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The Day after the Scandal [Part one]. A Theoretical Analysis of Liability Action and Reputational Risk

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ABSTRACT

This paper realizes a preliminary theoretical analysis concerning the correlation between the execution of a liability action and the increase of potential negative effects from a reputational point of view that undermine the company’s stability. The contribution concerns managerial, legal, and social points of view – because of the risky implications of liability action – and aims to bridge a gap that characterizes both corporate governance and the increasingly emerging issue of reputational risk. This work provides immediate practical feedback in order to draw the attention of corporate ownership in critical situations of liability actions to avoid increasing side effects due to potential reputational risks and it is even more useful to facilitate the provision of the arbitration clause for institutional purposes in those countries where it is not yet possible.

Questa ricerca vuole offrire una preliminare analisi teorica relativamente alla correlazione tra l'esecuzione di un'azione di responsabilità e l'incremento di potenziali effetti negativi, dal punto di vista reputazionale, che minano la stabilità dell'azienda. Il contributo riguarda aspetti gestionali, legali e sociali – per le implicazioni rischiose dell'azione di responsabilità – e mira a colmare un gap che caratterizza sia la corporate governance sia il tema sempre più emergente del rischio reputazionale. Il paper fornisce immediati riscontri pratici al fine di richiamare l'attenzione della proprietà aziendale in situazioni critiche di azioni di responsabilità, per evitare crescenti effetti collaterali dovuti a potenziali rischi reputazionali, ed è ancor più utile per facilitare la previsione della clausola compromissoria ai fini istituzionali in quelle Paesi in cui essa non è ancora possibile.

Keywords: Sustainability, Corporate Governance, Reputational Risk, Conflict Management, ESG

1 – Introduction

The complex set of links that binds and conditions the various internal bodies of companies (Michael and Goo, 2015; Young and Thyil, 2008) is certainly one of the first aspects that emerge in the scope of corporate governance. More precisely, one of the most complex analyses in terms of corporate governance is the agency relationship (Jensen and Meckling, 1976) which studies the behavior of managers and their relationship with shareholders (Armstrong *et al.*, 2015; Tompkins and Hendershott, 2012). Precisely in the context of the separation of ownership and control – already extensively described by Berle A. A. and Means G. C. (1932) – in recent years important studies have been developed on the efficiency of managers and their responsibility for the decisions taken (Dou *et al*., 2015; Davies *et. al.*, 2013; Warburton, 2011; Radin and Block, 2009; Baxt, 2005; Chew, 2004; Hopt *et al*., 1985).

The corporate governance structures have changed impressively, becoming increasingly complex and adapting to the ever-changing needs of companies (Tudway and Pascal, 2006; Trong Dan, 2005). The actors who hold the various positions are many and the way in which the relationship between them can be regulated is complex (Pillai and Al-Malkawi, 2018). More specifically, over time the analyses have focused on the relationship between those who hold managerial power and the actual owners (Zahra, 1996). Observing the American capitalist development in the book "The Modern Corporation and Private Property" of 1932, Berle A.A. and Means G.C. were the first to illuminate a long analytical path focused on the theme of the separation of control and ownership in modern corporations. In fact, the last two decades of 1900 were deeply marked by a continuous process of mergers and incorporations (Seifzadeh, 2017) which greatly influenced the organizational style within the company (Buono and Kerber, 2008).

The new organizational structures have in fact observed a large number of workers employed by one management as well as a considerable wealth of different individuals placed under one control (Rangone, 2017). As an immediate consequence a substantial number of corporate organizations were formed and supported by a plethora of shareholders – sometimes considered weak (Roe, 1994) – dependent on a few managers (Freeman and Reed, 1983). As the size of the company and the companies grew, so did the role played by managers and the board of directors (Mertzanis *et al*., 2019; Penhall, 2015; Bainbridge, 2006; Moustafa, 2005).

