



RICARDO MONIZ

**NON-ADJUDICATIVE ALTERNATIVE MEANS OF DISPUTE RESOLUTION
IN CORPORATE GOVERNANCE: A BUSINESS CENTERED APPROACH**

Dissertation to obtain the degree of Master of Law.

Guidance:

Prof. Dr. Pedro Caetano Nunes

and

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Dedicated to

My father for being an example of stoicism

And bravery

In the battle he faces every day.

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List of acronyms and abbreviations

ADR	- alternative dispute resolution
art.	- article
C.C	- Civil code
CEDR	- centre for effective dispute resolution
CEO	- Chief executive officer
ICFML	- Institute of certification and formation of lusophone mediators
NAADR	- non- adjudicative alternative dispute resolution
OEDCD	- organization for economic co-operation and development
p.	-page
SEC	- Securities exchange commission
U.S.A	- United States of America
vol.	- volume

Abstract

This thesis aims at exploring the benefits regarding the adoption of non-adjudicative alternative means of dispute resolution (NAADR), mediation in specific, in corporation's legal frameworks and contracts. This paper reviews literature, categorizes the types of corporate governance conflicts, analyses several studies and presents empirical evidence that shows the positive effects of a NADR as an enhancing factor in increasing the value of a company.

This paper starts by acknowledging the existence of several situations in corporate governance that are commonly identified as irritants for a healthy steering of a company. We can separate these situations causing conflict in two different groups: the conflicts that are board-related and the ones that are corporate governance related conflicts, without needing the presence of the board.

The categorization of corporate governance conflicts is followed by an overview of the negative consequences that these conflicts have for the overall performance of a company. It finds, supported on evidence presented, that corporate governance conflicts, on an economic stand point, contribute to undermine a company's overall performance by making it less profitable, leading inclusively to shareholder value decline.

This shareholder decline claim is illustrated by recent two different corporate scandals: The general motors case and the Volkswagen emission case. In both cases, decline in shareholder value happened after public disclosure of information. It continues by building on existence research that analyses the relation between a Director resignation that triggers the necessity of filling the 8-K filling form, and the reaction of the market that followed such happening. It follows, by presenting the ADR procedures continuum, highlighting, in specific the advantages of mediation and its

importance on the prevention in what concerns the negatives outcomes resulted from corporate governance conflicts.

It concludes by asserting that mediation is one of the best suited non-adjudicative alternative means of dispute resolution for corporations. Nevertheless, it acknowledges its lack of implementation on the corporate governance realm and analyses the main reasons behind that lack of implementation, with a specific focus on the Portuguese legal framework. It concludes that the legal Portuguese framework and the Portuguese lawyer's mindset doesn't favor the implementation of mediation as a true "forum" to seek grievance for the resolution of a conflict. This thesis ends by providing a thorough analysis on the macro and micro economic benefits that result from good corporate governance practices where NAADR mechanisms find its rightful place as an enhancing factor for firm growth.

Introduction

A corporation¹ is as integral to our society as a family is. This seems like a bold claim but it's nevertheless true. By pooling together human and capital resources efficiently and effectively, companies help economies achieve prosperity.

Nowadays, every person spends most time of their lives working on a company that provides their livelihood. As time goes by, each of any of us establish relationships with our co-workers. That is just bound to happen due to the time we spend working it's only natural do create friendships. That's part of human nature.

A company is like a big organism and it's workers are only little cells. Following that line of thought, for the organism to function in a healthy way all the cells must be riden of any kind of illness in the most proficient and efficient way. This paper aims at proving how alternative dispute resolution means are vital for keeping the "company organism" healthy and functioning at its full potential. We are all familiar with the social notion of "community". In modern governance, the board remains accountable to the company as the principal, but a board must make decisions that take into account the legitimate expectations of the company's stakeholders

Taking advantage of that notion it becomes much easier to explain how the board must be seen as a decent citizen in the community in which it operates. Corporate governance concerns not only how a board steers or directs a company and

¹ See JOHN ARMOUR, HENRY HANSMANN AND REINIER KRAAKMAN, *The essential elements of corporate law: What is corporate law?*, Harvard Law School, July 2009, p.7-15. For the purposes of this thesis the definition adopted regarding the term corporation is one that encompasses the following five core structural characteristics: (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital.

monitors management, but also how managers manage. Quoting Adrian Cadbury², “corporate governance concerns simply how companies are directed and controlled. In that regard, corporate governance provides principles and practices to aid directors and managers in discharging their responsibilities”. Academics and scholars present several different definitions for corporate governance³.

Steering a company in its right direction is an arduous task. Sometimes there’s the need to make business judgment calls on issues in which no one can be right all the time because the issues at stake concern future and uncertain events. To make the right judgment calls, its sometimes an almost impossible demand and one should keep in mind that is mandatory for the board to take into account the legitimate expectations of the company’s shareholders. The decisions and conduct of directors and managers also have a huge impact on society because companies today are so integral to society. Better companies mean better societies.

² ADRIAN CADBURY, *Report on the financial aspects of corporate governance*, December, 1992, p.14.

The Committee on the Financial Aspects of Corporate Governance, forever after known as the Cadbury Committee, was established in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession. The spur for the Committee's creation was an increasing lack of investor confidence in the honesty and accountability of listed companies, occasioned in particular by the sudden financial collapses of two companies, wallpaper group Coloroll and Asil Nadir's Polly Peck consortium: neither of these sudden failures was at all foreshadowed in their apparently healthy published accounts.

³ BOB TRICKER, *Corporate governance: principles, policies and practices*, Oxford University, 3rd ed., 2015, p.31-33. The author, commonly referred by the literature as the “father of corporate governance”, presents five different definitions of corporate governance based on five different perspectives: operational, relationship, stakeholder, financial economic, societal. The author considers that all this perspectives overlap themselves and that one should adopt the perspective that best is appropriate for the matter under review.

The board must strive in all situations to maintain this big organism called company healthy. In order to maintain a company working in the most efficient way when a dispute arises the members of the board must ask themselves this question: what is in the best interests of the company? The answer is astonishingly simple, and it is to resolve it effectively, expeditiously and efficiently. Thus, the importance of having adequate mechanisms to resolve disputes ingrained in the company's DNA.

The alternative means of dispute resolution also can be used as a tool to resolve conflict and to manage relationships. This paper focuses on showing how Mediation and other non-adjudicative alternative means of dispute resolution can become a management tool and thereby enabling companies to conflict prevention rather than conflict resolution. For the purpose of this thesis acronym NAADR will be used in reference to the non-adjudicative alternative means of dispute resolution which is the main focus of this research. The acronym ADR will be reserved for the alternative means of dispute resolution, in general, without distinction between adjudicative and non-adjudicative.

The NAADR mechanisms used as a management tool can add shareholder value to the company and therefore making it more profitable. That might seem a groundbreaking conclusion but this paper will put forward compelling reasons and research to support such claim. It's baffling how there are so many companies in the world that are lacking mediation provisions in their legal contracts, by-laws and frameworks. Mediation provisions and clauses inserted in contracts have the important consequence of putting the dispute resolution framework at the relationship's beginning, not when a conflict arises. By making NAADR provisions as part of a company framework and its binding contracts, the parties involved in a dispute become used to the process. Their minds become attuned to meeting, discussing, and identifying disputes and then resolving them based on an identity of interest, focusing on preserving the relationship to achieve agreed goals. There is also the value of immediate knowledge, by having mechanisms to solve disputes when they arise. Explaining it further, imperfect knowledge recalled in litigation, for example, a couple years later, will add fuel to the dispute, which could have been avoided if addressed and handled immediately. In sum, having NAADR mechanisms

in the company framework or contracts, will contribute very deeply to increase the “attunement” of the minds in what regards the skills of negotiation needed to solve disputes. That will have the effect as time passes, of a significant decrease of disputes arisen in said company.

Moreover, mediation can result in the parties agreeing to novel solutions, which an arbitrator or a judicial officer can never do. The deeper this process is ingrained in the company the better the solutions achieved by the parties involved in the process. NAADR procedures in general, are quicker, less expensive, confidential and more relationship preserving, whereas litigation is the most adversarial and destructive one in what regards relationships. With the adoption of NAADR mechanisms the cost of executive time is saved and a dilution of focus on the business is avoided. When one is involved in litigation, there is the discovery of documents, recalling of events, and a hunt for witnesses, interrogation, etc. – all very distracting for a business.

Another big advantage of the NAADR mechanisms is that having those means of dispute resolution permits avoiding most of the so called “agency costs” that a company incurs when its focus shift from the business normal activities to trying to resolve the internal dispute. That makes the company less profitable, and depending on the level of the conflict, especially if it becomes public, it might lead to a decrease of shareholder value. Any kind of good corporate governance must strive to avoid decline of shareholder value, hence the importance of NAADR procedures. Furthermore, when someone is involved in litigation, there is the discovery of documents, recalling of events, a hunt for witnesses, everything becomes business non-related and that might impair the company’s overall performance.

Nowadays the number of international corporate disputes that are settled before reaching the court doors is up to eighty percent and even for the ones that go to trial, several of them are settled after a few days of adversarial litigation. The awareness regarding this matter is definitely increasing and this paper strives at contributing to that. In other words, NAADR mechanisms as a management tool must be used due to the simple fact that they lead to the avoidance of enormous corporate pain and suffering. It is good governance to take “care” of the company and taking

care in that regard leads to the mandatory need to be in a position to resolve disputes efficiently and effectively, thereby preserving relationships.

This approach is still valid and much needed if we delve on this matter from an economical- financial view. For instance, all companies around the world are directed with the intentions of avoiding trouble, outperform their peers, and reduce the costs of capital by assuring shareholders and bondholders that they can obtain a fair return of their investment. These kinds of objectives can only be achieved with good corporate governance practices. In fact, investors around the globe have been increasingly examining countries corporate governance frameworks and companies individual practices prior to making any investment decision. In that type of investor-prior analysis the two factors in the balance are: the effectiveness of enforcement procedures and the existence of companies dispute resolution mechanisms. Investors are considering the existence of NAADR mechanisms in a company a plus worth of investment. As part of a worth investing good governance framework investors need to have a suitable venue to seek redress and deal with emerging disputes in a timely, less costly, and effective manner. A good framework, therefore, requires having a reliable way to resolve emerging existing disputes. Quoting Louis B. and Alexander Karpf, “a crucial prerequisite for effective enforcement is the availability of efficient mechanisms for dispute resolution”. Mervyn King goes even further stating that “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 the kind of time frame that big business can live with”.⁴

⁴ ERIC RUNESSON and MARIE GUY, *Global corporate governance forum focus 4: Mediating corporate governance conflicts and dispute*, International Finance Corporation, 2007, p.11-12.

This quote is filled with immense power because it leads to the conclusion that non-adjudicative alternative means of dispute resolution mechanisms are most suitable for corporate disputes. In what concerns the shareholders rights, the OECD also considered that an important determinant of the degree to which shareholder rights are protected is whether effective methods exist to obtain redress for grievances at a reasonable cost and without delay⁵. The NAADR procedures are one of the possible solutions to assure such protection of shareholder rights.

The use of alternative dispute resolution means is increasing worldwide and most of its development is owed to the fact that directors and shareholders of companies like to resolve the conflicts arisen within a company without public knowledge. In other words, full-blown disputes are always bad news for a company on an economic standpoint. They can lead to poor performance, scare investors, produce waste, divert resources, even cause shares to decline or paralyzing a company. It's not a surprise that corporations are seeking to settle those disputes outside the court room. The weak enforcement, especially in developing countries with "new born" legal frameworks, the lack of trust in the judiciary system in developed countries, the high costs and delays of trials, the difficulties of enforcing non-binding standards and reputational costs are the main reasons for this so increased development of NAADR mechanisms worldwide. In the USA, for example, almost 800 companies- including Time Warner and Coca-cola, had used several times NAADR mechanisms to solve internal or external disputes. In Colombia, for instance, out of 97 companies, 52 have included a dispute resolution clause promoting NAADR procedures, in their corporate governance codes.

In the end, the task we set upon writing this paper is to explore how consensus-based alternatives to adjudication, especially mediation, can help resolve

⁵ LOUIS BOUCHEZ and ALEXANDER KARPF, *OECD: Exploratory Meeting on Resolution of Corporate Governance Related Disputes*, Stockholm, March 2006,

corporate disputes and, consequently, contribute to improving corporate governance practices by strengthening investor confidence, increasing shareholder value, bettering the access to financing, lessening the cost of capital, supporting business continuity, and reducing the costs resulting from disputes. In order to fulfill this demand this paper reviews the types of corporate governance conflicts, considers the main advantages of mediation, discusses the obstacles to effective mediation, analyses the current state of development of alternative means of dispute resolution in Portugal, explores de macro and micro economic advantages⁶ of NAADR procedures in a company level.

⁶ See chapter V for further development regarding this topic.

Chapter I

1. Corporate governance conflicts and disputes

The law had always been an important part of society. It is however curious the fact that Law evolved in answer to our society needs. The way society shifts and transforms forces the law to evolve in answer to the new needs. It is a terrible mistake to think of the law as an isolated island in the middle of the “social sciences”. The law would always fail to oblige it’s task if it didn’t consider the existence of the other branches of science. It would become a fruitless tree. In the beginning of this chapter it becomes very useful to use a process created by psychology. It’s called labelling. Labelling is an important tool of mental organization. It provides a solid ground to start this thesis. Therefore, before delving further on the topic of corporate governance it is of greater importance do categorize the types of corporate governance conflicts and disputes. In the corporate governance macrocosm, there are basically two different categories of conflicts: The conflicts that are board-related, and the ones that are “corporate governance related” with the possibility of involving or not the board. In this chapter, will be addressed both of these conflicts and will be presented several cases to provide solid ground to the conclusions presented in the end of the chapter. The starting point will be board-room conflicts.

1.1 Board-room conflicts

The first point that is important to mention is that within the board conflict is very often unavoidable. That becomes very clear due to the nature of all decision-making processes.

To make a decision, especially within the board-room, is to consider all the information available and to engage in a vigorous debate⁷. Sometimes the board-room becomes a platform of disagreement in the process to make a decision where members debate and try to convince each other on which is the best option for the company. A board that never argues or disagrees is most likely a bad board or at least an inactive one. Moreover, as established by the Chancery Court of Delaware in 1985⁸, “a board that does not fully consider issues and available information before reaching a decision will fail to meet its fiduciary duties”⁹. All the governance issues,

⁷ JON MASTERS AND ALAN RUDNICK, *Improving Board Effectiveness: Bringing the Best of ADR into the Corporate Boardroom- A practical guide for mediators*, American Bar Association, 2005

⁸ See case *Smith v. Van Gorkom* 488 A.2d 858, 1985, Supreme Court of Delaware. Available at: <http://law.justia.com/cases/delaware/supreme-court/1985/488-a-2d-858-4.html>

⁹ For further development see BERNARD S. BLACK, *The principal fiduciary duties of boards of directors*, presentation at the third Asian roundtable on corporate governance, 4 April 2001, Singapore. The author identifies types of duties: loyalty, care, disclosure and extra care when selling a company. See also RICHARD C. REUBEN, *Corporate governance: a practical guide for dispute resolution professionals*, American bar association, 2005, p. 7-8, on the fiduciary role of Directors. Fiduciary duties, in general, are defined as legal obligation of one party to act in the best interest of another. For further reading: <http://www.businessdictionary.com/definition/fiduciary-duty.html>

standards or requirements provide fertile soil for disagreement and conflict. Each of these can lead to serious tension which can be triggered or intensified by personality disputes. Taking for example, a change in the corporate ownership structure, problems regarding poor performance, a crisis, disputes among the shareholders, disputes among shareholders and directors. It's how those kinds of internal disputes are handled that will determine whether the discord will work itself out, stabilize, or ripen into a dispute. In what regards conflict that evolves and becomes a full blown dispute, especially between shareholders and directors (can also involve management), one must mention the mechanism of the direct actions and derivative actions. The existence and use of said mechanisms corroborates the existence of conflicts between shareholders and directors that erupted beyond company walls. We choose to dedicate to this topic a few words. The literature regarding this subject defines a derivative action as an action with two causes: it is an action to compel the corporation to sue and it is an action brought by a shareholder on behalf of the corporation to redress harm to the corporation. Therefore, the nature of the action is two-fold. First, it is the equivalent of a suit by the shareholders to compel the corporation to sue. Second, it is a suit by the corporation, asserted by the shareholders on its behalf, against those liable to it. An action is derivative when brought by a shareholder on behalf of the corporation for harm suffered by all shareholders in common. When an officer, director, or controlling shareholder breaches a fiduciary duty to the corporation, the shareholder has the right to bring this type of action against faithless directors and managers, because the corporation and not the shareholder suffer the injury. In contrast, an action brought by a shareholder for harm done to an individual shareholder or a group of shareholders is a direct action.

The criterion is simple: if the injury is to one of the shareholders and not the corporation, it is direct. In the end, the classification of the action as direct or derivative claim rests on the existence of direct or "special" injury to the plaintiff stockholder.

The problem here is that if the conflict erupts to such a scale it's possible that it will lead to public disclosure and ultimately to a corporate scandal. Corporate public scandals have a strong negative impact in the way corporations are seen by the

public. The other problem of a conflict within the board concerns the fact that the bigger is the dispute the more of board resources and time will be needed. The loss of focus of the board members can put the survival of a company in the balance depending of course how big is the dispute. It is important to never forget the hypothesis of a conflict that metastasize itself and becomes not containable within the boardroom. Such happening might lead to huge financial costs and losses.

The division of the board in highly polarized camps is one of the factors the most contribute for a company bankruptcy because it makes all decision making a contest of wills. The board members start to put their personal interests first and the company's interest last and that leads to poor decision making. Now it's time before we continue this research on this topic to categorize the types of conflicts that can emerge in the boardroom. There are many types of disputes that can arise within a board, and it would be impossible to create a complete list. However, there are several common themes of board disputes.

1.2. Situations causing conflicts within the board

The literature regarding corporate governance conflicts that are board- related presents a catalog of situations which tend to cause conflict within the board. The situations are the following¹⁰:

1. Transitional periods, such as those following a merger or acquisition in which a significant group of new directors has joined the board.

¹⁰ The situations displayed are only examples. The catalog of situations is endless. For example, in addition to the ones already mentioned one could also refer the following: New long term strategies, poorly performing directors, Board dissatisfaction with CEO or other senior management performance, Director engagement with corporate constituencies such as shareholders, communities, or employees.

2. Lack of concurrence on the role of the board or its committees versus management's role
3. A new CEO who has trouble building relationships with the board or certain directors
4. Disagreement or dissatisfaction with content and conduct of meetings
5. A difficult period for a company stemming from adverse publicity, poor earnings, stock performance, ethical lapses, or executive misconduct
6. Direct conflict between directors and shareholders (see p. 20)

The boardroom is a fertile soil for the germination of seeds of disagreement. If those seeds keep being provided with the nutrients needed, the harmless little seed would become a big tree of disagreement and the bigger the tree the most difficult it becomes to be “chopped”, or in other words, contained. The tasking of categorizing all these types of disputes with board related origin proved challenging but it's nevertheless concluded. However, categorizing becomes limp without the aid of strong cases that shows empirical evidence. Quoting Lawrence M. Krauss, “empirical explorations ultimately change our understanding of which questions are important and fruitful and which are not”¹¹. Hence the importance of completing this research with cases that provide evidence.

¹¹ LAWRENCE M. KRAUSS, *A universe from nothing: Why there is something instead of nothing*, Simon & Schuster, 2012.

1.3 Cases studies

Case 1. Boardroom conflict over appointing new board members: Phoenix timber corporation.¹²

In 1895, 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 innovation and team spirit due to high internal competition. In a very stormy meeting, both sides claimed to represent the legacy of the former CEO. 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 disputes.

¹² RICHARD C.REUBEN, *Corporate Governance: A Practical Guide for Dispute Resolution Professionals*, American Bar Association, 2005, p.21-22.

Case 2. The Hewlett- Packard case¹³

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 Walter Hewlett voiced his opposition, the family of David Packard, the other co-founder of HP, supported 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 Walter-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 is completed. HP management then accused Walter Hewlett of disseminating misinformation about employment terms of senior executives. They also clarified that the CEO of HP then, 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 Walter Hewlett and the board led to a costly lawsuit for both sides. Walter Hewlett was not reappointed as a director on the merged HP-Compaq company, and the company's image was hurt by the media campaign.

These study cases excel in showing the negative effects of a full-blown boardroom dispute for the company image. When disputes are discussed in the press or trigger litigation, they indicate a serious failure of governance. They demonstrate a

¹³ RICHARD C.REUBEN, *Corporate Governance: A Practical Guide for Dispute Resolution Professionals*, American Bar Association, 2005, p.20-21

mismanagement of conflicts within a corporation or between the company and its stakeholders. They are normally perceived as the reflection of the lack of ability of executive managers or directors to deal with issues and emerging conflicts. Litigation exposes also a breakdown in relationships, often personal ones¹⁴. On these note we choose to end this subject and now we divert the focus of this paper to the so called “corporate governance related disputes”.

1.4 Corporate Governance related disputes

On this topic, it is paramount to address and analyze the disputes categorized as corporate governance related disputes. Disputes that qualify as corporate governance disputes (or disputes directly related to a company’s governance) mostly involve the corporation’s shareholders, board members, and senior executives. In this thesis, we decided not to include the disputes that might fall into the labor law (normally involving employees) disputes even though we acknowledge its existence and its importance in what regards corporate governance. The commercial law disputes (customers and suppliers) will not be addressed as well.

All the corporate governance related disputes consubstantiate such a vast and heterogenic universe that makes impossible the task of addressing all of them separately. In the light of that thought and having explained the need of narrowing the subject of analysis, corporate governance disputes may concern inter alia: conflicts of interest by board members or executives; the appointment of board members/executives; remuneration or bonuses to board members; discharging individual board members/executives; share valuation; the terms of a proposed

¹⁴ For further development see THOMAS WALDE, *Mediation / Alternative Dispute Resolution in Oil, Gas and Energy, from a Commercial and Management Perspective* CEPMLP Journal, 2005.

takeover, and acquisition or disposal of company assets¹⁵. From 2001 to 2006, 20 percent of the company law-related disputes settled by the International Chamber of commerce concerned corporate governance related disputes¹⁶. The most common where disputes about valuation of shares, disputes among the shareholders, bankruptcy related, shareholder participation in decision-making processes and takeovers .The landscape of the corporate related disputes is vast and heterogeneous. Hence the need that we felt to separate all of them into different categories. Therefore, in order to progress in this research, it is of great importance to approach the different categories of corporate governance related disputes.

1. Self-interested transactions (related party transactions, insider trading, conflicts of interest by board members, executives, and senior management)
2. Annual accounts (disputes between shareholders and board or auditor over the withholding of shareholder approval scenarios)
3. Nomination/ appointment of board members (disputes between shareholders and the nomination committee and/ or the board over nomination or appointment of board members/ executives, as well as the criteria for nomination/appointment)
4. Remuneration/bonuses for members (Disputes among the shareholders and the remuneration committee and/ or the board over remuneration or the bonuses of board members/ executives, as well as the criteria for remuneration bonuses)

¹⁵ The identified and classified types of corporate governance related conflicts we're drawn from a Questionnaire on Corporate Governance-Related Dispute Resolution, OECD DAF/CA; 03/01/06. For further development see JANET HOLMES, *The OECD's Work on Corporate Governance-Related Dispute Resolution: Categories of Disputes*, Paris, February 2007.

¹⁶ ERIC RUNESSON and MARIE GUY, *Global corporate governance forum focus 4: Mediating corporate governance conflicts and dispute*, International Finance Corporation, 2007, p.20.

5. Share valuation (Disputes between shareholders and the board and/ or auditors on the valuation method in case of “squeeze out”, and share/ bond issues).
6. 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) rules)
7. Disclosure requirements (Disputes involving shareholders and boards regarding compliance with non-financial disclosure requirements)
8. Corporate control in M&A transactions (concern disputes between shareholders and boards regarding a proposed acquisition or disposal of a substantial part of the company’s assets)
9. Minority shareholders’ rights (disputes among majority and minority shareholders in squeeze-out scenarios or on the nomination or appointment of board members.
10. Bankruptcy/suspension of payments (disputes between shareholders and/or bondholders and boards and/or receivers in corporate restructuring)
11. Share/Bond issues (disputes between shareholders/bondholders and boards on dilution issues)
12. Discharge of individual board members/executives (conflict between shareholders and board members/executives on individual discharge regarding their performance in the past fiscal year.
13. Mismanagement (disputes between shareholders and boards on alleged mismanagement of the company)
14. 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)

15. Works council (disputes between shareholders/boards and work's councils on the interpretation and applicability of works 'council legal corporate governance related rights)

1.5 Different criteria for categorizing corporate governance related disputes

The chosen one

This catalog of disputes is presented by OECD. However, for achieving the purposes of this paper we considered that another criteria should be used in order to shed some light on this matter. Nevertheless, most disputes cannot be that easily categorized. A corporate governance dispute will mostly contain several intertwined issues where the solution of one issue affects the determination of an acceptable solution to all the other pending issues (polycentric disputes)¹⁷. The presence of complex and intertwined issues on these types of conflicts makes categorizing an impossible task. Therefore, the most satisfying criteria for the analyses of cases we further intend to do is one simply based on the identity and characteristics of complainant and defendant. This is the chosen criteria.

