

# Limitations on Derivative Actions in Germany and Japan to Prevent Abuse

*Arno L. Eisen*

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## I. INTRODUCTION

The derivative action ideally is a cornerstone of a corporate governance system. In a derivative suit, a shareholder may bring an action on behalf of the corporation<sup>1</sup> against a director to enforce the director's duties to the corporation.<sup>2</sup> The benefits of a successful derivative action are received by the corporation<sup>3</sup> and only indirectly by the shareholder who brought the derivative action through the higher value of the shares owned by that

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1 S. KAWASHIMA / S. SAKURAI, Shareholder Derivative Litigation in Japan: Law, Practice, and Suggested Reforms, in: *Stanford Journal of International Law* 33 (1997) 9; A. REISBERG, *Derivative Actions and Corporate Governance, Theory and Operation* (Oxford et. al. 2007) 5.

2 M. WEST, Why Shareholders Sue: The Evidence from Japan, in: *The Journal of Legal Studies* 30 (2001) 354; L. LARKIN COONEY, A Modality for Accountability to Shareholders: The American Way?, in: *Oklahoma City University Law Review* 28 (2003) 718.

3 KAWASHIMA/SAKURAI, *supra* note 1, 10.

shareholder.<sup>4</sup> This mechanism enables minority and outside shareholders to put a last resort check on the incumbent management, which only in very exceptional cases enforces the corporation's claims against themselves or their peers.<sup>5</sup> While overlapping with other corporate governance mechanisms, the derivative action not only provides for a checking mechanism on management but also has a deterrent effect for others.

The derivative action, as all litigation,<sup>6</sup> inherently carries the risk of abuse.<sup>7</sup> Abusive litigation refers to actions that are filed with unreasonable motivation by the plaintiff in order to harass the defendant or to gain unjustified benefits from the litigation at the cost of the defendant.<sup>8</sup> In the case of the derivative action, this risk of abuse is special as the abuse might harm not only the defendant but all shareholders of the corporation, especially if it is the corporation that pays an amount of money to the plaintiff in a settlement.<sup>9</sup> Such payments reduce the value of the shares of all shareholders. This risk multiplies the negative effect of abusive litigation in the case of the derivative action.

This inherent risk is seen as a possibility to gain benefits by some. Hence, there is a need for limitations on derivative actions that prevent such abuse.<sup>10</sup> Such limitations have to be carefully balanced against the need to give minority shareholders the chance to keep incumbent management in check through the derivative action as one piece of the corporate governance puzzle. The limitations are also important because abuse of the derivative action will limit its deterrent effect for others.<sup>11</sup>

In this paper, the limitations to prevent abuse of the derivative action are compared by analysing the laws of Germany and Japan because both countries have actors who make a living (at least partly) out of filing abusive actions against corporations.

In Japan, the use of the derivative action by *sōkai-ya* in order to achieve a payout in a settlement with the corporation or the director sued has been perceived as a specific risk of abuse.<sup>12</sup>

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4 Cf. WEST, *supra* note 2, 353.

5 Cf. X. LI, A Comparative Study of Shareholders Derivative Actions (Deventer 2007) 2; REISBERG, *supra* note 1, 1; M. GROTHEER, Außenhaftung von Aufsichtsratsmitgliedern, in: Wertpapier-Mitteilungen 2005, 2074.

6 Cf. T. FUJITA, Transformation of the Management Liability Regime in: Japan: In the Wake of the 1993 Revision in: Kanda/Kim/Milhaupt (eds.), Transforming Corporate Governance in East Asia (New York 2008), 20.

7 Cf. LI, *supra* note 5, 4-5 (Li is mostly referring to the plaintiff lawyer-driven abuse situation in the US, see p. 5, fn. 14, rather than the shareholder-driven abuse whose limitations this paper addresses). See also REISBERG, *supra* note 1, 7 (describing the risk of 'strategic behavior by minorities' and 'gold-digging claims').

8 FUJITA, *supra* note 6, 20.

9 Cf. FUJITA, *supra* note 6, 20.

10 LI, *supra* note 5, 5.

11 LI, *supra* note 5, 6.

12 KAWASHIMA/SAKURAI, *supra* note 1, 33; H. ODA, Japanese Law (3rd ed. Oxford et al. 2009) 255 (stating that the 1993 legislative changes spurred the fear of abuse of the derivative action in companies).

In Germany, so-called ‘robber shareholders’ have been known to file frivolous lawsuits against shareholders’ resolutions to gain a payout from the corporation to drop the action. The German legislature was aware of these robber shareholders when it passed the legislation in 2005 that amended the German *Aktiengesetz* (hereinafter: AktG)<sup>13</sup> to allow for a derivative action that can be brought by a shareholder directly.<sup>14</sup> Therefore, the German legislature explicitly implemented mechanisms that were designed to prevent the abuse of the derivative action.<sup>15</sup>

Comparatively, the Japanese situation is interesting because the *sôkai-ya* pose a perceived risk of abuse that is similar to the robber shareholders; and further, the number of derivative actions has risen exponentially since 1993 when the derivative action was ‘rejuvenated’<sup>16</sup> due, amongst other circumstances which are not entirely clear,<sup>17</sup> to the substantial reduction of the filing fee for derivative actions. Hence, a major barrier to the derivative action was removed and the number of derivative actions filed increased substantially.<sup>18</sup> In Germany, on the other hand, there has been only one attempt to use the relatively new derivative action.<sup>19</sup>

These circumstances allow the comparison of two systems of limitations on derivative actions which have developed under different legal regimes but share similarities in the threats of abuse. The comparison is used to determine the differences between the

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13 Engl. transl.: Law on Corporations.

14 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESTAGS-DRUCKSACHE (Legislative Materials of the German Parliament) 15/5092, 1, 10, 20.

15 *Id.*, at 10, 20.; Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 2; cf. G. SPINDLER, Haftung und Aktionärsklage nach dem neuen UMAG, in: *Neue Zeitschrift für Gesellschaftsrecht* 2005, 866; U. SEIBERT, Berufsoponenten – Anfechtungsklage – Freigabeverfahren – Haftungsklage: Das UMAG, eine Rechtsfolgenanalyse, in: *Neue Zeitschrift für Gesellschaftsrecht* 2007, 841.

16 KAWASHIMA/SAKURAI, *supra* note 1, 10.

17 Cf. D. PUCHNIAK/M. NAKAHIGASHI, Land of the Rising Derivative Action: Revisiting Irraioality to Understand Japan’s Unreluctant Shareholder Litigant in: Puchniak/Baum/Ewing-Chow (eds.), *Derivative Actions in Major Asian Economies: Legislative Design and Legal Practice* (Cambridge 2012) 128.

18 WEST, *supra* note 2, 352; FUJITA, *supra* note 6, 19. See also PUCHNIAK/NAKAHIGASHI, *supra* note 17, Appendix A.

19 In the case before the Landgericht München I (District Court Munich I), Decision of 29 March 2007, file reference: 5 HK O 12931/06, *Neue Zeitschrift für Gesellschaftsrecht* 2007, 477-478. Research for reported cases was conducted via the two major German online databases, Juris and Beck Online.

two systems and to derive insights into the effectiveness of specific limitation mechanisms or sets of limitation mechanisms.

Consequently, this paper analyses the history, structure and limitations to prevent abuse of the derivative action in Germany and Japan in parts II and III respectively. This analysis is the basis for a comparison of the results and the identification of similarities and differences in part IV. Part V provides conclusions drawn from the comparison and tries to derive insights on the effectiveness of limitation mechanisms based on these conclusions.

The comparison shows some similarities but more differences in the mechanisms of limitation that are provided in the laws of Germany and Japan. The differences can be traced back to the differing historical and systematic developments of the derivative action in the two countries. Furthermore, the comparison shows that especially barriers that require the plaintiff to provide substantial sums of money in order to file or to continue with the derivative action successfully limit the number of derivative actions. It can be argued that limitations that allow a court to assess the case before it is not only through the briefs of the parties but also through observation of the plaintiff in an oral hearing together with the potential to use a limiting mechanism involving monetary obligations for the plaintiff work most effectively in weeding out abusive claims while leaving meritorious ones alive. Still, this limiting system is mostly based on the subjective perception of the court and will have its shortcomings in practice because it is almost impossible to always determine whether a derivative action was filed with abusive intent.<sup>20</sup>

## II. THE GERMAN DERIVATIVE ACTION

### 1. *The History of the German Derivative Action*

The derivative action was only introduced into German corporate law as the new § 148 of the AktG in 2005 by the *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* (hereinafter: UMAG).<sup>21</sup> Therefore, the derivative action in Germany as a corporate governance mechanism is relatively young.