As an immediate consequence, there was an increasing need to study the tasks of managers in depth (Davies *et al*., 2013; Hopt *et al*., 1985) – understood as the true representatives of large companies – and the interests at stake (Donaldson and Davis, 1991). At the same time, the importance and power held by managers have also increased the degree of responsibility. Scholars Jensen M.C. and Meckling W.H. (1976) have amply emphasized how much the relationship was linked to the need for shareholders to appoint managers to carry out the tasks useful to the control of the company. Although it is convinced that both parties have a common purpose, the Agency's Theory was the first to analyse the degree of transparency with which "agents" carry out their work (Martin *et al.*, 2016; Cuevas-Rodríguez *et al*., 2012).

As a direct consequence, this theory has stimulated subsequent studies (Ducassy and Guyot, 2017; Kiefer, 2017; Zhang *et al.*, 2014; Davies *et al*., 2013; Eisenhardt, 1989) on the effects that managers' decisions have on shareholders and how any critical effects can be avoided. It is indeed possible for agents to make business decisions by considering only the impact that such actions may have in the long term on their own personal interests and not on shareholders' ones (Fischer and Louis, 2008; Perry and Williams, 1994).

Profits that arise from mergers and acquisitions (Kirchner and Painter, 2000) or from various investments made may fall on them and not on the shareholders. In such cases, the result would, therefore, lead to an inevitable conflict (Davies *et al*., 2013; Hopt and Wymeersch, 1997). Therefore, what is the responsibility of the managers or collectively of the board of directors in the above-mentioned cases?

1.1 Framework and research methodology

The issue of reputational risk is an extremely multifaceted concept and brings to itself connotations of a clear interdisciplinary nature. Therefore, given the vastness of the prospects, it was deemed appropriate to implement both a theoretical and an empirical approach. The work is divided into two connected parts. In the first (I), namely the present one, the study presents the perspectives dictated by the reference literature, trying to follow the indications outlined on the subject of managerial responsibilities, judgment, and critical issues in connection with reputational risk.

In order to carry out this study, it was deemed appropriate to first analyze some specific normative codifications and international regulations which more than others have become exemplary. In the second analysis, to shed light on the *status quaestionis* that characterizes the subject today, the main literary production was approached with reference to the issues of corporate governance and again the management of critical issues in relation to reputational risk in a context of corporate social responsibility. In the second part (II), on the other hand, the empirical analytical method was privileged. Through questionnaires addressed to joint-stock companies, it was possible to find empirical confirmation of the hypotheses formulated in this first part.

2 – Background

2.1 – *Theoretical framework on managers' responsibility*

Analyzing the wide range of corporate law and corporate governance regulations, it is clear that the discipline of responsibility for decisions taken by managers or the board of directors is still too much tied to a profound principle of legal hermeneutics.

Hopt and Teubner (1985) have highlighted how many cases, often very similar to each other, appear in the panorama of the social responsibility of directors, but are regulated in a totally different way. Although there are countless cases in which liability actions can be brought against directors, all of them are attributable to the failure to comply with the obligations considered in the statute (Roe, 1994). Baxt (2005) emphasizes that directors are civilly liable for their actions towards:

– society;

– the social creditors;

– individual partners or third parties.

As per the contract, the directors have a responsibility towards the company. Therefore, any abuse or omission of the directors that may affect the company's assets (considering both the damage and the impediment to the achievement of profit) entails a social action of responsibility towards them (Chew, 2004). The most striking case is the irregular and summary keeping of books and accounting records which can provide incorrect information on the company's performance – historical or forecast – not only to shareholders (with reference to dividends) but also to the remaining stakeholders (with reference to capital gain) (Davies *et al.*, 2013; Bushman and Smith, 2001). In this regard, the U.S. experience (Bainbridge, 2004; Knowles and Flannery, 1995; Hinsey, 1984) has been largely masterful as it is well known the long regulatory process that had as its object the potential responsibility of companies to issue untrue forward-looking information to investors later deemed to be damaged (Radin and Block, 2009).