Accordingly, to these criteria corporate governance related disputes can be divided in: disputes among corporate officers, disputes among investors, disputes between shareholders and the corporation, disputes between the corporation and its corporate officers These are the four major categories. These criteria allows for the

¹⁷ LOM L.FULLER, *The Forms and Limits of Adjudication*, Harvard Law Review, 92, 1978, p. 353.

inclusion of all the types of disputes claimed in ODCE catalog. For instance, in the disputes among corporate officers can be included auditing, conflicts of interest or remuneration issues. In what regards disputes among investors, including shareholders or bondholders, it's possible to include share valuation, proposed takeover, acquisition or disposal of company assets. In the disputes among shareholders and the corporation it becomes very easy to include issues regarding voting rights or dividend payments. And the last one, disputes between corporation and its corporate officers, those kinds, typically concern fiduciary breach. The shareholders, acting in the corporation's name may initiate such disputes. The shareholders usually present a claim against the board for allowing misconduct or rule violation. The shareholders act in these kind of conflicts as the aggrieved party, hence the name of "derivative disputes".

Based on the aforementioned we consider this criterion the best one for the purposes of this paper. The other criteria's will be mentioned only briefly since we will not be. The corporate governance disputes can also be conglomerated in three different criteria: The nature of alleged harm, the type of remedy requested or the type of companies involved. All of that criteria lack completion to grasp all the situations that might be involved in corporate governance conflicts however and even though the concept of categorizing might me a frail one still the best criteria is the one based on the identity and characteristics of complainant and defendant for the reasons stated above. This will be the criteria adopted. We will from now on present cases regarding the three big categories of that criterion: disputes among corporate officers, disputes among investors, disputes between shareholders and the corporation. Following the same methodology used for the board-related corporate governance disputes, the next topic of this thesis will be dedicated to empirical evidence by presenting cases of study.

1.6 Cases studies

Case 3. Disputes between shareholders and the corporation:

The Bulgarian state v. E.ON Bulgaria¹⁸

As a 33 percent shareholder in the now foreign-owned regional power distribution companies, the Bulgarian state has received no dividend. Economy Minister Petar Dimitrov said on Wednesday. In his view, the interaction between the government and the current owners of the utilities leaves much to be desired. The sale of the seven regional power distributors generated EUR 693.2 million in sell-off proceeds. The contract for the sale of the regional power distributors in Gorna Oriahovitsa and Varna to Germany's E.ON was drafted in late 2004 and entitled the state to a 50-percent stake for 2003. If the deal was to be concluded before April 30, 2005, the 2004 dividend was to be distributed proportionally based on the equity holdings of the state and the investor. The sell-offs were finalized in early 2005. E.ON Bulgaria admitted the non-payment of dividend, but said it was due to the peculiar environment in which the regional power distributors operate. The power distributors faced high restructuring costs in the past two years while booming construction spiked electricity demand and entailed investment in the antiquated transmission grid, according to E.ON. The company said that the entire profit of the regional power distributors should be reinvested, quashing allegations that the earnings were expatriated. Austria's EVN, the owner of the regional power distributors in Plovdiv and Stara Zagora, said it has also reinvested all of its earnings.

¹⁸ Source: DNEVNIK, *Bulgaria raps power distributors for dividend non-payment*, August 9, 2007

Case 4. Dispute over exercise of voting rights:

Robert McEwen v. Goldcorp and Glamis Gold

Goldcorp and Glamis Gold entered into an agreement, the result of which may be the creation of one of the world's largest gold-mining companies. After the transaction's completion, current Goldcorp shareholders will own about 60 percent of Goldcorp and current Glamis shareholders will own 40 percent of Goldcorp. McEwan is the largest individual shareholder of Goldcorp and holds 1.5 percent of its shares. He asked the court to order Goldcorp to conduct a shareholder meeting to vote on the transaction and requests relief, including a declaration that Goldcorp has failed to comply with the requirements of the "Ontario Business Corporation Act."

Goldcorp states that it has complied with all statutory and regulatory obligations and that the transaction is in the best interest of Goldcorp and, hence, does not require shareholder approval.

Glamis supports Goldcorp's position and relied on the fact that the Goldcorp shareholders were not required to and would not vote on the transaction, since it would materially increase the execution risk profile and introduce a greater possibility that the deal would fail.

In conclusion, McEwen was not granted the orders he had requested mainly because he didn't demonstrate irreparable harm. Goldcorp's board exercised its business judgment in declining to seek shareholder approval as an exercise of its discretion, as found in the company's by-law, in approving the transaction's substance.¹⁹

¹⁹ Source: McEwen v. Goldcorp Inc., Ontario Superior Court of Justice, 24 October, 2006.

The cases presented provide solid ground for the next chapter of this research which will address more profoundly the negative effects that result from all those corporate governance related disputes and will present other kinds of negative effects of these conflicts for the healthy governance of a company. The main goal of the next chapter is bestowing additional comprehension on the consequences of corporate governance disputes in what concerns a profitable company's steering. Those disputes, when they erupt and become full blown disputes put the company profitability at risk, by undermining its overall performance, so in order to avoid such perilous consequence we must deal with the conflict arisen in the most efficient way.

Chapter II.

2. Consequences of Corporate Governance disputes

2.1 Introductory notion of corporate governance

Conflict in corporate governance is unavoidable. When left uncontrolled, conflict can escalate, leading to economic, emotional, and other costs²⁰. It can paralyze, even destroy the most successful and functioning business. The challenge for effective boards today is to harness the potential for conflict to lead to constructive outcomes rather than destructive outcomes.

This chapter aims at forfeiting the purpose of highlighting the most negative impacts of corporate governance disputes in order to facilitate understanding the necessity of preventing such bad consequences. In a review article, Shleifer and Vishny define corporate governance as “the way in which suppliers of finance to corporations assure themselves of getting a return on their investment.”²¹ . a corporate governance system encompasses the set of control mechanisms that reduce agency

²⁰ RICHARD C.REUBEN, *Corporate governance: a practical guide for dispute resolution professionals*, American bar association section of dispute resolution, 2005,p. 1

²¹ ANDREI SHLEIFER AND ROBERT VISHNY, *A survey of corporate governance*, *Journal of Finance* 52, 1997, p. 737-783.

problems among managers, shareholders, and other security holders²². These mechanisms include boards of directors; managerial incentive contracts; institutional investors and block holders; debt holders and banks; the market for corporate control; managerial labor markets; product market competition; stock market; auditors and security analysts; the media; investor rights; and the legal environment²³.

2.2 The role of Directors in balancing the power of shareholders

Directors play a particularly important role in a firm's governance, for they serve as fiduciaries of shareholders and are charged with hiring, monitoring, advising, compensating, and disciplining management. Using an analogy with the constitutional principle of checks and balances highlights the importance of the directors in a company.

²² JOHN AND SENBET, *Corporate governance and board effectiveness*, Journal of Banking and Finance 22, 1998, p. 371-403, define and analyze corporate governance more broadly to include conflicts between investors and other corporate stakeholders such as customers, suppliers, employees, government and society.

²³ For further development on this topic see JENSEN, MICHAEL C., and WILLIAM H. MECKLING, *Theory of the firm: Managerial behavior, agency costs, and ownership structure*, Journal of Financial Economics 3, 1976. See also FAMA, EUGENE F. and MICHAEL C. JENSEN, *Separation of ownership and control*, Journal of Law and Economics 26, 1983, p. 301-325 and AGRAWAL, ANUP and CHARLES R. KNOEBER, *Firm performance and mechanisms to control agency problems between managers and shareholders*, Journal of Financial and Quantitative Analysis 31, 1996, P. 377-397.

For instance, the mechanism of checks and balances, coined by Charles Montesquieu refers to a mechanism designed to limit the power of a single individual or body of government and provide for the harmonious interrelationship of the people and all of the organs of government or other social institutions. In any of these institutions, there is opportunity for one person to use their power to gain something at the expense of another. Financial audits, dual signers on checks, and appointment of CEOs by corporate boards are examples of checks and balances in the corporate sphere.

The general concept of checks and balances is based on the observation that many people behave selfishly and seek to enhance their own wealth and power at the expense of others. Lord Acton's quotation, "power corrupts, and absolute power corrupts absolutely"²⁴ is taken as a truism in political science today. The attempt to abuse one's position of power is not limited to outright use of force, but applies to human relationships throughout all levels of society and in all social organizations from the nuclear family, to cultural institutions, business arrangements, corporations and governments. The realm of corporate governance is no exception to that conceit. Checks and balances on power begin with the assumption that any person might abuse power, and that any good leader might turn bad.

In a simple way, shareholders own the company but directors have day to day control. The company's Board of Directors has a great deal of power. The basic powers include ability to authorize and allocate stock, and stock options. This is critical for paying employees with stock options, raising capital (including venture capital), etc.

²⁴ John Emerich Edward Dalberg Acton, first Baron Acton (1834–1902). The historian and moralist, who was otherwise known simply as Lord Acton, expressed this opinion in a letter to Bishop Mandell Creighton in 1887: "Power tends to corrupt, and absolute power corrupts absolutely. Great men are almost always bad men."

They are naturally also involved in buying companies, and selling the company itself. The Board also authorizes annual and quarterly expenditures, especially any large or new expenses. The power of directors can increase or decrease, depending on its constitution. On the other hand, Shareholders elect the Board of Directors and have the power to dismiss them. Shareholders, depending on the company framework might also have veto power, which can “tip the scales in their favor”. In a company the directors serve exactly to prevent abuses from the shareholders and to exert control on a company in a day to day basis, hence the analogy with the checks and balance.

The same happens within the 3 branches of power referred by Charles Montesquieu (legislative, executive, judiciary). All these different powers have their own mechanisms of control regarding the other branches of power. For instance, in Portugal the president has the prerogative to dissolve the Assembly of Republic, according to article 133º, e) and 175º of the Portuguese Constitution. This is called by the Portuguese doctrine an “atomic bomb” and it’s used by the literature to classify the Portuguese political regime as “Semi-presidentialist”²⁵. In the United States where Presidentialism is established , the congress and the mechanism of impeachment are among many of the mechanisms used to keep the president in “check”.

The examples are endless. The main conclusion of this analogy is that directors exert the function of balancing the power of shareholders in a company while contributing for preventing abuses of power by not allowing for the power to concentrate all in the same hands of the shareholders.

²⁵ See JORGE REIS NOVAIS, *O Sistema Semi-presidencial Português*, Vol.II, Almedina, 2010. Cf. PAULO OTERO, *O Direito Constitucional Português- Identidade Constitucional*, Vol I. Almedina, 2010. These authors classify the Portuguese political system of government differently.

2.3. The mal functioning of the board: An Inevitability

There's empirical (presented later on) evidence regarding the mal functioning of boards of directors.

The board, due to his inherent nature of functions is almost condemned of not functioning smoothly. All the process of decision making have imprinted in its identity discordance. A board that never disagrees is most of the times a bad board. Discussion is always part of governing a company. The HP case (No.2)²⁶ already presented in first chapter is great at shedding some light on this matter.

When Thomas J.Perkins resigned abruptly from the board of Hewlett-Packard in May 2006 he wrote several letters and e-mails to de HP board, stating that he had resigned because Chairman Patricia Dunn had targeted him and other board members with illegal and unethical "pretexting" practices in order to uncover the source of a board leak. In this ensuing controversy, Dunn resigned from HP's board in September 2006, and criminal felony charges were subsequently brought against her and other HP officials.

The HP incident, along with other recent episodes involving prominent companies suggests that a breakdown in board functioning can have adverse consequences for a company's operation, competitive position, and stock price²⁷. This might seem like a daunting statement but we will provide empirical data and compelling reason to support these claims. Moreover, internal board disputes that come to light are always highly embarrassing for a company image and they lead to

²⁶ See case No. 2 (H.P case) on topic 1.3, for further development.

²⁷ Board disputes that become public often lead to large declines in share values (see, e.g., the case of General Motors in October 2006 (Annex No.3) and Volkswagen case (Annex No. 4) .

the tarnish it's public image. That explains why the number of board disputes that become public are still very few.

Thus, there's a board likeness to operate out of the grasp of the public eye, making their internal functioning largely a 'black box' for financial economists. The board always strive for keeping its disputes within the board room and that makes hard to find systematic evidence on the nature, determinants and consequences of major internal disputes. Nevertheless, and even with all the efforts to keep the conflict within the walls of the boardroom the number of corporate scandals is getting bigger every day.

2.4 Corporate scandals

At the end of 2015 the scandal of the Volkswagen company led to the loss of \$20 billion dollars. Everything started when Volkswagen revealed in September that it had installed software on millions of cars in order to trick the Environmental Protection Agency's (see annex No. 4) emissions testers into thinking that the cars were more environmentally friendly than they were, investors understandably deserted the company. Volkswagen lost roughly \$20 billion in market capitalization, as investors worried about the cost of compensating customers for selling them cars that weren't compliant with environmental regulations.

The company not only had to deal with compensating their customers, but it will also need to contend with potential fines from regulators as well as a reputational hit that could severely affect its market share and even lead to criminal charges.

The Toshiba company corporate scandal is also very good at showing why conflict should be contained within the boardroom. In September of 2015, electronics conglomerate Toshiba admitted that it had overstated its earnings by nearly \$2 billion over seven years, more than four times its initial estimate in April. CEO and President Hisao Tanaka resigned from the firm, and an independent investigator found that "Toshiba had a corporate culture in which management decisions could not be challenged" and "Employees were pressured into inappropriate accounting by

postponing loss reports or moving certain costs into later years.” That undoubtedly tarnished the image of the company in the public eye.

One of the biggest corporate scandals that lead directly to stock fall was the so called “ Valeant secrete division”. In October of 2015, short seller Andrew Left accused drug company Valeant of using a specialty pharmacy company Philidor to artificially inflate its sales. Valeant denied the charges. But the fact that Valeant had never discussed its close ties to Philidor raised questions about Valeant's, and Philidor's, sales practices. It also shook investors' confidence in the acquisitive drug company, which had racked up debt as it did deals.

Valeant could still be “on the hook” today if Philidor broke any laws. Valeant employees appear to have worked at Philidor under aliases to hide their identities. And Valeant had paid \$100 million for an an undisclosed option to acquire Philidor for no additional dollars whenever it wanted, essentially giving Valeant ownership of the company. Valeant has appointed a special committee of its board, and an outside investigator, to look into the company's ties to Philidor, but it has yet to report its findings. Valeant said that Philidor sales never amounted to more than 7% of its total sales. Valeant's shares fell 75% in the wake of these revelations, to just over \$70 from a high of \$260. Also contributing to the stock fall was the fact that Valeant had been accused over the summer of price gouging, buying up drugs and then rapidly raising their prices.

Several members of Congress, including presidential candidate, Bernie Sanders, have called for an investigation into the company's drug pricing practices. And in early October, the company confirmed that it had received a federal subpoena. Many well-known hedge funders, including Bill Ackman, who has defended the company, suffered big losses on Valeant stock in the wake of the scandal. There’s a direct correlation between the eruption of the dispute that became full blown and surpassed the limits of the board room and the stock fall that accompanied it. The list of corporate scandals is endless and it serves only the purpose of surfacing the catastrophic effects of letting a conflict evolve into a full-blown conflict without the possibility to be contained within the boardroom.

2.5 Piercing through the veil of the board room: Finding the hidden true.

In European countries, it's very hard to collect evidence in what regards conflict within boardroom because all boards tend to keep it's secrecy fearing the hazards of public exposition. In this paper, we provide empirical evidence on the consequences of major internal board disputes. The collecting of evidence is only possible giving the existence of U.S securities rules requiring companies to disclose, in some circumstances, the details of internal disputes involving directors.

Under the provision (Securities Exchange Act Rule 3b-7), when a director of a firm resigns or refuses to stand for re-election in result of disagreements involving company operations, policies or practices, the firm must immediately disclose the circumstances surrounding such resignation in an 8-K filing with the SEC (Securities and Exchange Commission). Form 8-K is the "current report" companies must file with the SEC to announce major events that shareholders should know about²⁸

The events that trigger the obligation of filling the report are of various natures²⁹

²⁸ Note that disclosure is triggered without the director having to write a letter to the company and having to request that the matter be publicly disclosed. The company must disclose: (1) the date of the director's resignation, refusal to stand for re-election or removal, (2) membership of any board committees the director served on, and (3) a brief description of the management's view of the nature and circumstances of the disagreement. In addition, if the director provides the company with any correspondence describing the nature and circumstances surrounding her resignation, refusal or removal, the company must file the correspondence as an exhibit to Form 8-K, regardless of whether the director requests such disclosure. The company must provide the director with a copy of the disclosures it is making by the day of the SEC filing, and an opportunity to respond in writing indicating whether she agrees with the company's disclosures, and if not, why not. The company must file with the SEC any letter it receives from the director, within two days of its receipt, as an Exhibit that amends the previously filed Form 8-K

²⁹ The detailed lists of events that trigger the obligation of filling said report is available at: <https://www.sec.gov/answers/form8k.html>

In case of the happening of one of those events the company's has the public obligation to file a report with the SEC. In addition, the company must disclose the director's letter describing the reasons for his resignation³⁰. This provision will be our most important tool to lift the veil of secrecy that companies like to preserve in what concerns the disputes within the boardroom. This provision enables us to pierce through the smoke curtains surrounding the corporate governance disputes board-related. Its indeed due time to open this "Pandora box" and show empirical data on what cause this disputes, it's nature and the types of consequences that result from it. The dataset enables us to empirically study the nature of internal board conflicts as well as the implication of such conflicts for corporate governance and shareholder value.

³⁰ See annex No.5 for examples regarding Directors resigning letters.

2.6 Empirical evidence on the Boards mal function. The hazards of corporate governance conflicts

a) Stock fall and underperformance

The dataset used in this paper to collect empirical evidence is a surveillance of 168 companies on which we´re identified a total of 181 episodes where one or more directors resigned on the time lapse 1994-2006³¹.

The data collected in that study was an important step in developing a thorough understanding on the motives of boardroom disputes. In this topic, we aim at exploring the nature of the disputes that lead to director departures as well as understanding what types of governance characteristics are related to the incidence of such episodes. Finally, but not least important, we will address the question on how stock prices react to corporate governance conflicts and what determines the stock price reaction to these incidents. The study concluded that conflicts in the boardroom typically appear to be the result of power struggles between management and directors over corporate governance and control issues.

Their findings also indicate that these episodes are more likely to occur in CEO-founded companies, companies with shorter CEO tenures, higher independent block holdings, bigger or less independent boards, and non- independent audit or compensation committees. Moreover, departures of inside directors are more likely in smaller firms, and in firms where the CEOs are older or own less stock, and where other directors and officers own more stock.

³¹ For further development on this study see ANUP, AGRAWAL and MARK A.CHEN, “*An empirical analysis of disputes involving directors.: Boardroom Brawls*”, University of Alabama and Georgia State University, March 2008.

The results showed that companies which experience a conflict, directors with shorter tenures, and directors who are likely to be more powerful or independent are more prone to dispute whether directors who are CEOs or chairmen of other companies are less likely to be engaged in a dispute. The same happens with outside directors with greater stock ownership. The major conclusion and the one we must highlight is that the stock prices suffer a significant decline (economically) upon public disclosure of boardroom conflict. Upon news of director departures stemming from internal disputes, stock prices decline significantly (both statistically and economically).

The cumulative average abnormal return (CAAR)³² for the analyzed sample of director departures amid disputes was -2.6 % over days [-1, +1], and -6.1% over days [-10, +1]. The CAAR is even larger, -3.9% and -10.3% over the two windows, respectively, when the resigning director is an insider. In other words, the study proved that when directors resign, the market reacts in an unexpected expected (hence the name abnormal) negative way, which is verified by the negative percentage of the CAAR, following the directors resign. They also found that the decline in stock prices is greater in contract disputes and in disputes involving corporate strategy and direction, management style, management hiring and succession, conflicts of interest and possible fraud than in other types of disputes.

The study concludes also in its cross - sectional regression³³ that the stock price reaction is worse in larger firms and in firms where tenures of the CEO and the

³² CAAR in finance refers to cumulative average abnormal return. An abnormal return is the difference between the actual return of a security and the expected return. Abnormal returns are sometimes triggered by "events." Events can include mergers, dividend announcements, company earnings announcements, interest rate increases, lawsuits, etc. all of which can contribute to an abnormal return. Events in finance can typically be classified as information or occurrences that have not already been priced by the market. In stock market trading, abnormal returns are the differences between a single stock or portfolio's performance and the expected return over a set period of time.

³³ Cross sectional regressions definition: regressions with the same time period and the same variables of analysis.

resigning directors are shorter, the CEO founded the company, the CEO picks board members, and other directors and officers own less stock. Finally, they found out regarding the performance of the firms after said events that they have poor operating performance in the years surrounding the dispute episode, and experience significantly greater incidence of stock market delisting in the year following the dispute. In conclusion, this study enabled us to open the door of the boardroom and unveil the fact that power struggles between directors and top management can lead to costly governance failures. It is now time to shift the focus into other negative impacts of corporate governance related disputes.

b) Emotional costs

Starting by emotional costs, all conflicts incur them³⁴ and the sooner the conflict is extinguished the better it is for human relationships. Empirical research on the effects of conflict in groups and organizations have shown that conflict is associated with reduced productivity and lack of satisfaction³⁵. The risks of letting a conflict escalate to its final stage is of great danger because it will lead almost inevitably to the breakdown of human relationships. (See annex No. 9 for Glasls's scale: nine stages of conflict). Those emotional costs will significantly undermine the performance of a company. It is well known nowadays that companies with better environments tend to perform better. One of the most successful company's in the world was founded by Larry page: Google. The Google company is well known as the best place to work in the planet. They are always striving to keep their employees

³⁴ See article from STEWART LEVINE, *The many costs of conflict*. The article is available at: <http://www.mediate.com/articles/levine1.cfm>

³⁵ .KAREN A.JENH, *A Multimethod examination of the benefits and detriments of intragroup conflict*, Sage publications, June 1995, Vol. 40, p. 256-282

happy. Regarding this subject we must mention one article called “ 5 reasons google is the best place to work in America and no other company can touch it³⁶”.

The line of thought here must be if successful company like Google always focus on making the workplace a good environment for its workers it must be due to its influence in making the company perform well and become more profitable. According to PayScale, 86% of Google employees say they are either extremely satisfied or fairly satisfied with their job. As Google HR boss Laszlo Bock explains in his book, "Work Rules!³⁷" the key to Google's success as a workplace is constantly innovating, experimenting, and keeping things fun.

“The catch “in all this is Google does all that to keep their workers motivated. There’s nothing less motivating than a bad working environment. Hence the importance of preventing the emotional costs and the breaking of human relationships because they pollute the working environment destroying its healthiness. Avoiding conflict or resolving it the most efficiently is key to the success of a company. Corporate governance disputes make a company less profitable and less attractive for investors.

³⁶ The article is available at: <http://www.businessinsider.com/google-is-the-best-company-to-work-for-in-america-2016-4/#a-high-percentage-of-googlers-say-theyresatisfied-in-their-job-1>

³⁷. LASZLO BOCK, *Work Rules!: insights from inside Google that will transform how you live and lead*, Hachette book, April 2015.

c) Agency costs

Another major big negative consequence of disputes among a corporation are the so called “agency costs”. Agency costs are a type of internal cost that arises from, or must be paid to, an agent acting on behalf of a principal. These costs arise because of core problems, such as conflicts of interest, between shareholders and management. That happens due to the fact that Shareholders wish for management to run the company in a way that increases shareholder value, while management may wish to grow the company in ways that maximize their personal power and wealth that may not be in the best interests of shareholders. Based on a disagreement between management and shareholders as to what actions are in the best interest of the business, agency costs result. Agency costs include any expense that is associated with managing the relationship and resolving differing priorities.

While shareholders are most concern with increasing share value, management may be more concerned with growing the business in ways that increase their personal wealth. Any changes in business activities that may lead to lower share prices are likely to be met with resistance by shareholders who maintain profit as a primary concern. Agency costs are inevitable within an organization whenever the principals are not completely in charge; the costs can usually be best spent on providing proper material incentives, such as performance bonuses and stock options, and moral incentives for agents to properly execute their duties, thereby aligning the interests of principals and agents.

