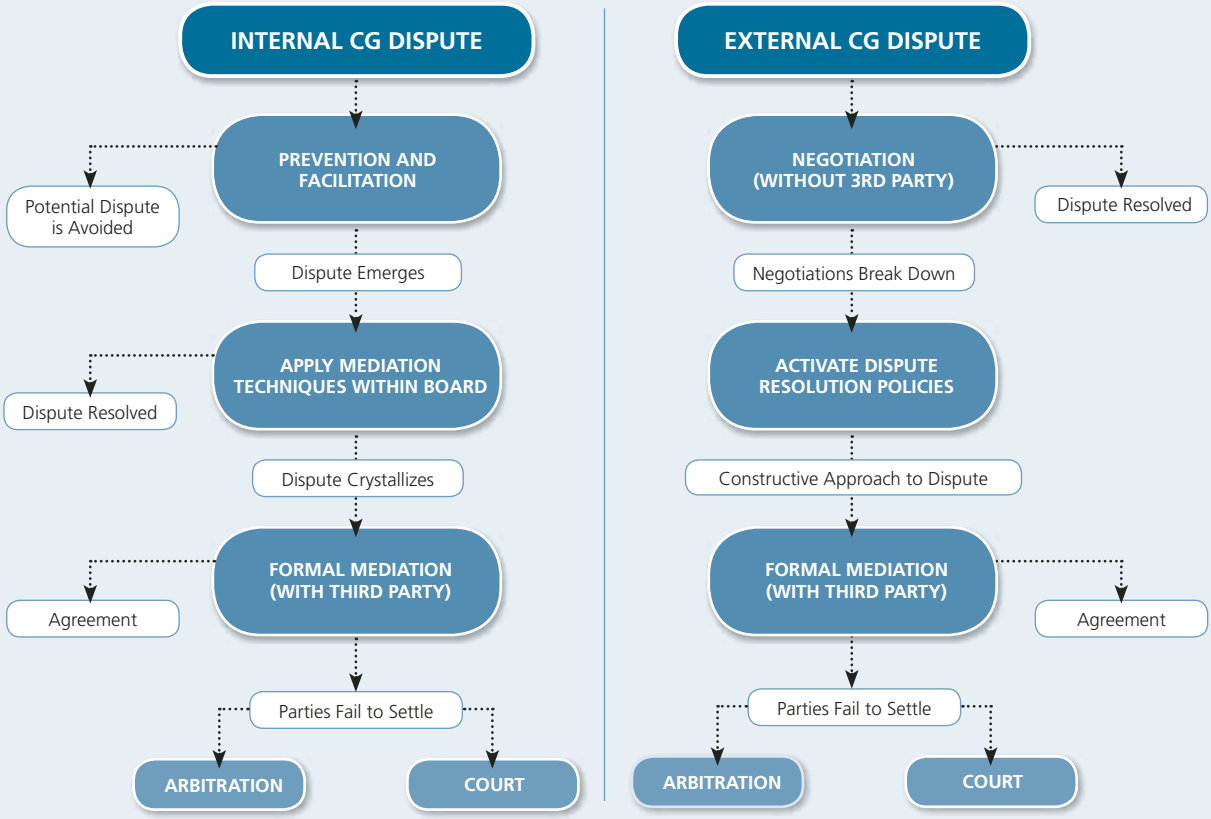
The most effective approach to solving a corporate governance dispute would have been to have foreseen the possibility of such a dispute and, then, to have established a dispute resolution framework to draw upon should a dispute arise. When such a framework is not in place, parties should try the most appropriate and effective approaches available before resorting to litigation.

The full range of dispute resolution options and techniques should be considered and selected based on the type of dispute and its stage of development. Informal approaches are typically most effective in the early stages before a dispute has been blown out of proportion.

TO REVIEW A SAMPLE LIST OF ALTERNATIVE DISPUTE RESOLUTION PROCEDURES, SEE VOLUME 1 ANNEX 6.

To help companies deal with their governance disputes, mediation and ADR specialists, law firms, consultants, institutes of directors, and corporate governance centers are all increasingly advising clients on dispute resolution and offering mediation or other ADR services.

GRADUATED STEPS TO DISPUTE RESOLUTION



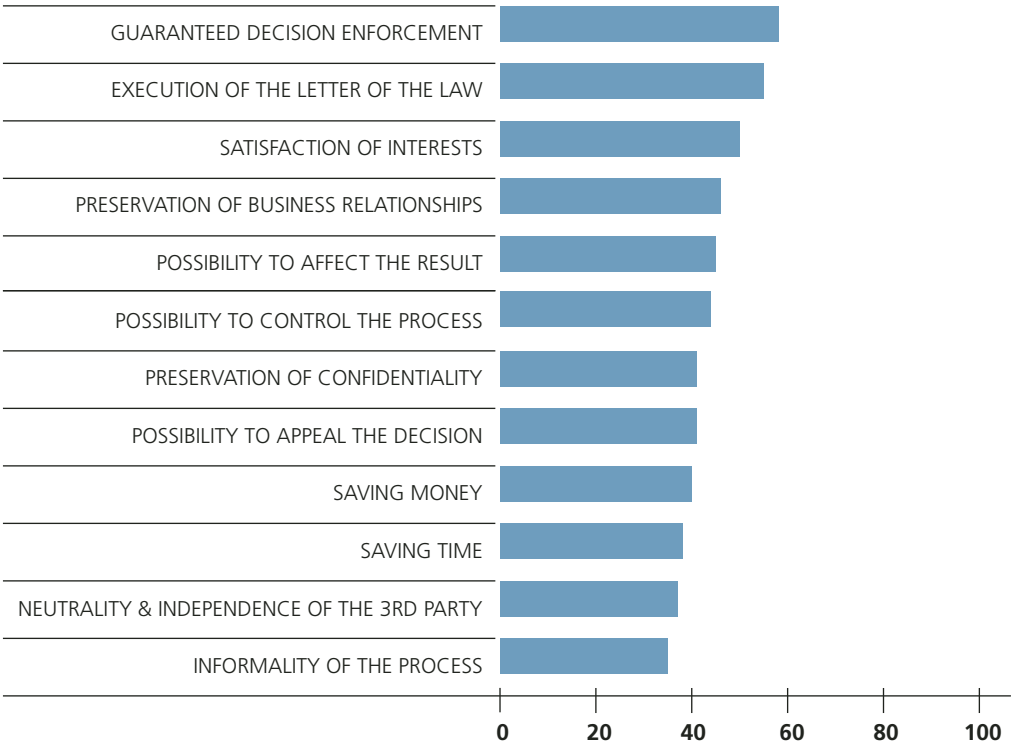
EXAMPLE

Factors for Selecting Dispute Resolution Methods
Ukraine

A study conducted by IFC in 2007 shows that without any awareness-raising campaign, Ukrainian companies are receptive to using ADR mechanisms.

This chart presents the results of surveyed Ukrainian companies on the most important factors that are considered when selecting dispute resolution processes.

PERCENTAGE OF COMPANIES TAKING THE FOLLOWING FACTORS INTO ACCOUNT WHEN SELECTING DISPUTE RESOLUTION METHODS



SOURCE: IFC, Ukraine Commercial Dispute Resolution Study. *Washington, D.C.: IFC, 2007. Available at: www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/UkraineADR_2006_Eng.pdf/$FILE/UkraineADR_2006_Eng.pdf.*

PRACTICE

Advising on ADR Uses

ADR service providers and lawyers should counsel clients on ADR uses. This advice should include:

- Full range of ADR techniques available
- Legal and financial implications of each
- Case's suitability for ADR
- Approaching the other party to agree on ADR
- Best time to attempt an ADR (process)

SOURCE: Karl Mackie, David Miles, William Marsh, and Tony Allen. The ADR Practice Guide, Commercial Dispute Resolution. Second Edition. *West Sussex, England: Tottel, 2006.*

PRACTICE

Criteria to Consider for Dispute Resolution

When selecting the right approach to resolving their dispute, parties should consider the following:

- Solution's finality
- Effect on current and future relations
- Speed
- Transparency
- Stakeholder impact
- Satisfaction with the outcome
- Transaction costs

SOURCE: Eric M. Runesson and Marie-Laurence Guy, Focus 4: Mediating Corporate Governance Conflicts and Disputes. *Washington, D.C.: IFC, 2007. Available at: http://www.gcgf.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+Mediation/$FILE/Focus4_Mediation_12.pdf.*

Several conditions determine the success or failure of such ADR processes as mediation and negotiation;

- ***The parties must be identifiable and willing to participate.*** For example, in a dispute over the benefits of listing the family business on an exchange, all the stakeholders and family members directly involved in the business must be willing to participate in person or via proxy to discuss opposing positions. If such critical parties as the company's founder are either absent or are unwilling to participate in the dispute resolution process, the solution will most likely not be enforceable.

- ***The parties must have a degree of interdependence.*** For a productive resolution process, the parties need either each other's assistance or restraint from negative action for their interests to be satisfied. For example, if none of the family members has a controlling stake in the family business, the decision of going public cannot be taken by one individual. Even if the founder has a controlling stake, his/her actions may require the moral approval of other family members involved in the company to avoid a family conflict that could adversely affect the company's operations.

- ***The parties must have a means of influence or leverage.*** For the parties to reach an accord over issues in disagreement, they must have other means to influence the attitudes and/or behavior of other party/ies. Often, influence is seen as the power to inflict pain or undesirable costs. For example, the family business founder's son or daughter may threaten to leave his/her position and never speak to his/her father again if the later doesn't agree to hear his/her vision on the company's future. Yet exerting influence can also be the ability to convince the other party or to have the other party change its perspective on a dispute. Asking thought-provoking questions, providing needed information, seeking experts' advice, appealing to influential associates, exercising legitimate authority, or providing rewards — these are all means of exerting influence.

- ***The parties must agree on some common issues and interests.*** To reach a settlement, parties must have

common issues and interests. Generally, parties will have some issues and interests in common with one another while others concern only one party. At the onset of the dispute resolution process, parties may only be able to agree that they disagree on the family business's future. Yet, as discussions progress, they may agree that they have the interests of both the family and the business as priorities.

- ***The parties have a sense of urgency.*** ADR is typically sought when there is pressure or a decision must be reached urgently. For the dispute resolution process to be successful, the participants must jointly feel a sense of urgency and be aware that they are vulnerable to adverse action or lost benefits if a timely decision is not reached. Urgency may be imposed by either external or internal constraints or by potential negative consequences of an unresolved dispute. External constraints include: court dates, imminent executive or administrative decisions, or predictable changes in the environment. Internal constraints, for example, may be artificial deadlines set by one party to enhance the motivation of another to settle.

- ***Parties should have no major psychological barriers to settlement.*** Strongly expressed or unexpressed feelings about another party can sharply affect a party's psychological readiness to find a workable solution to a dispute. For example, the chairman and the CEO systematically oppose each other's views on the company's future because they cannot tolerate each other. As a result, the board has become a hostage to an undefined dispute. Psychological barriers can also be based on over-optimism or an unrealistic perception of oneself. For example, the very successful founder of a company refuses to acknowledge that times are changing and the market for his/her services is disappearing. He/she has thus far always made the best business decisions and refuses to discuss with his/her partners the possibility of diversification. Psychological barriers to settlement must be lowered or eliminated for innovative solutions to emerge; this often requires a third party's intervention.

- ***Issues must be negotiable.*** For a successful settlement to occur, each party must believe that acceptable settlement options are possible as a result of participation in the dispute resolution process. If it appears that the outcome can only be a win/lose settlement and a party's needs will not be met as a result, parties will be reluctant to enter into a dialogue.

- ***The parties need to have the will to settle.*** For the dispute resolution process to succeed, parties must want to settle. If continuing a conflict is more important than settlement, then the dispute resolution process is doomed to fail. The negative consequences of not settling must be more significant than those for reaching an agreement.

- ***The parties must have the authority to decide.*** For a successful outcome, participants must have the authority to make a decision. If they do not have a legitimate and recognized right to decide, or if a clear ratification process has not been established, the ADR process will be limited to an exchange of information among the parties.

- ***The parties must be willing to compromise.*** Not all the solutions to every dispute require compromise. Agreements can be reached that meet every party's needs and do not require any one to sacrifice something. However, in other disputes, the willingness to have less than 100 percent of one's needs or interests satisfied may be necessary for the parties to reach an agreeable conclusion.

- ***The agreement must be reasonable and implementable.*** Some settlements may be substantively acceptable but may be impossible to implement. Parties to a dispute must be able to establish through the ADR process such as mediation or negotiation a realistic, workable plan to carry out their agreement if the final settlement is to be acceptable and hold over time. For example, even if all the concerned family members agree to listing the family business on a stock market, listing requirements need to be fulfilled before the business can go public.

Good mediators and negotiators can often help the parties find ways to overcome the obstacles described above. ■

MORE FLEXIBLE DISPUTE RESOLUTION

For this toolkit's purpose, it is sufficient to consider three broad approaches to out-of-court dispute resolution: negotiation, mediation, and arbitration. Negotiation and mediation are relatively informal and self-directed approaches to problem-solving. The parties agree to procedures, ensure that issues are "surfaced," and generate their own solutions. Arbitration, which is on the formal side of the continuum, is a regulated, quasi-judicial procedure.