In this regard, it is useful to remind the Liability for Certain Statements by Issuers provided for by the Securities Act of 1933 and again the countless amendments made over time to the Security Exchange Act of 1934, which have led to a more general contemplation of the potentially harmful effects of distorted forecasting information (Healy and Palepu, 2001). However, it should be noted that, in addition to such cases, there is also a form of liability due to how directors carry out their management duties (Ferrara *et al.*, 2005); a responsibility that is generally the source of often non-immediate business problems (Donaldson and Davis, 1991). These are specific choices in terms of investments, production strategy over a specific period and decisions taken for sales or debt ratio (Martin *et al.*, 2016). The directors, in fact, are jointly and severally liable to the company for damages that their failure to comply with the duties provided for the law or the statute may cause (Macey, 2008). As it is possible to see below considering the Business Judgement Rule, directors must perform their duties under the law and the articles of association with the diligence required by the nature of their duties and their specific competencies (Warburton, 2011). They still become jointly and severally liable if, being aware of prejudicial facts, they have not done all they could to prevent their accomplishment or in any case to mitigate the harmful consequences.

Liability for the acts or omissions of directors does not extend to who is free from fault among them (Baxt, 2005) or who has had his dissent noted without delay in the book of meetings and resolutions of the board, or who has demonstrated his clear extraneousness to the facts (Kaufman, 2002). It is also true that management guidance is not detached from the corporate context but is part of a specific decision-making process involving the entire board of directors, internal and external professionals consulted at the request of the latter (Business Roundtable, 2010) and, if applicable, the corporate governance committee. For this reason, since the field of investigation of management responsibilities is heterogeneous, it becomes even more difficult to obtain a clear identification of the guilt of the various subjects involved and, therefore, the execution of the action of responsibility.

2.2 – *Considerations on the scope of the Business Judgement Rule in cases of liability actions*

Considering the broad spectrum of management responsibility, it is essential, if not mandatory, to focus on a principle that is now widespread: the Business Judgement Rule. Although in some countries it is still in an emerging phase (Matsimela, 2011), the Business Judgement Rule is now accepted practice in almost all legal systems (Du Plessis, 2011). When invoking these regulations, the mind turns with a certain immediacy to the best-known prediction, namely the comparison of the director with the good family man (Radin and Block, 2009; Rutledge and Karim, 1999). Although it has very intuitive connotations, this *ratio* has produced quite a few puzzles to act on responsibility towards the managerial class as it involves a really thin line of demarcation between guilt and extraneousness to the facts (Preston and Sapienza, 1990).

More recently, to support a more objective form of assessment, amendments to the regulations have emerged to differentiate liability according to whether it relates to directors with delegated powers or general directors. The attempt lies in the legislator's willingness to be able to identify more carefully who is responsible for the actions that cause damage to the company or external parties. The prescription to act in a conscious and informed way on the possible repercussions for the company and third parties (*culpa in vigilando*) together with careful control of the movements and step-by-step decisions by the judge are also aimed at reducing the fog that hovers around the Business Judgement Rule (Branson, 2002). However, it still expresses a kind of double-edged sword today, as it often and willingly provides clear holds of salvation for the managerial class in the darkest and most difficult-to-judge matters (Hinsey, 1984). Over time, U.S. jurisprudence – which has been taken as the maximum term of comparison and example in this sense (Perruzzo, 2011) – has provided that the diligence of the average man (i.e. the ordinary family man) is not sufficient, but the diligence of the "good director" determined also according to the nature of the office and the specific competence of the director (Rangone, 2017). Therefore, to assess the level of diligence had by the director, during the liability action the plaintiff has to prove not only the damage caused but also the causal link between the damage and the director within an evidentiary context that goes beyond the negative outcome of the management (Bainbridge, 2004).

It should therefore be made clear that the link of trust between the agent and the principal or, in any case, between the company and the persons delegated to manage it has been broken. The level of diligence required will be all the higher as the size and complexity of the company managed increases, also considering the individual skills of the administrators (Dou *et al.*, 2015). However, the correct use of the Business Judgement Rule by the directors involved must also be supported by additional conditions. As managers are regarded as trustees, they must therefore comply with two fundamental obligations, namely the absence of conflict of interest and diligent management (Radin and Block, 2009). In doing so, they act according to two fundamental principles: *duty of loyalty* and *duty of care* (Eisenberg, 1993; American Law Institute, 1978). By the expression *duty of loyalty*, U.S. company law has described the principle that directors and companies must be bound by a relationship of trust and avoid possible conflicts of interest.

