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Mapping Types of Shareholder Lawsuits Across Jurisdictions

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For helpful comments and discussion, I thank Nemika Jha, Neshat Safari, and participants of the 2016 Corporate & Securities Litigation Workshop at the University of Illinois at Urbana-Champaign's Illini Center in Chicago.

Abstract

Shareholder litigation has been a prominent topic in the comparative corporate governance literature for decades. However, scholars trained in a particular jurisdiction often tend to look for types of lawsuits familiar from their home turf. In particular, the English-language literature has typically focused on derivative litigation, often from a somewhat US-centric or UK-centric perspective, in spite of the fact that derivative suits constitute only a minority of shareholder actions even in these jurisdictions.

To broaden the functional perspective in the comparative analysis of shareholder litigation, this chapter attempts to create a (likely incomplete) taxonomy of shareholder lawsuits across countries. While the distinction between derivative suits and direct class actions in the US is largely familiar, many other jurisdictions employ different types of shareholder lawsuits. In doing so, we can identify some patterns that may in part reflect influence between jurisdictions reflecting legal families or legal origins. The derivative suit has risen to prominence in the United States as a frequently used mechanism, from where it has spread to a number of Asian civil law jurisdictions. In the United Kingdom and other "Commonwealth" countries, where it also has a long tradition, it is often eclipsed by the "unfair prejudice" or "oppression" remedy. In the civil law world, derivative litigation and close equivalents exist, but often another form of shareholder litigation takes a more prominent role, namely litigation regarding the validity of shareholder resolutions.

After setting up the taxonomy, this chapter explores the main reasons that explain why specific types are pervasive in particular jurisdictions, analyzing especially standing requirements, allocation of cost and risk between plaintiffs and defendants, and access to information by plaintiffs. Finally, the chapter discusses lawsuits seeking to rescind shareholder decisions in Germany as an example for a frequently used type of litigation outside the American dichotomy of derivative and direct suits.

Keywords: Corporate Governance, Comparative Corporate Law, Shareholder Lawsuits, Derivative Suits, Direct Suits, Unfair Prejudice, Inquiry Proceedings, Rescission, Nullification, Courts, Discovery

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* Professor of Law, Fordham University School of Law; Research Associate, European Corporate Governance Institute. For helpful comments and discussion, I thank Nemika Jha, Neshat Safari, and participants of the 2016 Corporate & Securities Litigation Workshop at the University of Illinois at Urbana-Champaign's Illini Center in Chicago.

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1. Introduction

When corporate law scholars trained in the United States explore shareholder litigation abroad, they often start by looking for types of shareholder litigation familiar from the US legal landscape. In particular, scholarship often explores derivative litigation in various jurisdictions, often from a somewhat US-centric perspective (e.g., West, 1994; Baum and Puchniak, 2012; Gelter, 2012). To be sure, derivative litigation can potentially serve an important function in disciplining directors and other fiduciaries, even if it constitutes only a minority of shareholder actions. When we look at the totality of shareholder litigation from a functional perspective, even in the US we have to take a broader perspective and take direct actions, securities class actions and appraisal into account, as well as the oppression remedy when we look at small firms and outside of Delaware. In comparative analysis, we may have to look even further.

In this vein, this chapter attempts to create a functional (but likely incomplete) taxonomy of shareholder lawsuits across jurisdictions. While the distinction between derivative suits and direct class actions in the US is largely familiar, many other jurisdictions employ different types of shareholder lawsuits. While the buzzword of "legal origins" almost sounds like a broken record in comparative corporate law, we can identify some patterns of influence. The derivative suit, while it exists in common law jurisdictions in general, has risen to prominence in the United States as a frequently used mechanism, from where it has spread to a number of Asian civil law jurisdictions. In the UK and other "Commonwealth" jurisdictions, it is often eclipsed by the "unfair prejudice" or "oppression" remedy. In the civil law world, derivative litigation and close equivalents exist, but often another form of shareholder litigation takes a more prominent role, namely litigation regarding the validity of shareholder resolutions.

This chapter proceeds as follows. Section 2 briefly describes the types of harm shareholder lawsuits seek to address. Based on this, section 3 develops a taxonomy of shareholder litigation. Section 4 looks at common policy issues across jurisdictions that determine which types of suits will likely be used and identifies the most common factors. It takes a more in-depth look at German rescission litigation, and how German law addressed the frequently discussed problem of abusive litigation by repeat plaintiffs. Section 5 concludes.

2. Conflicts of interest and shareholder litigation

Corporate law gives rise to a number of different conflicts of interest between directors, managers, and shareholders, as well as among shareholders. The types of conflict of interest are of course to some extent contingent on the *type and ownership structure of the corporation*. These types are typically linked to different types of *harm* inflicted on corporations and (minority) shareholders.