Negotiation and mediation emphasize self-determination and joint problem-solving. The parties contribute to the design of the process, and they take ownership of negotiated agreements. In contrast, when the parties choose arbitration, they empower an independent arbitrator to assess the facts. The arbitrator then decides upon a legally binding settlement.

FOR A COMPARISON OF NEGOTIATION, LITIGATION, AND MEDIATION PROCESSES, SEE VOLUME 1 ANNEX 7.

Negotiation

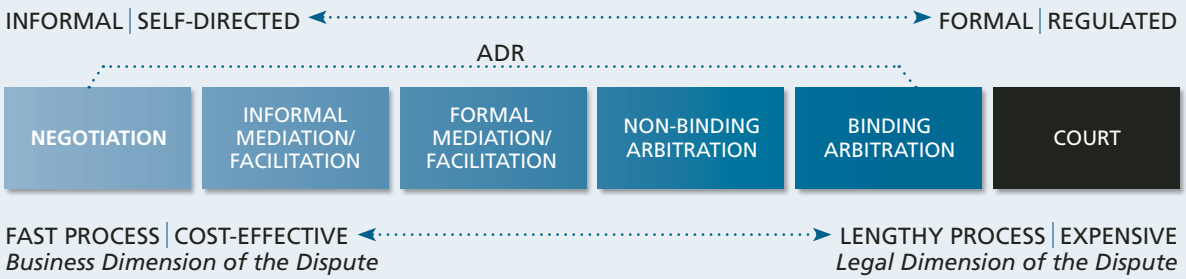
Negotiation is a problem-solving process in which two or more people voluntarily discuss their differences and attempt to reach a joint decision on their common concerns. It is a standard feature of everyday business and a component of any corporate governance decision-making process. Negotiation is also a distinct, out-of-court dispute resolution process. The process is informal, voluntary, and in most cases confidential although, of course, the outcome may be disclosed.

While it is the most commonly used out-of-court dispute resolution process, negotiation is also the major building block for many other ADR processes and a key phase of any formal mediation process.

Negotiations typically occur because the parties wish to achieve something jointly that neither could do on his or her own. The parties acknowledge the conflict between them and think they can use some form of influence to find a better outcome, rather than simply taking what the other side will voluntarily give them. In the boardroom, for example, directors typically prefer to search for agreement rather than fight openly, give in, or resign from the board.

When parties negotiate, they usually expect some "give and take." While they have interlocking goals that they cannot accomplish independently, they usually do not want or need exactly the same thing. This interdependence can either lead to a win-lose situation, as in the court room, or to a win-win situation in which a novel outcome is found that satisfies both parties. Hence, negotiation is very much dependent on both the type of issue involved and the way in which the negotiation is conducted. The disputants will either

COMPARING DISPUTE RESOLUTION MECHANISMS



SOURCE: Adapted from Lukasz Rozdeiczer and Alejandro Alvarez. Alternative Dispute Resolution Manual: Implementing Commercial Mediation, *Washington, D.C.: IFC, 2006. Available at: http://advisoryservices.ifc.org/docspubs/docpub.aspx?id=621.*

attempt to force the other parties to comply with their demands, influence their position, and move toward a forced compromise (**hard bargaining**), or manage to invent a solution that meets the objectives of all sides (**constructive negotiation**). In the context of corporate governance, the challenge in direct negotiation is to focus on corporate interests. A major risk is confusing substantive corporate issues with personality conflicts. When disagreements become interpersonal, the confrontations undermine the board's work and can stall important strategic decisions to advance the company's best interests. When board members, shareholders, or other stakeholders apply techniques associated with hard bargaining, the conflict is most likely to escalate rather than be efficiently solved. Risks associated with hard bargaining include the feelings of resentment, distrust, and anger that interfere with the loser's decision-making.

More than just a simple bargaining exercise, constructive negotiation requires parties to identify issues about which they differ, educate each other about their needs and interests, generate possible settlement options, and then bargain over the final agreement's terms.

When board members, shareholders, and other stakeholders can listen to one another's concerns and engage in constructive problem-solving, they are more likely to address their own, the corporation's, and shareholders' interests.

Among board directors, features of constructive negotiation include civility, discovery, open debate, and constructive dissent. Factors that encourage constructive outcomes in negotiation include:

- Shared goals
- Concern for reputations
- Flexibility in approach
- Effective communication
- Long-term relationships

A basic three-step approach helps to foster constructive negotiations. This approach can be effectively used to structure debates in the boardroom and guide difficult discussions with shareholders or other stakeholders. The first step is for each party to *prepare* by defining their own interests and concerns and then those of the other parties. The second is to *engage* in a respectful exchange of ideas. The third is to *review* progress.

Although directors may think they are naturally talented negotiators, they are not always well-trained in dispute resolution processes and aware of the benefits of, or techniques for, achieving win-win solutions to their disputes.

TO REVIEW TYPICAL STEPS INVOLVED IN CONSTRUCTIVE NEGOTIATION, SEE VOLUME 1 ANNEX 8.

GLOSSARY

Negotiation

Negotiation is a process of joint decision-making, in which two or more parties with differing interests must jointly reach a decision — the resolution they ultimately agree to.

SOURCE: Morton Deutsch and Peter T. Coleman, eds., The Handbook of Conflict Resolution: Theory and Practice. *San Francisco: Jossey-Bass Publishers, 2000.*

FOCUS

Negotiation Benefits

Constructive approaches to negotiation create opportunities for directors, shareholders, and other stakeholders to:

- Identify common concerns
- Bring issues to the surface
- Analyze issues and define the problem
- Encourage a free flow of solution ideas
- Prioritize interests
- Agree to solutions based upon interests
- Implement and monitor agreements

QUOTE

Limited Gains of Imposed Solutions

"The least successful conflict strategy is the application of authority, whereby a 'solution' for the conflict is essentially imposed by using power. Generally, this strategy amounts to taking account of the interests of only a single shareholder, such as the founder-owner of a family firm. The other family members are left standing in the cold. The exercise of authority means that the other family members cannot achieve their own objectives, which generates anger, stress, and distrust. In many cases, the application of authority will seriously perturb the family relations, thus weakening the cohesion within the family firm."

JOZEF LIEVENS
PARTNER, EUBELIUS LAW FIRM | MEMBER, FORUM'S PRIVATE SECTOR ADVISORY GROUP

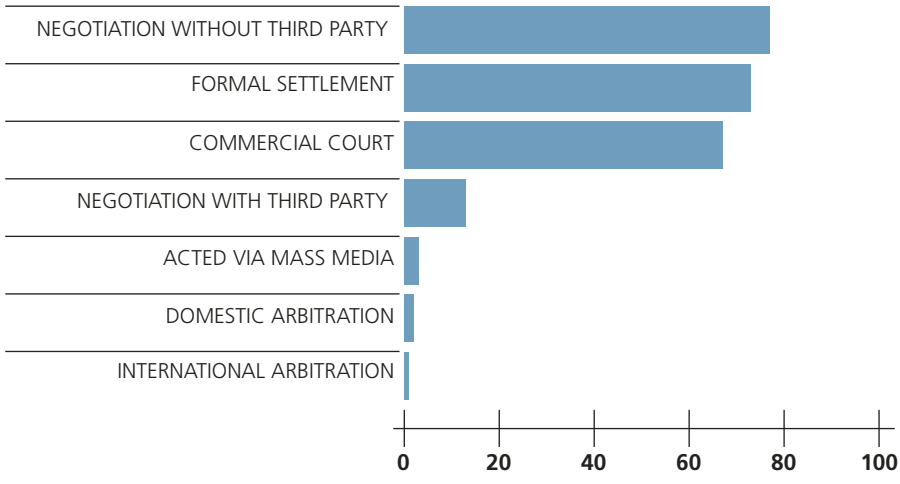
SOURCE: Jozef Lievens. "Collaborative Conflict Resolution — the 'Harvard Approach' Applied to Family Business." 2002 Working paper provided by the author to the Forum.

EXAMPLE

Company Use of Dispute Resolution Methods
Ukraine

An IFC study conducted in the Ukraine in 2007 found that 77 percent of businesses solved their disputes through negotiation without third-party involvement. "When third parties are engaged to assist in negotiations, parties often feel they've been brought in to exert influence rather than to help the parties conciliate or find ways to compromise." Despite this impression of the role of third parties in dispute resolution, 56 percent of the CEOs and other senior executives interviewed indicated that they would likely try mediation to resolve disputes if it were available.

PERCENTAGE OF SENIOR EXECUTIVES INDICATING THE FOLLOWING DISPUTE RESOLUTION MECHANISM AS THEIR PREFERRED WAY TO SETTLE DISPUTES



*SOURCE: IFC,*Ukraine Commercial Dispute Resolution Study. *Washington, D.C.: IFC, 2007. Available at: www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/UkraineADR_2006_Eng.pdf/$FILE/UkraineADR_2006_Eng.pdf.*

EXAMPLE

Hard Bargaining versus Constructive Negotiation
CEO's Compensation Package Review

HARD BARGAINING CEO ACTS IN HIS/HER BEST PERSONAL INTEREST	**CONSTRUCTIVE NEGOTIATION** CEO ACTS IN THE COMPANY'S BEST INTERESTS
PARTIES HAVE SET POSITIONS CEO REQUESTS A SPECIFIC INCREASE OF HIS/HER COMPENSATION PACKAGE	**PARTIES ARE LOOKING FOR COMMON INTERESTS** CEO REQUESTS A REVIEW OF HIS/HER COMPENSATION PACKAGE
PARTIES HAVE A COMPETITIVE AND AGGRESSIVE POSITION CEO REQUESTS A MINIMUM INCREASE OF HIS/HER COMPENSATION OR HE/SHE WILL RESIGN	**PARTIES HAVE A COOPERATIVE AND OPEN POSITION** CEO PRESENTS AN ASSESSMENT OF HIS/HER PERFORMANCE AND ASKS THE COMPENSATION COMMITTEE TO OFFER HIM/HER AN IMPROVED PACKAGE BASED ON PERFORMANCE AND CORPORATE RESULTS
PARTIES WITHHOLD INFORMATION CEO WITHHOLDS MATERIAL INFORMATION THAT MAY IMPACT NEXT YEAR'S PERFORMANCE OF THE COMPANY	**PARTIES SHARE INFORMATION ABOUT THEIR INTERESTS** CEO EXPLAINS HIS STRATEGY ON HOW TO MAKE THE COMPANY GROW IN A NEW MARKET NICHE THAT WILL HELP IMPROVE THE COMPANY'S PERFORMANCE
PARTIES ARE SUSPICIOUS AND DISTRUST EACH OTHER CEO THINKS SOME MEMBERS OF THE COMPENSATION COMMITTEE DISLIKE HIM/HER AND WANT TO REPLACE HIM/HER WITH SOMEONE ELSE	**PARTIES WORK ON BUILDING UNDERSTANDING AND TRUST** CEO ASKS THE COMPENSATION COMMITTEE TO TRUST HIM/HER IN IMPLEMENTING A NEW GROWTH STRATEGY AND IS WILLING TO LINK HIS/HER PACKAGE TO THE RESULTS ACHIEVED
PARTIES VALUE THEIR OWN GAINS CEO SEEKS THE HIGHEST POSSIBLE COMPENSATION PACKAGE REGARDLESS OF THE COMPANY'S PERFORMANCE	**PARTIES EXPLORE AND EXPAND OPTIONS FOR JOINT GAINS** CEO DISCUSSES PERFORMANCE OBJECTIVES ON WHICH HIS REVISED COMPENSATION PACKAGE COULD BE BASED
ONE WINS, THE OTHER LOSES CEO GETS THE HIGHEST POSSIBLE COMPENSATION PACKAGE OR RESIGNS	**MUTUAL GAINS (WIN/WIN)** CEO GETS THE HIGHEST POSSIBLE COMPENSATION PACKAGE LINKED TO SPECIFIC GOALS AND INDIVIDUAL PERFORMANCE TARGETS
THE OUTCOME IS DISTRIBUTIVE (EITHER/OR) THE CEO GETS MORE; SHAREHOLDERS BENEFIT LESS	**THE OUTCOME IS INTEGRATIVE (BOTH/AND)** THE CEO AND SHAREHOLDERS BENEFIT MORE IF THE COMPANY PERFORMS BETTER

SOURCE: Adapted from Richard G. Shell, Bargaining for Advantage: Negotiation Strategies for Reasonable People. *New York: Penguin, 1999.*

Traditionally, negotiation occurs directly between the parties. The assistance of a neutral third party is not required, but in formal negotiation settings, parties may be represented by a professional negotiator who typically would be — yet not necessarily the same professional in all cultures — their lawyer.

When both parties are willing to engage in constructive negotiation, both tend to gain. However, if one of the parties adopts a constructive approach while the other maintains a hard bargaining position, the outcome is more doubtful.

If negotiations break down and/or reach an impasse, a third party may be introduced, creating a process of facilitated negotiation — also referred to as "facilitation" or "informal mediation." For example, if the board cannot easily come to a joint agreement over a strategy decision, the chairman can usefully convene a strategy retreat facilitated by a third party to help surface individual interests and needs, and, then explore alternative solutions. This third party can be a trained mediator or a corporate strategy consultant.

Mediation

In mediation, participants are assisted in resolving their disputes by an impartial, independent third party. Mediation is an alternative for addressing corporate governance disputes when direct negotiation fails to produce satisfactory results or is not a viable option when, for example, the parties refuse to talk to each other.