The introduction of the derivative action was the result of a long development which gradually worked its way from allowing shareholders to compel the *Aktiengesellschaft* (AG) to enforce claims against a member of the management or supervisory board of the AG via the right to bring an action through a special representative to the right of minority shareholders to bring derivative actions themselves.

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20 Cf. WEST, *supra* note 2, 374 (also states that the number of abusive *sōkai-ya*-related suits still appears to be small for the time before 2001).

21 Engl. transl.: Law for Corporate Integrity and for the Reform of Shareholder Law Suits.

Art. 223 of the *Allgemeines Deutsches Handelsgesetzbuch* (hereinafter: ADHGB),<sup>22</sup> which was introduced in 1884, for the first time in German corporate law provided for a right to compel the AG to file an action against a member of the management or supervisory board for any shareholder that held 20% or more of the shares of the AG. The quorum of 20% was lowered to 10% when the ADHGB was reformed into the *Handelsgesetzbuch* (hereinafter: HGB) in 1897.<sup>23</sup> The next reform that resulted in the separate enactment of the AktG, and exclusively concerned the law of corporations for the first time, even let shareholders who held 5% or more in the AG bring such an action to compel the AG to file an action against a member of the management or supervisory board of the AG.<sup>24</sup> This mechanism was retained in §§ 122-124 AktG when the law was reformed again in 1937.<sup>25</sup> In the big reform of the AktG after World War II in 1965, the three paragraphs were merged into one (then § 147 AktG 1965).

The mechanism that had evolved until then therefore was not a derivative action but rather a possibility for minority shareholders to compel the AG to enforce claims against a member of the management or supervisory board of the AG, and it included the right of the shareholders' meeting or the courts to appoint a special representative to act for the minority shareholders in these actions.<sup>26</sup>

In 1998 a mechanism for the enforcement of claims against a member of the management or supervisory board of the AG by minority shareholders was introduced in § 147 (3) AktG through the reform of the AktG by the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* (hereinafter: KonTraG).<sup>27</sup> Still, even though the action was to be initiated by resolution of the shareholders' meeting or by minority shareholders representing at least 10% of the statutory capital or holding shares with a par value of EUR 1 million, the right was limited to having a special representative of the AG appointed by the competent court to file the action against a member of the management or supervisory board of the AG on behalf of the AG. The named plaintiff in the proceedings was still the AG<sup>28</sup> and not the minority shareholders, and the special representative was the person in control of the proceedings.<sup>29</sup> The special representative was a representative of the AG and not of the minority shareholders, and it had to be neutral in

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22 Engl. transl.: General German Commercial Code.

23 Engl. transl.: Commercial Code. See § 268 HGB 1897; cf. K. SCHMIDT, *Verfolgungspflichten, Verfolgungsrechte und Aktionärsklagen: Ist die Quadratur des Kreises näher gerückt? Gedanken zur Reform der §§ 147-149 AktG vor dem Hintergrund der Juristentagsdiskussion des Jahres 2000*, in: *Neue Zeitschrift für Gesellschaftsrecht* 2005, 797.

24 SCHMIDT, *supra* note 23, 797.

25 SCHMIDT, *supra* note 23, 797.

26 Cf. SCHMIDT, *supra* note 23, 797; LI, *supra* note 5, 193.

27 Law for Control and Transparency in the Corporate Sphere.

28 Cf. SCHMIDT, *supra* note 23, 797.

29 This was a distinct difference to some common law systems where the corporation is still the named plaintiff in a statutory derivative action but the shareholder is the one in control of the proceedings (e.g. s. 216A Companies Act of Singapore). Cf. for the situation under English law: REISBERG, *supra* note 1, 5.

deciding whether the action should be brought or not.<sup>30</sup> At the same time the minority shareholders did not have a right to legal recourse if the special representative decided not to bring the action.<sup>31</sup> Therefore, this did not amount to a derivative action with a special representative representing the minority shareholders, but rather a modified mechanism to compel the AG to enforce its claims against members of the management or supervisory board.

Only with the reform of the AktG by the UMAG in 2005 was a real derivative action introduced, giving the minority shareholders the right to file an action against a member of the management or supervisory board of the AG in their own right requesting the payment of damages to the AG.

## 2. *The Current Structure of the German Derivative Action*

The derivative action under § 148 AktG as it was introduced in 2005 requires the shareholders who want to bring the derivative action to go through preliminary certification proceedings before they can file the derivative action.<sup>32</sup> It follows from § 148 (2) sentence 9 AktG that the preliminary certification proceedings are proceedings where the parties are the minority shareholders and the member of the management or supervisory board who allegedly breached his or her duties; the AG has to be made a summoned party to these proceedings<sup>33</sup> as they concern its affairs.

To be certified for the derivative action, the shareholder or shareholders wishing to bring the derivative action need to meet the quorum requirement of § 148 (1) sentence 1 AktG, which stipulates that only shareholders who together hold 1% of the statutory capital or shares with a par value of EUR 100,000 can be certified for the derivative action. Furthermore, the shareholders need to prove that they held the shares before they gained knowledge of the alleged breach of a member of the management or supervisory board or of the alleged damage to the AG. Before filing for certification, the shareholders must have demanded the AG to file the action against the member of the management or supervisory board without success. In addition to these prerequisites, it is necessary that the shareholders present to the court facts that support the suspicion of damage suffered by the AG because of a severe breach of the law or dishonesty by the member of the management or supervisory board. Finally, the court has to be convinced

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30 Cf. W. BAYER, *Aktionärsklagen de lege lata und de lege ferenda*, in: *Neue Juristische Wochenschrift* 2000, 2615.

31 Cf. BAYER, *supra* note 30, 2615.

32 SCHMIDT, *supra* note 23, 800; C. ZIEGELMEIER, *Die Systematik der Haftung von Aufsichtsratsmitgliedern gegenüber der Gesellschaft*, in: *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 2007, 149; H.-F. MÜLLER, *Die Durchsetzung konzernrechtlicher Ersatzansprüche nach dem UMAG*, in: *Der Konzern* 2006, 728.

33 Cf. N. PASCHOS/K.-U. NEUMANN, *Die Neuregelung des UMAG im Bereich der Durchsetzung von Haftungsansprüchen der Aktiengesellschaft gegen Organmitglieder*, in: *Der Betrieb* 2005, 1781.

that there are no predominant reasons arising out of the sphere of the AG that justify the non-enforcement of the alleged claim. If the shareholders pass these hurdles and become certified, they have to file the derivative action within three months of the certification decision's legal effect after requesting the AG to file the action on its own once more.

In the following, the prerequisites of the certification proceedings and the derivative action are discussed in detail.

a) *The preliminary certification proceedings*

(1) The quorum requirement

Shareholders who desire to file a derivative action have to fulfil the quorum requirement of § 148 (1) sentence 1 AktG, which stipulates that only shareholders who together hold 1% of the statutory capital or shares with a par value of EUR 100,000 can move to be certified to bring a derivative action.

(2) Necessity to own the shares before gaining knowledge of the alleged breach and/or damage

The shareholders must prove that they acquired the AG's shares before they had knowledge through publications of the alleged breach of fiduciary duties and/or damage to the AG (§ 148 (2) sentence 2 no. 1 AktG). In the case that the alleged breach of fiduciary duties by a member of the management or supervisory board or a damage to the AG has been publicized in a major news medium, the shareholders have the burden of proof to show that they held the shares before such publication of the alleged breach and/or damage.<sup>34</sup> In cases of an on-going breach over a longer period of time, the first publication is decisive as it will raise the suspicion of the breach.<sup>35</sup> The publication does not have to be detailed. It suffices that it reports an alleged breach or an alleged damage to the AG.<sup>36</sup> Furthermore, it is irrelevant if the shareholders indeed gained knowledge of the publication. The wording of § 148 (1) sentence 2 no. 1 AktG refers only to the fact that the shareholders should have gained knowledge through the publication.<sup>37</sup>

(3) Prior request to the AG to file an action

The shareholders have to show that they requested the AG to file the action against a member of the management or supervisory board itself without success while providing a reasonable deadline for the AG to do so (§ 148 (1) sentence 2 no. 2 AktG). A deadline of two months is considered reasonable by the legislature.<sup>38</sup> Considering the two-tiered

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34 SPINDLER, *supra* note 15, 866; PASCHOS/NEUMANN, *supra* note 33, 1780.

