Arbitrability of Shareholders' Disputes under German Law

By Dr. Jan Kraayvanger and Dr. Mark C. Hilgard

It has long been a matter of dispute whether and under which preconditions disputes regarding the validity of shareholders' resolutions of a German limited liability company (GmbH) are arbitrable. In principle, if the shareholder of a GmbH considers a shareholders' resolution to be invalid or illegal, he or she may challenge such resolution in a lawsuit to be initiated against the GmbH. In the event of a court decision that annuls the shareholders' resolution, this court decision has a binding effect on all shareholders, all members of the management board, and all members of the supervisory board, regardless of whether they had participated in the lawsuit. This *inter omnes* effect is an exception to the general rule that court decisions are only binding on the participants in the underlying lawsuit.

The legal ground for this exception is found in sec. 248, para. 1, sentence 1 of the German Stock Corporation Act (AktG), which states: "To the extent the resolution is declared void by a final judgment, this judgment shall be binding on all shareholders as well as the members of the management board and the supervisory board even if they were not a party to the lawsuit."

The wording of this provision only refers to "judgments," and hence, in the past, it was unclear whether the provision was also applicable to arbitral awards in the event that the shareholders had agreed to submit corporate disputes to arbitration.

In its decision of March 29, 1996, the German Federal Supreme Court (BGH) declined to apply sec. 248 AktG to arbitral awards, and argued that as the provision was an exception, it had to be interpreted narrowly.[1] The Court indicated—although it did not say so expressly—that the legislator put greater faith in the expertise and impartiality of a national court than in an arbitral tribunal, and therefore had restricted the applicability of sec. 248 AktG to national courts. In addition, the Federal Supreme Court reasoned that the statutory law does not provide for a mechanism to ensure that all shareholders, as well as all the members of the management and supervisory boards, can participate in the nomination of the arbitrators.

Furthermore, the Court held that, unlike in court proceedings, there are no provisions that exclude conflicting decisions in the event that several shareholders initiate separate arbitral proceedings, or in the event that one shareholder applies for arbitration and another one for litigation. Hence, the Court held sec. 248 AktG not to be applicable to arbitral proceedings. On the other hand, the Court acknowledged that the invalidity of a shareholders' resolution can be determined with effect only for and against all shareholders. However, as this *inter omnes* effect could not be reached by means of an arbitration proceeding, the Court held that shareholders' disputes regarding the validity of a shareholders' resolution were not arbitrable at all.

The Federal Supreme Court was heavily criticized for its decision, and a vigorous debate ensued over whether and how the concerns that the Court had raised against the arbitrability of a shareholders' dispute could be overcome.[2] It was argued that the shareholders could agree upon arbitral proceedings that ensured that all shareholders as well as the members of the board of directors and the supervisory board could participate in the arbitration.[3] Several mechanisms were discussed in order to permit all parties to equally participate in the nomination of the arbitral tribunal. Some authors even suggested model clauses.[4] However, these clauses were never sanctioned by courts. As a result, it was uncertain whether they were permissible, and most practitioners refrained from suggesting their use to their clients. Shareholders who wanted to include an arbitration clause in the articles of association of their company were well advised to restrict its scope to ensure that it did not cover disputes regarding the validity of shareholders' resolutions.

In its landmark decision dated April 6, 2009,[5] the Federal Supreme Court addressed the concerns of its critics and overruled its prior case law.[6] The Court held that a dispute regarding the validity of a shareholders' resolution was in fact arbitrable. Most remarkably, the Court ruled that sec. 248 AktG is applicable to arbitral awards and that therefore an arbitral award that annuls a shareholders' resolution is binding on all shareholders, regardless of their participation in the arbitral proceedings. However, the Court outlined strict preconditions that the underlying arbitration clause as well as the arbitral proceedings have to fulfill in order to justify this *inter omnes* effect, and ruled that an arbitration clause that does not meet these requirements is invalid.