The fiduciary duty should induce managers to operate on behalf of their company (Ferrara *et al.*, 2005) and not aspire to personal gain: this is the case – often encountered – of executive compensation (Ashbaugh-Skaife *et al.*, 2006; Chung and Pruitt, 1996), disclosure to Shareholders (Clarkson *et al.*, 2011) or trading on inside information (Tong *et al.*, 2013). The principle of *duty of care*, on the other hand, presupposes that the manager is sufficiently careful and prudent in making decisions, referring back to the principle expressed above of the good father of the family. The case of mismanagement, therefore, can be avoided if the directors can identify the best investments, first analysing all the information gathered on them and then carefully examining the impact that such investments may have under certain conditions on the company (Siegel, 2013). In addition to the duty of diligence, the Board of Directors is required to exercise vigilance about all choices or actions taken (OECD, 2004). At the same time as diligence and supervision, however, the duty to intervene is also closely linked. Otherwise, the negligence of the directors can also be equated to a violation of the law for not intervening against any decisions taken by specific managers.

Company law and corporate governance rules, however, leave a wide margin of error to the directors (Ubelaker, 1981). Therefore, conversely, in case the company is in a difficult situation as a result of risky decisions, if the directors have been diligent and attentive to the decisions taken, they do not necessarily have to be subject to liability action. In light of this principle, the object of the analysis is not so much the adoption of a wrong decision but the way and diligence with which it was taken by the directors. For this reason, the Business Judgement Rule has also been defined as the doctrine of abstention (Bainbridge, 2004). Therefore, it is useful to underline that the directors could be responsible not so much for a violation, as in the case of a conflict of interest, but for not having respected the principles of *duty of care*, therefore for not having adopted the necessary precautions or carried out the preliminary analysis (Chew, 2004). The scope of this rule is just as difficult. As considered above, the review carried out by the judge must be comprehensive in examining the guilt of managers or the board of directors. In the case of liability action, the judge's assessment must reveal a significant presence of negligence on the part of managers as an expression of mismanagement of the company (Bonelli, 2004). To make a correct assessment, the conditions under which the manager is appointed, and the type of assignment entrusted to him by the company must also be considered and always in advance (Penhall, 2015). Once these conditions have been examined, the possibility of carrying out a social action of responsibility can then be examined.

This analysis is useful to avoid so-called "interference" by the judge in the sphere of freedom of action of directors who, since the beginning of the definition of their office, can therefore benefit from a *board primacy* principle (Bainbridge, 2006) well-known not only in U.S. company law but also in U.K. law (Moore, 2013). The analytical task of the judge seems not to be so simple in the case of mismanagement due to negligence or irrationality. Analyzing striking cases in the United States, Siegel M. noted, however, that the prevailing trend is a kind of middle ground between the possibility of a stubborn liability action and the less hostile request to directors to demonstrate that the actions taken were not taken due to lack of negligence (enhanced scrutiny) (Siegel, 2013). This practice is easily understood considering what is expressed in the Principles of Corporate Governance promoted by the American Law Institute (1978). It states that the decision taken by a manager must be considered in good faith (Eisenberg, 1993) if it is established that there are no grounds for personal interest in the business itself and if it is established that the directors have been informed about the business in question and the circumstances of its application, and again that the business has been considered of great importance to the company (Branson, 2002).

The limit imposed on the applicability of the liability action against the managerial class, intended as the only and potential legal instrument to protect shareholders or third parties outside the company, is thus substantially raised precisely because of the principle of the Business Judgement Rule which greatly enhances directors' freedom of action. The critical factor lies in understanding where is the limit to the so-called "excusable" error. This circumstance, therefore, leads our analysis to consider a further variable of the system, namely the flow of economic repercussions that can result from media exposure due to liability action. Therefore, this work aims to understand whether the risk arising from media exposure following the liability action is the optimal solution, bearing in mind that both the acquittal of directors under the Business Judgement Rule and dangerous economic repercussions on the company due to the resulting scandal may occur at the same time. Before analysing this critical factor, it is fundamental to examine the context in which the fundamental connection between reputational risk and business criticality from which a liability action may derive.

