CHAPTER 7
Arbitrability of Company Law Disputes
Andrew Johnston

7.1 Introduction

There is a great deal of legal and practical uncertainty surrounding the arbitrability of company law disputes. In its *Programme Statement for Corporate Governance and Arbitration of Company Law Disputes*, the OECD stated that, while

‘deficiencies in emerging market enforcement have helped make arbitration of company law disputes the preferred method of dispute resolution for private equity investors in many key emerging markets, such as Russia and China... variations in rules and practices across countries... raise doubts in the minds of investors... about the extent to which their rights and property will be protected.’

The OECD’s programme confirmed that these differences between legal systems represent a ‘trap for the unwary’. In particular, it identified a need for further specific comparative research on law and practice in areas such as the joining of officers and directors, and arbitration of derivative actions.1

This chapter seeks to respond to that need by tracing out the contours of the arbitrability of the different types of company law dispute under English law, and comparing the English position with the position under Australian and United States law where possible. In line with the OECD’s suggestion, it pays particular attention to disputes between companies and their directors or

* Andrew Johnston is Professor of Company Law and Corporate Governance at the School of Law at the University of Sheffield. He is also a member of the Sustainable Companies Project at the University of Oslo and a research associate at the University of Cambridge Centre for Business Research. In the past, he has taught at the Universities of Queensland, Cambridge and Warsaw.

1 See OECD, *Experts Group Meeting on Dispute Resolution and Corporate Governance: Synthesis Note*, 25th June 2003. In 2007, the OECD published research on the enforcement mechanisms for corporate governance in Asia, paying particular attention to the role of arbitration: see OECD (2007), Enforcement of Corporate Governance in Asia: The Unfinished Agenda, Corporate Governance in Emerging Markets Program, especially Chapter Five.
officers, and the procedural rules governing the rights of minority shareholders. It concludes that the courts have displayed considerable hostility to any attempt by shareholders to bring arbitration proceedings against company directors for breach of duty because this would imperil the overarching company law principle of the managerial prerogative under ‘majority rule’. In identifying the hostility of courts to minority shareholder arbitration of claims belonging to the company, the article also sheds new light on the rationale for foundational company law decisions which set limits to the contractual effect of the company’s constitution, and prevent companies from becoming parties to shareholder agreements. Those cases can be explained as part of the architecture which entrenches majority rule as the basis on which companies are controlled and governed, and prevents minority shareholders from bypassing the court’s protective mechanisms.

In economic theory, companies are conceptualised as ‘nexuses of contracts’ for the supply of the various resources needed for the business being undertaken. Many of these contracts are assumed to be complete, such as contracts for the provision of credit, supply of labour services or goods. In principle, all of these ‘normal’ contracts are arbitrable. It is the ‘contract’ between the company’s shareholders and its directors which poses the most tricky questions. From a legal perspective, there is no contract between shareholders and directors. Under English law, shareholders are contractually bound to each other, and to the company, to observe the company’s constitution.\(^2\) Contractual disputes arising under the company’s constitution, as we shall see, have long been recognised to be arbitrable. Likewise, shareholders can enter into agreements between themselves as to how they will vote, and those contracts are both enforceable and arbitrable (although under English law the company cannot be a party to them). The company’s executive directors, as well as its senior executives who are not on the board, on the other hand, will have service contracts with the company, which oblige them, expressly or impliedly, to perform their functions with an appropriate degree of care and skill. These contracts are enforceable by the company, and, while English authority, at least, appears to be non-existent, there is no problem in principle for disputes arising in relation to those contracts to be arbitrated, provided, of course, that the contract in question contains an appropriate arbitration clause. However, there are a number of policy arguments that directors’ duties disputes should be resolved in public, and these will be evaluated.

Beyond these essentially contractual claims, the directors’ relationship to the company will also give rise to fiduciary duties. Contrary to the simplicities