35 SPINDLER, *supra* note 15, 866.

36 SPINDLER, *supra* note 15, 866.

37 Cf. SPINDLER, *supra* note 15, 866.

38 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESTAGS-DRUCKSACHE (Legislative

board structure of the AG, it has to be assumed that the request has to be addressed to either the management board or the supervisory board which would be competent to file an action against a member of one of the boards respectively under §§ 78, 112 AktG.<sup>39</sup>

(4) Presentation of facts that support the suspicion of a breach

A competent court needs to be satisfied that there are facts present that support the suspicion that the AG has suffered damage because of dishonesty or a severe breach of the law (§ 148 (1) sentence 2 no. 3 AktG). The term ‘dishonesty’ is understood to at least cover criminal acts.<sup>40</sup> In the case of a breach of law, the severity of the breach lined up with factual evidence is decisive for the court.<sup>41</sup> The restriction to criminal acts and severe breaches substantially reduces the scope of the underlying cause of action out of §§ 93, 116 AktG. The restriction leads to a situation where only cases of very substantial breaches will fall within the scope of cases that can reach certification. Hence, these cases are not cases in which the court will have to measure the board members’ acts in light of the business judgment rule of § 93 (1) sentence 2 AktG. The cases that are to be covered by § 148 (1) sentence 2 no. 3 AktG are cases that go beyond entrepreneurial misjudgements and are rather serious breaches of fiduciary duties where a non-prosecution of such behaviour would be intolerable and would shake up the corporate and financial community.<sup>42</sup>

(5) No predominant grounds<sup>43</sup> for non-enforcement of the alleged claim

As a negative prerequisite, there shall be no predominant grounds present arising out of the sphere of the AG that support the non-enforcement of the potential claim against a

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Materials of the German Parliament) 15/5092, 22; Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill introducing the derivative action into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 43/44.

39 Cf. PASCHOS & NEUMANN, *supra* note 33, 1780.

40 PASCHOS & NEUMANN, *supra* note 33, 1780.

41 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESTAGS-DRUCKSACHE (Legislative Materials of the German Parliament) 15/5092, 22; Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill introducing the derivative action into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 44.

42 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 44.

43 Following the English translation also chosen by LI, *supra* note 5, 231.



member of the management or supervisory board (§ 148 (1) sentence 2 no. 4 AktG). This prerequisite should in almost all cases be fulfilled as it is hard to imagine that there will be a case where the prerequisite of facts that support the reasonable suspicion of a criminal act (a dishonesty in terms of § 148 (1) sentence 2 no. 3 AktG) is fulfilled and a reason arising from the sphere of the AG exists that would make it reasonable to pursue the alleged claim. The language of the provision with the wording of ‘predominant grounds’ already shows that the circumstances must be exceptional. The provision needs to be read in the light of the landmark decision of the *Bundesgerichtshof* (hereinafter: BGH),<sup>44</sup> the highest German court in civil matters, in *ARAG v. Garmenbeck*.<sup>45</sup> In this decision, the BGH held that the enforcement of claims against members of the management board by the supervisory board on behalf of the AG has to be the rule, and that reasons that can prevent the supervisory board from enforcing such a claim must be grave reasons.<sup>46</sup> Considering this background and the wording, it becomes clear that the prerequisite in the law is supposed to set an even higher threshold than the one that was set in *ARAG v. Garmenbeck* because the law uses the word ‘predominant’ whereas the *ARAG v. Garmenbeck* decision used the word ‘grave’.<sup>47</sup> Consequently, § 148 (1) sentence 2 no. 4 AktG provides for a safe harbor with an extremely small and treacherous entrance. The non-certification of a shareholder for bringing a derivative action because of predominant grounds out of the sphere of the AG that support the non-enforcement of the alleged claim will be the absolute exception in extremely rare cases.

*b) The main proceedings*

In the case of certification by the court, the shareholder under § 148 (4) sentence 1 AktG has to file the derivative action within three months from the day the certification decision has become binding for the main proceedings to be initiated. According to § 148 (4) sentence 1 AktG, the AG has to be requested again to file the action against the member of the management or supervisory board itself. This request can already be made to-

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44 The Bundesgerichtshof is the German Federal Court of Justice, the highest German appellate court in civil and criminal cases. Cf. K. LANGENBUCHER, *Vorstandshandeln und Kontrolle, Zu einigen Neuregelungen durch das UMAG*, in: *Deutsches Steuerrecht 2005*, 2089.

45 BGH, Decision of 21 April 1997 – II ZR 175/95 (*ARAG v. Garmenbeck*), BGHZ (Official collection of decisions of the BGH in civil cases) 135, 255.

46 BGH, Decision of 21 April 1997, 255.

47 Cf. *Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG)* (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESTAGS-DRUCKSACHE (Legislative Materials of the German Parliament) 15/5092, 22; cf. *Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG)* (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 45; cf. SCHMIDT, *supra* note 22, 800.

gether with the first request under § 148 (1) sentence 2 no. 2 AktG because the AG will be party to the certification proceedings and thereby will be informed about the course of the proceedings and the successful certification.<sup>48</sup>

Materially, the shareholder will have to prove the breach of fiduciary duties by the member or members of the management or supervisory board of the AG under §§ 93, 116 AktG in order to succeed with the derivative action.

*c) Cost of the German derivative action*

The cost of the certification proceedings is to be carried by the shareholders in accordance with § 148 (6) sentence 1 AktG if they are not certified in the certification proceedings.<sup>49</sup> The only exception from this rule applies if the shareholders are not certified for predominant reasons that arise out of the sphere of the AG under the exception in § 148 (1) sentence 2 no. 4 AktG. If the AG could have notified the shareholders of this reason before filing for the preliminary certification proceedings but did not, then the AG has to indemnify the shareholders under § 148 (6) sentence 2 AktG. This is due to the fact that the shareholders are acting on behalf of the AG.<sup>50</sup>

Furthermore, the AG has to cover the shareholders' cost if it files the action itself or takes over the shareholders' action under § 148 (3) sentences 1, 2 AktG.

If the shareholders' main derivative action is dismissed by the court, the AG has to cover the shareholders' cost if the certification was not gained through intentional or grossly negligent wrong pleading by the shareholders (§ 148 (6) sentence 5 AktG).

Consequently, in regular cases, the cost risk rests upon the shareholders during the certification proceeding but shifts to the AG if the certification is gained.

The court filing fee for the preliminary certification proceedings depends on the amount in dispute. The amount of damages that the shareholders are claiming to be paid to the AG generally determines the amount in dispute. Under § 53 (1) no. 4 *Gerichtskostengesetz* (hereinafter: GKG),<sup>51</sup> the amount in dispute is limited to EUR 500,000 for purposes of calculating the filing fee for the preliminary certification proceedings under § 148 (1) AktG. The filing fee for an action under § 148 (1), (2) AktG is limited to one fee under number 1640 of annex I to § 3 (2) GKG. The maximum filing fee for the preliminary certification proceedings is therefore EUR 2,956. The overall cost risk including the cost of representation in accordance with the schedule of fees is approximately EUR 12,000.<sup>52</sup>

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48 SPINDLER, *supra* note 15, 868.

49 C. DUVE/D. BASAK, Ungeahnte Unterstützung für aktive Aktionäre – wie das UMAG Finanzinvestoren hilft, in: Betriebs-Berater 2006, 1348.

50 SPINDLER, *supra* note 15, 869.

51 Engl. transl.: Law on Court Fees.

52 PASCHOS/NEUMANN, *supra* note 33, 1786 and note 68.

While the filing fee for the main action will be determined in relation to the actual amount in dispute without limitation, the shareholders bringing the derivative action can rely on their indemnification claim against the AG (even if they lose the case).

### 3. *Limitations to Prevent Abuse of the German Derivative Actions by Shareholders*

#### a) *The preliminary certification proceedings in general*

The first and foremost limitation on the German derivative action in order to prevent abuse by shareholders are the preliminary certification proceedings in general. These proceedings are designed to put the case in front of a court in proceedings where the parties (the shareholder(s) who want to bring the derivative action and the board member who allegedly breached his or her duties) have to appear before the court. Thereby, the legislature wanted to create a procedure that would enable the court in the earlier stages of the proceedings to weed out frivolous and abusive derivative actions.<sup>53</sup> The main argument for this limitation is that the court will be in a good position to distinguish between abusive and meritorious cases as they are presented with the parties' briefs and get to observe the parties in the proceedings.