Mediation is flexible, allowing the parties to control the dispute's process and outcome. The parties own their dispute and the solution. They fashion the solution to their issues themselves and formally agree to be bound by it. They are assisted in this process by a mediator. This expert surfaces facts and issues, focuses the parties on common interests, and helps them reach a formal agreement to resolve matters. Features of an effective mediation include:

- Respected neutral third party
- Confidentiality
- Fair, impartial process
- Consensual agreements
- Accountability

GLOSSARY

'BATNA'

BATNA stands for "best alternative to negotiated agreement." This concept was popularized in 1981 by Roger Fisher, William L. Ury and Bruce Patton in their well-known book *Getting to Yes: Negotiating Agreement Without Giving In*. The authors explain that the reason why one negotiates is to produce something better than the results that can be obtained without negotiating. The alternative to negotiation is the standard against which any proposed agreement should be measured. In other words, the negotiation's outcome should always be better than what it would have been without negotiating.

SOURCE: Roger Fisher, William L. Ury, and Bruce Patton. Getting to Yes: Negotiating Agreements Without Giving In. *(Second Edition). New York: Penguin, 1999. Copyright 1999. All rights reserved.*

GLOSSARY

Mediation

Mediation is an informal process employed by disputing parties in order to arrive at an agreed solution.

SOURCE: Southern Africa Institute of Directors (IoDSA). Available at: www.iodsa.co.za.

Mediation is a flexible process conducted confidentially, without prejudice, in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference, with the parties in ultimate control of the decision to settle and the terms of resolution.

SOURCE: Center for Effective Dispute Resolution (CEDR). Available at: www.cedr.co.uk.

QUOTE

Customary Mediation

"The general tendency in Uganda over the years was to litigate disputes with the view to get a legally binding decision. However, mediation as a dispute resolution mechanism is not all together new in traditional Uganda, and African society. There has for centuries been a customary mediation mechanism, using elders as conciliators/mediators in disputes using procedures acceptable to the local community, but which were not as formal as those found in the courts."

JUSTICE GEOFFREY W. M. KIRYABWIRE
COMMERCIAL COURT JUDGE MINISTRY OF JUSTICE, UGANDA

SOURCE: Geoffrey W. M. Kiryabwire, "Mediation of Corporate Governance Disputes through Court Annexed Mediation." Paper provided by the author to the Forum.

EXAMPLE

Court Litigation versus Mediation
Bosnia and Herzegovina

According to data collected by IFC's Commercial Mediation pilot in Bosnia and Herzegovina, only six percent of the cases filed in court between 2005 and September 2006 were related to corporate governance disputes and inadequate protection of minority shareholder rights. During the same period, 220 out of 300 mediated agreements involved individual shareholders or corporate investors and led to the release of EUR4.2 million.

COMMENT
As in Bosnia and Herzegovina, out-of-court settlement processes such as mediation can prove very successful. Raising awareness for companies to better understand ADR benefits is an important factor determining the success and sustainability of out-of-court settlements.

SOURCE: Lada Busevac, "The Promise of Mediation Practice in Corporate Governance." Paris, February 2007. Available at: http://www.gcgf.org.

The terminology used to describe mediation can vary widely. Mediation, conciliation, and facilitation, for example, are often used interchangeably. The term "mediation" is mainly used in Europe while the same process is referred to as "conciliation" in Latin America.

TO REVIEW SAMPLE DEFINITIONS OF MEDIATION FROM AROUND THE WORLD, SEE VOLUME 1 ANNEX 9.

Regardless of terminology, the important aspect to keep in mind when looking into ADR processes is the role that the (neutral) third party plays in dispute resolution and his/her level of engagement. In some cases, mediators facilitate communication, strategic planning, and problem-solving. In other cases, the mediator will be expected to formally help settle disputes.

Mediation provides a quicker, less costly, and more confidential way to resolve disputes than court litigation and, unlike arbitration or judicial forums, it helps preserve or restore valuable working relations between parties because it is founded on a negotiation approach. Through creative win-win solutions, mediation can save executives time and attention that may be lost in pursuing legal resolutions that may not be in the parties' best interests.

Mediation is typically a private and voluntary dispute resolution process, but the ways in which mediation has been introduced vary from country to country. In several countries — especially developing countries — mediation has been introduced with the support of the judiciary to help reduce the backlog of court cases. In Uganda, Bosnia and Herzegovina, and Pakistan, for example, court-annexed mediation centers have been used for early resolution of conflicts. For some cases, a mediated settlement must be explored by the parties before the case can go to trial. In India, the Supreme Court issued a landmark decision *(Salem Advocate Bar Association, Tamil Nadu* v. *Union of India)* in which it held that reference to mediation, conciliation, and arbitration is mandatory for court matters.

TO ACCESS LINKS TO SAMPLE MEDIATION RULES AND PROCEDURES FROM AROUND THE WORLD, SEE VOLUME 1 ANNEX 10.

Formal mediation generally consists of three phases: the initial preparations, mediated negotiations in which each party makes free and informed choices, and the concluding phase in which parties formalize their decisions. During mediation, each side may caucus or meet separately with the mediator. The mediator may raise questions and offer insights to encourage parties to resolve their issues.

TO REVIEW TYPICAL STEPS INVOLVED IN FORMAL MEDIATION, SEE VOLUME 1 ANNEX 11.

There are typically three dimensions to a dispute, particularly those involving corporate governance issues. Although it might not always appear that way, every dispute has a personal, business, and legal component.

The importance of each of these components may vary from one dispute to another. In the context of corporate governance, the personal component of disputes is often hidden or ignored but may actually be the real cause, or at least an important factor, of the dispute. For example, a company's CEO may be at odds with the board's chairman or have a history of dissent with an independent

FOCUS

Benefits of Mediation

- **Cost:** Transaction costs are considerably lower than those of adjudication.
- **Speed:** The process can start as soon as the parties agree to mediation. The mediation process itself rarely takes more than a few days.
- **Quality:** Mediators can be selected according to their skills and expertise.
- **Predictability:** The decision cannot be imposed on the parties.
- **Control:** The parties own the dispute and craft its solution.
- **Flexibility:** The parties can decide on the type of mediation and the procedure they will use, including, the timing and the location.
- **Confidentiality:** Parties can disclose only what they wish to. The content of the mediation and information exchanged usually remains confidential, but the parties may agree on disclosing the agreement.
- **Limited risk:** Parties do not have to settle and have the choice to seek another form of dispute resolution — including a court decision.
- **Liability:** It doesn't have to be admitted to reach a settlement.
- **Non-binding:** While the process is non-binding, the agreed outcome may be enforced as a contract or registered as a consent judgment.
- **Voluntary:** Unless required by court, the parties do not have to go to mediation. In all cases, parties do not have to settle.
- **Perspective:** Parties can gain a more objective, detached view of their positions before their views solidify and the battle lines are drawn, which makes a resolution more difficult to achieve. Further, the parties' circumstances may have changed from those prevailing when the conflict first occurred, thus allowing for an interim assessment.

SOURCE: Eric M. Runesson and Marie-Laurence Guy, Focus 4: Mediating Corporate Governance Conflicts and Disputes. *Washington, D.C., Global Corporate Governance Forum, 2007. Available at: http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus+Mediation/$FILE/Focus4_Mediation_12.pdf.*

THE THREE DIMENSIONS TO A DISPUTE

director that is affecting the board's decision-making process. Yet the animosity between the two may not have anything to do with the actual decisions that must be made on the company's behalf. Another example could be that of board members who have personal loyalties to the CEO, who is blocking shareholders' efforts to separate the positions of chairperson and CEO. They may hold a genuine principle against such a practice. In family firms, personal and business issues are often intertwined and the company's long-term perspective may be handicapped by sibling rivalries or succession issues.

An essential feature of mediation is that it can address the full dimensions of a dispute and help surface important issues that are hindering a corporate decision in the company's best interests. While litigation only deals with a dispute's legal dimension, mediation allows for parties to vent and surface conflicts before refocusing the parties on the dispute's business component and their common interest in finding a good solution.

Mediation is, therefore, a good risk-management technique because it provides a more objective or detached mirror of their position to executives who get caught up in the throes of a personalized corporate governance conflict. Mediation is not just about win-win outcomes; it can also help all parties confront the greater losses or risks that directors may face if they fail to settle.

The appointed third party will help the parties understand the dispute's issues and focus on identifying each party's specific needs and interests in working towards a consensual resolution. Mediation may be performed by a variety of professionals, who use different tactics in mediating corporate governance issues. The mediator's skills as well as his/her cultural and personal styles will vary. Hence, the choice of a mediator will influence the mediation and the core issues that will be addressed. It is essential that the parties in conflict respect the mediator and have confidence in the fairness and impartiality of the process.

TO REVIEW THE SKILLS REQUIRED FOR CORPORATE GOVERNANCE DISPUTE RESOLUTION, SEE VOLUME 3 MODULE 1.

FOCUS

Third Party's Role in Dealing with Corporate Governance Disputes

- **Informal Mediation or Facilitation:** The third party provides a controlled forum for discussion to help surface issues prior to any material corporate decision (e.g., facilitation of a board retreat or strategy meeting).
- **Formal Mediation or Conciliation:** The third party tries to get the parties to reach an agreement but is focused solely on process and not on who is legally right (e.g., mediation of a dispute between the board and dissident shareholders).
- **Formal Mediation or Early Neutral Evaluation:** The third party encourages the parties to reach an agreement but, also uses legal knowledge to convince the parties that they do not have a better alternative to a negotiated agreement (e.g., dispute over the value of shares in a squeeze-out procedure).

SOURCE: Adapted from David Thaler and Aniella Berstein, Strengthening Governmental Conciliation Institutions: A Practitioners Handbook. *July 2003. U.S. Federal Mediation and Conciliation Services. Available at: www.fmcs.gov/apecImg/APEC%20Handbook%2007.04.03/Handbook%5B1%5D.Final.06.30.03.doc.*

EXAMPLE

Three Dimensions of a Corporate Governance Dispute
Family Firm Dispute Case Study

Albert Tonga, a well-known agro-biologist in his country, set up a family firm 20 years ago to commercialize healthy baby food for busy working mothers. This was a new market niche at a time when only home-grown natural products were used to feed babies. Tonga's business turned out to be a success, and the company started exporting its goods to the region five years ago.

For tax purposes, Tonga transferred 30 percent of the company's shares to each of his two children, who had turned 19 and 21. His wife already owned eight percent of the company's shares, and Tonga kept a controlling stake of 32 percent.

Although the company has been very successful, its performance could be threatened by multinational food companies, which have started commercializing similar products at lower prices. To better plan for the future, Tonga's daughter thinks the family should list the company on the local exchange and raise funds to finance a diversification strategy, but no one ever listens to her.

Tonga's son, who sees himself as the company's future CEO, thinks that the company should remain private, but the capital should be opened to a strategic investor, who could fund a new plant to produce processed food for babies. He already has one person in mind: the wealthy father of his best friend.

Tonga thinks "small is beautiful," and the company is doing well as it is. He is increasingly annoyed with all these discussions over his company's future and upset that his children want to dilute the family business. He nearly regrets having transferred shares to them. They are too young and inexperienced to make good business decisions. Tonga's wife doesn't have a strong opinion on what the best option for the company should be, but she is increasingly worried about the tensions in her family. Her husband is sulking, and her children are hardly talking to each other.

COMMENT

This case study identifies the three dimensions of a family firm governance dispute — personal, legal, and business. A good mediator should address all three dimensions to help parties find a satisfying and sustainable approach to a growth strategy for their company.

DIMENSIONS OF THE DISPUTE	ELEMENTS OF THE DISPUTE	MEDIATION TECHNIQUES	RISKS OF DEALING EXCLUSIVELY WITH ONE DIMENSION OF THE DISPUTE
PERSONAL DIMENSION	▸ Tonga doesn't want to be challenged by his children. The company is his. He invested his whole life in it and he "owns" it. ▸ His son wants increasingly to play a role in the company and expects his father to hand over the business to him. ▸ His daughter wants to be respected and her educated opinions to be seriously considered. She is as savvy in business management as her brother. ▸ His wife wants the family to be happy and feels torn between her loyalties to her husband and her children.	▸ Allow each party to vent and express their frustrations and ambitions. ▸ Restore constructive channels of communications. ▸ Help each party to listen to the others' viewpoints, explore options, and remind them of their common family interests. ▸ Consider laying the grounds of a succession plan as part of the final agreement.	▸ For the sake of peace in the family, strategic decisions in the best interest of the business are postponed. The business may or may not survive it.
BUSINESS DIMENSION	▸ No changes are made to the company's current structure. ▸ The company goes public. ▸ The company's capital is opened to a strategic investor.	▸ Help re-focus primary attention on the company's interests. ▸ Review the pros and cons of each business alternative. ▸ Explore alternative innovative options. ▸ Review short- and long-term benefits of each alternative. ▸ Help reach an agreement on a satisfactory way to help the company grow and make the necessary investments without losing family control.	▸ If an agreement is reached in the best interest of the business without taking into account the interests of individual family members and the family as a whole, it will likely fail later. Even the best strategy cannot be carried out properly if underlying emotions, frustrations, and resentments haven't been addressed.
LEGAL DIMENSION	▸ None of the family members has a large enough stake in the company to make a decision of the company's future by him/herself. ▸ Family members can build alliances and put a suggested option to vote.	▸ Review the statutes of the company, the company law, and listing requirements. ▸ Clarify voting procedures and legal steps required for taking material decisions affecting the company now and for the future.	▸ The decision to open up the capital of the company or to go public can be put to a vote. This will result in a win-lose situation that will leave some family shareholders unhappy and have a negative effect on the harmony within the family. Most likely, this will set the grounds for future disputes.