Agency costs are a major negative impact of corporate governance related disputes due to their disruptive nature. They shift the focus of the board to solve this dispute at hand, and they shift the focus of the parties involved actively in the dispute causing major cost to the company well -being. They also lead to using important resources that might be useful in other areas.

Notwithstanding that, the disputes might lead to even more costs if the courts are involved. When the courts are involved there’s the need to collect evidence and the

confidentiality privilege will most of times suffer breaches for the court to reach a decision. When parties resort to seek grievance on courts they most of times stop being so productive because their minds always have this new concern of winning this lawsuit and they start to put their interests in front of the company. In fact, resorting to court in order to seek redress for a dispute becomes a bad habit and the minds of both parties become attuned in solving it's disputes by law action. That means that in the future in similar situations they will behave the same way. As we will explain further the tribunals as means to resolve a dispute are one of the most costly for the company's finances. Not only legal action is time consuming as it is resource consuming. Besides any kind of dispute leads to loss of trust. Trust is a vital element in the working environment³⁸.

d) Trust issues

Studies show that organizations with a high level of trust have increased employee morale, more productive workers and lower staff turnover. The alternative means of dispute resolution are also important "trust builders", by improving communication, allowing for full disclosure with the effect of reinforcing trust in the organizational level. Trust suffers a definitive breakdown when the conflict is resolved the Court. Court, as an adjudicative mean of dispute resolution, leads most of the times to the loss of human relationships.

³⁸ Quoting DENNIS S.REINA and MICHELLE L. REINA, "Business is conducted through relationships and trust is the foundation of those relationships". These authors describe trust as 'transactional' because it is an integrative approach that provides a foundation for effective relationships and work results. When trust is damaged, morale and productivity begin to decline and turnover increases. For further development see, from the aforementioned authors, book *Rebuilding trust in the work place*, Berett Koehler, 2010.

Trust is vital in a positive and productive working environment. If the board or the company employees do not trust each other the risk of covering or not revealing the problems when they appear increases very much. In the board-room trust is even more important because an effective board evaluates all the information before deciding. An effective board, in the words of Richard C. Reuben, is diverse, independent, active and informed. The lack of trust in the board room contributes significantly to undermine the effectiveness of the board.³⁹

e) Reputation issues

The media coverage of a dispute that happened within the walls of a company will also tarnish its public image and this will have the effect of scaring investors leading to the loss of good business opportunities. As showed above the disclosure of a corporate governance conflict by media has the pernicious effect of decreasing shareholder value. It would also lead to big breaches on the company's confidentiality. As stated above that's anathema to the company's interests because all boards like to keep it's secrecy on what happens within the walls of a company. Nothing is worse for an investor than to see a company with directors resigning a couple times and that will surely happen if the conflict escalades. Investors like stability in the company's direction⁴⁰. A company that lacks this important value is soon to be losing market

³⁹ . RICHARD C. REUBEN in *Corporate governance: a practical guide for dispute resolution professionals*, American bar association, 2005, p. 15-17, associates poor communication, homogeneity of perspective, dependence, passivity, and inadequate information, with ineffective boards.

⁴⁰ Using the words of Jeddelloh, of the TIS group, "The investor needs to be confident that he has a fair shot, that the deck is not stacked against him, or he will pull his capital out, unless something happens to convince him he should stay in." .The complete article is available at: <http://www.reuters.com/article/us-wallst-scandals-confidence-idUSBRE86F02I20120716>

value. The “big fuss” created by the Toshiba accounting scandal has been a big focus of concern of the Japan government since it’s happening. Japanese Finance Minister Taro Aso said accounting irregularities at Toshiba Corp were "very regrettable, coming at a time when Japan is trying to regain global investors' confidence with better corporate governance. If Japan fails to implement appropriate corporate governance, it could lose the market's trust." A director’s letter of resignation is most of the times a powerful diagnosis of a mal-functioning company. In conclusion, all mentioned consequences will lead, most likely, to loss of market value and to make the company less attractive for future investors.

The main focus of this paper is to show and prove how NAADR mechanisms are vital in the task of preventing and avoiding all these sorts of negative consequences. Next chapter will be dedicated to the ADR procedure continuum and we will explore the advantages of the ADR mechanisms as a tool to resolve corporate governance conflicts in a fast and efficient way, avoiding all the negative outcomes mentioned above, and subsequently allowing the company to remain profitable and functioning as wealthy as possible. NAADR mechanisms are the key in this process of preventing and dealing with conflict in the best way for the companies interests.

Chapter III.

3. Advantages of non -adjudicative alternative means of dispute resolution

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3.1.ADR continuum. The spectrum of dispute resolution processes

This chapter aims at exploring the spectrum of dispute resolution processes. The three core processes of disputes resolution are considered before introducing the alternative means of dispute resolution and mediation in specific. The main goal here is to show case very clearly the advantages and benefits of NAADR and specifically mediation in comparison with more adjudicative processes.

The term “ADR” is an umbrella term that encompasses a wide spectrum of techniques. The techniques vary amongst themselves based on the degree of structure or formality, the kind of involving of interveners (mediators or facilitators), and the degree of direct involvement of the parties. The starting point is the “conventional model of dispute resolution”.

The conventional model of dispute resolution has an adjudicative nature and in the clear majority of time is fulfilled by the courts. According to Shapiro the

ideal court, or more the properly the prototype of the court involves⁴¹: “(1) an independent judge applying (2) pre-existing legal norms after (3) adversarial proceedings in order to achieve (4) a dichotomous decision in which one of the parties was assigned the legal right and the other found wrong.”.

The author goes on to say that an examination of the courts across a range of societies reveals that the prototype “fits almost none of them.” Nonetheless, this does provide a suitable starting point for what one might call the conventional model of dispute resolution. This is clearly at the formal binding end of the spectrum. At the other end of the scale, problem solving between the parties represents the informal, non-binding approach, the successful outcome of which is an agreement to “settle”⁴².

It’s evident the conclusion that mediation and negotiation are located in the opposite end of the spectrum that is reserved for the most formal and adjudicative ones. The most basic form of process to seek closure in a dispute is Negotiation. Negotiation is a “process of working out an agreement by direct communication. It is voluntary and non-binding”. The process may be bilateral (two parties are involved) or it could be multi-lateral (many parties involved). There’s no obstacle for each party to utilize at its will any form of external expertise it deems necessary.

In fact, negotiation provides a simple party based problem solving technique. A further dimension is added whenever either party introduces advisers. This is often described as “supported negotiating”.

⁴¹MARTIN SHAPIRO, *Courts: A Comparative and Political Analysis*, The University of Chicago , 1981, p.6-15.

⁴² See annex No.10 regarding ADR spectrum.

However, what must be highlighted is that the essential feature of this process is that control of the outcome remains with the parties.

On the contrary, Litigation and arbitration require the parties to submit their dispute to another who will impose a legally binding decision. As it follows, the parties don't control the outcome in the adjudicative means of dispute resolution.

3.2.Mediation

Mediation is a private, informal process in which parties are assisted by one or more neutral third parties in their efforts towards settlement. In a simple way, what differs mediation from negotiation is the addition of a neutral third party who aids the parties in dispute towards settlement⁴³. A further important factor is that the mediator does not decide the outcome. Therefore, settlement lies ultimately with the parties. A distinction is often made between styles of mediation which are 'facilitative' and those that are 'evaluative'. During a facilitative mediation, the mediator is trying to re-open communication between the parties and explore the options for settlement. The mediator does not openly express his/or her opinions on the issues. If, on the other hand, the mediator is called upon to state his opinion on any issue then he/she is clearly making an evaluation of that issue, albeit not a binding one.

The boundaries between facilitative and evaluative mediation must be firmly distinguished and all parties must be well known on the type of mediation they are into. Failure of neutrality by the mediator will lead surely to less possibility of the parties to reach a multi satisfactory settlement which would be much less likely to be obliged by the parties in conflict.

⁴³See NICHOLAS GOLD, *Adjudication and ADR: an overview*, Fenwick Elliot LLP, February 2007, p.3-4.

3.3. Conciliation

Conciliation is generally considered to be an abbreviated form of mediation and is typically agency or court- related. For the purposes of this thesis the definition of conciliation that is adopted is the European one. Conciliation, accordingly to the UNICITRAL Model Law on International Commercial conciliation (article 1, 2002), 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. This definition is the one adopted due to its broad scope of application which combines to the harmonization goal of any model law.

The conciliator is a third impartial and neutral party that plays a relatively direct role in the actual resolution of a dispute and even advises the parties on certain solutions by making proposals for settlement. In conciliation, the neutral is usually seen as an authority figure who is responsible for the figuring out the best solution for the parties. The conciliator, not the parties, often develops and proposes the terms of settlement. Conciliation tries to individualize the optimal solution and direct parties towards a satisfactory common agreement.

The parties come to the conciliator seeking guidance and the parties make decisions about proposals made by conciliators. In conciliation, the conciliator typically meets with the parties and attempts briefly to facilitate a settlement. If one is not forthcoming, the conciliator will then help the parties proceed with their case, either in narrowing the issues for trial or in exploring more substantial dispute resolution processes.

In a brief conclusion, regarding the matter of controlling the outcome of disputes, in litigation, arbitration, adjudication, expert determination, the decisions are imposed. In processes like mediation, negotiation, or conciliation the control of the outcome rests with the parties. Nonetheless, at a basic level a distinction can be made between settlement processes and decision imposing processes .Control of the

outcome, or the power to settle rest with the parties during negotiation, mediation, and conciliation.

By contrast, adjudicative or umpiring processes, such as litigation, arbitration, and adjudication, rely on the judge, arbitrator or adjudicator having the power to impose a decision. Green and Mackie arguably defended that all dispute resolution processes are built upon three basic necessary methods: negotiation, mediation or conciliation, and some form of adjudicative umpiring process.

The prologue of this chapter comes to an end and it's now time to approach the core topic of this chapter: Advantages of NAADR mechanisms in comparison with other means of disputes resolution in the context of corporate governance. Before progressing further, we must ask the question: Why NAADR mechanisms are a valuable tool for solving corporate governance disputes? Why shouldn't we resort to the most conventional and adjudicative processes? Those are the questions we sought answer for, in the task of presenting compelling arguments supporting the use of NAADR mechanisms in the corporate governance world.

3.4 Advantages of adopting NAADR mechanisms in the corporate governance realm⁴⁴

3.4.1. Voluntariness

The first big benefit of NAADR processes is due to its voluntary nature of process. Parties choose to use NAADR procedures because they believe that NAADR holds the potential for better settlements than those obtained through litigation or other procedures involving third-party decision makers. In the simplest way "No one is coerced into using NAADR procedures". The voluntary nature of the process assures

⁴⁴ Regarding the advantages of NAADRA, see GENE P. BOUCHER, *to mediate or not mediate- that is the question. How mediation can be used to resolve labor relation conflicts*, (data unknown). The article is available at <https://www.calpelra.org/pdf/Boucher,%20Gene.pdf> . On the advantages of NAADRA see also MARGARET DOYLE, *why use ADR? Pros & cons*, advice services alliances, June 2012.

that parties will strive for the best agreement in their point of view. Transmuting these processes for the “corporate world”, or in other words, choosing mediation as the process to solve disputes, is a great step in assuring that the dispute will find its closure in the most expeditious and efficient way which business can live with. Moreover, since the settlement achieved is from the parties involved the risk of non-compliance is much lesser than in other procedures. Therefore, mediation is an insurance policy regarding the definitive closure of the disputes whereas seeking court redress makes the result less likely to be complied with due to its enforced nature.

3.4.2 Expedition

Another great vantage regards the fact that NAADR are expedited procedures. Because NAADR procedures are less formal, the parties are able to negotiate how they will be used. This prevents delays and expedites the resolution process. In the business world, there’s the common quote that “time is money”⁴⁵. NAADR procedures and in special mediation offer closure for the conflict in the most expeditious manner. This has the important consequence of shunning agency costs, resulting from the shift of the company’s focus from business related activities to non-business related activities. Mediation and other informal ADR procedures are the ones that use less of the company value resources, allowing it to function in a profitable way avoiding the risk of losing market value due to diversion of focus.

3.4.3 Control of the outcome

The NAADR processes consubstantiate also non-judicial decisions. That means decision-making is retained by the parties rather than delegated to a third-party decision maker. Consequently, the parties have more control over the outcome and there is greater predictability of the outcome for the company also. In the business world, most of CEO’s like to be in a position of power and control of the biggest

⁴⁵ BENJAMIN FRANKLIN,” Remember that time is money. He that can earn ten shillings a day by his labour, and goes abroad, or sits idle one half of that day, though he spends but sixpence during his diversion or idleness, it ought not to be reckoned the only expense; he hath really spent or thrown away five shillings besides”, *Advice to a Young Tradesman*, 1748.

number of events possible. When the disputes are solved by adjudication there's no way to control the content of the court award. On the contrary, by choosing NAADR procedures such as mediation, the parties involved, retain the control of the settlement. They can even use their skills of negotiation to find the better settlement that fulfills their best interests. This approach of negotiation and empowerment is much more keen to the business world than adjudication.

3.4.4 Decisions are made by people that know what the company need

The control by managers is another great "perk" of NAADR procedures. The NAADR procedures place decisions in the hands of the people who are in the best position to assess the short and long-term goals of their organization and the potential positive or negative impacts of any particular settlement option. This means decisions are made by those who best know their organization needs. Third-party decision making often asks a judge, jury, or arbitrator to make a binding decision regarding an issue about which he or she may not be an expert.

3.4.5. Confidentiality

There's another factor that makes NAADR means very suitable for the "realm" of corporate governance disputes and it's called confidentiality. NAADR mechanisms are a confidential procedure. NAADR procedures can provide for the same level of confidentiality as is commonly found in settlement conferences. Parties can participate in NAADR procedures, explore potential settlement options, and still protect their right to present their best case in court later without fear that information divulged in the procedure will be used against them. NAADR procedures protects confidentiality and the public image of the company, avoiding all the bad consequences that might result from the eruption of a corporation medial scandal which the most pernicious ones are the loss of shareholder value and investor confidence. In chapter V, the topic regarding economic advantages of using NAADR procedures in corporate governance practices will be analyzed in greater detail

3.4.6. Never hurts to try

Starting a mediation procedure doesn't always lead to settlement. Sometimes the parties simply can't reach a satisfactory solution in their best interests. Even in that case, mediation is still an important tool because it allows for the parties to "put the cards on the table" and to discuss the matters at stake and that might lead for a party to get discouraged to seek court grievance. Mediation permits the parties to see the case from the adversarial perspective and that most of times is sufficient to stop their "thirst for blood", because the parties get to know, measure and weight the power of the "court weapons of the other party" Suddenly, they shift their positions to a negotiation based on interests where going to court stops to be the best alternative, and other NAADR procedures become a possibility.

3.4.7. Flexibility in terms of settlement: customized settlements

NAADR procedures also offer greater flexibility in terms of settlement, providing an opportunity for the key decision makers from each party to craft customized settlements that can be better meet their combined interests than would an imposed settlement by a third party. NAADR mechanisms enables parties to avoid the trap of deciding who is right or who is wrong, and to focus the key decision makers on the development of workable and acceptable solution. In addition, these means of dispute resolution enable greater flexibility in the parameters of the issues under discussion and the scope of possible settlements. This allows participants to "expand the pie"⁴⁶ by developing settlements that address the underlying causes of the dispute, rather than be constrained by a judicial procedure that is limited to making judgements based on narrow points of law.

⁴⁶ See WILLIAM URY and ROGER FISHER, *Getting to yes*, penguin books, 1981.

3.4.8 Saves time

The savings in time is one of the major benefits of NAADR procedures⁴⁷. Nowadays with the significant delays in obtaining court dates, NAADR procedures offer expeditious opportunities to resolve disputes without having to spend years in litigation. In many cases, where time is money and where delayed settlements are extremely costly, a resolution developed through the use of an NAADR procedure is most of times the best alternative for achieving a timely resolution with the lesser costs dispended.

3.4.9 Cost savings

NAADR procedures have also inherently associated cost savings⁴⁸. These procedures are generally less expensive than litigation. The cost of the third neutral party is typically less than for attorneys. Expenses can be lowered by limiting the costs of discovery, speeding up the time between filing and settlement, and avoiding delay costs. These front-end expenses are often the costliest components of legal costs. These savings are in turn passed on to the taxpayer. Keep in mind that relieving the burden on the courts caused by unnecessary or inappropriate lawsuits can help save valuable public resources.

3.4.10 Reputation protection

The use of NAADR procedures to solve disputes will also protect much more the reputation of a company. Reputation in a market-economy is one of the most value assets of a company contributing for increasing its value on the market. That a good reputation is vital for attracting investors is an obvious claim. It's only normal for a

⁴⁷ See annex No.7 and 8

⁴⁸ See annex No. 7 and 8

good reputation to attract more clients and that will subsequently bring more investors. The confidentiality portrayed in NAADR means helps companies to protect its image. On the contrary the judiciary activity most of the times breaches the confidentiality of the board room and is followed by public disclosure, which depending on the events disclosed, might lead to loss of shareholder value.

The generic approach of NAADR procedures comes to its epilogue. The next topic will be dedicated to show the benefits of the specific NAADR procedure of mediation as an important tool for solving conflict in corporate governance. One of the main reasons to choose this dissertation subject was precisely due to the fact that we firmly believe in the potential of mediation to solve definitely corporate governance disputes. We truly believe that in the future NAADR schemes will become a reality in most of companies around the world and that mediation will become a benchmark in the way these procedures are structured and organized within a company.

3.5. What can mediation offer for corporate governance conflicts resolution

All mediation concepts are structured around mending fences⁴⁹ and finding a constructive approach to conflict resolution that brings to the surface issues of mutual concern, review the various angles of the issue at stake, and allow the conflict to be used as a learning tool and as a basis for improved relations among the parties. Mediation enables parties to resume, or sometimes to begin, negotiations.

⁴⁹ CEDR, *Boardroom disputes: how to manage the good, weather the bad and prevent the ugly*, IFC corporate governance knowledge publication, 2014, p. 38.

The Centre for Effective Dispute Resolution (CEDR) defines mediation as: “A flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference, but with the parties in ultimate control of the decision to settle and the terms of resolution.”. There is a multiplex of definitions of mediation.

For instance, the Portuguese law of mediation (Law no. 29/2013, 19 of April), in article 2º, a) defines mediation as “an alternative form of dispute resolution, weather done by private or public entities, where parties strive to reach an agreement with the assistance of a mediator”. It proceeds by defining, in the same article, b), the mediator as third neutral party, absent of powers to impose a solution on the parties, with powers only to assist them in reaching a settlement for the dispute. In Europe, the benchmark definition for mediation is present on the Directive 2008/52/EC of 21 May 2008, which defines this conceit as “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 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” (Article 3, a))

Mediation can sometimes be the most suitable tool for managing conflict within the walls of a company. In this thesis, we consider mediation as one of the most suitable ADR procedures for dispute resolution regarding corporate governance conflicts.

This statement is perfectly understandable taking in full consideration the ADR spectrum continuum. In this spectrum mediation is less formal one with fewer costs. It is very useful in a business approach to choose the less costly alternative. Every company in the world strives to deal with its disputes using the less possible resources and with minimum costs. The conflicts that arise within a company must be dealt expeditiously and swiftly. Again, mediation can lend it’s important hand in that

regard because is one of the fastest procedures in NAADR spectrum, where negotiation has the “pole position” in that regard. In mediation, we can control the quality of the mediator and we have the power to select the best one for our situation according to their skills and field of expertise. In litigation that doesn't exist and in more adjudicatory ADR processes this power only exists partially. For example, in arbitration we can nominate our arbitrator but the other party retains the right to nominate its own. Mediation is also the procedure where parties retain the control in all process. The content of a mediation agreement is the result of a bargain. In this bargain a skilled negotiator can use negotiation skills and techniques to influence the content of the agreement. In the business realm, to be able to influence the outcome of the procedure is a factor of empowerment of the parties and the mediation procedure itself.

It can be said that parties own the dispute and craft its solution. The solution is the one that best answer their needs and interests. Therefore it's predictable and never imposed. Business strive on predictability. On the contrary in litigation and more adjudicatory ADR procedures decision is always imposed and sometimes unpredictable.

Flexibility is also a great “trump card” for mediation because parties can decide on the type of mediation and how to set up the procedure, including the timing and the location. That is never bound to happen in other ADR processes nor else in litigation. Mediation is also the procedure where confidentiality is best assured and protected. 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.

Moreover, the risk in mediation has always limited nature. Parties do not have to settle and have the choice to seek another form of dispute resolution including a court decision. In litigation or arbitration, after the award there's no great panoply of means to resort seeking closure to the situation.

In mediation liability is never an issue. It doesn't have to be admitted to reach a settlement. The process of mediation itself is non-binding, however the outcome may be enforced as a contract or registered as a consent award. The fact that mediation is voluntary is of great mean and it should serve a good empowerment tool to strengthen the confidence of the parties in the process. Unless required by court, the parties do not have to go to mediation. In all cases, parties do not have to settle. This means that when parties decide to go to mediation they tend to be more committed to it. In court or other adjudicatory ADR means the parties are forced to be in trial.

In addition, in litigation there's only the possibility of winning or losing. Instead of coming out of a dispute with a winner and a loser, mediation helps create a win-win solution. Because of its relatively flexible approach, mediation can often produce outcomes that better satisfy participants than adjudication does⁵⁰. In some cases, an unforeseen creative solution might even emerge. The parties often come to mediation with a conflict and they leave the room with a business partnership that favors both parties. On the contrary, adjudication is often said to lead to an adversarial atmosphere that can hurt or break down on-going relations.

Moreover, by holding up a more objective and detached mirror on their positions to executives who become devoured by personalized or corporate conflict, mediation can help provide a useful reality check⁵⁰. By doing so, it constitutes a good risk-management technique⁵¹. This means that mediation may not be only about win-win outcomes, but can help all parties face up to the worst losses or risks (whether in terms of costs or reputational impact) they may face if they fail to settle.

⁵⁰ ERIC M. RUNESSON and MARIE-LAWRENCE GUY, *Mediating corporate governance conflicts and disputes*, International finance corporation, 2007, p. 27

⁵¹ ERIC M. RUNESSON and MARIE-LAWRENCE GUY, *Ibid.*

Another often underplayed factor is that, in most mediations, the parties' circumstances will have altered from those prevailing at the conflict's onset. Mediation thus allows for interim reassessment that may be otherwise hard to achieve once "battle positions" have been drawn. This is really important in a business ever changing world. Mediation assures adaptability of the solution to the circumstances that brought the parties to seek grievance. Sometimes, in adjudicatory procedures at the time of the conclusion of the procedure (award) its usefulness it's already lost. Due to the fact that the adjudicatory procedures take long time to find its closure, it's not uncommon for an award to be unable to solve the disputes taking in consideration the parties interests. Mediation assures full adaptability of the settlement with parties interests which has value for business.

Although they may be "dressed up" as conflicts over rights and obligations, most disputes, including corporate governance disputes, have at least three dimensions; legal, commercial, and emotional. These dimensions may not be equally important to the parties; their relative importance may vary from one dispute to the other. Interests and business needs can be the real drivers behind a legal position.

It is an important feature of mediation that there is room to consider all dimensions of the dispute. By contrast, the adjudicative process only considers a case's legal dimension. Because of its broader view on disputes, a mediated decision is more likely to be perceived as fair by all parties. To explain how mediation works, practitioners often use the following example:

Two children are fighting over the last orange in a bowl. Each argues that they are entitled to the orange since they took it first. This seems fair, since both parties are facing uncertainty as to the possibilities to prove early possession. Another way to resolve the dispute would be to have a mediator help explore the interests behind the legal position and facilitate an interest-driven negotiation that may reveal that one child claims the orange because he wants to eat it while the other child wants it because he is going to make jam. Each can have full satisfaction if one child gets the meat of the orange and the other gets the peel.

Mediation can be designed to allow for a desirable degree of openness and therefore has a greater potential to unlock hidden values in multi-issue disputes. It, therefore, seems that adjudication, by missing some issues, can result in lost value. Adjudication is said to be binary in character⁵² because its decisions tend to favor one party over another.

Adjudication is especially inadequate in multi-issue disputes where the challenge is to find an optimal solution that enables the parties to make trade-offs. The parties who bring a multi-issue dispute to adjudication may end up with, a 50/50 decision.

With mediation, however, the total “pie” can be enlarged, meaning that both parties may get more than 50 percent of the disputed value. As Fisher and Ury⁵³ explain, when a problem is defined in terms of the parties' underlying interests it is often possible to find a solution which satisfies both parties' interests. This type of approach it's only possible in negotiation-based procedures like mediation. Mediation by promoting negotiation based on the interests allows for a solution that favors both parties. On the contrary, the adjudicative procedures, such as litigation or arbitration don't allow this “pie enlargement” because, most of the times, the parties involved won't find the interests surfacing their positions.