#### b) *The quorum requirement*

The quorum requirement of 1% of the statutory capital or shares with a par value of EUR 100,000 is designed to prevent actions that cannot be seriously derived from the size of the economic participation in the AG.<sup>54</sup> The quorum requirement also may create the necessity that several shareholders have to get together to meet the requirement.<sup>55</sup> This further reduces the possibility of abusive derivative actions because in those cases all shareholders who get together would have to have the same abusive intent.<sup>56</sup>

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53 Cf. Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 17, 41.

54 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 41 (at that stage still concerning 1% of the statutory capital or EUR 100,000 of shares at their market value; the stock market value approach was later changed to a par value approach).

55 The UMAG created an online forum under § 127a AktG to facilitate the getting together of shareholders for several purposes, including finding other shareholders to meet the quorum requirement.

56 PASCHOS/NEUMANN, *supra* note 33, 1780.

c) *The requirement to have held the shares before news of the alleged breach by a board member or alleged damage of the AG were publicized*

The requirement to have held the shares before news of the alleged breach by a board member or an alleged damage of the AG were publicized is designed to prevent abuse by shareholders who acquire their shares after the news was released in order to profit from bringing a derivative action by getting bought out. Likewise the requirement is meant to prevent the acquisition of shares to bring a derivative action at such a point in time by borrowing the shares just in order to gain standing while not having to make a significant investment.<sup>57</sup> The fact that the requirement also extends to reports of an alleged damage of the AG also limits speculation by abusive investors who would buy shares after gaining knowledge of such reports in the hope of being able to capitalize on this news through bringing a derivative action based on alleged breaches of duty by board members that led to the alleged damage.<sup>58</sup>

d) *The limitation to severe breaches of the law*

The limitation to severe breaches of the law as a prerequisite for gaining certification limits the potential of abuse because it does not allow a shareholder with abusive intent to start a derivative action for any kind of negligent or light breach of the law. By limiting the scope of potential derivative actions in this way, the incentive for potential abuse is reduced.

e) *The possibility for the AG to take over the proceedings*

The potential for abuse of the German derivative action by shareholders is further reduced by the possibility of the AG under § 148 (3) sentences 1, 2 AktG to take over proceedings that have been initiated against one of its board members by initiating its own action in the same matter and thereby rendering the derivative action or the preliminary certification proceedings inadmissible or by assuming the position of the plaintiff in the derivative action itself. Hence, the AG can assume the position of the plaintiff itself. Then it has control over the proceedings and can withdraw the proceedings in accordance with § 148 (6) sentence 4 and § 93 (4) sentences 3, 4 AktG if it gets a resolution of the shareholders' meeting that it can withdraw the action and if there is no objection by shareholders who represent at least 10% of the statutory capital.<sup>59</sup> The discrepancy between the quorum of 1% of the statutory capital to file for a derivative

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57 Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 43.

58 Cf. PASCHOS/NEUMANN, *supra* note 33, 1780.

59 Cf. PASCHOS/NEUMANN, *supra* note 33, 1784.

action and of 10% of the statutory capital to successfully object to a withdrawal or termination of the action by the AG also ensures that not every shareholder or group of shareholders that initiated the derivative action can also block the termination of the action after it has been taken over by the AG.

Apart from the cost that the AG has to cover when taking over the proceedings under § 148 (6) sentence 4 AktG, and the administrative costs connected with a shareholders' meeting, there is no further cost risk connected with such a procedure. While these costs might still be substantial in cases of large AGs with numerous shareholders, the provision also has a deterrent effect as it presents another obstacle in the way of abusive shareholders bringing the derivative action in order to gain a personal profit for themselves by getting bought out of the right to pursue the derivative action.

*f) The disclosure duty for terminations of the derivative action*

A further important limitation on the abuse of the German derivative action is the duty to disclose the facts of any termination of the derivative action under § 149 AktG.<sup>60</sup> It has to be noted that this limitation applies only to listed AGs. The disclosure duty covers the termination of the preliminary certification proceedings as well as the main derivative action.<sup>61</sup> This makes sense because the danger of abuse is already connected with the preliminary certification proceedings.

The disclosure duty covers any kind of termination and thereby especially settlements, which would be the natural aim of an abusive shareholder trying to get paid for withdrawing the derivative action. § 149 (2) sentence 1 AktG requires that all and any terminating agreement along with supplementary agreements has to be published in the original wording and containing all names of the parties involved. In accordance with § 149 (2) sentence 2 AktG, the disclosure documents also have to separately describe any payments or other performance by the AG or by parties attributable to the AG. The complete disclosure is a prerequisite for the effectiveness of all duties arising out of the terminating agreement under § 149 (2) sentence 3 AktG. If complete disclosure is not made, then any performance of the duties under the terminating agreement is without legal cause and can be reclaimed under § 149 (2) sentence 5 AktG.

§ 149 (3) AktG clarifies that the stipulations of § 149 (1), (2) AktG also cover any agreement that is made in order to prevent the filing of preliminary certification proceedings or a derivative action. This equal treatment covers the stage before proceedings are even started, which is helpful because it deters attempts by abusive shareholders to

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60 Cf. Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), BUNDESRATS-DRUCKSACHE (Legislative Materials of the Federal Council of Germany) 3/05, 50; SPINDLER, *supra* note 15, 869.

61 Cf. U. HÜFFER, *Aktiengesetz, Kommentar* (Commentary), (10th ed. Munich 2012) § 149, para. 2.

threaten a board member and the AG with the initiation of a preliminary certification proceeding for the derivative action in order to get the AG or the board member to enter into a settlement which pays off the shareholder.

*g) The cost risk in cases of abuse*

Another limitation is placed within the provision stipulating who has to bear the cost of the derivative action. While in general the provision of § 148 (6) sentence 5 AktG determines that the AG has to indemnify the shareholders for their costs in the case of losing the derivative action, this is not the case if the shareholders gained certification by pleading intentionally or grossly negligent wrong facts. Hence, abusive shareholders who even go as far as basing their claim on wrong facts in order to gain a chance to profit from a settlement will sit on their costs if the board member concerned and the AG sit out the proceedings and can prove such behaviour.

*h) Abuse of rights doctrine*

A final limitation can be found in the general abuse of rights doctrine contained in § 242 of the *Bürgerliches Gesetzbuch* (BGB).<sup>62</sup> While the wording § 242 BGB only refers to the concept of good faith, it is generally accepted that this concept also covers the abuse of rights doctrine.<sup>63</sup> Under this doctrine, it is abusive if a party only files a derivative action in order to use its nuisance value to gain a benefit from a settlement with the defendant at the expense of the AG or with the AG directly. A court could therefore deny certification of the derivative action on the grounds of the abuse of rights doctrine arising out of § 242 BGB within the scope of § 148 (1) sentence 2 no. 4 AktG. It would find a predominant ground against the enforcement of the alleged claim arising out of the sphere of the AG in the form of the abuse of the shareholder's right to bring a derivative action, which arises out of the relationship between the shareholder with the other shareholders and the AG itself.

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62 Engl. Transl.: Civil Code.

63 See e.g. G. ROTH/C. SCHUBERT, in: Rebmann/Säcker/Rixecker (eds.), *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (Commentary on the German Civil Code), Schuldrecht, Allgemeiner Teil (Law of Obligations, General Part), (6th ed. Munich 2012) § 242, para. 198 et seq.; P. MANSEL, in: Jauernig, *Bürgerliches Gesetzbuch*, (14th ed. Munich 2011) § 242, para. 37; H. SUTSCHET, in: Bamberger/Roth (eds.), *Beck'scher Online-Kommentar BGB* (Online-Commentary on the German Civil Code) (24<sup>th</sup> ed. Munich 2012) § 242, para. 57.