EXAMPLE

Shareholder Dispute Settled through Mediation

Uganda: K.M. Patel and another vs. United Assurance Company Ltd. (Company Cause No. 5 of 2005)

In this case, two Asian brothers, whose family name is Patel, filed a minority petition as shareholders to terminate one of Uganda's largest private insurance companies. They alleged that their shares in the company — owning 40 percent — had been wrongfully and illegally diluted during a restructuring and sale of the company without any notice to them. Justice Geoffrey K. M. Kiryabwire of the Commercial Division of the Uganda High Court decided to mediate the case with the parties' consent. The mediation successfully settled the dispute and led to a consent judgment where the insurance company bought out the two shareholders. The company's CEO was later quoted by the media saying: "[We] are happy this has been amicably concluded. I believe the Patels as the founders will leave us with their blessings...."

COMMENT

This case illustrates how mediation can contribute to finding a timely, cost-effective resolution to corporate governance disputes without tarnishing the company's reputation while preserving business relations. Typically, a judge would not directly mediate a dispute that comes before him in court but, instead, refer it to mediation in a jurisdiction where court-annexed mediation has been established.

SOURCE Geoffrey K. M. Kiryabwire, "Mediation of Corporate Governance Disputes through Court Annexed Mediation." February 2007. Paper provided by the author to the Global Corporate Governance Forum.

FOCUS

Limitations of Formal Mediation

- Some disputes can be settled without third party intervention (e.g., the chairman offers to "mediate" a dispute between two opposing views in the boardroom on the company's sustainability strategy)
- The need for court assistance/protection (e.g., a court injunction to put a major corporate transaction on hold because legal procedures have not been complied with; ADR can then be sought to settle the substance of the dispute itself)
- The need to set a precedent (e.g., a wronged institutional investor is seeking redress as a matter of principle to influence governance standards)
- Seeking publicity (e.g., stakeholders want to shame and blame a company for ethical misconduct)
- The wish to demonstrate power and/or to threaten the other party (e.g., one of the main shareholders is seeking to exert more control and sues the family shareholders to push them to settle)
- The lack of interest in settling to gain time and avoid any outcome of a settlement (e.g., a family business in which one family member is determined to take control and has no interest in dialogue or a company faced with an environmental dispute, which anticipates a near-term political and legal change in its favor)

SOURCE: Adapted from Karl Mackie, David Miles, William Marsh, and Tony Allen. The ADR Practice Guide, Commercial Dispute Resolution, *Second Edition. West Sussex, England: Tottel. Copyright 2006. Used by permission.*

Despite a respected facilitator's best efforts, a constructive result may not be achieved. The parties in dispute may not be willing to resolve the problem, unforeseen factors may arise, or it may not be possible to overcome or compensate for the perceived damages. If the parties cannot reach an agreement through mediation, they may still consider other alternatives, such as arbitration.

Arbitration

Arbitration is a regulated alternative for settling corporate disputes. The process is usually confidential but awards may be made public. An independent, impartial arbitrator reviews documents and testimony and makes a judgment on the parties' rights and obligations. Opposing claims must be specific enough and formulated with sufficient clarity to allow for judgment. Arbitrators decide the case's merits and how to correct or compensate for any wrongdoing. Their awards are usually final and legally binding.

GLOSSARY

Arbitration

Arbitration is a proceeding voluntarily chosen by parties who want a dispute determined by an impartial arbitrator of their own mutual selection. The parties agree in advance that the arbitrator's decision — based on the case's merits — will be final and binding.

SOURCE: Federal Mediation and Conciliation Service, USA.

Non-Binding Arbitration

The purpose of non-binding arbitration is to encourage settlement by having a neutral expert evaluate the facts and apply the relevant law. An independent, impartial arbitrator decides the case's merits and the parties' rights and obligations. The arbitrator's award is not binding; the parties in dispute retain the right to bring claims before the court.

In arbitration, the parties contract to be bound by the decision of a single arbitrator or a panel of arbitrators. A procedure resembling a trial ensues, and the arbitrator(s) render(s) a decision.

TO REVIEW TYPICAL STEPS INVOLVED IN STANDARD ARBITRATION, SEE VOLUME 1 ANNEX 12.

Arbitration is designed to bypass the courts for quicker, less expensive, and more efficient adjudication. The process is confidential and generally less adversarial than litigation, though more so than mediation.

FOCUS

Use of Formal Arbitration

ADVANTAGES

- Avoid the expenses and delays of court litigation
- Parties can decide on the arbitration court and location
- Parties can jointly choose the arbitrator(s)
- Availability of arbitrators with appropriate legal and other specialized competencies
- Confidentiality of the proceedings can be legally protected
- Legal protection of any information revealed
- Awards are final, binding, and can be appealed only on the basis of a serious failing of procedure
- International recognition of arbitrator decisions (awards)

LIMITATIONS

- Needs agreement to refer to this procedure
- Can be time consuming and expensive, particularly for cross-border matters
- May address only the legal dimension of disputes
- Has the risk of an unpredictable award

EXAMPLE

Arbitration of Shareholder Dispute
South Africa - Tanzania - Kenya: Rift Valley Railways

Rift Valley Railways (RVR) was formed in Mauritius in 2006 as the holding company for the consortium led by Sheltam Corporation. This consortium had successfully bid for the 25-year concession of East Africa's oldest railway line. Sheltam has a 35-percent stake in the company while Primefuels Kenya, a liquid fuels logistics provider, holds a 15-percent stake in RVR, and Mirambo Holdings, an investment company, has a 10-percent stake. The remaining shares are held by the local equity fund TransCentury Limited (20 percent), Babcok and Brown Investment Holdings of Australia (10 percent), and Centum Investment Company (10 percent).

A dispute between the RVR partners arose from Sheltam's last-minute decision to abandon Mirambo and Primefuels as it moved to takeover Kenya-Uganda railways in 2006 on the grounds that Mirambo and Primefuels had failed to sign a shareholders' agreement when asked to do so.

The dispute between Sheltam and its initial partners, Mirambo and Primefuels, went for arbitration in London under Article 14 of the consortium agreement. This agreement provided that any dispute would be settled by three arbitrators in London under the rules of the London Court of International Arbitration.

Mirambo and Primefuels successfully argued that the document they had been asked to sign did not comply with the consortium agreement. The arbitrators decided that Sheltam had breached its obligation to serve a contractually compliant shareholders' agreement for execution by its partners and declared that Mirambo and Primefuels were entitled to participate as RVR shareholders.

The arbitrators further declared that Sheltam could not issue, allocate, sell, charge or transfer RVR shares in the manner it did and ordered that the two partners be brought back into the consortium.

Sheltam contested the decision through an appeal it filed in London's Royal Court of Justice in December 2007, arguing that the arbitrators had exceeded their powers in the awards. But a few months later, the South African firm threw in the towel and admitted that it had run out of money to pay the fees of its counsel for the case.

A decision was made to discontinue the claim where Sheltam contested the arbitrator's decision. The court further ordered Sheltam to cover the case's costs.

In July 2008, Mirambo and Primefuels returned as RVR shareholders.

COMMENT

This case demonstrates the importance of having dispute resolution clauses and processes in place before a dispute arises. Without an arbitration clause, this dispute may have dragged on much longer with parties arguing over which jurisdiction is most competent to decide the case. Yet, arbitration is typically more time- and cost-consuming than mediation.

SOURCE: Jim Onyango, "Shareholder Wars Expose RVR's Financial Weakness." Business Daily Africa, *August 11, 2008. Available at: http://www.bdafrica.com.*

QUOTE

Increase in Arbitration Cases
Bulgaria

"The Court of Arbitration of the Bulgarian Chamber of Commerce and Industry has seen a steady increase in the number of cases of voluntary arbitration. The court rendered around 160 cases in 2001, 200 cases in 2005 and almost 300 in 2006. One of the main reasons for this is that the speedy arbitration process brings about final decisions on important legal issues years before the same issues can reach the higher instances of the state court system.

"Because of the good work of the court and the notoriously disappointing functioning of the state courts, arbitration is becoming widely popular and used in Bulgaria. Reasons that would refrain from the use of arbitration include the wish to avoid liability in case of breach of duties and to delay a ruling by using the clumsy and ineffective state courts."

DR. SILVY CHERNEV
PRESIDENT, COURT OF ARBITRATION OF THE BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY

SOURCE: Silvy Chernev." Current Status of Arbitration and Other Dispute Resolution Means in Bulgaria." 2008. Working paper provided by the author to the Forum.

EXAMPLE

Arbitration Trends
Mexico

Although commercial arbitration is a relatively new method of dispute resolution in Mexico, it continues to gain acceptance as a means of resolving disputes regardless of whether the parties involved previously signed an arbitration agreement. It has particularly been favored in disputes involving companies from different jurisdictions that run their businesses from different locations and operate under different laws. Two forms of arbitration can be used in the resolution of cross-border disputes. With traditional arbitration, the award is granted in strict adherence to a particular body of law agreed upon by both parties. The alternative form is "amiable composition" which is based on principles of equity and considerations of what is reasonable and just for the parties.

COMMENT
ADR approaches are gaining acceptance worldwide. Arbitration is especially favored for cross-border disputes, according to a study by the Australian Centre for International Commercial Arbitration. "The two main reasons corporations preferred international arbitration over litigation were flexibility of arbitral procedure and the enforceability of the arbitral awards. Two other advances that corporations considered important were the privacy of proceedings and the ability of parties to select arbitrators suitable for resolving their particular dispute."

SOURCE: Viviana Castro Hurtado at Basham Ringe y Correa SC, "Arbitration Mexico: Two Approaches to Amiable Composition," International Law Office Newsletter, *October 04, 2007. Available at: http://www.internationallawoffice.com/Newsletters/detail.aspx?g=0e3c3f48-4201-4ef2-8621-ff0ba097aaf0. Australian Centre for International Commercial Arbitration,* Managing Cross-Border Disputes. *Sydney: ACICA, 2006. Available at: http://www.virgilcameron.com/acica/ACICA-IABooklet.pdf.*

One main advantage of arbitration as compared to litigation is that the parties may jointly choose the arbitrator and the location of the arbitration forum on mutually agreeable terms. They may also select the type of arbitration hearing that they prefer:

- ***Document Hearing*** — Arbitrator reviews documents or property to render a judgment, called an "award" or "order."
- ***Participatory Hearing*** — Arbitrator reviews documents or property and also receives testimony in person, by telephone, or online to render a judgment.

Joint selection of the arbitrator ensures that he/she will have the required skills and expertise to render an informed award. In many jurisdictions, parties may actually terminate the proceedings and ask that the arbitrator withdraw or be replaced because of prejudice, biased behavior, or incompetency.

Each party must "cooperate in good faith" with the arbitrator, whose conduct is governed by codes of procedure, the parties' agreements, and applicable law. The arbitrator has an ethical and legal obligation to disclose any conflicts of interests.

If negotiation and mediation have failed to help parties reach a satisfactory agreement and/or if parties wish to have the legal dimension of their dispute formally settled, arbitration may well be the appropriate process. Arbitration can be especially effective when dealing with cross-border disputes.

To some extent, court litigation of corporate governance disputes and, especially, cross-border disputes have been replaced by litigation before international or national arbitration tribunals. Yet, arbitration remains structurally related to litigation and, hence, burdened with the many drawbacks of court proceedings, including time and costs that are notably higher than with mediation. Yet, parties may be able to avert such high charges by jointly demanding an efficient arbitration process when drafting the contract. ■

QUOTE

The Cost of Arbitration

"Modern arbitral litigation is much closer to litigation except that it is more confidential and more independent from government influence. It tends to encompass massive costs for litigants. Both sides will employ several lawyers to make its case. There will be as a rule a three-person tribunal. Assuming preparation time of 15 days for 10 lawyers and 25 days for the exchange of briefs and hearings and say 15 days for arbitral deliberation and decision making, the total bill for direct costs can easily run up to US$1 million or more. This doesn't take into account staff time — corporate lawyers for managing the contract with the outside team, corporate management for giving evidence nor the time for enforcing an award once made."