The parties who successfully negotiate a solution may get a 70/70 decision (or, depending on bargaining skill, 85/55 which still makes both better off compared to the

⁵² DUNCAN KENNEDY in *A critique of adjudication (fin de siècle)*, Harvard university, 1997, p.185, considers that the binary character of adjudication, also called on/off, implies that the judge decides based on rule structure or rule interpretation, instead of based in the parties interests.

⁵³ ROGER FISHER and WILLIAM URY, *Getting to Yes: Negotiating Agreement Without Giving In*, New York penguin books,1983.

alternative of adjudication). The potential to find win-win solutions in multi-issue negotiations increases if the parties can work in an atmosphere of transparency and divulge private information about priorities and preferences without fear of being exploited.

Adjudication requires that the parties entrust the dispute's resolution to a stranger, whereas the resolution depends entirely on the parties in NAADR. The adjudicator draws his or her authority from the principle of objectivity – particularly in rationalizing the judgment and the law, in general. This may explain the three main procedural differences between adjudication and mediation. We will provide only a summarized explanation.

First, the adjudicator has little room for the application of rules that depend on the personal characteristics and the relation between the parties – even if the parties think that such norms are of relevance. Further, when rules collide, the adjudicator tends to choose one rule as superior rather than trying to find an in-between solution without the use of the law that is characteristic for mediation and negotiation.

Second, the adjudicator will treat alleged facts as either true or false under some burden of proof rule. With mediation, the parties can recognize that the other party's allegations may have some value and, with this in mind, accept an in-between solution.

Third, the choice of remedy for breaching a rule is constrained in the adjudicative process. The principal remedy is monetary compensation when specific performance of promises and duties is not feasible. With mediation, the gamut of remedies is in principle limited only by the parties' imagination and by practical considerations. Sometimes, an excuse is sufficient to settle a dispute.

More so than process, the main reasons that drive businesses towards mediation are time⁵⁴ and cost constraints⁵⁵. The delays and litigation costs have reached

⁵⁴ Table costs: see annex No.8

⁵⁵ Table time: see annex No.8

proportions, at least in some countries, that make it questionable to say that access to the courts can provide investor redress. It can be easily assumed that time and costs increase with the dispute's complexity, and that mediation can be decisively less costly and less time consuming than adjudication. The direct costs of any dispute resolution mechanism mainly depend on the need to obtain and convey information to the other party and to the third neutral person, whether that is a judge, an arbitrator or a mediator. It seems that mediation techniques, by minimizing the need for the parties to inform the third neutral person about the substantive issues, have the greatest cost advantage over adjudication. Mediation is, therefore, likely to work best when information asymmetries between the parties are minimal. Yet, transaction costs do not just refer to expenses associated with dispute resolution (direct costs). They also include the time value of a speedy resolution, the aggravation and loss of focus that people in an organization may feel when involved in a dispute, bad will, etc. The following case represents this very accurately.

Case 5. Time and Costs of Disputes: Pennzoil v. Texaco⁵⁶

In 1985, a Texas state court jury unexpectedly found Texaco liable to pay USD \$11.12 billion to Pennzoil for inducement of breach of contract. Following this, the parties got entangled in procedural moves and counter-moves for about three years. Studies of how the market value (stock price) of the two parties developed during this period revealed that setbacks for Texaco market value decreased. Pennzoil's market value increased, but not so as to set off Texaco's loss. In November 1987, the two

⁵⁶ For the original source and further development see ROBERT H.MNOOKIN and ROBERT B.WILSON, *Symposium on the Law of Economics of Bargaining: Rational Bargaining and Market Efficiency: Understanding Pennzoil v. Texaco*, Virginia Law Review 75 ,1989,p. 295. See also, regarding the same subject, DAVID CUTLER and LAWRENCE SUMMERS, *The Cost of Conflict Resolution and Financial Distress: Evidence from the Texaco-Pennzoil Litigation*, Rand Journal of Economics 19 ,1988 p. 157.

companies had lost more than 30 percent of their joint value before the dispute broke out. On December 11, 1987, a settlement payment of USD \$3 billion was considered by the parties. The settlement proposal resulted in increased market value for both parties. Texaco's value increased by USD \$898.3 million; Pennzoil's value increased by USD \$264 million. A settlement was eventually reached in April 1988. It appears that the risk of being held personally liable made Texaco's management reluctant to accept a settlement as long as there was a small chance that Texaco could win. It was not until Texaco's directors were given discharge that the settlement went through.

3.6 Mediation as a management tool to improve Board Governance

The role of mediation in corporate governance regards solving disputes in a more efficient and effective way. However, considering this role as the only one that mediation has doesn't allow us to perceive the vast and broad landscape on which mediation procedures might leave its imprint. The contribute of mediation to corporate governance is much broader than that.

Mediation can be an important tool in managing conflicts and therefore, having a role in preventing disputes. Conflict always has the potential to be constructive. Nevertheless, that potential lies locked. Mediation techniques have the power to unlock its potential to be constructive, bringing to the surface issues, interests, perspectives, and concerns that need to be addressed so that the corporation can perform better. The challenge for effective boards today is to harness the potential for conflict, which would lead to constructive outcomes rather than destructive ones⁵⁷. It is a director's fiduciary duty to resolve disputes as efficiently and effectively as possible. This makes mediation an especially relevant process to use in the boardroom.

⁵⁷ ERIC M. RUNESSON and MARIE-LAWRENCE GUY, *Mediating corporate governance conflicts and disputes*, International Finance Corporation, 2007, p. 36

Better relationships

In fact, mediation skills and techniques can improve governance and board effectiveness by fostering discussions and collaboration on decisions, while surfacing and working through disagreements and personality issues. By doing so, the directors build stronger, more constructive working relationships.

Increasing the free flow of information and Finding interests that surface the positions.

One of the big problems in what concerns board meetings is the lack of free flowing of information. Mediation techniques, encouraging the identification of interests as opposed to positions, highlighting, and making surface emotional issues entangled with the disputes are a perfect remedy for the lack of information within the boardroom. Positions reflect what we assert we want as an outcome. The more we defend our positions, the stronger we seem to hold onto them. It also seems our identity and ego becomes attached to what we perceive as the rightness of our view – and we defend our position at every turn⁵⁸. Along the way, our growing emotions cloud reason, and the challenges to effective problem-solving also grow.

Interests⁵⁹, on the other hand, reflect not only what is important to us as an outcome. They also reflect the reasons why they are important. Interests lie underneath what we

⁵⁸See FISHER and WILLIAM URY, *Getting to Yes: Negotiating Agreement without Giving In*, New York Penguin Books, 1983, p.38. Fisher and Ury's first principle is to separate the people from the issues. People tend to become personally involved with the issues and with their side's positions. And so they will tend to take responses to those issues and positions as personal attacks. Separating the people from the issues allows the parties to address the issues without damaging their relationship. It also helps them to get a clearer view of the substantive problem.

⁵⁹ p. 42, Ibid. Good agreements focus on the parties' interests, rather than their positions. As Fisher and Ury explain, "Your position is something you have decided upon. Your interests are what caused you to do so. Defining a problem in terms of positions means that at least one party will "lose" the dispute.

say we want – and reveal our hopes, needs, values, beliefs, and expectations. Unfortunately, they frequently become obfuscated in the fight for our positions – which do not necessarily reflect the core of what the disagreement is about.

By helping the parties focusing on their long-term objectives and interests, using procedures that encourage collaboration and emphasize flexibility, promoting discussions, and encouraging the free flow of ideas, mediation becomes a great management tool for the board to use. In addition, all mediation core procedures revolve around promoting the uncovering of information relevant to the problem and it's solution, facilitating the parties' collaborative development of their own solutions, rather than imposing solutions on them. Finally, using a third party most of the times facilitates the opening of a channel of communication that might be broken in case of escalation of conflict⁶⁰. Even though most boards will be reticent to have a dispute resolution professional, whether a mediator, facilitator or an external consultant, attend regular board meetings, it is the role of the chairman, lead director, or a committee chair, as the person presiding over a meeting, to facilitate meetings and create an environment where open, frank discussion is encouraged.

Directors should receive appropriate training on conflict resolution and mediation techniques as part of their ongoing professional education programs. Institutes of directors, or other organizations training directors, could include a module on dispute resolution skills and procedures in their curricula. After directors, had better understand mediation goals and processes the board may be more prone to hire a professional facilitator to mediate governance disputes.

When a problem is defined in terms of the parties' underlying interests it is often possible to find a solution which satisfies both parties' interests.

⁶⁰ See annex No.9 regarding the Glasl's scale on the nine stages of conflict.

However, even with adequate training, disputes cannot always be contained and managed within the boardroom. This is true mainly because directors, even though they may be independent, are not neutral parties. The most effective approach, then, would be to involve a neutral, third-party dispute resolution professional to assist the board. In cases where there are signs of poor board management and miscommunications between the board and management, an outsider or a facilitator, or mediator, with appropriate corporate governance skills may help establish a more effective flow of information and a framework for effective, collaborative decision making. Such a facilitator would be expected to have the necessary objectivity in relaying concerns between management and the board, working with both groups to arrive at an appropriate solution. The facilitator in those cases typically acts as a mediator who sounds the board's and management's viewpoints and requirements, and then ties them together to help reach an agreement on the best processes for the board's operation and the company's performance

In the end the main point is that mediation is key and empowers the board to harness the constructive power that exists in situations of conflict.

3.6 .Guide for risk management and dispute prevention for directors

A dynamic board seeks to stimulate the flow of ideas, identify key issues, consider alternatives, and make informed decisions. In order to achieve that you need deliberation and debate. But these positive processes can sometimes turn into boardroom disagreements that must be dealt with properly and promptly; otherwise, they can devolve into acrimonious disputes that undermine the board's effectiveness and the company's performance⁶¹.

⁶¹ CEDR, *Boardroom disputes: how to manage the good, weather the bad and prevent the ugly*, IFC corporate governance knowledge publication, 2014, p. 3.

This topic aims at describing key steps that the board can take to mitigate the impact of disputes and to minimize the risk of disputes arising in the first place in order to prevent all the negative consequences that we´re mentioned earlier in chapter II. However, is never enough to remind that disputes among a company can undermine significantly its performance. This statement is easily corroborated by a survey made by CEDR in 2013. In 2013, CEDR and the IFC Corporate Governance Group conducted a global survey of 191 directors and board members to learn about their experiences with and attitudes toward boardroom disputes. The results show the significant effects that boardroom disputes can have on an organization, and the challenges that individual members of those boards find in attempting to resolve them. In annex No.1 are presented the complete results of the aforementioned survey.

Moreover, when directors we´re asked about the motives of conflict these we´re some of the answers: “The CEO’s abrasive style with zero appetite for ‘changes’ has pushed the company to a stage wherein the company is under attack from the stakeholders, including the creditors”; “Factionalism on the board, and an unwillingness on the part of the chair to demand that members pull together”. “There is much manipulation and backroom dealing”; “Alpha members of the board are not listening to others or not hearing them, especially women or those perceived to be of no importance. There is lack of empathy or ability to appreciate motives of others”; “in my experience the avoidance of the dispute is the biggest problem, especially in a company with a dominant shareholder and two minority shareholders where the minority shareholders are suffering most from results of avoidance but are hardly part of the conflict management, as the conflict is played outside the board/board meetings”.

All the survey results enable us to conclude that conflict in corporate governance is a big reality and there must be strong mechanisms to prevent it. Further on we will present a step- by- step guide for companies to prevent conflict. The list of possible sources of conflict is endless and includes issues related to the business itself (what is being done, strategic priorities, related-party transactions, company control), board processes (how things are done, appointment of new directors, defining board agenda, succession planning), and personalities (who is doing things, behaviors and

attitudes of directors). Regardless of its source or nature, a governance dispute implicates the board in one way or another as a party or as an active participant, and resolving the conflict requires the directors' concurrence. This part of this paper will have its focus on developing policies, procedures, and directors' skills that help resolve disagreements in a constructive way, preventing some conflicts altogether by removing common "irritants," and create circumstances for a productive board environment.

To keep disputes from being destructive, the first and most important responsibility of the board is to apply good corporate governance practices, including initiating steps to minimize the risk of having disputes arise in the first place. The second responsibility is to see to it that individual board members develop the skills needed to better manage disputes and heated negotiations. To achieve these goals, a board should consider adopting the following interlinked steps, tailoring them to the board's specific circumstances. It is now time to approach the most important steps that directors should adopt in other prevent and resolve disputes within the company's walls. In annex No.2 is presented the full "Handbook guide for directors", therefore each of these steps will be only briefly mentioned. Its full development is presented in the aforementioned annex.

1. Clarify the roles of management and the board.
2. Establish orderly board processes.
3. Ensure the proper flow of information.
4. Encourage a board culture that allows for effective discussions, debates, and deliberations.
5. Step out of the boardroom to gain new perspectives.
6. Apply dispute resolution skills and techniques.
7. Incorporate ADR procedures into the company's culture and practices.

Each of these steps will be approached separately.

3.6.1. Clarify the roles of management and the board

Clarifying the roles of the board and management is crucial to preventing disputes. Failure to understand and articulate these different roles invites disputes and impairs

the board's effectiveness. The board also should establish committee charters that clearly define the committees jurisdictions and responsibilities. It is especially detrimental for boards or board committees to extend their roles into management's purview, for example, when the audit committee begins to redo the financial statements or conduct its own audit.

3.6.2. Establish orderly board processes

Orderly processes and procedures⁶² help create an environment that not only permits but also encourages discussion and debate. By contrast, disorganized, chaotic meetings not only impede the substantive aspects of the board meeting but also create numerous irritants. Two things are bound to happen quickly:

- First, confusion will reign, and from that confusion will spring misunderstanding, frustrations and even anger. What is the business at today's meeting? In what order, do we consider things? Is there follow-up from the last meeting?
- Second, time will run short, discussion and debate will be compromised, and some important matters will not be considered.

Board meeting organization must include a clear protocol for how meetings will be conducted and how the discussion will occur. Every director must have an opportunity to participate in discussions and debates.

Some boards will establish their own protocols that lay out the chair's role, procedures for calling on those who wish to speak, debate procedures (rebuttal and counter rebuttal), and clear rules for how to ask directors to end their remarks if they do not abide by the board's rules.

⁶² For further development on the measures that can help directors in establishing orderly meetings, creating the adequate environment for decision making, consult annex No. 2

For boards that don't want to develop their own rules for discussion, Robert's Rules of Order⁶³ is one solution. Published for the first time in 1876 by Henry Martyn Robert, it is one of the most commonly used meeting protocols.

However, the decision-making process under Robert's Rules tends to favor the majority and does not factor in the instability that can result from having unhappy minorities. In this paper, we defend that the decision-making processes founded on voting are a fertile soil for seeding conflict. To prevent frustrations and, consequently, disputes from building, boards are increasingly using more consensus based processes for decision making, in which voting would be a last resort for decisions. Therefore, our approach is much more keen to Lawrence Susskind and Jeffrey Cruikshank, who explained in their book called "Breaking Robert's rules"⁶⁴ that deciding on matters is not as simple as voting. They offer the five steps to improve decision making so that agreements can be reached and implemented more effectively.⁶⁵

⁶³ . HENRY M.ROBERT, *Robert's Rules of Order Pocket Manual of Rules of Order for Deliberative Assemblies*, October 2005.

⁶⁴ . See LAWRENCE SUSSKIND and JEFFREY L. CRUIKSHANK, *Breaking Robert's rules*, Oxford university,2006

⁶⁵ . Ibid. These authors present the following 5 steps:

- 1- Convening. Everything starts with agreeing to a particular decision making process.
- 2- Assignment of roles and responsibilities. In this step they highlight the need to clarify who is in charge and to specify ground rules. Accordingly, to these authors it is also of great importance to define the role of the facilitator/ chair.
- 3- Facilitate group problem solving. The major point here is generating mutually advantageous proposals and confronting disagreement in a respectful way. Ensuring that a range of solutions (including the ones no one thought of) are considered to address the concerns of all participants/members.

Voting as a process of decision making is much more simple than these 5 steps we propose in order to make a decision. Nevertheless, and even though voting is a faster and simple process it doesn't consider the future and the type of consequences that might arise an "unhappy minority". This minority that saw its vote lost its value can perform poorly in result of that decision making the company less profitable. To decide is always to keep the future of company in mind. Voting allows for present fast decision making but it forsakes the subsequent conflicts that might arise in the middle of the minority which can undermine the company overall performance.

3.6.3 Ensure the proper flow of information

Directors have a fiduciary duty to make decisions after considering all material information that is reasonably available. A board's well-constructed information system supports a healthy bond between the board and management. It helps ensure that the board has the basic facts necessary for a healthy discussion and debate. Typically, boards need two kinds of information:

3.6.4. Encourage a board culture that allows for effective discussions, debates, and deliberations

Sometimes impediments to discussion involve structural and organizational issues. Constructive inquiry, discussion, debate, and decision making require a conscious effort. When the board environment is comfortable and the tone encourages creative

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- 4- Reaching agreement. In this task, there's the mandatory need of coming as close as possible to meeting the most important interests of everyone concerned, and documenting how and why an agreement was reached.
 - 5- Holding people to their commitments. That is achieved by having participants/members do what they are supposed agreed to do. Keeping participants/members in touch with each other so that unexpected problems can be addressed together.

problem solving, people will challenge assumptions, ask probing questions, and make suggestions that contribute to innovation and informed decision making. To support the kind of environment that prevents disputes and promotes effective deliberations, boards must develop a boardroom culture based on collegiality and civility.

3.6.5. Step out of the boardroom to gain new perspectives

Governing a company is a demanding exercise, and board meetings can become consumed by urgent issues of the day. An effective way to put it all into perspective is to step out of the confines of the boardroom. Doing so provides opportunities for directors to accomplish important objectives, such as get to know each other in less formal settings, evaluate board performance and needs, focus on strategic development of the company, build consensus, and resolve emerging disagreements before they can become problems. The completion of such objectives is of great relevance especially because effective debates and deliberations require a certain level of familiarity and trust among board directors. Boards need to ensure that opportunities exist for directors to know one another in informal, comfortable surroundings.

3.6.6 Apply dispute resolution skills and techniques

Applying dispute resolution techniques, “borrowed” from negotiation and mediation are very useful in creating the desired collegial environment to encourage discussion, debate, and the free flow of ideas. They also can help boards develop an orderly process for decision making and consensus formation on specific issues the board has to contend with, which in turn improves the board’s all-around performance.

Typically, the chair (or lead director), being particularly attuned to board relations, is expected to mediate between disputing directors. But sometimes other directors who have a collaborative conflict-management style may draw on mediation techniques (perhaps without being aware of doing so) to find common ground. Such directors will ask questions, listen attentively, and encourage parties to resolve

differences. Ultimately, however, the board is collectively responsible for managing disputes in a timely, constructive manner. So, all directors should be able to strengthen the board's corporate governance through dispute resolution practices.

Nevertheless, even strong boards may encounter disputes from time to time. Throughout a dispute cycle, certain interpersonal skills and expertise can help board directors engage each other constructively and manage tensions. Chief among these skills are effective communication, consensus building, managing emotions, and constructive disagreement.

These are all soft skills "borrowed" from mediation and negotiation that are most useful in improving corporate governance. Annex No.2 examines each of those skills more profoundly. In this part of this thesis we provide only a brief and summarized explanation.

Communicating effectively

One of the biggest communication mistakes on boards and in general is to assume that we know how others receive what we are trying to communicate. People exposed to the same information can end up with completely different impressions and ideas. This is why the process of perception—how people receive, organize, interpret, and retain information transmitted to them from another person—can be a key obstacle, especially in multicultural environments, which modern boards increasingly are.

Communication also suffers when the hearers (or readers) tend to fill in any information gaps with something they already know. This process of closure, or aversion to ambiguity, fills the void with familiar concepts or information, even if that information is neither relevant nor correct. This is why effective communication skills involve more than just imparting information. A good communication is key for

conducting orderly meetings and to make decision with the best information available.

Building consensus

For a company to function properly, the board needs to be effective in resolving issues and making decisions. The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed ⁶⁶. Chairs ⁶⁷ and lead directors must ensure that the board performs these actions well. More and more boards are reaching decisions through consensus, a voluntary agreement following the deliberation and synthesis of different propositions. Generally, consensual decisions are less divisive than voting, which requires directors to take opposing yes-or-no positions. However, the consensus process tends to take more time than voting.

Consensus building should not be confused with groupthink, where directors follow the general trend of thought without questioning decisions. Consensus building is about working with directors who hold opposing positions at the outset and helping them come to a mutually beneficial and sometimes innovative agreement.

Managing emotions

Emotions are intrinsic to conflict although not readily apparent, especially in the boardroom. In conflict, emotions are frequently translated into something more acceptable, such as making judgmental statements ("you are mistaken"), attributing intentions to others ("you refused to disclose this information to me"), or serving up solutions ("this is what needs to be done"). Directors need to be aware of any biases. Strong analytical skills and the ability to isolate emotional issues from substantive ones are essential in any business role, but are particularly critical in resolving disputes.

Yet in many cases the solution to a conflict will be difficult without acknowledgement of the feelings in play. This doesn't mean that directors should be

“emotional.” This only means that an experienced Director should be able to communicate its emotions in a professional manner.

Disagreeing constructively

At times, a board director has a serious concern about a board decision or the standards on which the decision was made. Constructive dissent is the ability to challenge the majority view in a useful way. This skill can help prevent or limit groupthink, which precludes dissent and sound decision making. The risk when someone challenges groupthink is that the majority will be critical and try to silence or pressure the “outlier” to conform.

Disagreeing constructively requires courage and effective assertion. Various methods are used to pressure someone into agreement, including discounting expertise or using such statements as “be a team player.” Directors sometimes compromise their values and professional standards to maintain friendly, cohesive relations within the dominant group. The easiest response to groupthink pressure is to fall silent, hoping that another director will take a leadership role in addressing the issue.

A clear understanding of corporate governance responsibilities (and liabilities) will strengthen a director’s resolve in challenging the board’s majority opinion. The corporate secretary’s documentation of dissent during board meetings provides procedural support for directors who dissent, as there is a record of the topic, the risks identified, and the board’s responses.

3.6.7. Incorporate alternative resolution methods into the company’s culture and practices

Disputes will arise. Preparing in advance for dispute resolution is an essential board responsibility, so it is an important governance duty for the board to ask: Do we have an adequate mechanism in place to prevent and resolve disputes?

In the saying of James Groton⁶⁶ “the parties to a business relationship, at the time they enter into that relationship, should always address the subject of how they are going to handle any problems or disputes that may arise between them. At this point, they have a unique opportunity to exercise rational control over any disagreements that may arise, by specifying that any disagreements be processed in a way that is likely to avoid litigation, preferably by agreeing on a dispute resolution “system” that will first seek to prevent problems and disputes, and, next, establish a process for resolution of any disputes”.

The board’s approach to disputes should reflect the company’s culture as well as more tactical considerations as to what works best in particular circumstances. In the corporate governance arena, the question also breaks down as to policies for internal versus external disputes. Can the same policy apply to both? Although the board may be involved in both categories of disputes, it may determine that, for business or tactical reasons, external disputes should be treated differently from internal ones.

3.6.8 Who Should Manage the Dispute Resolution Process?

The board needs to ask: Who should oversee managing and implementing dispute resolution strategy and policies? A board member, the chair, a board committee, the CEO, or possibly a senior executive could assume this responsibility.

⁶⁶ ⁶⁶ CEDR, *Boardroom disputes: how to manage the good, weather the bad and prevent the ugly*, IFC corporate governance knowledge publication, 2014, p. 30.

Once the strategy is developed, it is important to identify who can assume the role of peacemaker/mediator for different types of conflict that are likely to arise.

Not everyone is a talented peacemaker, is trained in dispute resolution skills, or is willing to take a leading role in the company's dispute resolution. So the board should ensure that its skill profile includes the right mix of expertise and capabilities to manage corporate governance disputes properly, including one or two people who can act as a mediator if the need arises.

The best solution is to detect potential problems when they are small and solve them before they become severe. In many situations, a board member can encourage and lead the board to articulate concerns and to press for early resolution to a potential dispute while the level of intensity is still low. If a board has not yet developed that degree of peacemaking capacity, it can call on an external expert, consultant, lawyer, or mediator to assist in applying and implementing the company's governance dispute resolution strategy. Key to choosing between an internal or an external corporate governance peacemaker is determining who would provide the highest level of trust and comfort to all the parties involved in the dispute:

- Internal peacemakers –chair, independent director, corporate secretary, or an ombudsman: Directors prefer handling their disputes behind closed doors. From within the company, those who are in the best position to handle corporate governance disputes are the board chair and the chairs of board committees. The board chair is naturally positioned to build consensus, prevent conflicts, and ensure proper resolution of disputes.