2.3 – *Corporate criticalities and reputational dimensions*

In the digital age, presence and promotion on the web or social media are considered existential requirements for companies (Rangone, 2020). Therefore, should such events occur, it would easily attract the attention of the media, which can transform every news item into a media echo that is difficult to overcome and sometimes into real dramas (Culbert, 2009). This is mainly because today's companies play an important social role (Tetrault Sirsly, 2009; McWilliams, 2001) as well as an economic one, and their ethical responsibility depends on it (Barzaghi *et al.*, 2009; Bagnoli, 2005). The risk that the company runs in such situations can therefore generate a significant worsening in the perception of the company, leading to potential reputational damage (Detthamrong *et al.*, 2017; Martín de Castro *et al.*, 2006; Roberts and Dowling, 2002). In the literature, reputation is defined as "amorphous" and "difficult to frame" (Stansfield, 2006), but also as a collective assessment of a company's behaviour and skills (Bromley, 2002; Fombrun and van Riel, 1997), while by definition reputational risk is the current or prospective risk of a decline in profits or capital (Power et al, 2009) resulting from a negative perception of the company's image by stakeholders such as customers, counterparties, shareholders, investors or supervisory authorities. Generally, reputational risks may arise from specific corporate criticalities, as shown in Table 1.

Table 1 – Studies that have dealt with the important connections between business criticalities and reputational risk (Source: author's elaboration)

Criticalities	Main Literature
Health and safety incidents	– Larkin, 2003
Violation of privacy policy	– Bertino and Ferrari, 2017 – Mobasher and Anand, 2005 – Andrade *et al*. 2002
Operational events and crises	– Yu and Lester, 2008
Product recalls and quality control errors	– Mella, 2021 – Larkin, 2003 – Weigelt and Camerer, 1988
Interruption of activities and services	– Martín de Castro et al., 2006
Irregularities and financial losses	– Detthamrong et al., 2017 – Stansfield, 2006 – Roberts and Dowling, 2002
Negative partnerships with third parties	– Larkin, 2003 – Dollinger et al., 1998
Internal governance issues	– Arru and Ruggeri, 2021 – Detthamrong et al., 2017 – Gazzola and Mella, 2016 – Stansfield, 2006 – Gaultier-Gaillard and Louisot, 2006 – Srivastava et al., 1997
Legal and regulatory investigations	– Stansfield, 2006
Accusations regarding company procedures	– Gotsi and Wilson, 2001 – Fombrun and Shanley, 1990
Ethical issues and violations	– Gisti, 2018 – Fombrun and Shanley, 1990
Scandals involving the brand	– Davies and Chun, 2002

As these are crucial areas of business operations, reputational risk can significantly undermine the stability of the company. As a direct consequence, there may be a contraction in business volume (Stansfield, 2006), a reduction in brand value (Davies and Chun, 2002), and additional expenses to respond to the crisis and accusations or legal investigations (King *et al.*, 2002). In such a scenario a single negative event is capable, even in a short period, of destroying the public image of the company and sometimes of excluding from the market a company that has not properly cared for and protected its reputation in an environmental context (Aula, 2010). The 2017 Global CEO Outlook survey conducted by KPMG showed that reputational risk is, along with operational risk, the most feared risk by CEOs in 10 countries and 11 different industries. Survey results show that reputational risk has increased in importance for CEOs over the past year, becoming one of the top three most important risks to be addressed (out of 16 in total) (KPMG, 2017). And again, CEOs believe that reputation damage will have the second largest impact on the growth of their organization over the next three years. A change in sensitivity, therefore, given that in previous years risk was not even among the top ten challenges to be faced (KPMG, 2017). Therefore, for a company, reputation management means first of all communicating its essence, its way of being, and not only what it offers on the market. Reputation is primarily an emotional bond (Reputation Institute, 2017) that is created with stakeholders by demonstrating specific requirements. It has specific dimensions and characteristics, as shown in Table 2.

