Arbitration clauses in bylaws – possibilities, risks and current developments

While arbitration clauses in corporate bylaws are becoming more and more popular in many jurisdictions, they endure a wallflower existence in the Swiss arbitration and corporate landscape. Thierry P. Augsburger and Penelope Nünlist explain the reasons for this situation, comment the most recent Swiss Supreme Court decision on the matter and outline how an upcoming legislative amendment to the Swiss Code of Obligations might catapult Switzerland to the forefront of legislations friendly to the inclusion of arbitration clauses in corporate bylaws.

1. The increasing use of arbitration clauses in corporate bylaws

The advantages of having an arbitration clause in statutes or bylaws are plenty. Arbitration provides for a confidential, efficient and swift resolution of a dispute by a tribunal made up of arbitrators with specialist know-how.

An increasing number of arbitration or company laws all around the globe explicitly recognize the binding validity of arbitration clauses in bylaws for disputes between the corporation and its shareholders, board members and/or directors. Spain, Austria, France, the Netherlands, Finland, Sweden, Brazil or Italy, are only a few examples. It is thus not surprising that arbitration clauses in bylaws are becoming more and more popular in practice and finding their way into the bylaws of large publicly-traded corporations such as, for example Nokia Oyj, Royal Dutch Shell plc or DNA Oy.

2. The situation in Switzerland

In Switzerland, the discussion on arbitration and jurisdiction clauses in bylaws of legal entities (companies, associations, co-ownerships, cooperatives, etc.) is as old as the Swiss Civil Code. In 1907 already, the Swiss Supreme Court mentioned that “[t]he admissibility of bylaw provisions submitting internal affairs of a stock corporation to a particular jurisdiction or a particular adjudication process have constantly been upheld. It does not require any further explanation that a single shareholder subjects himself to such provisions by acceding to the stock corporation and that they, therefore, possess the effect of a contractual agreement” (Swiss Supreme Court Decision [SCD] 33 II 205 c. 5).
While one would assume that such a clear statement in favour of arbitration clauses in corporate bylaws should have paved the way for their frequent use in Swiss corporate practice, the reality of the past 100 years has been quite the opposite.

One reason might be that the Swiss Concordat on Arbitration of March 27, 1969 ("Concordat"), governing domestic arbitration in Switzerland, and in force until December 31, 2010, explicitly required a written declaration whereby the parties in question adhered to the bylaws’ arbitration clause. Since start of 2011, this condition is no longer part of the provisions dealing with domestic arbitration in the Swiss Code of Civil Procedure ("CCP"), having replaced the Concordat. In fact, neither the CPC nor the Swiss Private International Law Statute ("PILS"), governing international arbitration in Switzerland, explicitly deal with arbitration clauses in bylaws or statutes. The case law of the Swiss Supreme Court in connection with such clauses has remained piecemeal. Finally, legal doctrine is utterly divided as to the scope and extent of arbitration clauses in bylaws and statutes. As a result of this uncertainty, arbitration clauses in corporate bylaws and statutes are the wallflowers of the otherwise so arbitration-friendly Swiss legal landscape.

3. What is clear and what remains opaque in connection to arbitration clauses in Swiss corporate bylaws

As stated above, neither the CPC nor the PILS contains any provisions dealing explicitly with arbitration clauses in corporate bylaws. The Swiss Supreme Court has held, however, that both domestic and international cases are governed by the same rules when it comes to the validity and the extent of an arbitral clause in corporate bylaws. While the validity in principle of such clauses is accepted by both the Swiss Supreme Court and a large part of Swiss legal doctrine, there is no agreement as to when such a clause deploys its binding effect, which party it binds and which disputes are covered by it.

Art. 178 PILS and art. 358 CCP both require that the consent to the arbitration agreement has to be made in a form allowing it to be evidenced by text, even if it is only by reference. A signature is, however, not necessary.

Some authors uphold that no exchange of documents is required (as art. 178 PILS, unlike art. II NYC, does not contain the requirement that the arbitration agreement is exchanged between the parties), so that a written confirmation by one party only (i.e., in the form of the arbitration clause in the bylaws) suffices as long as the other party expresses its adherence by its conduct, i.e., implicitly consents to the arbitration clause.

Part of the legal doctrine and some cantonal courts even hold that the transfer of shares also transfers to the acquiring shareholder the binding effect of the statutory arbitration clause by means of either the principles of assignment or the “special” corporate nature of such an arbitration clause.

Contrary to the just mentioned view, some authors and cantonal courts require that the new shareholder explicitly accepts the arbitration clause. This view is in particular supported by corporate law academics holding that an arbitration clause in corporate bylaws not explicitly consented to by the
individual shareholder violates art. 680 CO, according to which “A shareholder may not be required, even under the articles of association, to contribute more than the amount fixed for subscription of a share on issue”. The confusion is increased by the fact that there is no agreement as to which degree of consent expressed by the joining shareholder is “enough” to bind him or her to the arbitration clause in bylaws.

In a recent but unpublished decision (SCD 4A_492/2015 of February 25, 2016 [unpublished]), the Swiss Supreme Court had the possibility to clarify if arbitration clauses in bylaws follow the same principle of consent as arbitration clauses in contracts or if they adhere to a “special” regime. The highest court decided not to do so. After dwelling on the above-mentioned different scholarly views in connection with the scope of arbitration clauses in bylaws and statutes, the Supreme Court held that it did not have to decide on the matter. It found that the party which had not signed the founding bylaws and only later on incorporated the legal entity had expressed its consent to the arbitration clause in the bylaws by initiating the arbitration. Hence, a party which has signed the bylaws containing the arbitration agreement is bound by such agreement even vis-à-vis other members of the legal entity which have not done so but only joined later.