In their leadership roles, these potential internal peacemakers are naturally expected to develop consensus on organizational principles and procedures and apply discussion protocols. The responsibilities of the nominating/governance committee chair make that person particularly well-positioned to create dispute resolution structures, policies, and processes.

- External peacemakers –negotiator, mediator, consultant, standing neutral, or an arbitrator: Even though they may have a strong peacemaker within their

ranks, boards should also consider drawing on external professional dispute resolution expertise. Beyond helping the board design an effective dispute resolution strategy and related policies, independent third parties or dispute resolution experts can help prevent or dissipate disputes by facilitating board discussions and retreats outside of standard board meetings.

An external, impartial dispute resolution expert can be especially desirable to mediate or help settle disputes between the board and external stakeholders. No matter how well-intentioned or objective a board director may be, it is unlikely that external stakeholders would fully trust that person, precisely because he or she is a board member and possibly part of the problem.

The approach on the techniques that Directors should use in preventing and managing corporate governance conflicts comes to an end. Following all of these steps will prove very useful in the arduous task of preventing and resolving corporate governance conflicts, harnessing its constructive potential and disrupting all its pernicious effects. Mediation used as a learning tool has the potential to create the right environment that encourages discussion and free flow of ideas allowing good decision making. Therefore, making the company more profitable. In conclusion, borrowing tools and skills from mediation procedures contributes very deeply to facilitate the task of steering a company in its right direction enabling people to work in a smooth work environment where disputes are solved permanently a fast and efficient way. We choose to end this chapter strongly claiming that mediation and other less formal and less adjudicative forms of dispute resolution are key for optimizing the performance of a company. Nevertheless, it is astonishingly true that NAADR mechanisms are still not a reality in most of the companies around the world. The purpose of the next chapter is to address the reasons behind the lack of implementation of mediation in Portugal. The analysis focus is on the Portuguese legal framework to find what are the biggest hindrances that mediation implementation still faces and that are hindering its implementation as a true mean to seek conflict resolution.

Chapter IV.

Limitations and barriers for mediation implementation in Portugal.

4.1 Idiosyncrasies of the Portuguese mediation legal tradition

All academic research has the ultimate purpose of contributing for the evolution of science regarding the topic subject of analysis. As it follows, we couldn't end this thesis without an overview regarding the difficulties of implementation of mediation in Portugal.

The purpose of this paper is not short in what concerns its ambition. The main goal we expect to achieve is to help raising awareness regarding the advantages of NAADR mechanisms implementation. The main goal regards helping mediation to found its rightful place on the ADR means of the portuguese landscape. Therefore, these chapter aims at analyzing the hurdles that implementation of mediation has been faced in Portugal with the objective of providing solutions to help removing those. We have no utopic ideas concerning this topic. All the evolution takes time and patience. This thesis strives only to help propelling mediation to move forward. Therefore, it's by analyzing the different kinds of barriers that have undermined the use of mediation as a truly alternative mean of dispute resolution that will clear the path for the evolution we strive for.

The first chapter of mediation in Portugal dates of 2001. Mediation is indeed not a new concept in Portugal, we had legislation governing this aspect of the law since 2001. Let's start by addressing its origin story. In 2001, the legislation regarding mediation was limited to very specific branches, primarily with regard to public mediation. The law No 78/2001 of 13 July, called the law of the "julgados de paz"(Justices of peace), also set forth the framework for the use of public mediation in small claims cases. Mediation, in Portugal, since the beginning was strongly associated with public systems of mediation. The law regarding mediation from 2001

was designed with the thought that mediation should only be applied in small claims court procedures.

The mediation process of implementation was tainted from the beginning due to its public regard. In this first mediation legislation, the concept of mediation was defined as “an extrajudicial means of private, informal, confidential, voluntary, and non-adversarial dispute resolution, in which the parties actively and directly participate, and are assisted by a mediator to find, themselves, a negotiated and amicable solution to the conflict opposing them”.

It became clear that Portugal desperately needed more extensive legislation on the issue due to its lack of completion. This first-time legislation only provided a simple definition for the concept of mediation. As it follows, Portugal needed more extensive legislation regarding this matter. The dawn of the Law 29/2013, 19 April (the “Mediation Law”) gave answer to that need of completion by establishing the general principles applicable to mediation carried out in Portugal, as well as the legal frameworks of civil and commercial mediation, of mediators and of public mediation.

The definition of mediation also suffered a transformation. Article 2 of the Law No 29/2013 of 19 April starts by altering the definition of mediation⁶⁷. Despite this leap forward concerning the evolution of the definition of the concept in Portugal, mediation on 2001 was still having a public scope and the “law design” corroborated this statement. We firmly believe that mediation suffered the stigma of being always associated to the public systems of family and labor mediation. The number of commercial mediation cases, for example, was indeed very limited. This assumption raises the question of lack of awareness in what regards the use of mediation in private matters. That was mostly due to its association with public systems from its very early stages. The fact of being associated with public systems of dispute resolution contributed very decisively for the fact that in Portugal the use of mediation is still nowadays not a common practice in the Portuguese legal environment.

⁶⁷ See topic 3.4 in what regards mediation definition.

4.2 Addressing the legal Status of Mediation in Portugal

Since its birth in 2001, the public mediation system in Portugal has been divided into four different systems: the justices of the peace, the Family mediation system, the Workplace mediation system, and the criminal mediation System, each covered by their respective legislation, provided mostly of the procedural rules regarding said systems. The analysis of the time frame 2001 to 2013 leads us to a very alarming conclusion. The conclusion that, although public mediation systems were granted legislative protection and frameworks, private mediation in itself was never the object of a law and was never recognized as a private means of dispute resolution nor granted the necessary guarantees for it to be able to function.

The statute of mediators evolved especially with the enactment of Portugal Mediation Law. In present time, they are now fully considered as a professional category and their role is expressly defined by law, alongside their rights and responsibilities. The mediation law (2013) constitutes a benchmark in the evolution of mediation in Portugal. Explaining it furtherly, the Mediation Law in article 3^o provides “the principles set forth in this chapter apply to all mediations carried out in Portugal, regardless of the nature of the conflict which is the subject of the mediation”. We can only assume that this provision is applicable to any mediation in Portugal, in Portuguese or in any other language, by certified mediators or non-certified mediators, regardless of its public or private scope. The enactment of this Mediation Law (2013) proved of vital importance in the task of putting private law systems in the radar of mediation procedures, therefore contributing very much to erasing its “public system association trauma”. This Mediation Law now provides all mediation carried out in Portugal with the minimum protection it needed so urgently.

The Mediation Law also sets forth a myriad of principles with inherent nature regarding mediation concept. The main principles are voluntariness, equality, impartiality, independence, confidentiality, responsibility and enforceability. There is vast literature about this subject. Thus, we choose only to explore them briefly due to the lack of originality of the Portuguese mediation law concerning this matter. This topic aims at showcasing the legal landscape of mediation in Portugal highlighting the

barriers that must be overcome in order for mediation to start to be seen as a true alternative mean of dispute resolution.

Voluntariness is the first principle appearing in the Mediation Law, in article 4, which provides that the mediation process is voluntary and that the parties are free to revoke their consent to mediation at any time during the process. That would not constitute a breach of their duty to cooperate under the terms of the civil procedure code. We considered that mediation should always remain voluntary. The arguments on mandatory use of mediation are still not able to persuade us to follow that direction. That is mostly due to the fact we consider commitment as a key factor for the success of all mediation procedure.

An article from Jack G.Marcil and Nicholas D.Thornton identifies lack of commitment to resolve a dispute and the fact the mediations are ordered by the court as one of the pitfalls of the mediation process⁶⁸. We are in total agreement with these authors. The increase of use of mediation will not come from imposing them on the parties. That only serves to make them more reluctant on the process. For mediation to be seen as a true alternative mean of dispute resolutions we must start by raising awareness of these type of procedures in the parties, highlighting its benefits. In the end the choice of going to mediation to settle a dispute should always be a decision from the parties involved. This matter is of vital importance because its only by creating awareness that will enable us to unburden the Tribunals, allowing for a swift and efficient justice.

Article 6 of the Mediation Law provides that the parties must be treated equally throughout the entire mediation process, whereby it is the mediator's role to

⁶⁸ See JACK G.MARCIL and NICHOLAS D.THORNTON, *Avoiding pitfalls: common reasons for mediation failure and solutions for success*, North Dakota law review 84, 2008, p.2-12. These authors found 15 reasons regarding why mediation isn't successful.

manage the process as far as to guarantee the balance of powers and the possibility for both parties to participate. Although the Mediator had no power to impose anything upon the parties, being a non-deciding neutral, the Mediator must nevertheless manage the process to try and preserve the balance of powers between the parties.

Article 6 of the Mediation Law further provides also that the Mediator must act impartially, and is not an interested party in the mediation.

The principle of confidentiality is present in article 5, containing four different sections on this subject. The first restating that the mediation process is confidential by nature, and that the Mediator must keep confidential all information obtained during the process, not being able to make any use of such information for her or her benefit or for the benefit of others. Section 2 further provides that anything communicated to the Mediator in confidence by one of the parties cannot be communicated to the other parties without the first party's consent.

Article 5 of the Mediation Law however provides a limit to the confidential nature of mediation, namely for reasons of public policy, for the protection of minors, when the physical or psychological integrity of a person is at stake, or for the purpose of enforcing the agreement in court. In Portugal, mediated settlement agreements consist of private agreements signed by the parties to a dispute, and therefore lack the legal effect that would allow them to be directly executed.

The apparent lack of enforceability is one of the biggest hurdles that mediation must still have to overcome in the countries around the world. There's still lack trust in the mediation settlement and people still fear its non-compliance due to its non-executive matter. However, the arguments explained in early chapters contradict this lack of compliance assuring precisely the opposite.

The main argument concerns the fact that since the solution is created by the parties involved it would fit much better their interests, being a "tailor made solution", improving the chances of compliance without the need for enforceability.

This “enforceability barrier” was surpassed by the Portuguese Mediation law which clarifies and sets forth an specific article to guarantee the enforceability of mediated settlement agreements, ending this controversy.

Article 9 of the Mediation Law indeed provides that such settlement agreements are automatically enforceable, without the need for a homologation by a court, if they fulfill certain requirements. The first requirement enabling a mediated settlement agreement to be automatically enforceable is if the law does not require homologation for that type of dispute. The second requirement is that the parties must have legal capacity to execute the settlement agreement. This requirement is consistent with the fact that settlement agreements are private contracts binding the signing parties.

The two following requirements are that the mediation was carried out under the terms provided by law, and that the settlement agreement does not violate public policy. The mediator must also be on the list of mediators managed by the Ministry of Justice. This means that settlement agreements will only be automatically enforceable is the acting mediator is recognized and on the lists of the Ministry of Justice. We consider this specific aspect of our Mediation law one to salute because it helps very much in removing the “lack of enforceability fear”, contributing for reinforcing the trust on the process.

Article 7 of the Mediation Law regards the principle of independence. It provides that the mediator has a duty to safeguard the independence inherent to his or her function, as well as to conduct him or herself with independence, free from any pressure, whether resulting from his or her own interests, personal values or external influences of mediation. No further explanation will be presented on this principle because this is something common to all Mediation laws around the world.

The Mediation Law, in article 8, further sets forth certain provision regarding the competence and responsibility of mediators. It provides that mediators can participate in training in specific skills, both in theory and in practice, in order to acquire the adequate skill set for the exercise of their activity. The Mediation Law refers specifically to courses approved by the Ministry of Justice, but is not limitative.

It is worth noting that there does not seem to be a general requirement to have attended a mediation course, nor to be a certified mediator to do mediations in Portugal.

In what concerns the liability of mediators, article 8 provides that mediators are civilly liable for any damage resulting from the violation of his or her duties in mediation, namely under the terms of the Mediation Law. Among some of these duties, which are listed in article 26 of the Mediation Law, and that are worth mentioning, mediators must refrain from imposing an agreement on the parties, must inform the parties on the nature, objective, fundamental principles and procedural phases of mediation, and abide by the European Commission's European Code of Conduct for Mediators (ECCM).

In conclusion, it suffices to state that from a legal perspective the law 29/2013 of 19 April establishes the general principles applicable to mediation carried out in Portugal, now providing a more complete base of fundamental rights and protections for mediation, mediators and other users.

4.3 Use of mediation in Portugal: The power of habit

Mindset constraints of Portuguese lawyers

One of the major pitfalls that implementation of mediation still faces in Portugal regards the mindset of Portuguese lawyers. Even with the new legal framework created by the Mediation law in 2013 the development of this ADR procedure is still subpar. That is mostly due to the mindset of Portuguese lawyers. Mediation still has a long way to go in our country, particularly in commercial matters.

The reasons for this subpar development and lack of application of mediation as an alternative mean for solving disputes are of various nature. The lack of awareness, of understanding, and of trust, in the process itself as well as in the mediators, are strong hurdles that mediation is still facing nowadays that are chaining

its widespread use. For now, the vast majority of mediations taking place are in the family public mediation system, as well as in the small claims courts, the Julgados de Paz. One of the challenges in order to increase the number of commercial mediations in Portugal will be to educate the users as well as the other legal participants in the process, who still feel threatened by mediation and see it as a way to undermine their activity.

It can be argued that this is a mindset issue. Portuguese lawyers are still viewing mediation services as competition for the services they provide. The universities are still not integrating (most of them), mediation classes and the students are still being taught that the courts are almost the only mean of dispute resolution. To integrate mediation in universities would constitute a major step in raising awareness regarding the uses of mediation as a mean of dispute resolution.

This would also contribute to ease the fear of concurrence that most of lawyers still feel regarding mediation. A lawyer with mediation skills, have no doubt, will be a better lawyer. The idea of training lawyers to develop mediation skills would also have the great consequence of alleviate adversarial litigations and improve the good practices of this profession since mediation teaches to work together in order to find a solution. Not all litigation needs to be adversarial litigation. Unfortunately, there has not yet been the much-needed mentality shift in recognizing mediation as a potential way to satisfy clients in a new manner, thus adapting one's role to what is expected from a modern advisor.

In that sense, Portugal is still heavily traditionalist in its approach to novelty, and overall resists this change fervently. All this hurdles are mostly due to the turbulent birth of mediation in Portugal and its association exclusively to public systems of law. Despite a struggling emergence of mediation as a market, and the difficult recognition by the legal community of mediation as a profession, more and more individuals are being trained in mediation and are joining the Mediator list published by the Ministry of Justice. Hence, the voice of mediation by Mediators is gradually becoming more organized, and Mediators are now seeking how to differentiate themselves from their colleagues and competitors in today's practically non-existent, and yet full of potential, commercial mediation market.

To that end, Mediators are looking towards certifications and accreditations, such as the ones delivered by the International Mediation Institute through local program providers. Their intent is to provide guarantees and assurances to users, primarily to differentiate themselves, but also to show all stakeholders that a new generation of Mediators is growing, one that is trained, prepared and ready to face the demands of the business and legal community. These highly trained mediators are competent not only to solve public system law disputes as private law disputes such as commercial and civil ones.

The mediation market in Portugal is still in its definition stage, the offers in mediation services are slowly becoming more differentiated in terms of area of mediation and style of mediation, although it is still very early to speak about mediation as mainstream or even common in Portugal. Mediation is still by far the exceptional means of resolving commercial disputes, with only a handful of known cases per year that are not in small claims.

As there is no current trend in commercial mediation in Portugal yet, it is also extremely difficult to identify any specific style of mediation as being the most common one in Portugal. Nonetheless, as most of the training provided in Portugal since 2001 was geared primarily towards family mediation, we would say that most.

There is still a long road ahead before all stakeholders in the commercial and in the legal fields recognize mediation as a viable path to a satisfactory dispute resolution mechanism, but progress is slowly being made. The Mediation law surely paved the way for the implementation of mediation that is surely, sooner or later, bound to follow.

The development of mediation in Portugal is much needed due to overburdening of our judicial system. A justice that is not timely done does not deserve to be called justice. The constant delays in reaching an award are starting to put trust in judicial system at stake and people are slowly losing confidence in Courts and are slightly turning to mediation to attend their needs. This mind shift is progressing slowly but we have no doubt that mediation will one day conquer its rightful place among the alternative means of dispute resolution in the Portuguese legal landscape.

4.4 The legal framework of mediation in Portugal: A form of sabotaging mediation implementation?

In this topic, we aim at overviewing the legal framework of mediation in Portugal, focusing on determining whether it favors or weakens mediation implementation. In order for us to totally grasp the “idiosyncrasies” of the actual mediation legal framework, we must, very briefly, approach it’s historical seeds since its dawn.

Back in 2008 precisely, the European Parliament and the Council ended the ten-year preparation of the directive 52/2008/EC. The main goal of this directive was to provide minimum legislative framework to all 27 members of the European Union⁶⁹, and, by doing so, to harmonize the legal status of mediation thorough the union and underscore the increasing role mediation is playing in business relations⁷⁰.

However, even before the transposition of the directive to the Portuguese law, there was already in motion in Portugal the developing of public mediation. The Civil Code, in particular, already contained several provisions designed to encourage settlement between the parties (article 1248°).

Indeed, Law No 78/2001 of 13 July, also called the law of the Julgados de Paz (Justices of the Peace), which entered into force in 2002, provided the legal framework for a public mediation system attached to a small claims procedure. As it has developed, the public mediation system in Portugal is divided into four subsystems: the Justices of the Peace System, the Family Mediation System, the Workplace Mediation System, and the Criminal Mediation System. They have all been in place

⁶⁹ except Denmark. This country has not adopted the Directive.

⁷⁰ . F. PETER PHILIPS, *The European Directive on Commercial Mediation: What it provides and what it doesn't*, Business conflict management LLC. The article is available: http://www.businessconflictmanagement.com/pdf/BCMpress_EUDirective.pdf

since before the enactment of the Directive, and have restrictions as to which cases can be presented before them.

The directive entered into force in May 2008, and Portugal realized that new legislation was needed to fill the gaps in its legal framework for mediation, in order to comply with said directive. As is follows, in the following year Portugal enacted legislation that would, in essence, transpose the Directive. On 29 June 2009, the Portuguese Legislature approved Inventory Law No 29/2009, whose Article 79 modified the Civil Procedure Code (CPC) by adding three articles related to the regulation of mediation: 249-A, 249-C, and 279-A. These articles concerned, in the main, pre-trial mediation and the suspension of prescription terms, the homologation (court confirmation) of agreements obtained in pre-court mediation, confidentiality, and the suspension of court proceedings by the judge.

The implementation of the Directive in Portugal wasn't made in silence. In fact, it came accompanied by a loud choir of criticism. Critics decried the choice to affect the transposition in a text designed primarily for an inventory process rather than to enact a law for the specific purpose of regulating civil and commercial mediation. In their view, increased visibility for ADR mechanisms, sought by many Portuguese practitioners, was thereby denied. Critics also argued that placement of the provisions in the CPC was inappropriate because the existing provisions on settlement through the public mediation system, as noted above, were (and remain) in the Civil Code⁷¹. Our journey through the history pages of mediation implementations finds now its epilogue. We will now shift our focus into analyzing how the legal framework contributes or discourages mediation implementation.

4.5 Overviewing the mediation legal framework

⁷¹ See DÁRIO MOURA VICENTE, *A Directiva sobre a Mediação em Matéria Civil e Comercial e a sua Transposição para a Ordem Jurídica Portuguesa* in ANTÓNIO MENEZES CORDEIRO, JORGE MIRANDA, EDUARDO PAZ FERREIRA, and JOSÉ DUARTE NOGUEIRA, estudos em homenagem ao Professor Paulo de Pitta e Cunha, Vol. III, Almedina 2010.

The starting point is article 5 of the directive. This article of the Directive invites member states to provide a mechanism by which a court may refer a case to mediation for settlement when the court deems it appropriate, taking into account all the circumstances of the case.

The Directive also encourages courts in member states to invite parties to attend information sessions about mediation if they are available⁷². The notion of court referral to mediation is entrenched in article 273° of the Portuguese civil law code (From now on referred as CPC). The Portuguese provision strives to maintain the voluntary nature of mediation by giving the prerogative for each party to oppose its remittance through express notification. In practice, however, citing Ana Maria Gonçalves and Thomas Gaultier, “, the judge acts essentially as a mediator in the pre-mediation phase, informing the parties of the benefits and disadvantages of mediation, as well as about mediation procedure⁷³. The apparent notion of voluntariness can thus be somewhat undermined, since in practice, parties may well be reluctant to oppose the will of a judge ordering them to go to mediation.”. That poses a threat to one of the major set-stones of the Portuguese mediation legal framework: voluntariness.

For avoiding jeopardizing the core principle of voluntariness, judges when ordering a case to mediation must exert extreme care to avoid pressuring parties into mediation. The parties have the right to choose if mediation is the right forum to solve their dispute. Besides, for court referral to mediation to be fully effective and voluntary there is also the mandatory need for full awareness of the characteristics, advantages, disadvantages, of mediation by judges, parties and attorneys.

Even though this issue, the discretionary power of remittance, present on article 273° CPC, still, contributes to enhance the use of mediation. Nevertheless, there are

⁷²European Mediation Directive 2008/52/EC (‘the Directive’), Art 5(1).

⁷³ ANA MARIA GONÇALVES and THOMAS GAULTIER, *EU law and practice*, Oxford university press, chapter 21, 2012.

some steps that must be taken in order to the parties involved and the court to educate itself in order for this referral do mediation to be completely effective.

In the article 273° CPC, the major issue regards the fact that it empowers the judge to remit the dispute to mediation, leaving orphan the clarifying its impact on private mediation.

The article never addresses private mediation in specific. Still, an overview of the different sections of the article strongly suggests its appliance to private mediation systems⁷⁴. The number 2 of the Article states broadly that “notwithstanding the provisions of the preceding paragraph, the parties may, jointly, opt to resolve the dispute through mediation, agreeing to the suspension of the instance in the terms and for the maximum period foreseen in paragraph 4 of the previous article.

The presence of the word “Jointly” in the article leaves open whether it means that both parties need to agree on the use of mediation once the trial has started, or if it is sufficient for one party to ask for mediation and for the other not to oppose it. The majority view, regarding this subject, is that both parties need to consent beforehand and jointly ask for their case to go to mediation. This question is still open for debate in the present day. All this doubts could be easily avoided by a better redaction of this article. The word jointly was indeed a poor choice of words and it raises doubt on an area on which is very important to be clear in order for favoring the implementation of mediation.

4.5.1. Confidentiality

⁷⁴ For an overview on the Portuguese mediation system and legal framework see ANA MARIA GONÇALVES and THOMAS GAULTIER, *EU law and practice*, Oxford university press, chapter 21, 2012.

It is now of vital importance to address the provisions regarding confidentiality. One of the biggest strengths of mediation procedure in comparison with adjudicative procedures is the fact that mediation allows for confidentiality protection. This protection is a key advantage for mediation. Preserving confidentiality during all procedure maintains public confidence in process, allowing for the parties to communicate honestly and openly in the effort to reaching a workable settlement.

The Directive in its article 7 was sensible to these concerns by stating that the mediator cannot be compelled to give evidence in subsequent proceedings between the parties about what took place during mediation⁷⁵. This provision has an important drawback. It only prevents the mediator from being compelled to share information, not the parties. This lack of regulation of the directive allows for the parties to subsequently share the information obtained in mediation process in the court, in arbitration, or even with the press⁷⁶.

Portugal transposed the confidentiality provision of the Directive into one provision, the article 249-C of the CPC (currently revoked by the PML). The article 5° of the PML defines, currently, the principle of confidentiality. This provision definition of confidentiality is much broader than the scope of confidentiality included in the directive, since even the parties are prevented from giving evidence regarding the content of the mediation sessions either in the same case or in any subsequent dispute. This wider scope granted by the Portuguese text is probably due to the need of harmonization with the law of “Justices of peace”, that already demonstrated this wider level of confidentiality.

⁷⁵ The Directive states two possible exceptions to this principle, one based on public policy and the other on the need to implement or enforce the agreement, but there is nothing in the Directive preventing member states from enacting stricter measures to protect the confidentiality of mediation.

⁷⁶ ANGELICA ROSU, *International Regulations Dealing with Alternative Dispute Resolution for International Commercial Disputes*, Danubius University of Galati, 2009

This broad protection of confidentiality, granted by the Portuguese mediation law, is one to salute. However, the law is silent regarding sanctions in case of a breach of confidentiality during or after mediation. This is a major flaw that urges correction.

The lack of existence of sanctions may as well stripe this provision of its applicability. In the next reform of mediation law, we strongly believe that this aspect must be addressed in order to advance further in the implementation process of this NAADR procedure. Unfortunately, a law without sanctions is most of times an inoperative law. Confidentiality is at hearth of any mediation session and people must trust the process will remain confidential, or else, it might crumble. The imposing of sanction in that regard will be much important in reinforcing trusting in the mediation process.