### III. THE JAPANESE DERIVATIVE ACTION

#### 1. *The History of the Japanese Derivative Action*

Initially, it is interesting to note that the Japanese Commercial Code of 1899, which was modelled after German law – unsurprisingly, given this background – contained a right for minority shareholders holding one-tenth or more of a company’s capital to require the company to file an action against directors similar to the one contained in § 268 of the German HGB 1897.<sup>64</sup>

The derivative action (*kabunushi daihyô soshô seido*) was introduced into Japanese corporate law in 1950<sup>65</sup> during the reforms of the allied occupation period.<sup>66</sup> The derivative action system as it was introduced then and is still in existence in the Japanese Companies Act of 2005<sup>67</sup> (hereinafter: Companies Act) in the form that it has taken after the reform in 2006 is based on the derivative action of the Illinois Corporations Act 1933. After its introduction, the derivative action was mostly dormant,<sup>68</sup> and until 1993 only a few cases were recorded.<sup>69</sup>

A major change that influenced the use of the derivative action in Japan came about in 1993 with a legal reform which led to a substantial reduction of the filing fee for a derivative action. The Commercial Code, following the judgment of the Tokyo High Court in *Asai v. Iwasaki et al.*,<sup>70</sup> was amended to provide in Art. 267 (4)<sup>71</sup> that the derivative action was to be deemed an action relating to a claim which is not a claim based on a property right in calculating the value of the subject-matter of the suit. Consequently, the value of the subject-matter of the dispute was to be determined in accordance with Art. 4 (2) of the Law on the Fee of Civil Lawsuits. Therefore, the amount in dispute was deemed to be incalculable and set at ¥ 950,000, leading to a fixed filing fee of ¥ 8,200.<sup>72</sup> Before this change, the filing fee was determined by the amount in dispute and therefore by the amount of damages sought by the plaintiff.<sup>73</sup> Con-

64 Cf. *supra* II.1.; KAWASHIMA/SAKURAI, *supra* note 1, 13.

65 FUJITA, *supra* note 6, 16.

66 Cf. T. FUJITA, *Modernising Japanese Corporate Law: Ongoing Corporate Law Reform In Japan*, in: *Singapore Academy of Law Journal* 16 (2004) 322, 341; KAWASHIMA/SAKURAI, *supra* note 6, 14.

67 *Kaisha-hô*, Law No. 86/2005, as amended by Law No. 109/2006; Engl. transl.: <http://www.kl.i.is.nagoya-u.ac.jp/told/h17a08601en.3.2.txt>, last viewed: 5 October 2012.

68 B. ARONSON, *Reconsidering the Importance of Law in Japanese Corporate Governance: Evidence from the Daiwa Bank Shareholder Derivative Case*, in: *Cornell International Law Journal* 36 (2002) 23.

69 FUJITA, *supra* note 66, 341; WEST, *supra* note 2, 351; M. WEST, *The Pricing of Shareholder Derivative Actions in Japan and in the United States*, in: *Northwestern University Law Review* 88 (1994) 1438.

70 Tokyo High Court, 30 May 1993, *Kosai-Minshû* 46, 20.

71 Now Art. 847 (6) Companies Act.

72 FUJITA, *supra* note 6, 17.

73 Cf. FUJITA, *supra* note 6, 16.

sequently, the filing fee presented a major deterrent from filing a derivative action as it was substantial if the damages sought were high.

While the use of the derivative action rose due to the lower filing fee in the years after 1993,<sup>74</sup> many derivative actions were dropped once the court ordered the plaintiff to post a bond for security for costs under Art. 267 (6) and (7) of the Commercial Code.<sup>75</sup> Such orders were regularly issued upon request of the defendant by the court. This was the prevailing court practice, if a *prima facie* assessment showed that the action had little chance of succeeding and was thus regarded to have been filed in bad faith. This allowed the court to order security for costs.<sup>76</sup>

This practice was changed by the landmark decision of the Osaka High Court<sup>77</sup> in 1997 in appeals against the preliminary decisions of the Osaka District Court which ordered the plaintiff to post a bond for security for costs in the derivative actions against directors of Daiwa Bank. In the years after the 1993 reform that lowered the filing fee, it was common for the court seized in a derivative action to order the plaintiff to post a bond for security for costs.<sup>78</sup> The decision by the Osaka High Court in this case was a landmark because it set a higher standard for the practice of requesting the plaintiff in a derivative action to post a bond for security for costs, and thereby seemed to further reduce the obstacles in bringing a derivative action.<sup>79</sup> Still, there is no empirical evidence that shows that the number of derivative actions rose further after this decision.

The framework of the derivative action was again altered in 2001 when a Commercial Code reform enabled the exemption of the management from liability by shareholders' super-majority voting, by the board's decision when authorized in the certificate of incorporation and by contract between an outside director and the company when authorized in the certificate of incorporation.<sup>80</sup> Thereby, the amount recoverable from directors in derivative actions may be capped.

The Companies Act in general retained the existing derivative action. The reform extended the scope of the derivative action from only directors to include statutory auditors, incorporators, liquidators and officers.<sup>81</sup>

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74 FUJITA, *supra* note 6, 17; WEST, *supra* note 2, 352; KAWASHIMA/SAKURAI, *supra* note 1, 21.

75 The mechanism was retained in the Companies Act in Art. 847 (7) and (8).

76 Cf. FUJITA, *supra* note 6, 21; FUJITA, *supra* note 66, 342.

77 Osaka High Court, 8 December 1997, Shiryô-ban Shôji Hômu 166, 138; Osaka High Court, 18 November 1997, Shiryô-ban Shôji Hômu 165, 291.

78 ARONSON, *supra* note 68, 24.

79 Cf. ARONSON, *supra* note 68, 25/26.

80 Art. 266 (7), (12), and (19) Commercial Code. Now Art. 425, 426 of the Companies Act with only minor amendments.

81 Cf. Art. 847 (1) Companies Act; ODA, *supra* note 12, 253.



## 2. *The Structure of the Japanese Derivative Action*

### a) *Requirement to have held shares for six months or more before demanding the filing of an action from the company*

Any shareholder who has held at least one share in the company before demanding the filing of an action from the corporation can file a derivative action under Art. 847 (1) Companies Act. This is not a contemporaneous ownership requirement<sup>82</sup> or in some way connected with the knowledge of the alleged breach by a director, statutory auditor, incorporator or liquidator.<sup>83</sup> If the shareholder ceases to be a shareholder during the derivative action the action must be dismissed under Art. 851 Companies Act if the shareholder does not fulfil one of the exceptional circumstances under which he or she has lost the status of shareholder (e.g. a merger).<sup>84</sup>

### b) *Demand to the company to file an action*

Before the shareholder can file a derivative action, that shareholder has to request that the company file an action for the alleged breach or damage. The right to request that the company file the desired action is not available to the shareholder if the action that the shareholder wants the company to pursue is one that seeks unlawful gains for the shareholder or a third party or seeks to inflict damage on the company. The unavailability of the right to demand creates the unavailability of the derivative action for the shareholder in such cases.

### c) *Expiration of the waiting period of sixty days and filing of the derivative action*

When sixty days from the day of the request to the company have passed without the company filing the requested action, the shareholder can file the derivative action with the competent court having jurisdiction over the location of the head office of the company<sup>85</sup> under Art. 847 (3) Companies Act. Under Art. 847 (4) Companies Act, the company has the duty to notify the shareholder in writing without delay of its decision not to pursue the desired action and its reasons for the non-pursuit. In cases in which the company refuses to file the desired action before the sixty days have elapsed and gives notice to the shareholder as required by Art. 847 (4) Companies Act, the shareholder can

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82 As noted for the prior provision of Art. 267 (1) of the Commercial Code by K. UTSUMI, *The Business Judgment Rule and Shareholder Derivative Suits in Japan: A Comparison with those in the United States*, in: *New York International Law Review* 14 (2001) 134 and Z. SHISHIDO, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and their Solutions*, in: *Delaware Journal of Corporate Law* 25 (2000) 197.

83 These are the persons against which a derivative action can be brought under Art. 847 (1) Companies Act.

84 Cf. M. MATSUSHITA (ed.), *CCH, Japan Business Law Guide*, 15-420.

85 Art. 848 Companies Act.

file the derivative action at this point because the company has made its intention clear not to pursue the alleged claim.

If the waiting period of sixty days creates the likelihood of irrecoverable loss to the company, the shareholder may file the derivative action immediately under Art. 847 (5) Companies Act.

The shareholder has the duty to inform the company of the filing of the derivative action, which in turn has to inform the other shareholders.<sup>86</sup>

*d) Substance of the derivative action*

The derivative action will be based on a cause of action under Articles 120 (3), 212 (1), 285 (1) or 423 (1) Companies Act. The cause of action in the case of a derivative action against a director based on Art. 423 (1) Companies Act will be for the breach of the duty of a good manager under Art. 330 Companies Act, the duty of loyalty (Articles 355, 419 (2) Companies Act), the duty of supervision under Art. 357(1) Companies Act, or the duty to establish the internal control system arising out of Art. 348(4), 362(5) Companies Act.