If this perspective is considered, it becomes clear that reputation must be valued as a real intangible asset useful to build one's financial solidity. The reputational heritage (Adeosun and Ganiyu, 2013; Gaultier-Gaillard and Louisot, 2006) is therefore a strategic tool for creating competitive value and making the company increasingly competitive in an era where news and information dissemination takes place in real-time and on global scale. It turns into real capital capable of generating profits (Jackson, 2004) or losing them if it is lost. Reputation, therefore, proves to be not only a means to grow one's business but also a form of long-term protection. The analysis of the reference literature and of the major international scandals involving multinational companies provides more than evident elements of the potential negative effects, especially economic ones, that may fall on the company as a result of actions promoted internally (by internal stakeholders) or externally (by external stakeholders), thus undermining economic and financial stability.

The case of Volkswagen and the 2015 Dieselgate scandal is a more than explicit example. The Reputation Institute (2016) stated that "in the 2015 Global RepTrak® 100 – a list of the world's most reputable companies measured across 15 countries – Volkswagen ranked 14th with a strong RepTrak® Pulse score of 75.0". In the months following the scandal, Volkswagen was able to observe a sharp decline in the value of its shares (Reputation Institute, 2016) due to the fierce media echo that ensued (Figure 1) and a simultaneous downgrade from Moody's to A2/P-1.

In January 2018 the economic damage of the scandal was estimated at about $ 25 billion (Il sole 24 ore, 2018) bearing in mind that according to the annual report for the year 2015 alone, legal and consulting fees amounted to € 7 billion (Volkswagen AG, 2016). However, after the first years of acute difficulties in which there were even fears of the destruction of the "brand reputation", the company seems to have regained its place, renewed and more stable than ever. The Volkswagen case has even been referred to as an extraordinary "successful restructuring" (Il sole 24 ore, 2018).

Table 2 – Descriptive variables of a company reputation (Source: author's elaboration)

Reputation Dimensions	Reputation Drivers	Main Stakeholders involved
GOVERNANCE	– Seriousness – Transparency – Fairness	– Shareholders – Community – Media – Business Partners – Creditors – Political Parties
PRODUCT AND SERVICES	– Quality – Reliability	– Consumers – Business Partners – Media
PERFORMANCE	– Stability – Solidity	– Shareholders – Business partners – Creditors
INNOVATION	– Attention to changes and needs	– Future Generations – Comminity – Business Partner – Consumers
WORKPLACE	– Welfare – Enhancement of Human Resources	– Employeyes – The Public – Policy Makers – Media
RESPONSIBILITY	– Sustainability – Social Participation	– Communyity – Future Generations – The Public – Policy Makers – Media

Obviously, it is right to point out that the company has learned a very important lesson from the scandal, which has prompted management to focus its resources on new corporate development strategies in an "eco" key (Volkswagen AG, 2019). However, it is interesting to note that the restructuring has not affected the governance structure, contrary to what happens in most cases to demonstrate a clear detachment from the old leadership and again because specific accusations have subsequently emerged against the management board (Sandrock and du Plessis, 2017).

As pointed out by the Australian Institute of Company Directors, following the resignation of the CEO there have been no drastic changes, but on the contrary, the old structure has been maintained as closely as possible with important figures of shareholders holding about 90% of the shares with voting rights and – even more delicately – the main members of the Supervisory Board (Australian Institute of Company Directors, 2015). Although important and, above all, important from an ethical point of view, it is not intended to open up a perspective here on the freedom of action of the Supervisory Board or the control of the management of Volkswagen AG's board of directors. On the contrary, we would like to underline how, for the above analysis, an authoritarian and cohesive model of governance – which by its very nature avoids scandals linked to liability actions – can be successful to reduce as much as possible the reputational risks arising from over-exposure to the media.

Fig. 1 – Volkswagen stock trend before and after the "dieselgate" scandal
(Source: IT-Finance)

3 – Potential consequences of judicial and extrajudicial solutions

Thanks to the analysis of the literature, it has been possible to underline how sometimes unpredictable the judicial solution can be in cases of a liability action against the managerial class, especially in situations where the guilt of managers is not clear or not supported by clear empirical evidence. This is because the legal procedures make extensive reference to the Business Judgement Rule principle analysed above. The liability action can therefore represent a double-edged sword, since not only can the outcome of the judgment be favourable to the party involved (in this case the manager) but also because the dispute would become public knowledge and would expose the company to a very delicate media judgment involving the most important corporate stakeholders (Figure 2).