4.5.2. The enforceability of mediation agreements

The enforceability of mediation agreements is the next subject that needs addressing. One of the biggest hypothetically disadvantages of mediation procedures concerns the fact that the reached settlement lacked enforceability. On the contrary, a court award would always be enforceable. The lack of enforceability of the mediation agreement was a major setback for the parties to adopt the process. They would legitimately ask: What will assure me that the other party, which I don't trust at all, will comply with the agreement? Those opposed to mediation have thus raised the question of "How can one party be sure that the other will respect the settlement agreement when a breach of contract is what brought them to mediation in the first place?". The directive strived to end this question on article 6. Article 6 of the directive makes possible for the parties, or one of them with the explicit consent of the other, to request that the content of a written agreement resulting from mediation to be enforceable. In Portugal, article 9 of the PML, regulate the enforcement of the mediation agreement. This provision sets forward the possibility of enforcement of

mediation agreement without the need for judicial homologation which is a major step that contributes greatly for increasing the trust of the parties in the process of mediation.

The second way to make a mediated settlement agreement enforceable, under the light of Portuguese law, is to have it confirmed by a judge, in accordance with article 14º of the PML. The confirmation therefore entails two major aspects. The main issue of this article regards the discretionary power that the court has of refusing the confirmation of the mediation agreement, if it finds it contrary to legislation in force, public order, or even if the parties acted in bad faith etc. (see number 3, article 14, PML).

Both these mechanisms contribute to assure the effectiveness of the mediation process by enhancing the confidence of the parties involved in the mediation process. That happens due to the fact that both parties are not anymore only bound by a mere contractual agreement, which is much easier to breach than a court award. A court award comes from an authority with *ius imperi* which is better assuring, in the parties point of view⁷⁷, at least .

This confirmed mediation agreement will achieve exactly the same public status of a court decision.

The existence of these mechanisms of enforceability, under the light of Portuguese law, we´re indeed a step in moving forward regarding the implementation of mediation in Portugal. However, it must be argued, that mediation empowers parties to find the agreement that better fulfills their underlying interests, which improves very deeply the chances of compliance. The parties feel that the agreement reached comes from them, instead of what happens with a court imposed decision. The mediation agreement is a true “tailor made” solution crafted by the parties. The parties are the true masons of the sculpture, that is the solution, they have unlimited powers to cut its

⁷⁷ Despite that, it must be noted that submitting the mediated agreement to a judge for confirmation, have the important consequence of relinquishing the parties right of confidentiality.

corners and to shape it the way they want. Therefore, complying with the mediated agreement is much probably than with an imposed court solution.

4.5.4 Requirements for parties and lawyers to consider mediation as a dispute resolution option

This analysis of mediation landscape in Portugal would never be complete without addressing the topic of the requirements for parties and lawyers to consider mediation as a dispute resolution option. Article 9 of the Directive provides that member states shall encourage the availability to the general public of information about how to contact mediators and organizations providing mediation services. The states may do so by any means which they consider appropriate, but use of the internet is particularly encouraged.

In Portugal, the articles transposed we're introduced through a law that had little to do with mediation itself. The law did not address the state's involvement in educating practitioners and users about the mediation process. Nevertheless, the Gabinete de resolução alternativa de litígios (GRAL) (Alternative Dispute resolution bureau) does have a comprehensive website describing the mediation process as well as the characteristics of each public mediation system. Thus, even though no significant step was taken in terms of making information on mediation available to the public after the enactment of the Directive, Portugal still fulfils the requirements through this website and through the conferences on mediation and ADR mechanisms in general that are organized by the GRAL.

Also, the Portuguese Bar Association Regulations (Estatuto da ordem dos advogados), provide in article 106° that lawyers have a duty to cooperate, always to the benefit of their respective clients, in order to avoid unnecessary claims. Article 95 of the same regulation provides that lawyers must advise their clients towards a just and

equitable settlement. As it follows, and even though there's no mandatory rule requiring lawyers or parties to consider mediation as an option for dispute resolution, the combined duty of lawyers to seek a just and equitable settlement for the benefit of their clients, as well as the existence of a visible public entity promoting the use of ADR means (and mediation in particular) would in fact fulfil the requirements of the Directive in terms of making information available to users and practitioners.

Since the directive had seen its dawn it never shied away from acknowledging that its main purpose was to increase the use of mediation in Europe. In order for mediation to take a leap forward, there was the need of using compulsory incentives such as sanctions, provided that it doesn't prevent parties from exercising their right of access to the judicial system⁷⁸.

This was the mindset behind the directive. However, Portugal has opted for a voluntary mediation system, without the need for compelling the parties to use mediation. All of the mediation systems in the Portuguese legal framework function on a voluntary basis, and the refusal by one of the parties to participate in mediation simply put an end to the process⁷⁹.

We truly believe that voluntariness is a set stone regarding the mediation process. The imposition of sanctions on the parties to force them to use ADR procedures can, instead of propelling mediation forward, constitute a big step back in its implementation. The parties must be willing to resolve their dispute through mediation, not respecting their will, significantly undermines all mediation process with the risk that they start to see the process as inoperant. To force the parties to choose ADR mechanisms as the right "forum" for their dispute resolution has the long road consequence of making the parties disbelieve in all the process. This is a

⁷⁸ Cf Directive, Recital 14 and Art 5(2).

⁷⁹ An illustration of this can be found in Law 78/2001, Article 55 of the Justices of the Peace law, which provides that withdrawal from the mediation process by the parties is permissible at any time.

consequence of human nature. We are always reluctant in accepting something imposed on us.

The mediation process to work needs the right mindset from the parties, they must be willing to engage in opening dialogue and finding the best settlement that satisfies best their interests.

The lack of this mindset impairs all the process. With this impairing of process comes the conclusion that mediation is not a useful mean of dispute resolution. The parties will always be more keen to blame the process than themselves. For all this reasons we consider that imposing sanctions will not propel mediation forward. We do not align with the ones that claim “Mediation without the use of mechanisms to forcing parties “ is a fantasy”. In the conclusion of this chapter we will provide notes on the right way for mediation to move forward.

Another idiosyncrasy of the Portuguese mediation framework is the fact that there are no provisions for continuing mediator education and training in Portugal.

In the absence of any quality control or recognized national organization for mediators, there are no nationwide codes or standards for mediators. Nevertheless, most mediation training institutions have adopted their own codes of conduct and ethical standards and generally adhere to the ECCM.

The law is silent as to the accreditation requirements for private mediators. Disputing parties for private mediations therefore appear to be free to choose any mediator they wish, regardless of the level of training, experience, or qualification.

Also, no particular steps were taken with regard to mediator (private) duties after the Directive’s entry into force. However, the duties of mediators in the public mediation systems had already been set out by the laws and ordinances implementing these systems. These duties consist of the duties of impartiality, independence, confidentiality, and diligence.

The analysis of the Portugal legal mediation framework comes to its epilogue. It’s now time to present some brief conclusions. Starting by the current state of

development of mediation in Portugal, the statistics (Annex no.7) confirm that since the global crises of 2008, the economic hardship has contribute for the increasing of mediation processes.

The fact that is less costly (Annex no.8) than most of adjudicative means of dispute resolution has attracted new parties to its use. The awareness is also increasing step by step. Portugal have been the stage, since 2008, for a myriad of international conferences regarding mediation. This aspect contributes undoubtedly to raise awareness of its benefits, thus promoting awareness on the Portugal legal community and other participants. In addition, in November of 2011, a non-profit organization, the ICFML—Instituto de Certificacao e Formacao de Mediadores Lusofonos, which offers certification as well as training in mediation—was created. The organization is the qualifying assessment programme in the Portuguese-speaking countries for the IMI, the International Mediation Institute.

The ICFML was created partly to be able to offer private mediators a certification for their skills, if recognized to be in accordance with international standards, but also to reinforce the trust users have in mediation, particularly with regard to the quality of mediation, as per Article 4 of the Directive. With a new way of guaranteeing that mediators, after obtaining this certification, meet strict skill, competence, and experience requirements, users are able to trust the quality of the mediator and of the process even more, and ultimately use it more as well.

Another recent development concerning mediation in Portugal is the communication made by the Bank of Portugal to all financial and credit institutions recommending the use of mediation and arbitration to resolve certain types of consumer disputes⁸⁰.

However, there are some issues that still need discussion and development, particularly the subjection private mediation to the same procedural benefits which public mediation enjoys, particularly in the area of suspension of terms, confidentiality, and enforceability of mediated settlement agreements. The resolution

⁸⁰ Letter (Carta-Circular) no 45/2011/DSC, of 28 July 2011.

of this issues will surely have big results in reinforcing confidence that the parties have in the process of mediation, contributing for it to start to be seen, each day more, as a true alternative for conflict resolution.

The dawn of the Portuguese mediation law, in 2013, by addressing, confidentiality and the enforceability of mediated settlement agreements, constitute only a small step in a much longer process that is still in the starting phase. The need of regulation for civil and commercial mediation is still present. The literature point to the necessity of a 20 years' phase process in order to implement mediation in a country. There are some authors that consider mandatory the implement of compulsory sanctions for aiding this process.

These authors defend that the implementation of mediation without compulsory sanctions is theoretically attractive, but utopic. We respect that stand, but we feel obliged to demonstrate why we disagree with that notion. As stated above, voluntariness is key to all mediation process. It's the fact that parties agree to choose mediation as their form to solve a dispute, that empowers them and the process itself. Mediation depends on the party's willingness to engage in an open dialogue in order to find the settlement that will best fulfill their interests. In the situation where parties went to mediation by obligation, they will not have the right state of mind to make the process fruitful, which will lessen the trust on the process itself. This consequence, instead of propelling mediation forward will, on the opposite, contribute for delaying the implementation of such necessary process.

The way forward to further implementation of mediation in Portugal must start by raising awareness regarding the parties and all involved in the process. This can be made by highlighting the vantages of the process. Since this process is less costly than other adjudicative means of dispute resolutions, it's only natural that the parties slowly start to choose it. What is still missing in Portugal is awareness. For instance, in Universities, only few have mediation as curricular subject. It's only by shaping the minds of the "new lawyers", on the value of mediation, that we will have taken a major step in its implementation. Lawyers must inform their clients on the vantages of the different ADR means at their disposal, and allow them to choose which one is the best

for their interests. We must “sell “better the mediation process, instead of using compulsory sanctions to force the parties into the process.

In addition, we must not haste the process. The process of implantation is slow in its nature as it normally lasts 20 years before full implementation. We must never forget that we are trying to develop mind awareness of this process. This takes time and starts with education. Law Universities need to adopt mediation in their curricular plan. By doing that, we are confident that mediation use will in fact improve in the years to come.

There’s still an oddity in the Portugal legal framework that begs addressing. The fact that Portuguese law recognizes the mediated settlement agreements reached in other member states, without specifying if they are private or public, and that Portugal itself only recognizes public mediation agreements, undermines significantly the use of private mediation, and that’s prejudicial for its development.

The fact that mediation settlements have now the possibility of enforcement, without judicial confirmation, is one to salute. These enforcement prerogatives contribute very deeply to even the balance between mediation and adjudicative means of dispute resolution. However, the Portuguese law demands much discretionary power from the judge, in the case of judicial homologation, due to the fact that the judge can choose whether to confirm or not the agreement. In addition, the fact that the judges may refer parties to mediation, still enforces the value of mediation, in a country that is till shackled by the need of a judicial authority for settling the dispute.

Regarding the standards and accreditation of mediators, the model chosen by Portugal, which relies on the training institutions, does not, set the standards required to maintain and improve the quality and status of mediation, nor to protect users of mediation services. It is especially important to ensure an acceptable level of quality and accountability for mediation. The start could be the creation of common national standards for mediator accreditation, followed by a national mediation accreditation system. It is vital to have a process of formal and public recognition and verification that an individual must meet, and continue to meet, according to specifically defined criteria, which Portugal does not yet have.

This overview on the Portugal mediation legal framework comes to its end. We hope that this analysis helps in showing the aspects that still need to be addressed in order for mediation to take a major leap forward in our country. We can conclude that the directive was, in fact, transposed. However, that's not enough to assure implementation of mediation. There's still much work to do and we truly hope that the suggestions made so far might help in moving mediation forward.

The main goal of this thesis since its first chapter was to prove how NAADR and mediation in specific can be one of the most useful tools for company's good governance. To adopt NAADR within a company's legal framework is to take a major leap forward in assuring that the negative consequences present in chapter II will be significantly avoided. However the advantages of ingraining NAADR in a company's legal environment don't relate only to avoid "corporate suffering". In fact the role of NAADR mechanisms in corporate governance is broader than that. The next chapter of this paper will be dedicated to addressing the macro and micro economic advantages of NAADR as an enhancing factor of good corporate governance. This will be the last chapter of this thesis, nevertheless it is a key chapter of this paper. This paper was constructed around proving NAADR usefulness for business. This last chapter provides compelling economical reason in order for understanding how NAADRA adoption has the power of enhancing the company's overall economic value.

Chapter V.

5. Macro & Micro economic analysis on the advantages of good corporate governance. ADR mechanisms as an enhancing factor.

Corporate governance, a phrase that a decade or two ago meant little to all but a handful of scholars and shareholders, has become a mainstream concern and staple of discussion in corporate boardrooms, academic meetings, and policy circles around the globe. Several events are responsible for the heightened interest in corporate governance.

During the wave of financial crises in 1998 in Russia, Asia, and Brazil, the behavior of the corporate sector affected entire economies, and deficiencies in corporate governance endangered global financial stability. Just a few years later confidence in the corporate sector was sapped by corporate governance scandals in the United States and Europe that triggered some of the largest insolvencies in history. And the most recent financial crisis has seen its share of corporate governance failures in financial institutions and corporations, leading to systemic consequences. In the aftermath of these events, not only has the phrase corporate governance become more of a household term, but also researchers, the corporate world, and policymakers everywhere recognize the potential macroeconomic, distributional and long-term consequences of weak corporate governance systems.

The crises, however, are just manifestations of a number of structural reasons why corporate governance has become more important for economic development and well-being. The private, market-based investment process is much more important for most economies than it used to be, and that process needs to be underpinned by good corporate governance. With firms increasing in size and the role of financial intermediaries and institutional investors growing, the mobilization of capital is increasingly one step removed from the principal-owner.

At the same time, the allocation of capital has become more complex as investment choices have widened with the opening up and liberalization of financial and real markets, and as structural reforms, including price deregulation and increased competition, have increased companies' exposure to market forces risks. At the same time, the recent financial crisis has reinforced how failures in corporate governance can ruin corporations and adversely affect whole economies. These developments have made the monitoring of the use of capital more complex in many ways, enhancing the need for good corporate governance.

For the purposes of this thesis one must proceed to analyze thoroughly the Macro and Micro economic benefits of adopting good corporate governance practices. In the end of this analysis will be explained the importance of NAADR procedures as an enhancing factor of economic growth (macro-economic level) and as a big plus for improving a company performance (micro- economic level), by making it more profitable.

Academics and Corporate governance experts have long tried to identify and empirically prove that there is a link between good corporate governance practices and the success of the firms. To prove causality between good corporate governance and the firm's success is an impossible task, at least based on the data collected till today. However, correlation had already been implied in several studies, that shall be now approached. The empirical data collected showed that good corporate governance leads in most cases to economic tangible benefits.

One of the biggest benchmarks of asserting good corporate governance is to resolve every kind of dispute that rises in a company within its walls, evading the consequences of a full blown dispute that evolves into a "corporate scandal". In previous chapters this topic was addressed very thoroughly and the worst economic consequences are normally the decrease of shareholder value and bad company performance results, which has the consequence of scaring future investors. It's never enough to state that good solve disputes systems are inherent to exert good corporate governance and good corporate governance comes several times with economic

benefits. In this chapter, we review a recent survey on corporate governance⁸¹, with a special focus on emerging markets. It finds that better corporate governance benefit firms through greater access to financing, lower cost of capital, better performance, and more favorable treatment of all stakeholders.

5.1 Better access to financing

Starting by the advantages regarding greater access to financing, the role of legal foundations for financial and general development is well understood and documented⁸². Evidence also shows that voluntary and market corporate governance mechanisms have less effect when a country's governance system is weak. Legal foundations matter crucially for a variety of factors that lead to higher economic growth, including financial market development⁸³, external financing, and the quality of investment.

A good legal and judicial system is also important for assuring the benefits of economic development that are shared by many. Legal foundations include property

⁸¹ STIJN CLAESSENS and B.BURCIN YURTOGLU, *corporate governance in emerging markets: a survey*, emerging markets review 15, June 2013.

⁸² See THORSTEN BECK and ROSS LEVINE, *Legal institutions and financial development*, Springer Berlin Heidelberg, 2008, p. 251-278. For further development see also ASLI DEMIRGUÇ-KUNT and VOJISLAV MAKSIMOVIC, *Law, finance, and firm growth*, the Journal of finance.53, 1998 December, p. 2107-2137 and ANG, J.B, *A survey of recent developments in the literature of finance and growth*", Journal of Economic Surveys 22, 2008, p.536–576.

⁸³ For further development see RAGHURAM G. RAJAN and LUIGI ZINGALES, *Financial Dependence and Growth*, the American economic review 88, June 1998, p. 559-586.

rights that are clearly defined and enforced and other key rules (disclosure, accounting, regulation and supervision). Comparative corporate governance research documenting these patterns took off following La Porta et al.,⁸⁴ These two pivotal papers emphasized the importance of law and legal enforcement for the governance of firms, development of markets, and economic growth. Numerous following studies have documented institutional differences relevant for financial markets and other aspects. Many other papers have since shown the link between legal institutions and financial development⁸⁵.

Studies have established that the development of a country's financial markets relates to these institutional characteristics and that these characteristics can directly affect growth. Beck and Ross Levine in their article "Finances and sources of growth", for the Journal of financial and economics document how the quality of a country's legal system not only influences its financial development but also has a separate, additional effect on economic growth

In addition, there is also evidence on the importance of the cost of capital channel, both for equity and debt financing (Chen et al.)⁸⁶. Moreover, Ashbaugh-Skaife report

⁸⁴ See R. LA PORTA, F. LOPEZ-DE-SILANES, A. SHLEIFER and R. VISHNY, *The quality of government*, the journal of law, economics and organization, Oxford academic, March 1999, p. 222-279. For further development on this topic see also GLAESER, E.L, LA PORTA, and LOPEZ-DE-SILANES, *Do institutions cause growth*, Journal of Economic Growth, 2004: p. 271. For better understanding see R. LA PORTA, LOPEZ-DE-SILANES, A.SHLEIFER, and R. VISHNY, *Corporate ownership around the world*, The Journal of Finance 59, p. 471-517.

⁸⁵ For reviewing purposes see THORSTEN BECK and ASLI DEMIRGUÇ-KUNT, *Law and firms' access to finance*, American Law and Economics Review 7, 2005, p. 211-252.

⁸⁶ KEVIN C.W.CHEN, ZHIHONG CHEN and K.C JOHN WEI, *Legal protection of investors, corporate governance, and the cost of equity capital*, journal of Corporate Finance 15, 2009, p.273-282. The findings of Chen et al., pointed to the conclusion that U.S. firms with better corporate governance have a lower cost of equity capital after controlling for risk and other factors, with effects

that firms with a higher degree of accounting transparency, more independent audit committees and more institutional ownership have a lower cost of capital, whereas firms with more blockholders have a higher cost⁸⁷. For example, regarding accounting transparency, imagine that an accountability manager made a mistake and fears the reaction of the supervisor and the consequences it might have on the continuity of the job, the reaction of the accountability manager might be to try and hide the mistake. The problem is that the mistake is probably going to be discovered in a subsequent auditing. If that's the case it's the Company's transparency that suffers the consequences. A firm with better accounting transparency is attractive for investors and permits access to lower cost of capital. The implementation of NAADR procedures ingrained on a company level fosters the honest dialogue and disclosure of information. In the case presented by telling the supervisor that he made a mistake, the entire problem could be solved. That is the power of NAADR procedures as an enhancing factor. Mediation as procedure that promotes honest dialogue and disclosure of information improves the channels of communication on a company, contributing for its health functioning.

Hail and Leuz⁸⁸ showed how legal institutions affect the cost of equity. Moreover, sound corporate governance has been shown to lower the cost of debt for US⁸⁹ firms .

stronger for firms that have more severe agency problems and face greater threats from hostile takeovers. For further development see KEVIN C.W.CHEN, ZHIHONG CHEN and K.C JOHN WEI , *Agency costs of free cash flows and the effect of shareholder rights on the implied cost of capital*, Journal, of Financial and Quantitative Analysis 46, 2011,p. 171–207.

⁸⁷ H.ASHBAUGH-SKAIFFE, DANIEL W. COLLINS and RYAN LAFONDE, *Corporate governance and the cost of equity capital*, October 2004

⁸⁸ . These authors make a direct relation between the cost of equity capital and the legal framework of Institutions and securities regulation. For further development on this topic see LUZI HAIL and CHRISTIAN LEUZ , *International differences in the cost of equity capital: do legal institutions and securities regulation matter?*, Journal of Accounting Research 44, 2006, P. 485–531.

Laeven and Majnoni find that better higher judicial efficiency⁹⁰ and enforcement of debt contracts are critical to lowering intermediation costs for a large cross-section of countries. On this topic, the value of NAADR schemes concerns the subsequent effect of unburden the judicial system, increasing its efficiency and the trust of financial institutions regarding the enforcement of debt contracts which leads for less intermediation costs charged.

The main conclusion one must highlight here, is that good corporate governance is ought to attract investors, due to lesser cost of capital (cost of equity), facilitating greater access to financing for companies. Investors are driven towards stability. NAADR mechanisms, by allowing conflict resolution within the company, allows for more stability and better protection of a company image by avoiding the consequences of a corporate scandal. NAADR mechanisms, in this perspective can add value for a company .The better access to financing is merely a drop in the ocean of economic vantages that come from healthy corporate governance. Another great economic benefit concerns **higher firm evaluation and better operational performance**

5.2.Higher firm evaluation

⁸⁹ The findings are present in RONALD C.ANDERSON,SATTAR MANSI and DAVID M.REEB., *Board characteristics, accounting report integrity, and the cost of debt*, Journal of Accounting and Economics 37, 2004 p. 315–342.

⁹⁰ · See LUC LAEVEN.,GIOVANNI MAJNONI, *Does judicial efficiency lower the cost of credit?*, Journal of Banking & Finance.29, 2005, p.1791–1812.

The quality of the corporate governance framework affects not only the access to and the amount of external financing, but also the cost of capital and firm valuation. Outsiders are less willing to provide financing and are more likely to charge higher rates if they are less assured that they will get an adequate rate of return. Conflicts between small and large controlling shareholders, arising from a divergence between cash-flow and voting rights, are greater in weaker corporate governance settings, implying that smaller investors are receiving too little of the returns the firm makes. This bad consequence can be avoided by having an NAADR scheme implemented in the company that allows for fast and swift conflict resolution without undermining the company performance.

5.3. Better overall firm performance

Good corporate governance can also add value by improving firm performance, through more efficient management, better asset allocation, better labor policies, and other efficiency improvements.

The country and firm level studies suggest that better corporate governance improves market valuations. Two forces are at work here. First, better governance practices can be expected to improve the efficiency of firms' investment decisions, thus improve the companies' future cash flows which can be distributed to shareholders. The second channel works through a reduction of the cost of capital which is used to discount the expected cash flows. Better corporate governance reduces agency risk and the likelihood of minority shareholders' expropriation and possibly leads to higher dividends, making minority rights shareholders more willing to provide external financing. There are also empirical studies that analyze operating performance rather than valuation, reporting in general positive effects when agency issues are less⁹¹.

⁹¹ For empirical data see JEFFREY WURGLER, *Financial markets and the allocation of capital*, Journal of Financial Economics 58, 2000, p. 187–214.

We consider in this thesis that NAADR schemes implementation is a great solution to minimize the agency costs that come from a conflict within a company. The faster and efficiently conflicts are handled the less resource consuming they are. Subsequently, fewer agency costs will undermine the company overall performance. One must also state that implementing NAADR schemes in a company contributes for the development of communication skills of all its members.

The ADR mechanisms, negotiation based ones, are founded in dialogue. Dialogue, in mediation for example, becomes the major tool in solving disputes. The implementation of NAADR schemes in a company fosters the communication channels, which allows for better flow of information, contributing for the optimization of decision making processes which can improve the company overall performance.

There is also other great economic vantage of good corporate governance that demands its addressing in this chapter: less volatile stock prices.