*e) Cost of the derivative action*

The filing fee for the derivative action is ¥ 8,200 under Art. 847 (6) Companies Act and Art. 4(2) of the Law on the Fee of Civil Lawsuits. If the shareholder prevails with a derivative action, the shareholder can recover reasonable costs excluding court fees from the company under Art. 852(1) Companies Act. If the shareholder loses the case, the shareholder cannot recover legal costs from the company but is also protected from having to reimburse the company for losses due to the failed derivative action under Art. 852(2) Companies Act. Under Japan's 'loser pays'<sup>87</sup> system of costs, a losing shareholder will have to pay the defendant's cost.

*3. Limitations to Prevent Abuse of the Japanese Derivative Actions by Shareholders*

*a) No right to demand filing of an action from the company with abusive intent*

The right to demand the filing of an action against a director, incorporator, liquidator or statutory auditor from the company under Art. 847 (1) Companies Act, which is a prerequisite for the possibility to file a derivative action under Art. 847 (3) Companies Act, is not available to a shareholder who wants to demand the filing of an action to seek an unlawful gain or to inflict harm on the company.<sup>88</sup> Thereby, the law limits the availabil-

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<sup>86</sup> ODA, *supra* note 12, 253.

<sup>87</sup> Art. 89 *Minji soshô-hô*, Law No. 109/1996, as amended by Law No. 95/2007; Engl. transl.: <http://www.kl.i.is.nagoya-u.ac.jp/told/h08a10901en.3.0.txt>, last viewed 5 October 2012.

<sup>88</sup> Cf. Art. 847 (1) Companies Act, at the end of the paragraph.

ity of the derivative action to shareholders who have abusive intent by preventing them from validly fulfilling the prerequisites to gain the right to file a derivative action.

*b) Security for costs orders by the court on petition of the defendant*

Under Art. 847 (7) and (8) Companies Act, a competent court can order the plaintiff in a derivative action to provide reasonable security for costs in response to a petition by the defendant. To succeed with such a petition, the defendant has to show *prima facie* that the derivative action has been filed in bad faith. After the 1993 reduction of the filing fee, courts regularly granted such orders on petition by the defendant if they believed that the case had little chance of success.<sup>89</sup> This approach changed after the preliminary rulings in the Daiwa Bank cases.<sup>90</sup> Nonetheless, this mechanism provides the court with a possibility to weed out abusive cases at an early stage of the proceedings if the defendant moves to obtain an order for security for costs. The fact that the amount of security is based on the amount of damages sought leads to very substantial sums of security that would have to be provided by the plaintiff. These sums work as a deterrent of abusive derivative actions because the plaintiff will not be willing to continue the case at this heightened financial risk. The situation after the preliminary rulings on security for costs in the Daiwa Bank cases is seen as giving the courts a possibility to flexibly review cases while still having available the security for costs mechanism to weed out abusive cases without ending non-abusive cases at a preliminary stage.<sup>91</sup> The court is in a position to use this technique wisely as it has the briefs of the parties and their court appearances available to make its assessment on the case's abusive or non-abusive character.

*c) Right of the company to object to settlements*

Under Art. 850 (2) Companies Act, the company is to be informed by the court of any settlement in a derivative action to which it is not party. The company then has the possibility to object to this settlement within two weeks.<sup>92</sup> This provision was introduced in the 2005 reform of the company law and is therefore a limitation that did not exist under the Commercial Code. Still, the provision does not provide for the facilitation of in-court settlements under review by the court; instead, it simply gives the company the right to object to any settlement. The effect of this objection remains unclear.

While this limitation does not address the case of a derivative action filed with the abusive intent to gain a profit from a settlement with the defendant and the company, it is still a barrier to reaching a deal with the person against whom the derivative action is

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89 FUJITA, *supra* note 6, 21.

90 *Supra* III.1.

91 Cf. ARONSON, *supra* note 68, 41 (referring to the situation before the Daiwa Bank preliminary rulings).

92 Cf. ODA, *supra* note 12, 255.

filed because it opens any potential settlement with that person to the scrutiny of the company as the involved third party on whose behalf the derivative action was filed by the shareholder. Hence, this provision merely protects the interest of the company in any settlement of a derivative action and indirectly also works as a limitation on the abuse of derivative actions. The provision protects the company from settlements that would confer improper benefits on the plaintiffs and defendants in a derivative action at the expense of the company.<sup>93</sup> Nonetheless, since the provision does not provide for a court review of the settlement but merely for the right to object, the effect of the limitation has to be seen as minor in deterring potential abusive derivative actions.

*d) Abuse of rights doctrine*

A further limitation is to be found in general Japanese civil law. The abuse of rights doctrine as enacted in Art. 1 (3) of the Japanese Civil Code<sup>94</sup> stipulates that a party cannot use its legal rights with the sole intent of harming another without any legitimate benefit to itself.<sup>95</sup> A shareholder-plaintiff who files a derivative action in order to merely gain a benefit at the expense of the company without any legitimate basis for that claim therefore abuses the right to file a derivative action. In Japan this doctrine has been interpreted as a balancing test in the context of derivative actions. The benefit that a plaintiff wants to gain by filing a strike suit is not qualified as legitimate. In determining whether such an abuse exists in a given case, the Japanese courts have developed a system in which they weigh the harm caused and the degree of absence of a legitimate benefit and decide on the grounds of equity.<sup>96</sup> The abuse of rights doctrine is evaluated as an effective tool, especially in conjunction with the possibility of the court to order the plaintiff to furnish security for costs, to weed out abusive cases.<sup>97</sup>

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93 Insofar Art. 850 (2) Companies Act fulfils the function that Kawashima/Sakurai saw as desirable in: KAWASHIMA/SAKURAI, *supra* note 1, 57.

94 *Minpō*, Law No. 89/1896 and Law No. 8/1898, as amended by Law No. 78/2006, Engl. transl.: <http://www.kl.i.is.nagoya-u.ac.jp/told/m29a08901en.2.0.txt>, last viewed: 5 October 2012.

95 Cf. KAWASHIMA/SAKURAI, *supra* note 1, 39; WEST, *supra* note 69, 1468.

96 WEST, *supra* note 69, 1468.

97 KAWASHIMA/SAKURAI, *supra* note 1, 41.

#### IV. COMPARISON OF THE LIMITATIONS OF THE GERMAN AND THE JAPANESE DERIVATIVE ACTION

In comparison there are twice as many limitations on the German derivative action as on the Japanese derivative action.<sup>98</sup>

The cost of bringing a derivative action is relatively low in both jurisdictions<sup>99</sup> and therefore does not deter abusive actions. The maximum risk of cost in Germany is about EUR 12,000. In Japan, the cost risk will comprise the ¥ 8,200 filing fee plus possible costs for witness examinations and the plaintiff's attorney fees.

##### 1. *Same and Similar Limitations*

Out of the four limitations identified within Japanese law, only the abuse of rights doctrine is the same under German law.<sup>100</sup>

The limitation created by the right of the company to object to a settlement in accordance with Art. 850 (2) Companies Act<sup>101</sup> has some similarity with the duties of disclosure of any kind of settlement or termination agreement under § 149 AktG.<sup>102</sup> In this regard the German law goes much further than the Japanese law by requiring the full disclosure of any settlement, while the Japanese law requires notification of the company only in cases where it is not party to the settlement agreement, thereby giving it the right to object. The consequences of an objection by the company are not stipulated in the law and therefore remain unclear. While it would follow from the rationale of the provision that an objection by the company must lead to at least a reconsideration of the settlement agreement that takes the interest of the company into account, this does not follow from the law directly. This lack of a deterring legal consequence of the objection weakens the limitation. While the German provision dictates the duty to disclose all settlement agreements between the plaintiff and the defendant as well as with the company and affiliated parties, it still needs to be noted that this limitation is also weakened by the fact that the disclosure duty exists only for listed AGs. Furthermore, there is also no court approval of the settlements necessary in Germany.

The limitation that is provided by the right of the defendant under Japanese law to ask the court to order the plaintiff to provide security for costs in accordance with Art. 847 (7) and (8) Companies Act<sup>103</sup> does not exist in a similar way under German law.<sup>104</sup> Nonetheless, it can be argued that there are similar procedural features in the

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98 *Supra* II.3. and III.3.

99 *Supra* II.2.c. and III.2.e.

100 The general doctrine is similar; the contents differ to some degree. *Supra* II.3.h. and III.3.d.

101 *Supra* III.3.c.

102 *Supra* II.3.f.

103 *Supra* III.3.b.

104 While there is the possibility to request security for costs, it has a much higher threshold than under Art. 847 (7) and (8) Companies Act.

request for securities for costs in a Japanese court and the preliminary certification proceedings<sup>105</sup> in a German court. In both situations, the judge or the panel of judges can assess the plaintiff's arguments and demeanour in an oral hearing. This gives them a good position to weigh and scrutinize the arguments and provides the courts with a fair chance to determine whether a derivative action is brought with abusive intent.