Fulfilling Preconditions

In the April 6, 2009, decision, the Court considered the arbitration clause to be void as it did not fulfill the following criteria:

- First, all shareholders must agree upon the arbitration clause in the articles of association. Alternatively, the Court considered it sufficient that the arbitration clause is agreed upon in a side agreement to the articles of association. However, in such case the company, represented by its management, has to be a party to the side agreement.
- Furthermore, the arbitration clause has to ensure that all objections against a specific shareholders'

resolution are concentrated in one single arbitral proceeding. As the arbitral award that renders the underlying shareholders' resolution void is binding on all shareholders as well as the company and its representatives, the arbitration clause must exclude the possibility of conflicting decisions. Therefore, a shareholders' resolution may only be subject to one single arbitral proceeding and all objections against the resolution have to be decided in the course of that single arbitration. The arbitration clause must provide a mechanism to achieve this aim. For instance, the clause could stipulate that all objections have to be forwarded to the management of the company and that only the first objection against a specific shareholders' resolution received by the management initiates an arbitral proceeding, whereas the following objections are added to the first arbitral proceeding.

The Court argued that the validity of the arbitration clause could not be dependent upon the actual number of shareholders of the company, given that this number is subject to change.

- Third, all shareholders as well as the managing directors and the members of the supervisory board, if any, must be informed of the initiation of an arbitral proceeding and must be given the opportunity to participate in this proceeding. They must be granted a hearing and must be entitled to put forward additional objections against the resolution under scrutiny. Therefore, an application for an arbitral proceeding has to be circulated to all shareholders as well as the company and its representatives. Furthermore, all parties involved must be invited to join the proceedings, at their respective option, on the side of the claimant or the defendant (which in such disputes is always the company itself) within a certain period of time.
- In particular, the arbitration clause has to ensure that each shareholder as well as the company can participate in the nomination of the arbitral tribunal. Hence, the objecting shareholder must not be allowed to nominate a co-arbitrator in the statement of claim. Before such nomination is made, each shareholder must be informed of the arbitration and must be given the opportunity to participate in the nomination process in the event that the shareholder joins the arbitration on the side of the claimant. Likewise, each shareholder who joins the defending company upon information about the arbitration must be entitled to participate in the nomination process of the co-arbitrator on the side of the defendant. The arbitration clause must provide a mechanism to nominate a co-arbitrator by majority vote in the event that there is more than one party involved on the side of the claimant and/or the defendant.

While these requirements appear largely redundant for a limited liability company with only two shareholders, especially if these shareholders are at the same time the managing directors, the Court nevertheless held that even in such a situation the aforementioned requirements must be observed. The Court argued that the validity of the arbitration clause could not be dependent upon the actual number of shareholders of the company, given that this number is subject to change.

The Federal Supreme Court's decision of April 6, 2009, allows the shareholders free choice between litigation or arbitration as a dispute resolution mechanism. This new ruling is highly welcome. There is no good reason why shareholders of a limited liability company should not be able to submit their dispute about shareholders' resolutions to arbitration, as these disputes are ideally suited for the advantages of arbitration. Shareholders' resolutions primarily concern internal matters of the company that the shareholders do not want to discuss in public court proceedings. Hence, the privacy of arbitral proceedings is favored. Moreover, shareholders are often long-term business partners, and arbitration allows them to settle their disputes in an amicable way by avoiding confrontation in a courtroom. Furthermore, limited liability companies are often used for joint ventures of parties from different jurisdictions, and it is only fair towards the foreign investor to solve the conflict in the course of an international arbitration rather than in a German court proceeding subject to the rules of a potentially unfamiliar legal system.

By stipulating precise requirements for the validity of an arbitration clause, the Federal Supreme Court has significantly increased legal certainty in this area. Companies and shareholders that have agreed upon arbitration clauses in the past should now review these clauses and assess whether they meet the requirements set out by the Federal Supreme Court.

In the event that shareholders refrained from agreeing upon an arbitration clause or excluded disputes regarding the validity of shareholders' resolutions from arbitration due to the Court's prior 1996 decision, they should reconsider their past choice. It must be noted, however, that the inclusion of an arbitration clause or the extension of

an existing arbitration clause in a company's articles of association requires the consent of *all* shareholders. An amendment by mere qualified majority vote is not possible.[7]

As a reaction to the Federal Court's decision, the German Institution of Arbitration (Deutsche Institution für Schiedsgerichtsbarkeit e.V.) has issued Supplementary Rules for Shareholders' Disputes (*Ergänzende Regeln für Gesellschaftsrechtliche Streitigkeiten—DIS-ERGeS*)[8] and has drafted a model clause that can be included in the articles of association. In translation, this model clause reads as follows:

1. All disputes between shareholders or between the company and its shareholders arising in connection with these articles of association or their validity shall be finally settled in accordance with the Arbitration Rules and the Supplementary Rules for Corporate Disputes (DIS-ERGeS) of the German Institution of Arbitration e.V. (DIS) without recourse to the ordinary courts of law.
2. The arbitral award shall be binding on the shareholders, which are nominated as "parties concerned" in due course regardless if they have taken the opportunity to join the arbitral proceedings as a party or intervenor (Nebenintervenient) (sec. 11 DIS-ERGeS). The shareholders who have been nominated as "parties concerned" in due course shall acknowledge the binding effect of an arbitral award rendered pursuant to the provisions of the DIS-ERGeS.
3. Former shareholders remain to be bound to this arbitration clause.
4. The Company shall object against the jurisdiction of the national courts if a lawsuit is filed against the Company before the national courts concerning a dispute that is subject to sec. 1 of this arbitration clause.[9]

Moreover, DIS recommends that the following provisions be added to the arbitration clause:

- The place of arbitration is . . . ;
- The language of the arbitral proceedings is . . . ;
- The arbitral tribunal consists of [one or three] arbitrators.

The Supplementary Rules for Corporate Disputes provide in particular for the following:

- In the statement of claim, the claimant must identify not only the defendant but also all shareholders on which the arbitral award will have binding effect (so-called parties concerned).
- The DIS secretary submits the statement of claim to all parties concerned and gives them the opportunity to join the proceedings within 30 days on the side of the claimant or defendant.
- Thirty days after the statement of claim has been served on the defendant and the parties concerned, or 30 days after a party concerned has validly joined the proceedings, the claimant and the defendant may each nominate one co-arbitrator. If on the side of the claimant and/or defendant there is more than one party involved, such parties have to agree on a joint candidate. If either the claimants or the defendants cannot agree on a joint arbitrator, the DIS Appointing Committee will nominate both co-arbitrators. The co-arbitrators will then nominate the chair. If the arbitral tribunal consists only of one arbitrator, this arbitrator has either to be nominated jointly by all parties involved or—if the parties cannot agree on an arbitrator—the arbitrator will be appointed by the DIS Appointing Committee.
- Even if a party concerned does not join the arbitral proceedings, the DIS will submit any brief exchanged in the arbitral proceedings to such party concerned, and the party concerned may join the arbitral proceedings at any later stage, provided it does not challenge the constitution of the arbitral tribunal.
- In the event that more than one arbitration is filed against the same shareholders' resolution, the first arbitral proceedings block the subsequent proceedings and the parties of the subsequent proceedings may join the prevailing proceedings.

The DIS Supplementary Rules for Corporate Disputes provide a sensible framework for corporate disputes. Shareholders who wish to submit their disputes to arbitration should consider applying these rules rather than developing their own set of rules in order to prevent the risk that such self-made rules may fail to meet the very strict requirements set out by the Federal Supreme Court.

Endnotes

1. BGHZ 132, 278.
2. Schneider, GmbHR 2005, 86; Bender, DB 1998, 1900; Trittmann ZGR 1999, 340; Bayer, ZIP 2003, 881; Raeschke-Kessler/Wiegand, AnwBl. 2007, 396.
3. *See, e.g.*, Bayer, ZIP 2003, 881 (887 et seq.).
4. *See, e.g.*, Raeschke-Kessler, SchiedsVZ 2003, 145 (153, footnote 71); Trittmann ZGR 1999, 340 (355).
5. BGH decision dated April 6, 2009, ref. no. II ZR 255/08.
6. BGHZ 132, 278; BGH WM 1966, 1132; BGH NJW 1979, 2567; OLG Hamm ZIP 1987, 780.
7. Bayer, ZIP 2003, 881 (890).
8. The rules are *available at* www.dis-arb.de.
9. This translation was prepared by the authors and is not an official translation by the DIS that was not yet available by the time this article was published.

Dr. Jan Kraayvanger is with Mayer Brown LLP in Frankfurt am Main, Germany. He can be reached at jkraayvanger@mayerbrown.com. Dr. Mark C. Hilgard is a partner of Mayer Brown LLP in Frankfurt am Main and head of Mayer Brown's German litigation and arbitration practice. He can be reached at mhilgard@mayerbrown.com.