5.4.Less volatile stock prices

There is empirical data that supports the statement that the quality of corporate governance can also affect firms behavior in times of economic shocks and contribute to the occurrence of financial distress, with economy-wide impacts. Poor corporate governance truly has economy-wide effects. In the early 2000s the argument was made that in developed countries corporate collapses (like Enron), undue profit boosting , managerial corporate looting , audit fraud and inflated reports of stock performance (by supposedly independent investment analysts) led to crises of confidence among investors, leading to the declines in stock market valuation and other economy-wide effects, including some slowdowns in economic growth.

Evidence from financial crises suggests as well that weaknesses in corporate governance of financial and non-financial institutions can affect stock return

distributions. Consistently, Bae et al.,⁹² find that during the 1997 Asian financial crisis, firms with weaker corporate governance experience a larger drop in their share values, but during the post-crisis recovery period, such firms experience a larger rebound in their share values. And during the recent financial crisis, firms that had better internal corporate governance tend to have higher rates of return (Cornett et al.,)⁹³.

Importantly, in the recent financial crisis, corporate governance failures at major financial institutions, such as Lehman and AIG, contributed to the global financial turmoil and subsequent recessions. While this is more anecdotal evidence, it is clear that corporate governance deficiencies can carry a discount, either specific to particular firms or for markets as whole, in developed as well as developing countries, and even lead to financial crises. As such, poor corporate governance practices can pose a negative externality on the economy as a whole. There are macro-economic effects that emerge from bad corporate governance. Quoting Arthur Levitt, former chairman of the US Securities & Exchange Commission “If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country suffer the consequences⁹⁴. ” Economic growth is a key

⁹² KEE-HONG BAE, JAE-SEUNG BAEK, JUN-KOO KANG and WEI-LIN LIU, *Do controlling shareholders' expropriation incentives imply a link between corporate governance and firm value? Theory and evidence*. Journal of Financial Economics 105, August 2012.

⁹³ For empirical evidence see MARCIA M. CORNETT, JAMIE J. MCNUTT, HASSAN TEHRANIAN, *The financial crisis, internal corporate governance, and the performance of publicly traded U.S. bank holding companies*, January 22, 2009.

⁹⁴ This quote was drawn from the speech of Chairman Arthur Levitt in the conference “Corporate Governance in a Global Arena”, that took place in 1999, October 7.

factor on analyzing the economic development of a country. The external investment is a major factor in helping an economy to grow.

Good corporate governance contributes to strength the confidence of investors. The implementation of NAADR schemes on a company level, with the focus on mediation and other negotiation forms of dispute resolution, will undoubtedly contribute in larger scale for good corporate governance. As explained before, investor value stability. The resigning of directors is normally is an important factor that has the potential to drive investors away.

5.5.Favorable treatment of stakeholders

In addition, we should never forget about the fact that the principal owner and management, public and private corporations must deal with many other stakeholders, including banks, bondholders, labor, and local and national governments. Each of these monitor, discipline, motivate, and affect the management and the firm in various ways. They do so in exchange for some control and cash flow rights, which relate to each stakeholders' own comparative advantage, legal forms of influence, and form of contracts.

Commercial banks, for example, have a greater amount of inside knowledge, as they typically have a continued relationship with the firm. Formal influence of commercial banks may derive from the covenants banks impose on the firm: for example, in terms of dividend policies, or requirements for approval of large investments, mergers and acquisitions, and other large undertakings.

Furthermore, lenders have legal rights of a state-contingent nature. In case of financial distress, they acquire control rights and even ownership rights in case of bankruptcy, as defined by the country's laws.

Debt and debt structure can be important disciplining factors, as they can limit free cash flow and thereby reduce private benefits. Trade finance can have a special role, as it will be a short-maturity claim, with perhaps some specific collateral.

Suppliers can have particular insights into the operation of the firm, as they are more aware of the economic and financial prospects of the industry.

There is also the so called “market for senior management”, where poorly performing CEOs and other senior managers get fired or good performing managers leave weakly performing corporations, that exerts some discipline on poor performance. It is hard to give a definitive answer as to whether and which forms of stakeholders' involvement are good for a corporation as a whole, let alone whether they are socially and economically optimal.

There are many aspects of stakeholders' involvement, with various consequences – for firm performance, value added, risk taking, environmental performance, etc. – and the overall net benefits are often unclear given current state of research. Even if this question is still nowadays left unresolved, there is little doubt that a corporate scandal will impair very much the relation with outside stakeholders, diminishing their confidence in the company's good performing. This lack of trust would ultimately lead, in the case of banks, for instance, to greater difficulty regarding financial access. In a simple way, distrust is never good for business.

The advantages of adopting good corporate governance have also effects within the company (micro-economic), contributing for increasing the firms overall economic value by:

1. Improving access to capital and financial markets
2. Help to survive in an increasingly competitive environment through mergers, acquisitions, partnerships, and risk reduction through asset diversification
3. Provide an exit policy and ensure a smooth inter-generational transfer of wealth and divestment of family assets, as well as reducing the chance for conflicts of interest to arise (very important for the investors).
4. Better system of internal control, thus leading to greater accountability and better profit margins.
5. Good Corporate governance practices can pave the way for possible future growth, diversification, or a sale, including the ability to attract equity investors

nationally and from abroad – as well as reduce the cost of loans/credit for corporations

6. Better management
7. Higher level of transparency
8. Stakeholder Benefits
9. Reputation and Recognition
10. Reduces Wastage
11. Reduce Risks, Mismanagement and Corruption

Better management

If a company is practicing corporate governance, people not linked to the firm will also be able to assess its governance. This is because the most fundamental principle of corporate governance is transparency and the principles of disclosure. Every step taken by company authorities, having control over the company's management, is in the best interests of the company and its stakeholders. This has a positive impact on the community and may reflect upon the market valuation

Higher level of transparency

¹⁰³. Companies that follow a set of best practices are encouraged to be highly transparent about their business. This helps them attain the trust of the community and its stakeholders and eases the task of raising capital, when needed. As the business is easy to assess and evaluate due to its high level of transparency, many investors and financial institutions prefer funding these companies than those that are not following the core principles of corporate governance.

Stakeholder's benefits

¹⁰⁴. Under corporate governance, a firm tends to act in the best interest of the firm and its stakeholders. This will ensure greater success as the goal of the company managers will now be aligned with the goals of the company. The result of this will be greater profits and faster growth which will benefit the company and all the stakeholders.

Reputation and recognition

The practice of good corporate governance followed by firms will allow them to gain the trust of the investors, the customers and the community at large. This will have a positive impact on the company's reputation and it will be recognized as a fair and transparent company. This image will help the company prosper in the long run and achieve its goals more quickly.

Reduces wastage

Good practices of corporate governance help companies become more efficient in their business. Employees that are trained to follow ethical business practices will avoid excess wastage of company resources will tend to utilize all resources optimally.

Reduce Risks, Mismanagement and Corruption

A company can reduce the amount of risks in their business as well as any attempts of corruption and mismanagement by following the practices of good governance. Due to the amount of transparency necessary in companies that follow the principles of good governance, many individuals intending to misuse their position and power will be unable to do so. This will reduce the overall incidences of negative acts in the company and help it achieve success and a positive image in the community.

Conclusion

This thesis finds now its epilogue. The task we set us upon on writing about this topic proved very challenging but it's nevertheless concluded. The main goal of this thesis was to prove the utility of NAADR procedures for corporate governance and we hope that this goal was achieved.

A company following good corporate governance practices will be able to achieve the trust of the community and hence, success in the long run. A firm's good reputation ensures a good flow of capital by attracting investors.

In countries such as the U.S.A and United Kingdom there are established an agglomerate of corporate governance principles which reflects their deep understanding and development on the corporate governance area. In Portugal there are no set of principles applied to corporate governance which translates into lack of awareness regarding its importance for the Portuguese economy.

The implementation of NAADR mechanisms, even with reserves on considering them as an economic vantage by itself, at minimum level, it contributes to at least enhance most of the factors that dictate a good company performance. This happens not only due to the fact it enables avoiding all the pernicious effects of a corporate scandal for the firms image and performance, but also due to the creation of the right environment for decision making, increasing the flow of information, by harnessing the constructive potential that a conflict has in the company level, allowing better decision making. The fact that NAADR mechanisms are less costly, less time and resource consuming coupled with the possibility of a "taylor made" settlement that fulfills both parties interests, make them very suitable for the business world.

At the level of the firm, the importance of corporate governance for access to financing, cost of capital, valuation, and performance has been documented for many countries and using various methodologies. Better corporate governance leads to

higher returns on equity and greater efficiency. All good corporate governance must include a swift conflict resolution system that can function optimally without undermining the company's performance.

The advantages of using NAADR mechanisms, especially mediation or other negotiation procedures, are superior of not having these mechanisms. Even with founded reserves on considering them a direct economic vantage it's hard to refute its potential on the enhancing of all the factors that contribute to make a company more profitable. The advantages regarding the procedure itself, we early explained, coupled with this economic vantages makes NAADR one of the most optimal and reliable form of dispute resolution in the company level.

Also, judicial efficiency is a criterion for investors to choose a country for their endeavors. The implementation of NADR procedures will contribute undoubtedly for the unburdening of the judicial systems, allowing for increasing its efficiency, with the important consequence of strengthen the trust of investors in the country legal framework.

The implementation and development of NAADRA procedures will also contribute in the future for a new form of legal sustainability where the intervention of Courts would only be triggered as last resort. The literature often characterizes mediation by being a procedure that enables win-win solutions. We finish this thesis on the same note. The implementation of NAADR procedures at the company level will contribute not only for the unburdening of the judicial system as well for adding economic value for a firm. A firm that shows good performance is ought to attract more investors. More investors help economies to grow. It is definitely and by all means a win-win situation without any foreseeable drawbacks. The gains in efficiency regarding conflict resolution in corporate governance are exponential at minimum costs which makes the option of not ingraining them in the company's legal framework a bad business decision. Every business decision strives at gaining the most and spending the less. That's exactly the ultimate offer of NAADRA for corporations.

Annexes

Annex No.1

Survey CEDR and the IFC Corporate Governance Group in 2013

In 2013, CEDR and the IFC Corporate Governance Group conducted a global survey of 191 directors and board members to learn about their experiences with and attitudes toward boardroom disputes. The results show the significant effects that boardroom disputes can have on an organization, and the challenges that individual members of those boards find in attempting to resolve them. The results we're the following:

- A sizeable portion (29.6 percent) of respondents have experienced a boardroom dispute affecting the survival of an organization.
- 42.8 percent of respondents report that conflict reduced the level of trust among board members.
- The most common subject matter of disputes is “financial, structural, or procedural workings of the organization,” closely followed by the “personal behavior and attitudes of directors.”
- Disputes are most commonly resolved through internal negotiation (61.2 percent) or internal mediation (25.2 percent).
- A significant proportion of respondents (67.2 percent) report that they have encountered unresolved issues; 15.6 percent report that conflicts are not resolved “frequently,” and another 11.0 percent report that the issues are resolved “frequently” by “avoiding the conflict and letting it pass.”
- Respondents say that the most frequent complicating factor in resolving disputes are “issues regarding handling the emotions of those involved,” and this was the second-most difficult factor to deal with after issues over “competing factions on the board.”

- Respondents are extremely eager for training in dealing with personal factors, with 74.8 percent describing training in the “ability to deal with different personalities” as very useful.
- A gender difference emerged regarding which skills respondents desired: women are far more interested in receiving training in negotiation skills, while men are more keen to receive training in how to deal with different personalities.

Source: CEDR, *Boardroom disputes: how to manage the good, weather the bad and prevent the ugly*, IFC corporate governance knowledge publication, 2014, p. 4-6

Annex No. 2

Handbook guide for directors

The following guidelines are presented with the ultimate goal of helping directors to prevent and manage corporate governance conflicts.

1. Clarify the roles of management and the board.
2. Establish orderly board processes.
3. Ensure the proper flow of information.
4. Encourage a board culture that allows for effective discussions, debates, and deliberations.
5. Step out of the boardroom to gain new perspectives.
6. Apply dispute resolution skills and techniques.
7. Incorporate ADR into the company’s culture and practices.

Each of these steps will be approached separately and explained briefly

1. Clarify the roles of management and the board

Clarifying the roles of the board and management is crucial to preventing disputes. Failure to understand and articulate these different roles invites disputes and impairs the board’s effectiveness. The board also should establish committee charters that clearly define the committee’s jurisdictions and responsibilities. It is especially detrimental for boards or board committees to extend their roles into management’s purview, for example, when the audit committee begins to redo the financial statements or conduct its own audit.

Similarly, management must understand its role and that of the board; otherwise, board meetings can become consumed by routine or irrelevant matters that management should be dealing with. Also, gaps can develop in areas that the board believes are part of management's responsibility but management assumes the board is handling. For example, the board establishes how much expenditure the CEO can authorize without requesting board approval, and it cannot permit ambiguity in that area; doing so would create room for constant friction between the board and the CEO.

The board's role does not include running the company. The board hires people for day-to-day management, oversees and monitors management and corporate activities, reviews and approves (or disapproves) key strategies and policies, and acts on significant matters after having fully informed itself.

2. Establish orderly board processes

In what concerns the board organization it is clear that, at a minimum, good board organization should include routines for information flow both to and within the board, preparation of materials in advance of meetings, and an orderly environment in which the board can conduct its business. The following are some good practices for preparing board meetings:

- **The agenda and its content.** A carefully constructed agenda determines the issues under discussion and ensures a basic order to meetings. The agenda is generally put together by the chair and the corporate secretary, with input from the CEO. Any director can request that the chair include a matter on the agenda.

A problem for many boards is having directors overwhelmed with mundane and administrative issues, which leaves too little time for substantive discussions on matters of strategic importance. This imbalance breeds resentment among directors, who feel that they cannot fully perform their duties and participate in critical decision making. Agendas should strike a balance between reviews of past performance and forward-looking issues. Strategic issues require ample time for debate, so the agenda should allocate sufficient discussion time. The agenda should show the amount of time allocated for each item, and it should limit the number of items, so the board will have sufficient time for deliberations on each one.

- **The agenda annual calendar.** To keep the "peaks" and "troughs" of a board's business within reasonable limits, many boards develop an agenda annual calendar. This allows sufficient time for specific issues during meetings throughout the year. Certain items will need

to be fixed according to the financial reporting cycle, but less time-specific topics can be included on the board agendas when there are fewer items to discuss.

- **Board meeting frequency.** Typically, 6 to 10 board meetings per year will be sufficient, particularly when committees meet between board sessions
- **Board meeting duration.** The length of meetings should be tailored to the issues requiring board consideration. Ideally, board meetings should last no more than four hours and conclude with lunch or dinner, so members can continue more informal conversations
- **Minutes.** Minutes record what actually happened at a meeting in the order in which it happened, regardless of whether the meeting followed the written agenda. Minutes also serve as important reminders of action to be taken between meetings. Aim to keep them short and to the point, usually not more than four pages.

At a minimum, the minutes must contain 1) meeting location and date, 2) names of attendees and absentees, 3) principal points arising during discussion, and 4) board decisions. Include dissenting members' views in board meeting minutes to show that all positions have been heard and that the board values open discussions.

- **Meetings of non-executives.** Many companies with unitary boards have developed the practice of regularly scheduling so-called "executive meetings" of the nonexecutive directors. The purpose is to provide nonexecutive directors a chance to voice any suggestions or concerns about the functioning of the board or discuss any other board matters without the presence and possible influence of other directors. An effective way to avoid the feeling that "an executive session means bad news" is for the board chair to routinely put executive sessions on every agenda, or on four agendas per year.

3. Ensure the proper flow of information

Directors have a fiduciary duty to make decisions after considering all material information that is reasonably available. A board's well-constructed information system supports a healthy bond between the board and management. It helps ensure that the board has the basic facts necessary for a healthy discussion and debate. Typically, boards need two kinds of information:

- On-going information contributes to the board's oversight and monitoring of the company and its business. For ongoing information flows, boards and management should:

- Agree on certain performance indicators that give management and the board a snapshot of how the business is doing and the outlook for the short, medium, and long terms;
 - Determine frequency of reports with performance and risk indicators and their publication format; and
 - Determine other informational materials (such as press releases, certain regulatory filings or reports by investment analysts on the industry or company itself) that the board may want to receive regularly.
- Specific information —for proposals and actions— helps directors understand and evaluate proposals for board action so they can make knowledgeable decisions.

The specific information is one of the most important kind of information due to its decision-nature. It is of vital importance that the board materials (briefing papers) are summarized and formatted to allow board members to readily grasp and focus on the most significant issues in preparation for the board meeting. Briefing papers to realize its function must be short, concise, and material. Board papers associated with a particular agenda item need not be more than four to six pages, with any further detail provided in annexes. The briefing papers must also be focused and action-oriented. The papers should present the issue for discussion, evaluate the risks of each identified alternative, offer solutions for how to effectively address the issue, and provide management's view on which action to take. It should be clear what is required from the directors. Is this a matter for decision, for information only or to be noted (if exercised within existing CEO/management authority)? Finally, they must be timely distributed. Information should be distributed, preferably in the hands of directors, at least five business days in advance. This allows board members particularly non-executive directors, who are not as familiar with the business as executive directors are to fully consider the issues before the meeting.

4. Encourage a board culture that allows for effective discussions, debates, and deliberations

Sometimes impediments to discussion involve structural and organizational issues. Constructive inquiry, discussion, debate, and decision making require a conscious effort. When the board environment is comfortable and the tone encourages creative problem solving, people will challenge assumptions, ask probing questions, and make suggestions that contribute to innovation and informed decision making. To support the kind of environment that prevents

disputes and promotes effective deliberations, boards must develop a boardroom culture based on collegiality and civility.

Collegiality promotes respect for one another and for each member's ability to express views, regardless of whether anyone else embraces those views. It permits participants to be more open to new ideas, rather than being defensive of their own conclusions. In reality, a board is a group of people each with an equal vote in the decision-making process. A democratic environment should prevail which means no one person should rule. The environment should foster flexibility and collaborative thinking, and it should encourage directors to hear different views, argue the merits, and ultimately arrive at a consensus.

Civility complements collegiality. Civility involves adherence to certain manners and practices for interaction among individuals. A civil environment does not preclude animated debate, deeply held beliefs, emotional speech and action, or passionate convictions. But it does mean that the board will not tolerate personal attacks or behavior designed to embarrass another person. A lack of civility can too easily trigger antipathy and anger, thus inhibiting free discussion and debate. Lack of civility also can lead to destructive interpersonal relationships and, in the process, create an additional layer of emotional content that will have to be addressed if disputes are to be resolved.

Civility is especially important as boards become more diverse. Diversity facilitates creative problem solving and provides exposure to a wide range of perspectives, yet diversity without civility can produce misunderstandings and disagreements based on cultural and other differences.

However, heavy preoccupation with civility can create its own problems. When people become overly concerned about avoiding confrontation or embarrassment, thinking they are being civil, they sometimes do not address matters directly, or they avoid discussing certain issues. Directors' personalities also can affect the board culture in ways that may stifle debate. Obviously, a domineering director needs to be reined in, but it is also important to establish a culture that draws out directors who are shy about speaking up. The following are some examples of personal inhibitions that may keep people from openly expressing their ideas:

- Discomfort about appearing to be the sole objector
- Concerns about appearing to be noncollegial, or not being a team player
- Reluctance to challenge the CEO or another dominant personality on the board
- Tendency to avoid issues that are emotionally sensitive

- Fear of appearing ignorant or uninformed
- Peer pressure
- “Groupthink”—where people conform their views to what they believe is the group’s consensus rather than engaging in debate on the problems or issues that must be confronted
- A director who, for any reason, feels inhibited about speaking up will become frustrated. Frustration easily festers and becomes anger, creating dissonance and dysfunction among directors.

The composition of the board can directly affect its collegiality and civility. This makes the nomination of directors a critical factor in establishing the culture of the board. To promote a collegial environment that facilitates the board’s work, a board and especially its nomination committee should:

- Encourage directors to meet with potential directors before they are nominated, and to weigh in on the nomination process. For example, the non-executive directors (NED) would individually meet with the proposed new NED and the entire board will have an audience with a proposed executive director;
- Perform thorough background investigations of potential directors, and obtain as much information as possible on how the potential directors have functioned in group decision making settings;
- Avoid nominating people who are reputed to argue for argument’s sake;
- Avoid nominating people who, because they are fearful of making decisions, prolong debate and resist developing collaborative solutions; and
- Make sure the board has at least some people with skills and training in conflict resolution, consensus building, negotiation, and mediation.

5. Step out of the boardroom to gain new perspectives

Governing a company is a demanding exercise, and board meetings can become consumed by urgent issues of the day. An effective way to put it all into perspective is to step out of the confines of the boardroom. Doing so provides opportunities for directors to accomplish important objectives, such as get to know each other in less formal settings, evaluate board performance and needs, focus on strategic development of the company, build consensus, and

resolve emerging disagreements before they can become problems. The completion of such objectives is of great relevance especially because effective debates and deliberations require a certain level of familiarity and trust among board directors. Boards need to ensure that opportunities exist for directors to know one another in informal, comfortable surroundings. The following are some useful practices that should help Directors create the level of familiarity needed for better decision making procedures:

- Arranging a dinner for all directors before each board meeting is a great way to create and strengthen those bonds of familiarity that help in creating the right environment for discussion. Moreover, constitutes great practice for the CEO to meet over a meal at least once annually with each director to hear thoughts and ideas that the director has about the company, management, and the CEO's performance.
- In addition, board assessments and retreats provide excellent platforms for identifying interests, surfacing issues, promoting discussion, and facilitating collaborative decision making. In many companies, these processes have become standard practice and thus fit neatly into the board calendar of activities and also offer the opportunity for the board to meet with not just the executive directors but other senior management. In a board assessment, the main objective is to elicit each board member's candid views about how the board operates and its effectiveness as a group. Typically, the assessment involves either a written survey or a confidential interview of each board member, often conducted by the chair, lead director, or an external advisor. Regardless of the format, the key to a successful evaluation is to create an environment in which respondents will be candid. They must be assured that their responses cannot be attributed to them and that they will not be personally embarrassed in front of the whole board by what anyone else in the group may say about them. However, it is well known that people have a natural inclination to resist evaluation. One technique for reducing this resistance is to recast assessments as performance improvement plans. These plans emphasize that the objective of the exercise is to improve performance rather than to criticize performance or behavior. Treating reviews as a forward-looking planning process, rather than a backward-looking critique, may invite a more goal-oriented and positive attitude toward the process.
- Board retreats are the next step following a board assessment. In fact, board assessments are not self-executing. Once the assessment surfaces and identifies issues of concern, it's time for the board retreat. The retreat becomes a venue for group discussion of the assessment results and formulation of action plans by which disagreement and disputes can be resolved. Board retreats focus on important matters in a setting that does not have the time pressures or other distractions involved in regular board meetings with their typically lengthy agendas. Generally, participants identify common concerns early in the process. With a clear focus on the corporate vision and mission, they analyze options, prioritize interests, and formulate strategies. The outcomes include agreements on future priorities and increased

focus within the board. To help make board retreats more effective, the board can call on an external expert or facilitator. This neutral or impartial third party brings objectivity to the process, giving all participants assurances that the proceedings are not skewed for or against one position or another. This can be a welcome change from regular board meetings. For example, if one or two strong personalities are allowed to dominate on the board, a good facilitator may ensure that dissenting opinions are at least fully heard during assessments and retreats.

- A skillful facilitator can identify, with the full group's affirmation, issues in dispute and issues that have been resolved. This process permits a collaborative resolution to matters in dispute. As points are resolved, a written record memorializes the consensus derived.

6. Apply dispute resolution skills and techniques

Applying dispute resolution techniques, “borrowed” from negotiation and mediation are very useful in creating the desired collegial environment to encourage discussion, debate, and the free flow of ideas. They also can help boards develop an orderly process for decision making and consensus formation on specific issues the board has to contend with, which in turn improves the board's all-around performance. Chief among these skills are effective communication, respect for cultural sensitivities, consensus building, managing emotions, and constructive disagreement. These are all soft skills “borrowed” from mediation and negotiation that are most useful in improving corporate governance. Each of these skills will be examined separately

1. Communicating effectively

Communicating well starts with “active listening.” Good communicators are good listeners. Being attentive and receptive to others' views helps ensure collaborative, two-way communication. The process of active listening requires a range of skills: observing and understanding others' nonverbal communication, awareness and use of your own nonverbal signals, appropriate use of silence and minimal verbal prompts, reflection of feelings, paraphrasing and summarizing, and careful use of questions. These skills might sound easy, but in reality, their appropriate application requires careful observation, good judgment, and excellent timing. Mastering these skills requires extensive training and practice—they constitute the core of the joint IFC-CEDR training program for directors on managing disputes and difficult conversations on the board. However, directors can start practicing some elements of those skills such as paraphrasing, reframing, summarizing, and questioning on their own.