## 2. *Unique Limitations in the Respective Jurisdictions*

The limitation that the potential plaintiff does not have the right to require the company to file an action for an alleged breach or damage to the company under Art. 847 (1) Companies Act<sup>106</sup> does not exist under German law.

Similarly, the quorum requirement<sup>107</sup> as prescribed by German law is non-existent under Japanese law.

The same is the case for the limiting effect of the risk to bear the costs under German law.<sup>108</sup> After the 1993 amendments to the Japanese Commercial Code, which were carried over into Art. 847 (6) Companies Act, the low filing fee along with potential further nominal fees for witness examinations etc. do not create a considerable cost risk for the plaintiff in a derivative action in Japan and therefore do not have a deterring and limiting effect on abusive derivative actions.

Under Japanese law there is also no possibility for the company to take over the derivative action from the plaintiff once it has been brought. This right exists under German law.<sup>109</sup> Still it has to be noted that the limiting effect of this right of the AG is minor because the plaintiff can claim costs from the AG under § 148 (6) sentence 4 AktG. Consequently, the deterring function of the right of the AG to take over the proceedings is limited by the fact that in that scenario, the risk for the plaintiff to have to carry the costs in the case of losing is no longer relevant.

While there is a restriction under Japanese law that a derivative action can only be brought by a shareholder who has held share(s) for at least six months before bringing the derivative action,<sup>110</sup> the Japanese law does not require that the shares were held before the shareholder learned of the alleged breach or damage like the requirement under German law.<sup>111</sup> Hence, the Japanese law does not limit the possibilities of acquiring the shares after the alleged breach or damage has become known and then bringing the derivative action after six months have passed. While some commentators interpret the requirement to have held the shares for six months prior to bringing the derivative

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105 *Supra* II.3.a.

106 *Supra* III.3.a.

107 *Supra* II.3.b.

108 *Supra* II.3.g.

109 *Supra* II.3.e.

110 *Supra* III.2.a.

111 *Supra* II.3.c.

action to mean that the shares must have been held before the alleged breach or damage became known,<sup>112</sup> the wording of Art. 847 (1) Companies Act does not require this.

Another limitation unique to German corporate law is the shifting of the costs of the derivative action to the plaintiff if the plaintiff gained certification by intentional or grossly negligent pleading of the wrong facts.<sup>113</sup>

Last but not least, the most severe limitation of the German derivative action is the limitation of the substantive scope of the derivative action by § 148 (1) sentence 2 no. 3 AktG.<sup>114</sup> This excludes the majority of cases, which arise out of negligent behaviour by a member of the management or supervisory board, from the sphere of the German derivative action.<sup>115</sup> Such a limitation does not exist under Japanese law, which does not limit the scope of the underlying causes of action when brought in a derivative action.

## V. CONCLUSIONS

The main conclusion that can be drawn from the comparison of the limitations on the Japanese and German derivative action is that the limitations of the German derivative action are too many and too severe and therefore work to bar almost all derivative actions, whether abusive or not; on the other hand, the Japanese system has limiting factors that work but that have to be refined to be more effective in barring abusive derivative actions while allowing meritorious ones.

This is supported by the numbers of derivative actions that are being brought in the respective jurisdictions. In Germany, only one case is reported where preliminary certification proceedings were conducted but certification was denied by the *Landgericht München I* (District Court of Munich I).<sup>116</sup> In contrast, in Japan the number of derivative actions rose to approximately 75 per year in the six and a half years following the 1993 reduction of the filing fee.<sup>117</sup> Informally it is estimated that around 400 derivative actions were filed in Japan since 1993.

Given that the damages awarded in a derivative action go to the corporation and only indirectly to the shareholder who brings the derivative action and the costs connected with bringing the derivative action, it can further be concluded that the economic incentive to bring a derivative action is minimal because the benefits that can be gained by

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112 Cf. UTSUMI, *supra* note 82, 134 and fn. 27.

113 *Supra* II.3.g.

114 *Supra* II.3.d and II.2.a.(4).

115 M. KLING, Die Innenhaftung des Aufsichtsratsmitglieds in der Aktiengesellschaft, in: *Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht* 2005, 55.

116 *Landgericht München I*, *supra* note 19. Research for reported cases was conducted via the two major German online databases, Juris and Beck Online. Quite in contrast to the expectation of active use of the new German derivative action by DUVE/BASAK, *supra* note 49, 1349.

117 ODA, *supra* note 12, 254.

the plaintiff indirectly through a gain in the value of its shares are rather small (especially when a shareholder who brings a derivative action has only a small number of shares). These benefits therefore might not outweigh the costs, especially when also taking into account nonmonetary costs such as effort and time spent on the derivative action.

Consequently, the limitations on the derivative action mostly have to be aimed at potential plaintiffs who at least to a certain extent disregard the economic background and rather have other incentives to bring the derivative action, such as a 'robber shareholder' or a *sôkai-ya* benefitting directly from the nuisance value of the derivative action in a settlement with the defendant or the corporation involved.

This implies that only a certain number of limitations that are specifically directed at the prevention of abusive claims are necessary, because the economic barrier arising out of the benefits and costs of the derivative action already work to limit the non-abusive derivative actions to where the plaintiff sees a reasonable economic benefit after conducting a cost-benefit analysis.

### 1. *Too Many Limitations in Germany*

In Germany, only one attempt to bring a derivative action has been made to date.<sup>118</sup> The many limitations implemented in the German law together with historical and systematic factors work to not only prevent abusive derivative actions but also bar almost all derivative actions.

First, historically the derivative action is a fairly new mechanism in Germany<sup>119</sup> that has not been accepted and used by minority shareholders as a corporate governance mechanism. This can be seen by the fact that only two requests by shareholders to fellow shareholders to join a derivative action under § 148 AktG have been registered in the online forum for shareholders (*Aktionärsforum*) that was created under the UMAG to help shareholders meet the quorum requirement of § 148 (1) sentence 1 AktG.<sup>120</sup> Both requests date back to 2006. Since then no new requests have been added.

Second, the limitations in place are too many and their consequences are too severe. The legislative fear that was spurred by strike suits brought by robber shareholders against shareholders' resolutions led to too many limitations on the derivative action; these go beyond weeding out abusive derivative actions to bar almost all derivative action. The substantive limitation<sup>121</sup> excludes most cases of breaches of fiduciary duties by members of the management or supervisory board of an AG from being actionable in a derivative action.<sup>122</sup> Together with the further prerequisites that a plaintiff has to fulfil

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118 *Supra* V., note 100.

119 *Supra* II.1.

120 As already noted by SEIBERT, *supra* note 15, 842.

121 *Supra* II.2.a.(4), II.3.d.

122 KLING, *supra* note 115, 55.



within the preliminary certification proceedings, this leads to an accumulation of limiting factors that not only prevents abusive claims but also prevents meritorious claims. Either the alleged breach is already excluded from being actionable in a derivative action, or the company will file an action itself because the breach is a severe one that cannot be tolerated. Even if the company does not file an action in such a case, the threshold that the potential plaintiff has to overcome to file the derivative action is too burdensome. First, the plaintiff has to overcome the quorum requirement with shares that it held before the alleged breach or damage became known; secondly, it has the burden of proof for prima facie evidence that supports the suspicion of a breach; and thirdly, it still has to bear the risk of having to carry the cost of unsuccessful preliminary certification proceedings.

Third, systematically the two-tier board system, which allocates the responsibility to file an action for the breach of fiduciary duties to the AG by a member of the supervisory or management board with the respective other organ of the AG, further limits the number of cases in which a derivative action becomes an option. This is only a minor effect due to the close relationship between the two boards, and it does not incentivize one board to file an action against a member of the other board.<sup>123</sup> Still, this allocation of the duty to file an action limits the already limited number of cases which could qualify for a derivative action due to the severe nature of the alleged breach. In cases of a severe breach that could qualify for a derivative action, the likelihood that the respective board will file an action is much higher.

The limitations in place in Germany in conjunction with the specific historical and systematic factors in Germany consequently not only work to prevent abusive claims but actually bar almost all derivative actions.