THOMAS WÄLDE
PROFESSOR, UNIVERSITY OF DUNDEE

SOURCE: Thomas Wälde, "Mediation/Alternative Dispute Resolution in Oil, Gas and Energy Transactions: Superior to Arbitration/Litigation from a Commercial and Management Perspective." Ogel Journal. *2003. Available at: http://www.ogel.org/journal-author-articles.asp.*

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ANNEXES

1.4

1. Further Reading
2. Sample Board Structures and Potential for Disputes
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9. Sample Definitions of Mediation from Around the World
10. Links to Sample Mediation Rules and Procedures
11. Typical Steps in Mediation
12. Typical Steps in Arbitration

FURTHER READING

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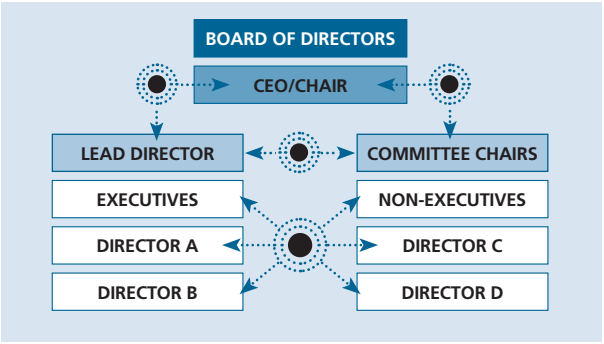
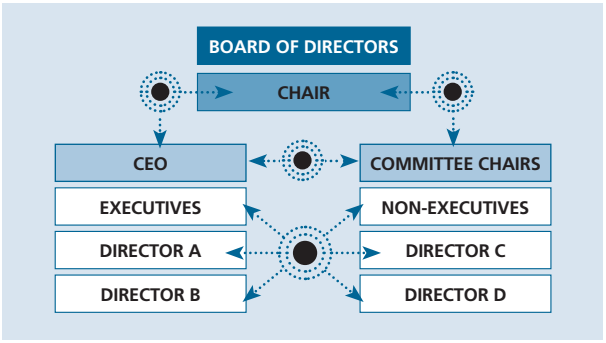
SAMPLE BOARD STRUCTURES AND POTENTIAL FOR DISPUTE

Regardless of the type of board structure adopted, disputes may arise as a result of conflicting interests and diverging views on the company's strategic and business priorities. Multiple variations of the board models described below have been implemented around the world.

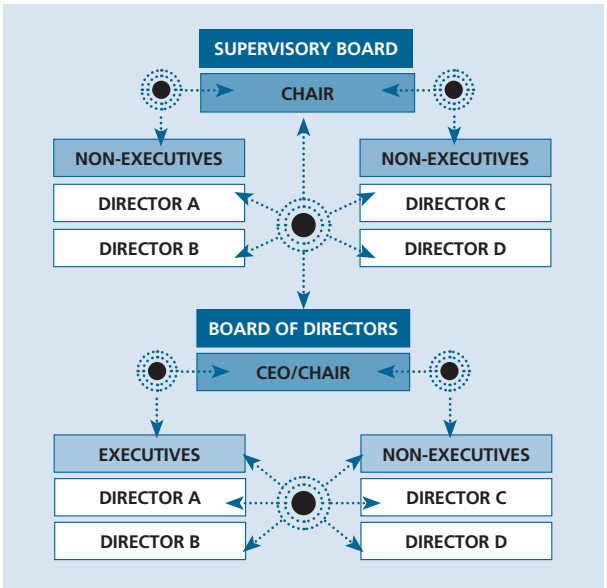
UNITARY BOARD STRUCTURE



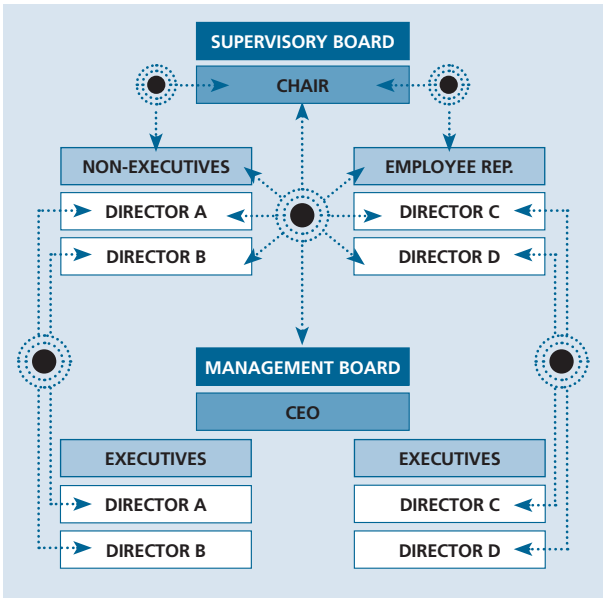
UNITARY BOARD STRUCTURE



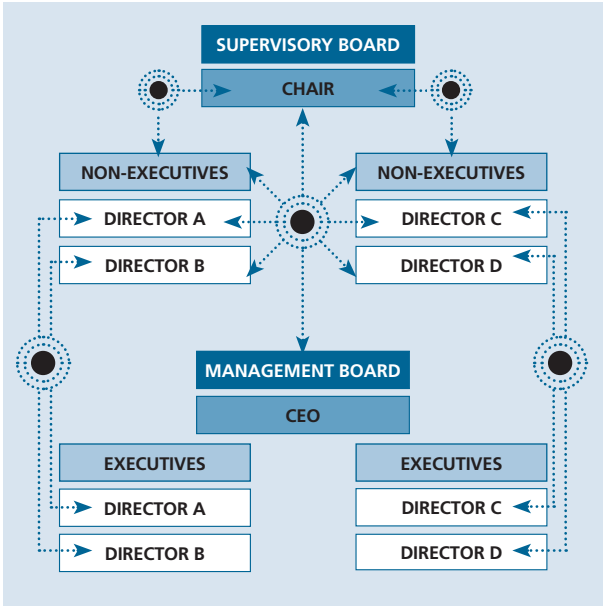
HYBRID BOARD STRUCTURE



TWO-TIER BOARD STRUCTURE



TWO-TIER BOARD STRUCTURE



= POTENTIAL DISPUTE

ANNEX 3

EXCERPTS FROM DIRECTORS' RESIGNATION LETTERS IN THE UNITED STATES

ROBERT D. SANDERSON
Fair Isaac Corp., 6/1/2001

I am resigning because I disagree with the rest of the Board's willingness to grant 100,000 stock options to Tom Grudnowski in fiscal 2001. This was an incorrect decision for two principal reasons. First, the Company's 1992 Long-Term Incentive Plan limits the number of options which may be granted to any one employee to 50,000 a year. While it may be legal to grant Mr. Grudnowski 100,000 options, doing so would violate the spirit of the agreement among the Company, the Board and the shareholders embodied in the plan. Second, Mr. Grudnowski doesn't deserve the grant. He was hired to get the Company growing again and to develop Internet-based new business. During his tenure as CEO revenue growth has been below the Company's long-term record, and revenues from new business have been miniscule. He has not earned the reward of an extraordinary option grant. It is my hope that the Board will conclude, as I have, that the Company will not achieve long-term success with Mr. Grudnowski in charge and that the best way to increase shareholder value is to sell the Company.

JAMES A. MILLER
Surge Components, Inc., 8/1/2001

Since joining the board of directors of Surge, I have on numerous occasions expressed my belief that I have not been given appropriate and relevant information necessary for me to perform my duties. It has been difficult for me to receive requested information either in a timely manner or at all. Furthermore, it has come to my attention that there were significant events and actions taken which were not properly disclosed to me. Case in point: the company recently filed two 10-Qs without my advice, review or approval. This is particularly disturbing given the fact that I am chairman of the audit committee. As a result of these and other unacceptable circumstances, I do not believe I can discharge my responsibilities in the manner in which the shareholders deserve. This letter shall serve as my resignation from the Board of Directors of Surge Components Inc., effective as of today, July 25, 2001.

JEROME T. OSBORNE
GLB Bancorp, Inc., 9/8/2003

This resignation is prompted by my profound disagreement with the decision of the Board of Directors to approve the proposed merger with Sky Financial Group, Inc. Accordingly to the preliminary proxy statement/prospectus ("Preliminary Proxy Statement") relating to the special meeting of shareholders of GLB, filed with the Securities and Exchange Commission by Sky Financial Group, Inc. in its Registration Statement on Form S-4, filed August 22, 2003, the Board of Directors of GLB has also voted to recommend approval of the transaction, a recommendation I disagree with. The Board has abandoned the

original vision of GLB as a financial institution with a community focus and a substantial community ownership base. In addition, once the decision was made to sell the Company, I do not believe that the GLB Board of Directors received adequate information regarding, or adequately considered, the community impact or value of alternative proposals described in the Preliminary Proxy Statement, which is why I voted against the proposed merger with Sky Financial Group, Inc. For example, I believe that the transaction proposed by the institution described in the Preliminary Proxy Statement as "Bank X" would have provided a substantially greater value to the shareholders of GLB.

J. PETER PIERCE
Iron Mountain, Inc., 12/26/2002

My resignation from the Board will enable me to pursue shareholders' rights with other interested shareholders in seeing to it that Iron Mountain is governed and managed properly. Board meetings that are held in violation of the bylaws should not be countenanced. Actions taken by "rump" sessions of the Board without notice to all Board members should not be authorized. If there are issues that exist with any Board members, special committees should be formed and authorized to investigate. This did not happen at Iron Mountain at any time. No minutes were taken of the so-called surreptitious "Board meetings". The unauthorized nature of certain "Board actions" has been confirmed under oath by your general counsel Gary Watzke. It is also now clear that on March 27, 2002, the Executive Committee met and purported to authorize the lawsuit that was filed against me the next day in New Jersey state court, even though the Board had never given the Executive Committee this authority at a duly authorized meeting of which I received notice. Interestingly, even though the "Board," as of March 5th, had purported to authorize the lawsuit against me, no disclosure of that "fact" was made by you in your note to the shareholders in the 2001 Annual Report, dated March 20, 2002, nor was there any mention of my alleged secret investment in Sequedex in the description of me as a Board member, that was set forth therein. In addition, there was no disclosure in the legal proceeding section of the first quarter Form 10-Q concerning the litigation filed against me as a material proceeding adverse to Iron Mountain. I simply will not be a part of a Board that attempts to conduct business in such a surreptitious and improper manner.

JAMES SCHROEDER
Streamedia Communications, Inc., 10/12/2000

Given the recent events at Streamedia and the vast disagreement and disarray of the principal shareholders I feel that I no longer represent the views and interests of those shareholders. I serve at their discretion and I in good conscience do not agree with the proposed direction of this company as set forth by the Chairman. It is the right of the shareholders to have the company run the way they want whether I, as a board member, agree or not. I do not agree to the recent direction and management suggestions of the Chairman and feel there will be severe consequences to the corporation. Therefore, I feel that I must resign as a director and allow the shareholders to choose a board of their liking.

ANNEX 3

CLIFFORD WYATT
Electropure, Inc., 4/20/1999

I have become increasingly concerned by the fact that the Company is seemingly unable to finalize its audit with respect to its financial statements for Fiscal October 1998, and accordingly is unable to issue a 10-K in compliance with Federal securities laws. Since the end of the fiscal year, several months have passed, including the end of the first quarter of fiscal 1999, and I have yet to receive any financial statements for any period of the current year....It was only after repeated requests and having a call made to the Company's counsel for corporate matters that I finally received a draft 10-K....The draft 10-K contained numerous material misstatements and omissions which I found quite shocking. For example, it did not mention the cross-complaint filed by Wyatt Technology against the Company, although it did mention the action filed by the Company against Wyatt Technology. Further it appears that the Company had not informed its auditors that Wyatt's position was that it was entitled to obtain rescission or termination of the technology license described at length in the draft 10-K.

VAUGHAN SHALSON
Discovery Laboratories, Inc., 3/27/1998

In summary, I have serious reservations about the judgment of Dr. Capetola and feel deeply that the compensation proposed for the management team, and in particular for Dr. Capetola, involves an excessive use of cash. As I have stated repeatedly in our conference calls, I do not believe this to be in our shareholders' best interests....On the subject of Dr. Capetola's judgment, at our Board Meeting on December 5 we discussed a merger proposal from Dr. Capetola dated August 28, 1997. The compensation package included in this proposal was characterized by one of the other board members present at that meeting as egregious. I and others agreed with this sentiment....My own evaluation was that Capetola's proposal went so far beyond the pale of what could be considered negotiation posturing, as to lead any reasonable person to conclude that he exhibited either lack of experience or extremely poor judgment — neither of which should be acceptable qualities in the proposed CEO of the combined company....I regard this proposal as further evidence of Capetola's lack of judgment, by even proposing to expose the company to cash payments of such magnitude that they could severely strain the company's resources, and that are excessive by any reasonable standard for a development-stage company in such fragile financial condition.

KENNETH P. WEISS
RSA Security, Inc., 6/4/1996

In my opinion, you have surrounded yourself with a Board of Directors that does not, and perhaps is incapable, of providing you with independent objective guidance. To the contrary, from all of the actions that I have seen, these directors appear to be working for you, rather than you working for them. I have seen this time and time again under many circumstances.

Illustrative is the way in which you are able to influence the Compensation Committee to pay you what you demand and to make decisions based upon on what you want, rather than on any objective policy. Recent events in this area have been consistent with a pattern of conduct that I have observed over the years. For example, contrary to the compensation consultant's recommendation for a consistent policy, you recently recommended that the vast majority of your bonus be calculated at "threshold" plan while the other executives had the majority of their bonus awarded at "stretch" plan. The Compensation Committee approved this unfair inconsistent treatment....On an individual basis, certain of these directors have performed particularly poorly for the company. In my opinion, one of them frequently disrupts meetings and appears to be motivated principally by self-aggrandizement and another appears to be inept and makes little or no positive contribution to the Board. Their continued participation on the Board is particularly glaring, especially in the light of your engineered forced departure of the most experienced director.