We consider very important to provide a brief explanation on the usefulness of these techniques.

Starting with paraphrasing, the main goal of these technique is to briefly state in your own words the essence of what you think someone has just said. A paraphrase should be nonjudgmental and should not introduce interpretations or your own thoughts. Nor should it just repeat verbatim what the person said. Here are some uses of paraphrasing:

- To check to be sure you have accurately understood what was said. This helps prevent (or correct) miscommunication and false assumptions.
- To show that you recognize, acknowledge, and accept the thoughts of the other person without making a judgment about what you think you have heard.
- To help defuse anger and cool down a crisis.
- To help you remember what has been said.
- To provide an opportunity for the other person to hear his or her own message more clearly. This can lead to further exploration and, often, the development of a fresh appreciation of the issue.

The next technique is called reframing. Reframing changes the words used or the way ideas are presented to cast them in a different light. It offers a new and more positive view of the situation. Reframing can take several forms:

- Taking the sting out of language—detoxifying or depersonalizing it;
- Interpreting actions from a different perspective— for example, focusing on what is needed for the future rather than what has not worked in the past;
- Presenting claims or proposals in a different way— to make them more palatable; or
- Rewording demands made by one party of another—for example, the idea of apologizing may be rejected on principle, but an expression of regret may be acceptable.

One of the most effective underrated tools is called summarizing. The importance of summarizing is due to the fact that it draws together draws together the main threads of what a person has said. For example, a summary is useful for clarifying a lengthy or elaborate

explanation, checking progress before moving on, or identifying an underlying theme that may provide new insights. The summary should not be the listener's interpretation of what has been said, but rather it should draw on the other person's own words and be recognizable to the speaker as an accurate account. When summarizing, it is important to allow the other party to correct or add to the summary.

The following are some of the benefits of summarizing:

- A summary shows that you have been listening attentively and want to understand what the other person thinks and feels about the situation.
- It allows you to check your perception of the situation and clarify what you think you have heard.
- It may connect confused and fragmented thoughts and feelings and bring some order to them and avert any ambiguity.
- It gives feedback to all parties about what they have said, and it can alert them to an interpretation of conflicting or contradictory thoughts, feelings, and ideas.
- Summarizing is a way to focus on particular issues and can help the parties begin making decisions about priorities, what needs to be tackled first, or what concessions or proposals they are prepared to make. Summarizing is an especially useful skill for the board chair. Being able to summarize the discussion, and decision agreed if applicable, helps move it forward.

The sole use of questions is also a great tool in establishing good dialogue and the right environment for ideas to flourish. However this tool must be applied sensitively. Different forms of questions will be appropriate at different times. For instance, open-ended questions ("What do you think about. . ." "Tell me more about. . .") encourage a meaningful, extended response. On the other hand, closed-ended questions (requiring or allowing for a one-word or yes-or-no reply) may have the effect of limiting or "leading" the discussion.

Careful framing of a question is important, for questions can:

- encourage a party to talk,
- show empathy and support.

- But questions can also:
- indicate partiality, judgment, criticism, seem prying or irrelevant, or become an interrogation.

Timing and context are also important in the use of questions. In deciding when and how to ask questions, you need to take into account the listener's level of trust. For example, questions that are probing and challenging would not be appropriate right away, before a party is ready to trust you with that level of information or exposure. Open-ended questions are particularly useful in the exploration phase. Close ended questions are more appropriate when checking and summarizing and in the later stages. Hypothetical questions can be used at any stage for trying out ideas. These hypothetical questions are an important tool to activate the engine of brain storming.

3. Consensus Building

For a company to function properly, the board needs to be effective in resolving issues and making decisions. The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed³⁹. Chairs⁴⁰ and lead directors must ensure that the board performs these actions well. More and more boards are reaching decisions through consensus, a voluntary agreement following the deliberation and synthesis of different propositions. Generally, consensual decisions are less divisive than voting, which requires directors to take opposing yes-or-no positions. However, the consensus process tends to take more time than voting.

Consensus building requires the good communication skills described above and also also requires the following:

- Bringing issues to the surface;
- Analyzing and finding patterns for organizing the information;
- Generating alternative solutions;
- Prioritizing options, using a cost/benefit assessment; and

- Reaching agreements that include contingencies—and results that can be monitored.

Consensus building can occur outside the confines of board meetings—in retreats, executive sessions, and other less structured settings. The chair (or lead director or board member who acts as a peacemaker) may need to work behind the scenes and organize private meetings to find common ground on contentious issues. This requires time and commitment.

3. Managing emotions

Solutions to disputes require communicating feelings in a professional manner before refocusing the discussion on the directors' fiduciary responsibility to act in the best interests of the company and its shareholders. Here are five tips for positively influencing the emotional climate during a conflict:

- Show appreciation for all parties. Demonstrate an understanding for others' positions and recognize the value of what they think, feel, or do. This does not mean that we have to agree with their position.
- Create a bond. Share information about common interests and ask others about personal aspects of their work or life.
- Respect the parties' autonomy. People like to make independent decisions. Give others the space to express their views. Talking too much, for example, can threaten the autonomy of others.
- Acknowledge the other party's status. Status helps clarify a person's position relative to the others.
- Highlight the other party's role. Board directors each play an important role. Each role must have substance, and the directors must be respected for their roles.

4. Disagreeing constructively

Constructive dissent is most effective when proposed with careful preparation. A director is more likely to gain serious attention when presenting information with confidence using facts, examples, comparisons, and risk assessments.

The perfect recipe to defuse disputes in board rooms must contain the following ideas:

- Listen actively. As people communicate, pay close attention and demonstrate genuine interest by asking questions, summarizing key points, and linking relevant ideas and experiences.
- Use open-ended questions. Ask questions that require more than yes-or-no answers. Open-ended questions encourage speakers to reveal their concerns and interests. Such questions usually begin with who, why, what, how, when, or where. Clarify reasons. Encourage cooperation by clarifying shared goals and confirming objectives. Do this early in meeting discussions.
- Be aware of body language. Show your interest and desire to communicate through friendly, open, and attentive facial expressions and posture. Notice others' body language.
- Speak on behalf of yourself. Use "I" statements, so listeners understand that you are not making universal statements but only expressing your own opinions, sharing personal observations, and offering alternatives. Others may have different experiences, perceptions, and ideas. Phrases that demonstrate respect for differences include I noticed, I suggest, or from my experience.
- Recognize others' positive ideas through constructive feedback, and explain why their proposals are useful. If more helpful contributions are needed, be specific in your requests. Ask for practical suggestions to improve specific situations.
- Stay calm as you work professionally and diplomatically to defuse tension. At times, others will discount the value of your ideas, no matter how carefully you phrase your thoughts. People become defensive for many reasons, including circumstances beyond your control. When that happens, acknowledge and respect the different views. You have offered your perspective based on your experiences. Offer to meet at another time, when emotions have cooled, to continue the discussion.
- Avoid misunderstanding. Paraphrase other board members' statements to ensure proper understanding of their position. Allow them to acknowledge that your summary of their remarks is correct.
- Allow others to "save face" by reframing their statements in less confrontational terms to unlock disputes. Saving face is especially important in some cultures; but no one likes to be publicly embarrassed especially in the boardroom. To save face, directors may take a defensive position, although they don't oppose a decision.

Source: CEDR, *Boardroom disputes: how to manage the good, weather the bad and prevent the ugly*, IFC corporate governance knowledge publication, 2014, p.8-33

Annex No.3

The case of General motors

On February 6, 2014, General Motors (GM) recalled about 800,000 of its small cars due to faulty ignition switches, which could shut off the engine during driving and thereby prevent the airbags from inflating. The company continued to recall more of its cars over the next several months, resulting in nearly 30 million cars worldwide recalled and paid compensation for 124 deaths. The fault had been known to GM for at least a decade prior to the recall being declared. As part of a Deferred Prosecution Agreement, GM agreed to forfeit \$900 million to the United States.

The first recall was announced on February 7, 2014, and involved about 800,000 Chevrolet Cobalts and Pontiac G5s. On March 31, GM announced it was going to recall over 1.5 million more cars of six different models, due to faulty power steering. Of these, over 1.3 million were in the United States, and three of the models were also involved in the faulty ignition recall. The total number of cars recalled during 2014 as of 1 April was 6.26 million. On May 15, GM recalled 2.7 million more cars, bringing the total number of recalled vehicles in 2014 to 12.8 million worldwide, 11.1 million of which were in the United States

On June 16, 2014, GM announced they were recalling 3.4 million more cars, all of which were produced from 2000 to 2004. They also announced that they intended to replace the cars' keys because if they did not, the ignition switches could rotate, causing the car's engines to shut off and disabling power steering.

On June 30, 2014, GM announced they were going to recall 8.45 million additional cars, almost all of which were being recalled for defective ignition switches. This announcement brings the total number of recalled cars in North America to about 29 million. In November 2014 emails surfaced that showed GM ordered a half-million replacement ignition switches nearly 2 months before ordering a recall.

The faulty ignitions have been linked (by GM itself) to 124 deaths.

Public disclosure of the problem

The defect was not disclosed by GM nor was it discovered by government regulators or transportation safety agencies. Instead, public knowledge came about because Lance Cooper, a Marietta, Georgia attorney who sued GM on behalf of the family of a woman who had died in a crash, obtained thousands of pages of documents from GM and took the depositions of several GM engineers.

Reaction to the recall

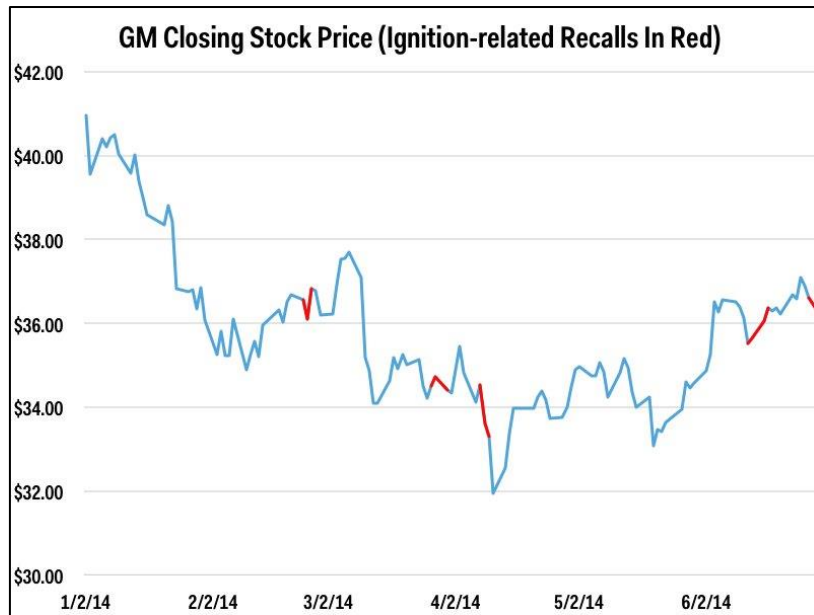
The recall, following the public disclosure, cost GM more than \$3 billion in shareholders' value over four weeks

Since February 2014, GM has spent \$2.7 billion to cover expenses linked to the ignition switch recall, including \$1.3 billion from its first quarter of 2014 earnings, \$2.15 billion in restructuring costs, an uncapped compensation program for the victims of the faulty switch (General Motors, 2014d) and \$1.2 billion from its second quarter of 2014 (General Motors, 2014e). All the while, GM's vehicle sales increased its second and third quarters of 2014 compared to 2013 (General Motors, 2014d, 2014e). GM opened 2014 with a share price of \$40.95. While it fluctuated between \$38 and \$33, October 2014 marked a significant decrease in stock value, and at the end of the month, GM shares were worth \$31.40. After news broke that the ignition switch death toll had risen to 27, GM hit an all-year low of \$29.69 on October 15. Likewise, GM stock dropped to \$30.73 on December 16 after the death toll was verified at 42. GM closed 2014 with a share price of \$34.91 (Yahoo! Finance).

Source: https://en.wikipedia.org/wiki/General_Motors_ignition_switch_recalls

Figure No.1

This figure represents the market reaction following the “recall scandal”



Source: <http://www.businessinsider.com/gm-recall-investor-response-2014-7>

Annex No.4

Volkswagen emission scandal investor's reaction

Sep 23, 2015

German automaker Volkswagen has seen its stock price tumble about 30% since the Environmental Protection Agency announced last Friday that the automaker manipulated software to hide the emissions its cars produce.

Shares of VW have fallen from around \$160 on Friday to around \$110 as of Wednesday afternoon.

The emissions scandal is the biggest in VW's history. The automaker has now admitted it cheated on emissions tests, misinforming U.S. regulators about the measurements of toxic emissions in some of its diesel cars. VW could face lawsuits and \$18 billion in penalties, and a damaged reputation could also affect car sales. VW has recalled nearly half a million vehicles as a result of the scandal.

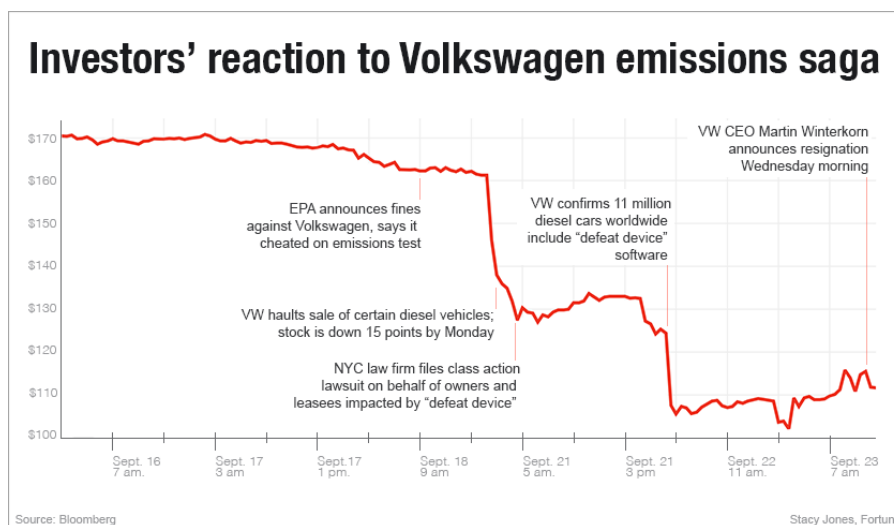
On Wednesday, VW's CEO Martin Winterkorn announced his resignation, causing the automaker's stock price to halt its decline: "As CEO I accept responsibility for the irregularities that have been found in diesel engines and have therefore requested the Supervisory Board to agree on terminating my function as CEO of the Volkswagen Group," he said in a statement. "I am doing this in the interests of the company even though I am not aware of any wrong doing on my part."

The VW models involved in the initial recall include the diesel versions of the following models: The 2009-15 Volkswagen Jetta; the 2009-15 Beetle; the 2009-15 Golf; the 2014-15 Passat; and the 2009-15 Audi A3.

The volatility of the stock is shown in the chart above, including the EPA announcement on Friday, the announcement of a class action lawsuit, news of the CEO resigning, and more.

Figure No.2

This figure demonstrates the investor's reaction following Volkswagen the emissions saga scandal.



Source:

Annex No.5

Directors resigning letters

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.

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.

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.

Source: ANUP, AGRAWAL and A.CHEN, Mark *An empirical analysis of disputes involving director.: Boardroom Brawls*, University of Alabama and Georgia State University, March 2008,p.26-30

Annex No.6

Satisfaction mediation survey

Between September 2007, when the online customer survey questionnaire was first introduced, and February 2009, more than 3,000 users of the small claims mediation service gave their views as follows:

Figure No.4

Satisfaction mediation inquiries.

How satisfied were you with the following aspects of your contact with the Small Claims Mediation Service?			
	Satisfied/ Very	Neither satisfied nor	Dissatisfied/ very dissatisfied
Written information received about the service	93.9%	5.1%	1.1%
How easy was it to get in touch with the service	91.3%	5.9%	2.9%
Explanation of how the service could help me out	95.9%	3.6%	0.4%
Helpfulness of the mediator	97.5%	1.8%	0.7%
<i>Answered question</i>			3238

Figure No.5

How satisfied were you with the following aspects of the mediation?			
	Satisfied/ Very satisfied	Neither satisfied nor dissatisfied	Dissatisfied/ very dissatisfied
Your opportunity to participate and express your views	95.8%	3.2%	1.0%
The time allowed for the mediation	94.6%	4.1%	1.5%
The professionalism of the mediator	98.1%	1.5%	0.5%
<i>Answered question</i>			3235

Figure No.6

Would you be prepared to use the mediation service again?		
	Response Percent	Response Count
Yes	94.5%	3040

No	1.7%	55
Don't know	3.8%	123
Answered question		3217

Source: *Civil Court mediation service manual*, civil justice council, Judicial studies board, version 3, February 2009, p.28. Available at:

https://www.judiciary.gov.uk/wpcontent/uploads/JCO/Documents/Guidance/civil_court_mediation_service_manual_v3_mar09.pdf

Annex No.7

Mediation Statistics

Public mediation systems have been in place for several years already, and the GRAL has published statistics regarding their figures and success rates, as set out in Table below

Figure.7

Mediation statistics in Portugal

Justices of the Peace	2008	2009	2010	2011
Number of cases filed	6453	7160	8143	9353
Number of cases	1460	1644	1853	1988
Success rate	25 per cent	22 per cent	24 per cent	22 per cent
Average time for	68	61	n/a	n/a
Workplace Mediation	2008	2009	2010	2011
Number of mediations filed	607	538	237	253
Number of mediations	43	61	25	20
Number of cases	29	39	13	15
Success rate	67,44 per	63,93 per	52 per cent	75 per cent
Average time for	35	47	54	46
Family Mediation System	2008	2009	2010	2011
Number of mediations filed	252	450	372	426
Number of mediations	79	157	158	136
Number of cases	48	76	56	57
Success rate	60,76 per	48,41 per	35,44 per	41,91 per
Average time for	135	99	n/a	59
Criminal Mediation System	2008	2009	2010	2011
Number of mediations filed	95	224	261	90

Number of mediations	30	87	284	84
Number of cases	16	47	71	35
Success rate	53,33 per	54,02 per	25 per cent	41,67 per
Average time for	90	99	118	134,25

Source: ANA MARIA GONÇALVES and THOMAS GAULTIER, *Mediation in Portugal*, 2012, p.292.

Annex No.8

Percentage of cost and time of ADR (comparison)

In 2010, in a survey conducted by the Rome-based ADR Center (funded by the European Commission)[9], research was done to assess the current status of intra-European Union ADR practices. The study was meant to assist policy makers in applying the newly approved EU Mediation Directive with the ultimate goal being to ensure the growth of cross-border commercial transactions. Comparing litigation to the ADR alternatives of arbitration and mediation, arbitration takes slightly less time than court proceedings, but still (on average) takes more than a year to complete. Mediation takes significantly less time and is exponentially more cost efficient.

Figure 8. Percentage of cost

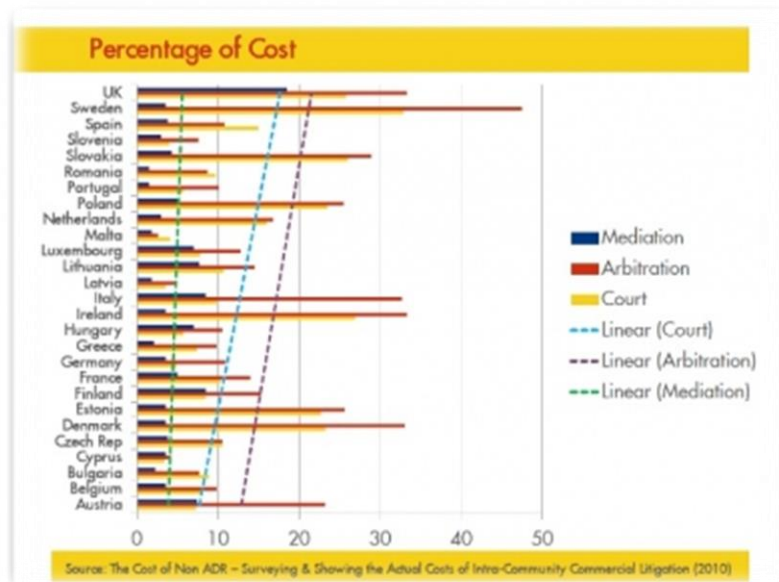
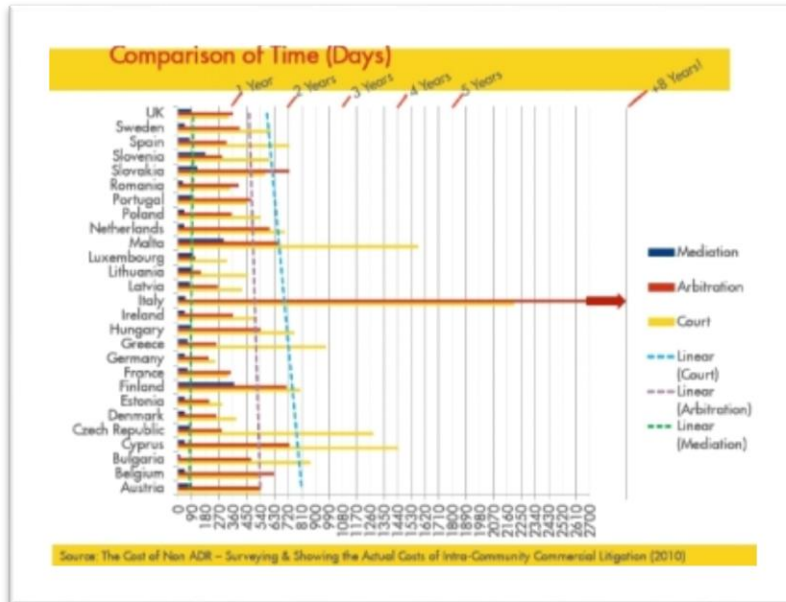


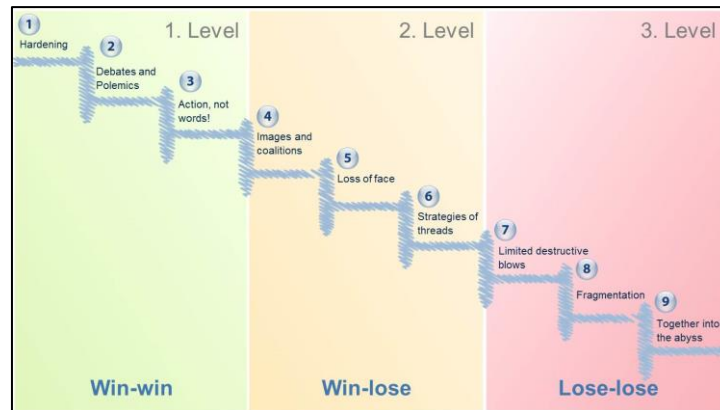
Figure 9. Number of days for resolution



Source: <https://immediation.org/lawyers-as-a-catalyst-for-change>

Annex No.9

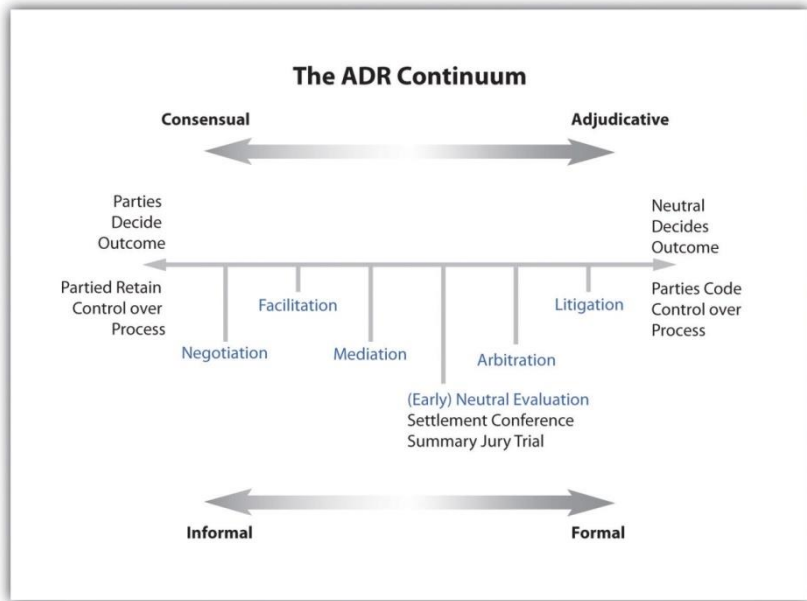
Figure 10. Friedrich Glasl’s model of conflict escalation



Source: <http://www.kraus-partner.eu/project-management/basics/conflict-management-in-projects>

Annex No.10

Figure 10. ADR Continuum



Source: <http://www.nycourts.gov/ip/adr/images/continuum2.jpg>

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