As analyzed above, there is a fundamental and delicate relationship between critical business conditions and the reduction of the company's credibility due to the perception of its reputation. Having said that, this work has so far attempted to demonstrate that pursuing the path of liability action is not always the optimal solution unless there is more than concrete evidence that managers are responsible; however, even then – as the Volkswagen AG example shows – liability action is not necessarily the optimal solution. Therefore, it would be preferable to adopt the arbitration clause as a precautionary measure to follow the out-of-court settlement if necessary and to keep the episode of the dispute as discreet as possible (see figure 2).

Arbitration as a term in the context of international law dates back a long way (Sayre, 1928; Balch, 1915). However, until recently, its application in U.S. law – which has always been a pioneer in corporate matters – was still restricted to the areas of commercial transactions and labour (Demaine and Hensler, 2004). Today there is still widespread uncertainty as to whether it is convenient to refer disputes to arbitration rather than judicial litigation (Veasey, 2015) (this is the motivation that confirms the usefulness of this work) and we often encounter legal systems that link the use of arbitration to specific areas (De Groot, 2015). For several years the international practice has indeed increased the use of arbitration for the resolution of corporate disputes (Queen Mary University and PwC, 2006) not only from a "contractual" but also from an "institutional" point of view, given the important advantages it brings in terms of *confidentiality*, *flexibility*, *resolution time* and *cost-effectiveness*.

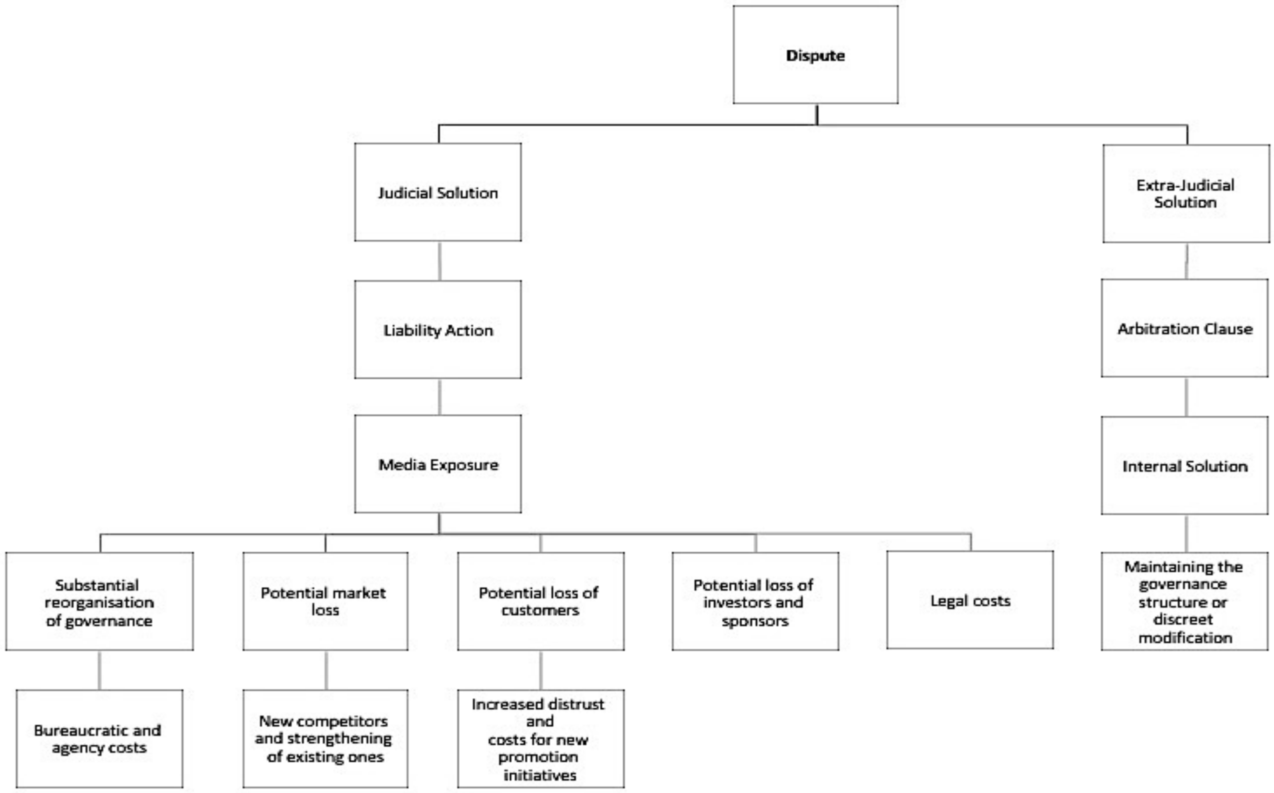

Fig. 2 – Potential consequences of judicial and extrajudicial solutions
(Source: author's elaboration)

