RECHTSPRECHUNG

Shareholde's Action in the Nomura Securities Case
Judgement of the Supreme Court, July 7, 2000[1]

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This is the second case where the Supreme Court has ruled on a case involving shareholder's action since the Mitsui Mining case in 1993.

The present case involves the compensation of loss incurred by a major customer by a securities company. In order to maintain the business with this customer, which was a major broadcasting company and held a discretionary account, the securities company compensated the losses caused to the broadcasting company by the fall in the securities market in 1990. The primary concern of the securities company was to maintain the position of the lead securities company in this broadcasting company's issue of securities. The compensation amounted to 360 million yen. The securities company managed to maintain the relationship with the customer, and later acted as a lead underwriter when the customer issued new shares, and received a commission of 120 million yen.

The plaintiffs, who are shareholders of this securities company, sued the representative directors for the breach of duties as a director and causing loss to the company.

The Supreme Court ruled first, that compensation of loss to specific customers was not against the Securities and Exchange Law at the time of the act (it was made illegal after the 1992 amendment).

One of the contested issues was whether the breach of law as listed as one of the grounds for liability of directors in Article 266 of the Commercial Code included the breach of any law, or is limited to breaches of law which affect the interest of the company or shareholders. In fact, the second instance court in this case ruled that Article 19 of the Anti-Monopoly Law, which, the plaintiffs claimed, served as the basis of the directors' liability, should not be included in the 'law' in the context of Article 266 of the Commercial Code, since Article 19 of the Anti-Monopoly Law was intended to protect competitors in the market, and those whose interest is harmed by its breach are not the company. The Supreme Court ruled that all laws which are mandatory for the company are included here. It is the duty of the directors to ensure that the company does not violate the law, and if they failed, it serves as a basis of the liability of directors.

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1 www.courts.go.jp

In the present case, the Supreme Court found that compensation of losses to specific customers was against the normal and legitimate practice of the securities industry and was against the general designation of the Fair Trade Commission on unfair trade practices based upon Article 19 of the Anti-Monopoly Law (solicitation of customers by offering of unjust benefit). This provision is mandatory on companies, and therefore the decision to pay compensation and the actual payment by the defendants are the 'breach of law' in the meaning of Article 266.

The liability of directors for the breach of law is based upon fault. The Supreme Court ruled that in this case, the defendants were not aware that the compensation of loss to selected customers was against the Anti-Monopoly Law, and that it was inevitable that they were not aware of it. This was supported by the fact that even the Ministry of Finance, at that time, understood that the Securities and Exchange Law was the primary instrument in regulating the securities business and had never realised that the Anti-Monopoly Law was applicable. The Fair Trade Commission itself was not of the view that this provision was applicable until November 1991.

Therefore, in conclusion, the liability of the defendants was denied by the Supreme Court. An appellate court had reached the same conclusion in a similar case involving another securities company earlier.

It should be added that concerning shareholder's action, recently, there have been two significant lower court judgements.

One was the Asahi Shinbun case, where a media company, in substance, purchased unlisted shares of another media company in which it was a major shareholder, from a foreign company which had been purchasing shares with the intention of a hostile takeover. The price paid for this transaction was much higher than the actual value of the shares, but this was the price which the foreign company had actually paid for the acquisition of shares. Shareholders of Asahi Shinbun sued the directors for the loss, i.e. the difference between the payment and the actual value. The court applied the business judgement rule in this case and ruled that the decision was within the scope of discretion of the management. The court found that although the price paid was higher than the actual value determined by various methods, the price was determined by negotiation by taking into account the long term strategy of the company, based upon information collected by a project team and analysed and discussed by the directors in a prudent manner[2].

Another case was the Daiwa Bank case, where directors were sued by shareholders. A rogue trader had been concealing the loss he had accumulated in New York. The Bank management found this out, but failed to report it to the US authority. The Bank was heavily fined and eventually had to withdraw from the United States. Directors were sued for the failure to prevent such irregularity and also to report to the US authority.

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2 *Shôji Hômu Shiryô-ban* 185, 228. Comments by Y. HIRAIDE in *Juristo*, October 1, 2000.

The first instance court fully acknowledged the liability of directors and ordered the defendants to pay 82 billion yen. The case is pending appeal[3]. This is not the first case where the directors' liability was acknowledged, but the amount of damages was stunning. This judgement has triggered criticisms of the present system of shareholder's action and proposals for setting a ceiling to the amount of damages have been made.

3 *Nikkei Shinbun*, September 21, 2000.