NIRMAL MULYE, PH.D.
Synovics Pharmaceuticals, Inc., 9/21/2006

During the past several months, however, you, the other members of the Board and employees of the Company under your direction have acted in a manner designed to curtail meaningful participation by me in my role as a director of the Company....Specifically, I have been asked to vote on matters as a director of the Company while being denied access to the information needed by me to make informed decisions with respect to such matters....I have also been denied the opportunity, on a number of occasions, to engage in full substantive deliberations with the other members of the Board with respect to matters on which I was then being asked to vote. For example, you as Chairman of the Board have severely restricted the ability of directors to discuss matters on which the Board was requested to act by either refusing to allow discussion of certain items at all or by abruptly and prematurely terminating discussions with respect to certain items and calling for an immediate vote on those items prior to all views of Board members being properly aired.

STEPHEN D. MOSES
AcuNetx, Inc., 5/5/2006

As each of you knows, I have endeavored to coordinate and mediate consensus on the issues confronting us from time to time. That is my style. I believe it to be not only appropriate, but optimal. But that technique does not work at AcuNetx. It does not work with a C.E.O. who responds to suggestions with petulance....It does not work with a C.E.O. who declines to be open and forthcoming with his Board...It does not work when the Board decides that it will not and cannot yet be fully Sarbanes-Oxley compliant, but allows the C.E.O. to announce to its shareholders that it will be Sarbanes-Oxley compliant and then reacts angrily when the Chairman notes that paying consulting fees to the Compensation Committee Chairman would be a violation of Sarbanes-Oxley....It does not work when the C.E.O. responds to suggestions, or worse, criticism, with McCarthy-like investigations and mischaracterizations of his critic. It is unfortunate that the C.E.O. can stifle dissent and/or creative advice with tyrannical conduct.

ANNEX 3

RICHARD A. AJAYI
Surgilight, Inc. 6/5/2001

Dr. Lin controls 70% of the voting shares of the company and I am convinced that he has repeatedly refused to accept, or simply ignored, some decisions and guidance of the Board regarding compliance with regulations of the Food and Drug Administration and the Securities and Exchange Commission. Therefore, after working diligently, but unsuccessfully, for several months to resolve these issues, I have come to the conclusion that there are no other alternatives for me but to resign from the board.

PETER G. LEIGHTON
Intelect Communications Systems Limited, 5/5/1997

This letter also conveys my resignation as a Director of ICSL. Because of my complete objection to the Facility, and the course on which ICSL has been set by a majority of its Board members, it is impossible for me to continue as a Director of this Company....In my view and belief, the Facility is not in the interest of ICSL in its present form. As a Director I disassociate myself from it as a funding option. The Facility is being forced upon ICSL by Mr. Frietsch (and certain other ICSL Directors, namely Anton Liechtenstein and Phillip Sudan) over my repeated objections. I have repeatedly made clear to Mr. Frietsch that I regard the Facility as a unilateral and improper initiative. I consider that ICSL's entry into the Facility has been engineered by Mr. Frietsch, acting completely in excess of his executive authority as regards the Company's affairs.

SOURCE: Anup Agrawal and Mark A. Chen. July 2008. Boardroom Brawls: An Empirical Analysis of Disputes involving Directors. *University of Alabama and Georgia State University. Working paper. Available at: http://papers.ssrn.com.*

ANNEX 4

CATEGORIES OF CORPORATE GOVERNANCE RELATED DISPUTES

Self-Interested Transactions

Related-party transactions, insider trading, conflicts of interest by board members, executives, and senior management

Annual Accounts

Disputes between shareholders and the board and/or auditor over the withholding of shareholder approval

Nomination/Appointment of Board Members

Disputes between shareholders and the nomination committee and/or the board over nomination and/or appointment of board members/executives, as well as the criteria for nomination/appointment

Remuneration/Bonuses of Board Members

Disputes between shareholders and the remuneration committee and/or the board over remuneration and/or bonuses of board members/executives, as well as the criteria for remuneration/bonuses

Share Valuation

Disputes between shareholders and the board and/or auditors on the valuation method in case of (a) squeeze out, and (b) share/bond issues

Takeover Procedures

Disputes between shareholders and boards regarding terms and conditions of a proposed takeover, and/or compliance with internal (articles of association) and/or external (listing rules, securities legislation, etc.) rules

Disclosure Requirements

Disputes between shareholders and boards regarding compliance with nonfinancial disclosure requirements

Corporate Control (in M&A Transactions)

Disputes between shareholders and boards regarding a proposed acquisition or disposal of a substantial part of the company's assets

Minority Shareholders' Rights

Disputes between majority and minority shareholders in squeeze-out scenarios or on nomination/appointment of board members

Bankruptcy/Suspension of Payments

Disputes between shareholders and/or bondholders and boards and/or receivers in corporate restructuring

Share/Bond Issues

Disputes between shareholders/bondholders and boards on dilution issues

Discharge of Individual Board Members/ Executives

Disputes between shareholders and board members/ executives on individual discharge regarding their performance in the past fiscal year

Mismanagement

Disputes between shareholders and boards on alleged mismanagement of the company

Non-Compliance with Corporate Governance Codes

Disputes between shareholders and boards on the application of "comply or explain" principles as provided in corporate governance codes

Works' Council

Disputes between shareholders/boards and works' councils on the interpretation and applicability of works' council legal corporate governance related rights

SOURCE: L. Bouchez and A. Karpf, Exploratory Meeting on Resolution of Corporate Governance-Related Disputes. Stockholm: OECD, March 2006. Available at: http://www.oecd.org.

ANNEX 5

EXAMPLE OF DISSIDENT SHAREHOLDER LETTER TO THE BOARD

Germany:Volkswagen AG vs. VIP (Vereinigung Institutionelle Privatanleger e.V.)

By fax: + 49 5361 9 2369Vereinigung Institutionelle Privatanleger e.V.

To: Volkswagen AG — The Executive Board
HV-Stelle I Brieffach 1848 I D 38436 Wolfsburg
Hvstelle@volkswagen.de

Association of Institutional Shareholders
Association des Actionnaires Institutionnels
Kuthstr. 37a I D-51107 Köln
www.vip-cg.com

From: Hans-Martin Buhlmann, Vorsitzender
Tel: +49 (0)221 · 297586 1 I Fax: +49 (0)221 · 297586 4
hmbuhlmann@vip-cg.com

10/04/08

Annual General Meeting of VOLKSWAGEN AG on 24 April 2008

Dear Prof. Dr. Martin Winterkorn,

Dear Board Members,

Regarding the convocation, announced in the eBAnz for 13./20. 03. 2008, of the AGM of VOLKSWAGEN AG on 24. 04. 2008, we — VIP Vereinigung Institutioneller Pivatanleger e.V. (Köln, fax + 49 1212 508233040) (www.VIP-cg.com) — hereby announce pursuant to § 126 AktG, as a shareholder in the company, the following (counter-) motion on the agenda and call on all shareholders to vote with VIP or give VIP e.V. their proxy to exercise their vote accordingly or in conformity with their instructions:

1. Counter-motion on agenda item 4:

The Executive and Supervisory Boards propose to give discharge to the Executive Board — VIP Vereinigung Institutioneller Privatanleger e.V. (Köln, fax + 49 1212 508233040) (www.VIPcg. com) recommends: No, individual discharge, and assent only if company interests have been safeguarded.

The Supervisory Board of VOLKSWAGEN AG has already for some considerable time been attracting special attention — not least since the chair of the German Corporate Governance Code Commission, Dr. Gerhard Cromme, resigned from that very Supervisory Board because of governance criticisms of it.

Finally on 23 October 2007 the European Court of Justice clarified that the practice of the special law, the so-called "VW Act," is unlawful. This decision must now be implemented, even if its beneficiaries lose their advantages (unlawful for years now).

The Supervisory Board has, with or without discussion of the issue, failed in its duty to take account of the interests of all shareholders and establish homogeneous fairness among all those concerned — instead, individual Supervisory Board members have evidently pursued particular interests. There have been conflicts of interest that the Supervisory Board chair ought definitely to have taken up in his report!

The interests concerned are those of the State of Lower Saxony, and its secondment rights and those of the Federal Republic of Germany. These and the existing voting-rights restriction must be abolished in their entirety — yet management (through the Executive and Supervisory Boards) has made no recommendation for that.

The point is to reduce the needlessly raised charter limit for structural and fundamental decisions to the normal legal level — on which not only are there no recommendations from the Supervisory Board, but not even any attempt to ward off the moves by some of its members to publicly ignore their obligations and bring in improper motions to conserve the unlawful special advantages of the State of Lower Saxony. Such proceedings run counter not just to the EU judgment but also, thinking personally, to the interests of shareholders.

It is then only logical for shareholder Porsche SE to throw out the errors in the agenda in its motion in item 9.1, and it is pure self-interest for the State of Lower Saxony instead to create confusion and seek to conserve its special privileges in item 9.2. Had the Supervisory Board met its fundamental obligations to take account of the interests of all and not of individuals, it would have acted on this elementary point.

Additionally, the Supervisory Board, represented by its chairman, has unpardonably neglected to inform shareholders of the existing conflict of interest.

For such weakness in decision the Supervisory Board cannot expect any discharge from shareholders. We shall put the motion, instead of wholesale discharge, to consider each Supervisory Board member for discharge separately — enabling each shareholder to issue individual discharge instructions (to us or their proxy voter) up to their declarations at the AGM.

The resolution put by Porsche SE as item 9.1 fits into a framework of good corporate governance in the interests of all investors, whereas the motion by the State of Lower Saxony as item 9.2 is, from the same viewpoint, clearly to be rejected with a No.

It remains to be hoped that Porsche will actually cultivate this improved corporate governance at VOLKSWAGEN and also introduce it at Porsche — where several rules of best practice are still ignored (opt-out on executive remuneration, 1 share — 1 vote).

Each shareholder should carefully consider whether he wants to re-elect the Supervisory Board members not to be given discharge immediately in item 5. In no case is it acceptable for the old representatives of the State of Lower Saxony to be re-elected, given the above-mentioned conflict of interest, unmentioned for so long.

Neither VW, its employees nor the shareholders need a "Volkswagen Act" as a special law — all shareholders are called upon, even without a board recommendation, to form an opinion and vote or instruct a representative (www.vip-cg.com) to do so.

We — VIP (www.VIP-cg.com) — point out that VOLKSWAGEN AG is obliged pursuant to § 126 AktG to make the foregoing (counter-) motions accessible to all shareholders.

We are ready and willing to represent the voting rights of third parties or to execute instructions for casting the vote.

Yours faithfully,

VIP Vereinigung Institutionelle Privatanleger e.V.
Hans-Martin Buhlmann
Chairman

SOURCE: www.vip-cg.com (English version provided by VIP).

ANNEX 6

REVIEW OF SELECTED ADR PROCESSES

Arbitration

Arbitration is a private process where disputing parties agree that one or several individuals can make a decision about the dispute after receiving evidence and hearing arguments. Arbitration is different from mediation because the neutral arbitrator has the authority to make a decision about the dispute. The arbitration process is similar to a trial in that the parties make opening statements and present evidence to the arbitrator. Compared to traditional trials, arbitration can usually be completed more quickly and is less formal. For example, often the parties do not have to follow state or federal rules of evidence and, in some cases, the arbitrator is not required to apply the governing law. After the hearing, the arbitrator issues an award. Some awards simply announce the decision (a "bare bones" award), and others give reasons (a "reasoned" award). The arbitration process may be either binding or non-binding. When arbitration is binding, the decision is final, can be enforced by a court, and can only be appealed on very narrow grounds. When arbitration is non-binding, the arbitrator's award is advisory and can be final only if accepted by the parties.

In Court-Annexed Arbitration, one or more arbitrators, usually lawyers, issue a non-binding judgment on the merits after an expedited, adversarial hearing. The arbitrator's decision addresses only the disputed legal issues and applies legal standards. Either party may reject the non-binding ruling and proceed to trial; sometimes, cost sanctions may be imposed in the event the appellant does not improve his/her position in court. This process may be mandatory or voluntary.

Private (v. Court-Annexed) Arbitration may be "administered," meaning managed by private organizations, or "non-administered," meaning managed by the parties. The decisions of arbitrators in private arbitration may be non-binding or binding.

Binding Arbitration decisions typically are enforceable by courts and not subject to appellate review, except in the case of fraud or other defect in the process. Often, binding arbitration arises from contract clauses providing for final and binding arbitration as the method for resolving disputes.

Early Neutral Evaluation

Early neutral evaluation is a process that may take place soon after a case has been filed in court. The case is referred to an expert, usually an attorney, who is asked to provide a balanced and unbiased evaluation of the dispute. The parties either submit written comments or meet in person with the expert. The expert identifies each side's strengths and weaknesses and provides an evaluation of the likely outcome of a trial. This evaluation can assist the parties in assessing their case and may propel them towards a settlement.

Mediation

Mediation is a private process where a neutral third person called a mediator helps the parties discuss and try to resolve the dispute. The parties have the opportunity to describe the issues, discuss their interests, understandings, and feelings, provide each other with information, and explore ideas for the resolution of the dispute. While courts can mandate that certain cases go to mediation, the process remains "voluntary" in that parties are not required to come to agreement. The mediator does not have the power to make a decision for the parties, but can help the parties find a resolution that is mutually acceptable. The only people who can resolve the dispute in mediation are the parties themselves. There are a number of different ways that mediation can proceed. Most mediations start with the parties together in a joint session. The mediator will describe how the process works, will explain the mediator's role, and will help establish ground rules and an agenda for the session. Generally, parties then make opening statements. Some mediators conduct the entire process in a joint session. However, other mediators will move to separate sessions, shuttling back and forth between the parties. If the parties reach an agreement, the parties and the mediator can help the parties reduce the agreement to a written contract, which may be enforceable in court.