Concerning our subject, two of the above-mentioned aspects emerge in particular: the "confidentiality" (Yu, 2011) and the "cost-effectiveness" of the practice (Mylovanov and Zapechelnyuk, 2013; Drahozal and Hylton, 2003). Confidentiality is the first feature that is useful to greatly reduce the potential reputational risk that litigation involves. According to the study conducted by Queen Mary University of London together with PwC in 2006, as many as 69% of respondents claim that arbitration minimizes the escalation of the dispute (Queen Mary University and PwC, 2006). As can be seen in Figure 2, the extra-judicial choice defines an "internal" solution that must be established by the parties in a "contractual" or "institutional" way (De Groot, 2015) through the adoption of the specific arbitration clause. According to the literature study and empirical evidence, the confidentiality feature not only reduces the escalation of the dispute but also reduces all potential negative economic effects in terms of bureaucratic costs, costs to face new market challenges as a result of the scandal, costs to recover new sponsors and investors as well as the above-mentioned legal costs. The arbitration clause is the source of arbitration (Fox, 1988) and indicates the disputes that may be the subject of arbitration, the type of arbitration, and how to appoint arbitrators (Agarval, 2016). The arbitration clause may also contain the specification of the time limit within which the arbitrators must deliver the arbitration award.

Without these arbitration clauses, once a dispute has arisen the parties can still agree to let the arbitrators examine and resolve their dispute using a different contract known as a "compromise". The statutory arbitration clauses must obligatorily provide that the appointment of the arbitrators must be entrusted to a person outside the company (Agarval, 2016). As an alternative, the company can resort to the traditional judicial settlement of the dispute, which can lead not only to media exposure for the company but would involve much more drastic solutions, as analyzed above.

This is where the principle of the economy comes in. Certainly, the costs of lawyers employed to follow the arbitration or related to the arbitration institution may seem a disadvantage in international contract cases (Queen Mary University and PwC, 2006). However, if the total costs of arbitration for institutional purposes are compared with the potential legal costs that traditional legal proceedings entail, the economic savings immediately emerge, not to mention the comparison of the total costs of arbitration with the potential economic and financial repercussions shown in Figure 2, which derive precisely from media exposure and are due to the "concatenated distortion" of relations with its stakeholders.

4 – Conclusions

Studies on Corporate Governance have made significant progress over time, trying to understand the evolutionary trend of companies. Given the importance they have at a global economic level, an in-depth analysis is required of the relationships that bind the various internal bodies but also and above all the repercussions that the decisions taken by managers have not only on shareholders but also on the company. Managers and the board of directors in general have enormous decision-making powers from which derive many responsibilities. It is on the basis of these considerations that corporate law and corporate governance studies have attempted to develop legislation capable of regulating the different roles but also the possible repercussions for the decisions taken.

This is the case with the *business judgement rule*, which presents a considerable variety of interpretations in the international context without finding a well-defined place. It is precisely this heterogeneity, in some cases wrapped up in a halo of discretion, that must make the injured parties taking part in corporate governance reflect on the potential alternative to a liability action.

In this sense, discretion makes it more difficult to assess when an investment or decision has been appropriate in the circumstances. Because of this "uncertainty", the injured parties are often not only at risk of having their claims rejected in court, but they are also at even greater risk of seeing the sacrifices made over the years for a deterioration in the reputation of the company of which they are part or with which they have multiple interests in common. Through the analysis of the reference literature, this work approaches a very current topic, defining specific interdisciplinary key aspects but reserving to successive empirical evidence the further demonstration of the doctrinal hypotheses.

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