It could be that the German legislature, being aware of the abusive actions brought by ‘robber shareholders’ in other contexts, ‘overreacted’ and therefore included the high number of limitations on the derivative action. Adding to this fear was also a defensive stance that the business community had towards the derivative action when the UMAG was being drafted and discussed in the German parliament. Further, the limitation of the derivative action, especially the limit on its substantive scope, could be because the introduction of the derivative action was rather a measure to improve the perception of the German corporate law system by having familiar features for foreign – especially Anglo-American – investors.<sup>124</sup>

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123 Cf. B. CHEFFINS/B. BLACK, *Outside Director Liability across Countries*, *Texas Law Review* 84 (2006) 1425.

124 Cf. *Begründung des Regierungsentwurfs eines Gesetzes zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG)* (Explanatory statement of the government for the bill on the integrity of enterprises and the modernization of the law of derivative actions into the German law of corporations), *BUNDESRATS-DRUCKSACHE* (Legislative Ma-

## 2. *Few but Relatively Effective Limitations in Japan*

The limitations on the Japanese derivative action do not have the same negative effect on derivative actions in general as in Germany. The lower number of limitations in comparison to Germany and the reduction of the filing fee in 1993,<sup>125</sup> as well as arguably the heightened standard for the issuing of orders for security for costs,<sup>126</sup> have provided a fertile ground for derivative actions.<sup>127</sup>

Historically, the high filing fee together with the great likelihood that an order for security for costs for a substantial amount would be issued upon request effectively limited derivative actions.<sup>128</sup> The filing fee reduction led to a rise in derivative actions.<sup>129</sup>

Nonetheless, the most effective limitation<sup>130</sup> in Japan is still the possibility for the court to issue an order for security for costs. The monetary consequences of such an order have a high deterring effect. Further, at this point of the proceedings the court will have the briefs of the parties and its observations from an oral hearing to assess whether the derivative action is brought with abusive intent.

## 3. *The Effectiveness of the Limitations*

Because the German derivative action as it now exists within the law is rarely used in practice, it remains unclear which of the numerous limitations is effective in limiting the abuse of the derivative action.

The Japanese situation, especially with regard to the court's possibility to order security for costs, suggests that a limitation that connects a substantial monetary element with close court observation is the most effective in preventing abusive derivative actions. While such a measure can never be perfect because it depends on the judge's subjective assessment of the situation and because abusive intent as an internal fact within the plaintiff is hard to establish, the monetary element together with the case-by-case assessment of the basis on which the derivative action is brought by the court make

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terials of the Federal Council of Germany) 3/05, 44. The legislative materials refer expressly to cases that would impair the perception of the legal environment in Germany within the international business and finance community. This could be seen as supporting the claim that the improvement of the 'investment climate' was the aim and maybe not so much a really functioning derivative action.

125 *Supra* III.1.

126 *Supra* III.1.

127 *Supra* V.

128 C. MILHAUPT/M. WEST, *The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime*, in: *University of Chicago Law Review* 67 (2000) 58. Fewer than 20 derivative suits were filed in Japan from 1950 to 1990; see WEST, *supra* note 2, 351. See also PUCHNIAK/NAKAHIGASHI, *supra* note 17.

129 *Supra* V.

130 Also seeing security for costs orders as effective limitation to prevent abuse: UTSUMI, *supra* note 82, 136.

this limitation the most effective of the limitations that exist in Germany and Japan. The downside is that this allows the abusive derivative action to be brought initially; the upside is that it allows derivative actions to be brought at all rather than preventing all of them.

A good supplement to such a limitation is the disclosure duty as contained in the German law for all agreements that terminate a derivative action or that prevent filing in the first place. This prevents deals that allow abusive plaintiffs from profiting by getting a payment for the nuisance value of the abusive derivative action.

The historical Japanese experience with a high filing fee and a high likelihood that an order for security for costs would be issued<sup>131</sup> shows that the main problem in creating an effective limiting mechanism to prevent abusive derivative actions but allow meritorious ones is this question: At which amount is a monetary payment that is (e.g. in the form of the filing fee) or can be (e.g. in the form of a bond for security for costs) requested from the plaintiff substantial enough to deter abusive claims but still allow meritorious ones? The answer depends on the economic circumstances in the respective jurisdictions and even more on the economic circumstances of the average minority shareholder. Furthermore, any system to prevent abuse will have shortcomings due to the difficulties in determining the abusive intent of a plaintiff as an internal fact.

Limitations in Japan such as the non-availability of the right to demand<sup>132</sup> and the right of the company to object to a settlement<sup>133</sup> seem to be mostly ineffective in preventing the abuse of the derivative action. They lack a deterrent effect due to either a lack of enforceability (in the case of the non-availability of the right to demand) or the lack of clarity in terms of legal consequences (in the case of the right of the company to object to a settlement). Similarly, the limitation indirectly contained in the possibility of the AG to take over the proceedings in German law does not seem to be effective because the deterrent effect is low due to the possibility for the plaintiff to recover its costs.

#### 4. *Proposals to Enhance the Effectiveness of Limitations*

For the Japanese situation it might be an option to raise the filing fee for the derivative action by introducing a tailored provision for the derivative action filing fee rather than relying on the general rule to which the law refers now.<sup>134</sup> A higher monetary bar would further question the seriousness of the plaintiff and thereby act as a more effective limitation.

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131 *Supra* III.1.

132 *Supra* III.3.a.

133 *Supra* III.3.c.

134 *Cf. supra* III.2.e.

In Germany, the AktG should be amended to eliminate the substantive limitation on the scope of the derivative action as it seems to eliminate most of the potential derivative actions. Furthermore, the quorum requirement should be lowered further as it is restrictive and limits the possibilities for minority shareholders to play a more influential role in corporate governance by means of the derivative action. At the same time, a system similar to the one in Japan that allows the court to issue orders for security for costs linked to the general abuse of rights doctrine should be introduced. Thereby, the system should become more effective in allowing meritorious actions and weeding out frivolous and abusive ones.

#### ABSTRACT

*This paper investigates the limitations on corporate derivative actions in Germany and Japan that are designed to prevent abuse. The analysis is based on the historical development of the derivative action in the respective jurisdictions, the current status of the derivative action and the specific limitations in existence. By comparing the two systems of limitations on the derivative action against a similar background of abusive sōkai-ya and 'robber shareholders', which create a specific necessity for limitations, the effectiveness of the limitations is assessed. It is found that comparatively there are twice as many limitations on the derivative action in Germany as there are in Japan. Further it is found that the lowering of the filing fee for the derivative action and the reduction of further limitations has been one factor that has led to an increase in the number of derivative actions in Japan, which seems to suggest an increase in abusive derivative actions. In comparison, under the German legal system it is found that there are too many limitations, which not only act to prevent abuse but which completely prevent the effective use of the relatively new derivative action in Germany. It is therefore suggested that the limitations in Germany need to be significantly lowered, while the seemingly effective limitations in place in the Japanese system should be further refined, for example by a thorougher disclosure duty for all settlements to deter abusive settlements to pay off the abusive litigant.*

## ZUSAMMENFASSUNG

*Der Beitrag untersucht die Einschränkungen der gesellschaftsrechtlichen Aktionärsklagen zur Verhinderung von Missbräuchen in Deutschland und Japan. Ausgangspunkt ist die historische Entwicklung der Aktionärsklage in den beiden Rechtsordnungen; so dann werden die jeweilige aktuelle Rechtslage und deren Beschränkungen für derartige Klagen analysiert. Der Vergleich beleuchtet die Effektivität dieser Einschränkungen vor dem vergleichbaren Hintergrund der „räuberischen“ Aktionäre in Deutschland und der „sôkai-ya“ in Japan, die derartige Regelungen erforderlich machen. Der Verfasser kommt zu dem Ergebnis, dass in Deutschland im Vergleich zu Japan ungefähr doppelt so viele Hemmnisse existieren. Darüber hinaus ist festzustellen, dass die Herabsetzung der Gerichtsgebühren und die Reduktion anderer Beschränkungen zu einem Anstieg von Aktionärsklagen geführt haben, was auch einen Anstieg von missbräuchlichen Aktionärsklagen vermuten lässt. Im Vergleich hierzu ist für das deutsche Rechtssystem festzustellen, dass hier zu viele Einschränkungen bestehen, welche nicht nur den Missbrauch verhindern, sondern auch die effektive Nutzung der Aktionärsklage überhaupt. Der Verfasser schlägt daher vor, die Zahl der Hemmnisse in Deutschland erheblich zu verringern und die generell effektiv wirkenden Beschränkungen in Japan z.B. durch die Einführung einer strengeren Veröffentlichungspflicht für Vergleiche weiterzuentwickeln, um ungerechtfertigte Zahlungen an räuberische Kläger zu verhindern.*