Conciliation is sometimes defined as a type of mediation whereby the parties to a dispute use a neutral third party (a conciliator), who meets with the parties separately

in an attempt to resolve their differences. Conciliation differs from arbitration in that the conciliation process, in and of itself, has no legal standing, and the conciliator usually has no authority to seek evidence or call witnesses, usually writes no decision, and makes no award. Conciliation is sometimes used interchangeably with mediation.

Mini-Trial

A mini-trial is a private, consensual process where the attorneys for each party make a brief presentation of the case as if at a trial. The presentations are observed by a neutral advisor and by representatives (usually high-level business executives) from each side who have authority to settle the dispute. At the end of the presentations, the representatives attempt to settle the dispute. If the representatives fail to settle the dispute, the neutral advisor, at the request of the parties, may serve as a mediator or may issue a non-binding opinion as to the likely outcome in court.

Negotiation

Negotiation is a voluntary and usually informal process in which parties identify issues of concern, explore options for the resolution of the issues, and search for a mutually acceptable agreement to resolve the issues raised. The disputing parties may be represented by attorneys in negotiation. Negotiation is different from mediation in that there is no neutral individual to assist the parties to negotiate.

Neutral Fact-Finding

Neutral fact-finding is a process where a neutral third party, selected either by the disputing parties or by the court, investigates an issue and reports or testifies in court. The neutral fact-finding process is particularly useful for resolving complex scientific and factual disputes.

Ombudsman

An ombudsman takes two forms. In one approach, the ombudsman is a third party selected by an institution — for example, a university, hospital, or governmental agency — to investigate complaints by employees, clients or constituents. The ombudsman works within the institution to investigate the complaints independently and impartially. The process is voluntary, private, and nonbinding. In a second approach, the ombudsman is appointed by public bodies or industry sectors to adjudicate on citizen or consumer complaints by recommendation and/or compensation awards.

Settlement Conference

A settlement conference is a meeting in which a judge or magistrate assigned to the case presides over the process. The purpose of the settlement conference is to try to settle a case before the hearing or trial. Settlement conferencing is similar to mediation in that a third party neutral assists the parties in exploring settlement options. Settlement conferences are different from mediation in that settlement conferences are usually shorter and typically have fewer roles for participation of the parties or for consideration of non-legal interests.

Summary Jury Trial

In summary jury trials, attorneys for each party make abbreviated case presentations to a mock six-member jury (drawn from a pool of real jurors), the party representatives, and a presiding judge or magistrate. The mock jury renders an advisory verdict. The verdict is frequently helpful in getting a settlement, particularly where one of the parties has an unrealistic assessment of their case.

Settlement Week

In a typical settlement week, a court suspends normal trial activity and, aided by volunteer mediators, sends numerous trial-ready cases to mediation sessions held at the courthouse. The mediation sessions may last several hours, with additional sessions held as needed. Cases unresolved during settlement week return to the court's regular docket for further pretrial or trial proceedings as needed. If settlement weeks are held infrequently and are a court's only form of ADR, parties who want to use ADR may have to look outside the court or may incur additional litigation expenses while cases await referral to settlement week. This can be overcome by regularly offering at least one other form of ADR.

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Case Evaluation ("Michigan Mediation")

Case evaluation provides litigants in trial ready cases with a written, non-binding assessment of the case's value. The assessment is made by a panel of three attorneys after a short hearing. If the panel's assessment is accepted by all parties, the case is settled for that amount. If any party rejects the panel's assessment, the case proceeds to trial. This arbitration-like process has been referred to as "Michigan Mediation" because it was created by the Michigan state courts and subsequently used by the federal district courts in Michigan as well.

Med-Arb., or **Mediation-Arbitration:** An example of multi-step ADR, parties agree to mediate their dispute with the understanding that any issues not settled by mediation will be resolved by arbitration, using the same individual to act as both mediator and arbitrator. The parties may, however, be unwilling to speak candidly during the mediation when they know the neutral may ultimately become a decision maker. They might believe that the arbitrator will not be able to set aside unfavorable information learned during the previous mediation. Additional related methods have evolved to address this problem.

In **Co-Med-Arb**, different individuals serve as neutrals in the arbitration and mediation sessions, although they both may participate in the parties' initial exchange of information. In Arb-Med, the neutral first acts as arbitrator, writing up an award and placing it in a sealed envelope. The neutral then proceeds to a mediation stage, and if the case is settled in mediation, the envelope is never opened.

Fact-finding: A process by which a third party renders binding or advisory opinions regarding facts relevant to a dispute. The third party neutral may be a technical or legal expert designated by the parties, or appointed by the court.

Judge-Hosted Settlement Conference/Judicial Mediation: In this court-based ADR process, the settlement judge (or magistrate) presides over a meeting of the parties in an effort to help them reach a settlement. Judges have played a variety of roles in such conferences, articulating opinions about the merits of the case, facilitating the trading of settlement offers, and sometimes acting as a mediator. In some jurisdictions, a new judge will be required to try the case if a first judge has endeavored to settle it.

Private Judging: A private or court-connected process in which parties empower a private individual to hear and issue a binding, principled decision in their case.

The process may be agreed upon by contract between the parties, or authorized by statute (in which case it is sometimes called **Rent-a-Judge**).

SOURCE: Lukasz Rozdeiczer and Alejandro Alvarez de la Campa, Alternative Dispute Resolution Manual: Implementing Commercial Mediation. *Washington, D.C.: IFC, 2006.*

TABLE COMPARING NEGOTIATION, LITIGATION, MEDIATION

NEGOTIATION	LITIGATION	MEDIATION
VOLUNTARY	**NOT VOLUNTARY**	**USUALLY VOLUNTARY**
If agreement, can be enforceable as contract	Binding, subject to appeal	If agreement, can be enforceable as contract or court award
No third party neutral involved	Imposed decision; decision-maker may have subject expertise	Mediator selected by parties as third party neutral; may have subject expertise
INFORMAL	**FORMAL, RIGID RULES**	**INFORMAL**
Freedom to choose how and when to present evidence, arguments, and interests; often focused on the past	Opportunity for each party to present proofs and arguments; focused on past events	Freedom to choose how and when to present evidence, arguments and interests; often focused on the future
Outcome: mutually acceptable agreement sought	Outcome: imposed decision, supported by reasoned opinion	Outcome: mutually acceptable agreement sought
PRIVATE	**PUBLIC**	**PRIVATE**
Parties often not present if there is a dispute	Parties may attend, but participate in process only as witnesses	Parties usually present and free to be fully engaged in the process and outcome

SOURCE: Centre for Effective Dispute Resolution. The CEDR Mediator Handbook. Effective Resolution of Commercial Disputes. *Fourth Edition. London: CEDR, 2004.*

ANNEX 8

TYPICAL STEPS IN CONSTRUCTIVE NEGOTIATION

1. Prepare (Set the Stage)

- Gather information
- Identify common concerns
- Analyze own and other's priorities
  - *a.* My *best alternative to negotiated agreement vs.* Their *interests*
  - *b.* My *interests vs.* Their *options/choices*
  - *c.* My *options/choices vs.* Their *best alternative to negotiated agreement*

2. Engage (Negotiate)

- Express genuine interest in finding resolution
- Surface issues
- Listen attentively to each other's perspectives
- Identify common concerns and interests
- Prioritize issues
- Brainstorm and prioritize alternative solutions
- Agree to solutions with joint benefits

3. Review (Formalize)

- How to improve future decision-making?
- How to monitor progress and make necessary adjustments?

SOURCE: Adapted from: Richard G. Shell, Bargaining for Advantage: Negotiation Strategies for Reasonable People. *New York: Penguin, 1999. Copyright 1999. All rights reserved.*

ANNEX 9

SAMPLE DEFINITIONS OF MEDIATION FROM AROUND THE WORLD

Albania — Albanian Mediation Law

ART. 1 Mediation is an activity without going to the court, where the parties ask for the mediation of a third person or a group of persons, to achieve an acceptable reconciliation of the dispute and which not non-compliant with the law.

SOURCE: Albanian Mediation Law No 9090 of June 26, 2003.

Bosnia and Herzegovina — Law on Mediation Procedures

ART. 2 ART. 2. For the purposes of this law, the mediation shall be a procedure in which a third party (mediator) assists parties in an effort to reach a mutually acceptable solution to the dispute. The mediator may not impose the solution to the dispute on the parties.

SOURCE: Law on Mediation Procedures — Bosnia and Herzegovina (2004).

Brazil — MEDIARE

Mediation is becoming an important resource for the resolution of conflicts in situations that involve different interests associated with the necessity of negotiating them. It is a confidential and non-mandatory process where the parties are responsible for the decision-making. Unlike Arbitration and Judicial Resolution — situations that transfer the decision to a third person — Mediation keeps the power of decision with the parties.

The technical resources of Mediation have been widely used for the prevention, negotiation, and resolution of conflicts. As a preventive strategy it creates favorable conditions for cooperation in order to make it possible for continuing relations to grow in a positive way.

The Mediator is an impartial professional that facilitates the communication between people with the aim of increasing the alternatives for the resolution of impasses. He/ she helps to transform relations, making it possible to reduce the conflicts to workable levels and to build agreements that are mutually acceptable.

Mediation differs from other forms of conflicts resolution in the following aspects: on one hand, the Mediator is the person who facilitates communication without intervening actively in the decisions; on the other, the parties involved keep in charge of the resolution of their conflicts, therefore transforming their relations in a positive way.

SOURCE: MEDIARE. Available at: http://www.mediare.com br/01ingles/05mediac_instrum.htm.

Croatia — Croatian Law on Conciliation (2003)

Conciliation is set as a general term comprising mediation and/or conciliation, meaning any procedure, regardless of its name, in which the parties try to resolve their dispute with the assistance of one or more neutral conciliators helping the parties to reach an agreement without any authorities to impose any binding resolution on the parties in dispute.

SOURCE: Croatian Law on Conciliation (2003).

Egypt — The Cairo Regional Centre for Commercial Arbitration

ART. 1 Where parties to a contract have agreed in writing to seek an amicable settlement of disputes arising out of or relating to their contract by mediation in accordance with the Rules of Mediation of the Mediation and ADR Centre (A branch of the Cairo Regional Centre for International Commercial Arbitration), then such mediation shall take place in accordance with such rules.

SOURCE: The Rules of Mediation — The Cairo Regional Centre for Commercial Arbitration.

WEB LINK: http://www.crcica.org.eg/adr_rules.html.

European Union: Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008

ART. 3 (A) 'Mediation' means a structured process, however named or referred to, whereby two or more parties to a dispute attempt by themselves, on a voluntary basis, to reach an agreement on the settlement of their

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dispute with the assistance of a mediator. This process may be initiated by the parties or suggested or ordered by a court or prescribed by the law of a Member State.

It includes mediation conducted by a judge who is not responsible for any judicial proceedings concerning the dispute in question. It excludes attempts made by the court or the judge seized to settle a dispute in the course of judicial proceedings concerning the dispute in question.

SOURCE: Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation.

WEB LINK: http://eurlex.europa.eu/LexUriServ.LexUriServ.do?uri=CELEX:32008L0052:EN:NOT.

Hungary — Mediation Act LV of 2002

CHAPTER 1, SECTION 2: Mediation is a special non-litigious procedure conducted according to this Act to provide an alternative to court proceedings in order to resolve conflicts and disputes where the parties involved voluntarily submit the case to a neutral third party (hereinafter referred to as 'mediator') in accordance with Subsection (1) of Section 1 in order to reach a settlement in the process and lay the ensuing agreement down in writing.

SOURCE: Act LV of 2002, Hungary.

India — Indian Institute of Arbitration and Mediation (IIAM)

Mediation is a settlement effort, which utilizes the services of an impartial, third party mediator in an effort to reach a mutually acceptable agreement. By agreeing to mediate, parties agree to negotiate to attempt to settle their differences. It is an informal and non-adversarial process, which has the objective of helping the disputing parties, reach a mutually acceptable and voluntary agreement. Neither IIAM nor the mediator has the power or authority to render a binding decision or to force the parties to accept a settlement.

SOURCE: Indian Institute of Arbitration and Mediation (IIAM).

WEB LINK: http://www.arbitrationindia.org/.

International Chamber of Commerce — ADR Rules and Guide to ICC ADR

ART. 5 (1) 1 For purposes of the Rules, mediation is the settlement technique in which the Neutral acts as a facilitator to help the parties try to arrive at a negotiated settlement of their dispute. The Neutral is not requested to provide any opinion as to the merits of the dispute.

To facilitate an amicable settlement, the Neutral generally holds joint meetings with all of the parties present and may also hold separate meetings, often called caucuses, with each of the parties alone. These meetings permit the Neutral to create an atmosphere appropriate for negotiations, obtain useful information, identify the interests of each party and help the parties find common ground for the resolution of their dispute. Any oral statements or written documents provided to the Neutral by one party during a separate meeting or otherwise will not be conveyed to the other party unless the first party has explicitly authorized the Neutral to do so.

SOURCE: International Chamber of Commerce Alternative Dispute Resolution Rules (in force as from 1 July 2001).