The Supreme Court, however, abstained to deal with the question whether the arbitration could also haven been brought the other way around, i.e., by a shareholder which had explicitly accepted the corporate arbitration clause against a new shareholder that in turn had not done so when acquiring the shares.

Another pressing question not yet addressed by the Swiss Supreme Court and on which doctrine is deeply divided is if the (simple or qualified) majority of the shareholders of a corporation (or any other legal entity for that matter) can introduce an arbitration clause into its bylaws against the will of an opposing minority. Some authors vehemently oppose to this, inter alia referring to ECHR case law denouncing arbitration forced upon a minority shareholder against his will (ECHR 1643/06, Suda v. Czech Republic, October 28, 2010). On the other end of the spectrum, some legal scholars want to allow the introduction of an arbitration clause in the bylaws by means of such majority decision. They base their view, inter alia, on a Swiss Supreme Court decision from the year 1898 which had supported such an approach (SCD 24 II 552 c. 8). In addition, it is also argued that the minority shareholder may always bring the decision changing the bylaws before a judge if he is of the opinion that it violates the bylaws or the law (cf. art. 706 et seqq. CO), and is thus not helpless.

In all this obscurity comes a new legislative endeavour is about to change the level playing field completely.

4. The planned addition of art. 697 I to the CO

On November 28, 2014 the Swiss Federal Council presented both a preliminary draft of modifications to the part of the CO governing stock corporations and an explanatory report on the preliminary draft for consultation. On September 17, 2015 the report on the results of the consultation phase was published. On December 4, 2015 the Federal Council announced that it had issued its guidelines for the final draft and the Message to the same to be brought before parliament.
Art. 697i CO included in the preliminary draft reads as follows:

“Arbitration

Art. 697i

1 The bylaws may provide that corporate disputes shall be resolved by an arbitral tribunal. They might provide that the arbitration clause is binding for all shareholders, the corporation and its bodies.

2 The arbitration proceedings are governed by the provisions of the 3rd part of the Swiss Code of Civil Procedure. The bylaws may, within the scope of these provisions, regulate the details of the arbitral proceeding.

3 If an arbitral award is to effect the corporation and all shareholders, the board of directors shall notify the shareholders of the initiation of the respective arbitration proceeding and points out to them their rights in such proceedings.”

According to the explanatory report, an arbitration clause in the bylaws shall not require any further formalities or any kind of explicit consent. It shall bind the parties mentioned in the bylaws’ arbitration clause (such as shareholders, the company and/or the bodies of the company) ipso jure when they acquired their status, e.g. by obtaining shares of the company, accepting to act as board member or auditor of the corporation. The preliminary draft and the explanatory report clarify that the introduction of an arbitration clause into a corporation’s bylaws shall require a qualified majority in the general assembly (meaning at least two-thirds of the voting rights represented and an absolute majority of the nominal value of shares represented, cf. the also new art. 704[1][13] CO). Such qualified majority is justified by the fact that by the introduction of such clause the shareholders renounce to their right to state courts.

According to the report on the results of the consultation phase, the introduction of art. 697i CO has been widely acclaimed and only minor suggestions for modifications have been made. It is to be expected that art. 697i CO will form part of the definitive proposal and the message submitted to the parliament in late 2016.

Hence, art. 697i CO breaks with the principle of consent in arbitration, considered one of the cornerstones of a valid arbitration agreement under the PILS and the CCP. The rupture is, however, not complete. As mentioned in the explanatory report, the existence of an arbitration clause in the corporate bylaws will have to be included in the public company register excerpt of the corporation. According to art. 933(1) CO, “Ignorance of an entry that has become effective in relation to third parties is no defence”. Thus, any new shareholder is deemed to have acknowledged the statutory arbitration clause before acquiring the shares of the corporation in question due to the positive publicity effect of the publication in the company register.

In any event, art. 697i CO will make it possible to introduce a statutory arbitration clause binding for all shareholders and the corporation’s organs, meaning the board of directors and the auditors, irrelevant of whether they agreed to it or not. The bylaws will also be able to define which kind of
corporate disputes shall be covered by the arbitration clause, including the possibility to cover disputes between shareholders. It might well be argued that due to the positive publicity effect of the publication in the company register, the arbitration clause also binds creditors of the company in the bankruptcy of the corporation, when they get assigned claims against the directors out of the latter’s liability – which is something the Swiss Supreme Court denies for the time being, as it considers that “such binding cannot be deducted from the corporate bylaws” (SCD 136 III 107 c. 2.5.2).

In summary, art. 697i CO would resolve most of the uncertainty surrounding the scope and application of arbitration clauses in bylaws of Swiss corporations. Switzerland would close the gap to jurisdictions which already have such an arbitration-friendly regime.

5. Conclusion

As long as art. 697i CO is, however, not enacted by the Swiss parliament, a corporation (and any other legal entity) with an arbitration clause in its bylaws is well advised to require every new shareholder, director or auditor to explicitly submit to the arbitration clause, for instance by requiring a written statement to that effect. How this is best done depends on the nature of the legal entity and should in any case be discussed with a legal advisor.

In addition, arbitration clauses in bylaws require careful drafting as to fit the needs of the founders of a company wishing to introduce such a clause in their bylaws. The introduction of such a clause at a later stage might be difficult, in particular if it is not unanimous – at least before the entry into force of art. 697i CO.

Finally, actual and future shareholders, board members and corporations should monitor the developments in connection with the finalized draft of the amendments to the CO and the message of the same, to be submitted to parliament in late 2016 – or ask us, because we will.