WEB LINK: http://www.iccwbo.org/court/adr/id4452/index.html.

Italy — ADR Center

Mediation is a procedure by which the parties and their lawyers use the skills of a third party neutral in order to reach a mutually acceptable solution to their dispute.

SOURCE: ADR Center Mediation Guide.

WEB LINK: http://www.adrcenter.com/doc/ADR%20Center%20Mediation%20Guide%20-%20ENG%20FIN.pdf.

Pakistan — Karachi Center for Dispute Resolution

Mediation is an ADR mechanism that may be used for settling disputes informally and promptly with the assistance of a neutral third-party mediator.

Often disputes arise out of a misunderstanding concerning the expectations and responsibilities of the parties. These disputes may be settled agreeably once a dialogue is established. Mediator does not act as a judge

of decision maker, but as a neutral individual whose purpose is to facilitate settlement between the parties.

SOURCE: Karachi Center for Dispute Resolution.

WEB LINK: http://www.kcdr.org.

Serbia — Serbian Law on Mediation

ART. 2 Mediation is any procedure, notwithstanding its name, whereby the parties wish to settle their dispute through one or more mediators assisting the parties to reach an agreement. Mediators shall not be authorized to impose a binding agreement on the parties.

SOURCE: Serbian Law on Mediation (2005).

Romania — Romanian Mediation Act

ART.1. - (1) Mediation represents an optional modality to settle the conflicts in a conciliatory way, with the assistance of a third person specialized as a mediator, under the conditions of neutrality, fairness and confidentiality.

(2) Mediation is based on the trust that parties give to mediator, as a person able to facilitate negotiations between them and to support them to settle the conflict through a mutual convenient, efficient and lasting solution.

SOURCE: Romanian Mediation Act.

Slovakia — Slovak Act on Mediation (2004)

ART. I, §2 (1) Mediation means extra-judicial action in which the parties settle a dispute, arising from or concerning their contract or other legal relationship, through a mediator.

SOURCE: Slovak Act on Mediation (2004).

United Kingdom — Centre for Effective Dispute Resolution (CEDR)

"Mediation is a flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference, with the parties in ultimate control of the decision to settle and the terms of resolution."

SOURCE: Centre for Effective Dispute Resolution (CEDR)

WEB LINK: http://www.cedr.com/index.php?location=/news/archive/20041101.htm.

United Nations — United Nations Commission on International Trade Law (UNCITRAL)

For the purpose "conciliation" means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person or persons ("the conciliator") to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator does not have the authority to impose upon the parties a solution to the dispute.

SOURCE: UNCITRAL "Model Law on International Commercial Conciliation with Guide to Enactment and Use" (adopted on 24 June 2002).

WEB LINK: http://www.uncitral.org/uncitral/en/uncitral_ texts/arbitration/2002Modelconciliation.html.

United States — International Institute for Conflict Prevention and Resolution (CPR)

The most widely used ADR process, mediation is a process in which a third party neutral — a mediator — sits down with the disputing parties and actively assists them in reaching a settlement.

Mediation should not be confused with binding arbitration or private adjudication. The mediation process is non-binding, although a settlement agreement resulting from a mediation usually is binding. The mediator has no authority to make any binding decisions or impose a resolution. The role of the mediator — and the goal of the process — is to help parties achieve their own resolution.

Mediation is private and generally confidential. It is highly flexible and informal. Typically, it is concluded expeditiously at moderate cost. The subject matter can be complex or simple, the stakes large or small, the number of parties few or many. An exchange of information commonly occurs in a mediation, and limited discovery also is possible. All parties can participate in tailoring the ground rules. The process typically is far less adversarial than litigation or arbitration, and therefore less

disruptive of business relationships. Since other options are not foreclosed if mediation should fail, entering into a mediation process presents few risks.

SOURCE: CPR International Institute for Conflict Prevention and Resolution.

WEB LINK: http://www.cpradr.org/ClausesRules Mediation Procedure/ tabid/90/Default.aspx.

United States — Federal Mediation and Conciliation Service (FMCS)

Mediation is a voluntary process, bringing a neutral third-party into a negotiation as a facilitator. It may or may not lead to an agreement between the parties.

SOURCE: Federal Mediation and Conciliation Service (FMCS).

WEB LINK : http://www.fmcs.gov/internet/ FMCS.

ANNEX 10

LINKS TO SAMPLE MEDIATION RULES AND PROCEDURES

Stockholm Chamber of Commerce

CONTENTS

- Mediation Institute
- The Mediator
- Confidentiality
- Initiation 0f Mediation
- The Proceedings Before the Mediator
- Termination of the Mediation
- Costs

LINK: http://www.sccinstitute.com/_upload/shared_files/regler/web_a4_medling_eng.pdf.

Center for Conflict Resolution — Brigham Young University

CONTENTS

- Good Faith Effort
- Confidentiality
- Courtesy
- Role of the Mediator
- Representation
- Legal Counsel
- Termination of Mediation
- Arbitration and Court
- Exclusion of Liability

LINK: http://ccr.byu.edu/index.php?option=com_contents&task=view&id=3458&itemid=4500.

Medal — The International Mediation Services Alliance

CONTENTS

- Initiation of Mediation
- Appointment of the Mediator
- Disclosures and Replacement of a Mediator
- Representation
- Arranging Date, Time and Place of the Mediation
- Conduct of the Mediation and Authority of the Mediator
- Mediation Sessions are Private.
- Confidentiality
- Exclusion of Liability
- Interpretation and Application of the Rules
- Administrative Fees
- Role of Mediator in Other Proceedings
- Referral to Another MMO
- Governing Law and Jurisdiction
- Termination of the Mediation
- Settlement Agreements

LINK: http://www.medal-mediation.com/rules.html.

Centre for Effective Dispute Resolution — CEDR Solve

CONTENTS

- Mediation
- Referral to Mediation
- Choosing the Mediator
- Preparation for the Mediation
- Documentation
- The Mediation Agreement
- The Mediation
- Confidentiality in Relation to the Mediation
- Conclusion of the Mediation
- Complaints

LINK: http://www.cedr.com/about_us/library/documents.php.

UNCITRAL

CONTENTS

- Article 1. Scope of Application and Definitions
- Article 2. Interpretation
- Article 3. Variation by Agreement
- Article 4. Commencement of Conciliation Proceedings
- Article 5. Number and Appointment of Conciliators
- Article 6. Conduct of Conciliation
- Article 7. Communication Between Conciliator and Parties

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- Article 8. Disclosure of Information
- Article 9. Confidentiality
- Article 10. Admissibility of Evidence in Other Proceedings
- Article 11. Termination of Conciliation Proceedings
- Article 12. Conciliator Acting as Arbitrator
- Article 13. Resort to Arbitral or Judicial Proceedings
- Article 14. Enforceability of Settlement Agreement

LINK: http://www.uncitral.org/pdf/english/texts/arbitration/ml-conc/ml-conc-e.pdf.

International Chamber of Commerce

CONTENTS

- Article 1. Scope Of The ICC ADR Rules
- Article 2. Commencement Of The ADR Proceedings
- Article 3. Selection Of The Neutral
- Article 4. Fees And Costs
- Article 5. Conduct Of The ADR Procedure
- Article 6. Termination Of The ADR Proceedings

LINK: http://www.iccwbo.org/court/adr/id4452/index.html.

International Institute for Conflict Prevention and Resolution (CPR)

CONTENTS

- Agreement to Mediate
- Selecting the Mediator
- Ground Rules of Proceeding
- Exchange of Information
- Presentation to the Mediator
- Negotiations
- Settlement
- Failure to Agree
- Confidentiality

LINK: http://www.cpradr.org/clausesrules/mediationprocedure/tabid/90/default.aspx.

The Cairo Regional Centre For Commercial Arbitration

LINK: http://www.crcica.org.eg/adr_rules.html#two.

Belgian Center on Mediation and Arbitration

CONTENTS

- Scope
- Confidentiality
- Request for Mediation
- Answer to the Request for Mediation
- Effect of the Mediation Agreement
- Written Notifications or Communications and Time Limits
- The Mediator General Provisions
- Appointment of the Mediator
- Replacement of the Mediator
- Transmission of the File to the Mediator
- Language of the Mediation
- Seat of the Mediation
- Examination of the Case
- Settlement
- End of the Mediation
- Nature and Amount of the Mediation Costs
- Advance On Mediation Costs
- Decision On Mediation Costs

LINK: http://www.cepani.be/en/default.aspx?pid=403

Singapore Mediation Centre

CONTENTS

- The Mediation Process
- Mediation Agreement
- The Parties
- The Mediator
- The Centre
- Exchange of Information

- The Mediation
- Settlement Agreement
- Termination
- Stay of Proceedings
- Confidentiality
- Fees
- Waiver of Liability
- Interpretation

LINK: http://www.mediation.com.sg/mediation%20procedure_1%20april%202007.htm.

Mediation Center with the Court of Arbitration at the Bulgarian Chamber of Commerce and Industry

CONTENTS

- Mediation Center — Scope, Goals and Services
- Mediator
  - Requirements to the Mediators
  - Entry in the List of Mediators of the Mediation Center
  - Deregistration from the List of Mediators
- Documents
  - Forms
  - Maintenance and Keeping of Documents
  - Delivery and Receipt of Documents
  - Evaluation of the Mediation by the Parties
- Mediation Rules — General Provisions
- Preparatory Activities before Conduction of Mediation
  - Commencement Of Mediation
  - Selection Of A Mediator
  - Termination Of Mediator's Functions
- Applicable Rules and Principles for Conduction of Mediation
  - Applicable Rules for Conduction of Mediation
  - Representation of the Parties and Participation in the Meetings
  - Assistance by the Parties in the Mediation
  - Role of the Mediator
  - Provision of Information and Materials
  - Confidentiality
- Conduction of Mediation
  - Joint Sessions and Caucus
  - Informing the Parties about Mediation
- Suspension And Termination Of Mediation
  - Grounds for Suspension of the Mediation Proceedings
  - Grounds for Termination of the Proceedings
- Waiver of Liability of the Mediator, the Mediation Center and its Employees
- Mediation Fees And Expenses
  - Determination Of Fees
  - Responsibility of the Parties for the Costs of the Mediation Proceedings

LINK: http://www.mediation.bcci.bg/english/index.php3?vheader=charter%20and%20mediation%20rules&vfile=it5.htm.

ANNEX 11

TYPICAL STEPS IN MEDIATION

1. Prepare (Set the stage)

- Meet first with each party to explore the issues and to ensure a genuine commitment to problem solving.
- Offer to mediate a fair, impartial discussion. Agree to confidentiality.
- If the parties agree to meet, clarify in advance the mediation steps.
- Determine a convenient time and a neutral, private, and acceptable location and any prior information exchange that would be helpful.

2. Engage (Negotiate)

- To begin, review procedures. Clarify the steps in the mediation. Agree to maintain confidentiality and respect diverse perspectives. Emphasize active listening and agree to norms — no interrupting, blaming, or aggressive behaviors.
- Facilitate an exchange of perspectives. Provide fair and balanced opportunities for each person to communicate.
- Questions to address include:
  a. *From your perspective, what is the issue and why?* (Define problem.)
  b. *What is your concern?* (Recognize personal and commercial interests.)
  c. *Do you have suggestions for improving this situation?* (Identify and document options.)
  d. *Which of these proposed solutions are most useful?* (Prioritize.)
  e. *Agree to changes in practices and next steps.* (Propose solutions.)

3. Review (Formalize)

- Clarify the terms of agreement.
- Anticipate barriers to progress, and discuss responses.
- Decide how to monitor and take action to ensure accountability.
- It may be helpful to write down an agreement's terms to clearly define expectations and the next steps, or document a legally binding agreement between parties.

SOURCE: Adapted from: Christopher W. Moore, The Mediation Process: Practical Strategies for Resolving Conflict. *Third Edition. San Francisco: Jossey-Bass, 2003.*

ANNEX 12

TYPICAL STEPS IN ARBITRATION

1. **Party (Claimant) files a Statement of Claim to request arbitration.**
2. Claimant is notified that the Claim has been accepted (or has deficiencies).
3. If the Claim is accepted, the sponsoring organization receives a deposit. The final settlement of costs is determined in accordance with the Code of Procedure.
4. The other party (Respondent) is served with the Statement of Claim and Notice of Arbitration, in accordance with the Code of Procedure.
5. Respondent files a Written Response.
6. Director of Arbitration reviews the case information and documents.
7. Parties select an Arbitrator on mutually agreeable terms, or they may agree to the appointment of an Arbitrator.
8. Parties select either a Document Hearing or Participatory Hearing.
9. Parties submit documents and information to the Arbitrator.
10. **Participatory Hearings generally include the following:**
    - Arbitrator, parties, and witnesses are sworn to tell the truth
    - Claimant presents testimony and relevant documents
    - Respondent presents testimony and relevant documents
    - Witnesses may provide testimony
    - Any claim or counter claim may be questioned
    - Parties may present rebuttal evidence, if appropriate
    - Closing statements may be presented
    - Parties leave together at the end of the hearing
    - Post-hearing briefs may be filed
11. The Arbitrator reviews relevant information, testimony, and document submissions.
12. **Arbitrator issues an Award establishing the rights and obligations of the Parties.**

SOURCE: Adapted from International Chamber of Commerce, ADR Rules, *July 1, 2001. Available at: www.iccadr.org.*