First, harm may be inflicted *upon the corporation*, either through the careless business decisions, or because of a transaction benefiting the fiduciary (for example, self-dealing). In this case, other shareholders are harmed reflectively because of the loss in value of their shares. This is a pattern that we often see in the classical "Berle-Means corporation," which continues to animate most policy discussions in the US. It is characterized by a powerful management and dispersed shareholders, who suffer from collective action problems and are therefore rarely in the position to coordinate and influence management (e.g., Berle and Means, 1932; Roe, 1994). Traditional comparative corporate governance scholarship emphasizes how dispersed ownership prevails in the US and the UK, setting these jurisdictions apart from other large economies. The US and the UK have often been distinguished by the dominant type of dispersed owners, since in the US historically retail investors took a large proportion, whereas in the UK share ownership was typically dispersed among institutional investors (e.g., Armour, 2009, pp. 109-110). The typical conflict of interest is between managers and shareholders as a class. Managers may, for example, self-deal, take corporate opportunities, or act carelessly in making decisions, thus harming the corporation.

Harm to the corporation may also arise from the presence of a controlling shareholder. Corporations with concentrated ownership have traditionally prevailed in public corporations dominating in most other developed jurisdictions besides the US and UK. Managers are thought to be largely held in check by large shareholders, but besides the occasional squabble within the controlling coalition, conflicts of interests typically erupt between outside investors on the one hand, and controlling shareholders (another firm or financial institution, a family, or the government) on the other (e.g., Becht & Roëll, 1999; La Porta et al., 1999; Ringe, 2015, pp. 496-498). Harm to the corporation often results from self-dealing transactions between the corporation and a major shareholder.

Second, *shareholders may get harmed directly* without any corresponding loss to the corporation, typically by *diluting* their ownership stake in some way for the benefit of majority shareholders. This typically happens when new shares are issued (for example, to a majority shareholder at a low price), when shares are repurchased, and in the course of a merger where shareholders received inadequate compensation (e.g., Conac et al., 2007, p. 496). One of the most salient scenarios is the freezeout merger (internationally often known as "squeezeout",[1] see, for instance, Khanna and Varottil, 2016, p. 1012). These types of problems are particularly salient in firms (and jurisdictions) with concentrated ownership, given that the majority typically benefits from diluting the minority.

Third, shareholders may sometimes be formally treated equally, but a particular conduct, or the absence of such conduct, has a more significant impact on some shareholders than on others, resulting in particular harm to the former. This happens especially in closely-held firms, where conflicts of interest typically arise between a majority shareholder (or a controlling coalition) and minority shareholders, although the impact on whoever ends up in the minority are often more severe. Shares in closely-held corporations are typically an illiquid investment without a market allowing a sale, and often a legal arrangement locking minority shareholders into a position where

[1] In the US, the term "squeezeout" tends to refer to situations where minority shareholders are put under significant pressure by the majority in closed corporations. *See* O'Neal & Thompson (2016), § 9:2.

they can expect neither profits nor capital gains (Bachmann et al., 2014, pp. 9-11). For example, shareholders in control might withhold dividends from the minority and remove them from management functions in order to coerce them to sell at a low price (e.g., Moll, 2005, p. 890-891; O'Neal and Thompson, 2016, § 9:2). In closely-held firms, patterns of oppression often combine harm to the corporation and to minority shareholders.

Fourth, shareholders in publicly-traded firms may be harmed by false and misleading information being publicized by the company. Oddly, in this situation the harm incurred by plaintiffs is actually compensated by the gains of other market participants. The social cost is actually the reduced functioning of the market, and in part results from inefficient decisions being made based on distorted information (Velikonja, 2013). The taxonomy in the following section omits the fourth type of harm, which is typically within the purview of securities law.

3. A taxonomy of shareholder lawsuits

3.1. Lawsuits addressing harm to the corporation

Seeking redress for harm to a corporation is usually a task assigned to a corporation's directors or officers. In two-tier board systems such as the German one, litigation might be a responsibility of the supervisory board if the defendant is a member of the management board. In many jurisdictions, however, shareholders have some form of remedy if a claim is not pursued, at least under circumstances that raise suspicions that the decision to sue was not disinterested.

US law is comparatively liberal in permitting shareholder litigation of this type, allowing a derivative suit in principle for any claim "in the right of the corporation," meaning the derivative suits are not limited to claims against directors or managers.[2] A major hurdle is the "demand requirement," which gives the board the opportunity to pursue the claim itself, and which is only waived if the board is conflicted in a way that would render demand futile.[3] Many jurisdictions limit derivative suits to claims against directors for violations of their duties as such, which is in principle true even for the UK, where a derivative claim must arise from a violation of directors' duties.[4] Others, such as controlling shareholders, may be sued under this provision only if they were involved in the director's breach (see Davies and Worthington, 2016, ¶ 17-14).[5] In the UK, the rule of *Foss v. Harbottle*[6] historically made derivative suits difficult by limiting them mainly to cases of "fraud on the minority" where the majority shareholder is conflicted and it would not be appropriate for shareholders to decide collectively whether to bring a suit (Baum and Puchniak, 2012, pp. 68-69). While the rule has been superseded by the somewhat more lawsuit-friendly Companies Act 2006, it continues to influence other common law jurisdictions, including those in Asia (see Puchniak, 2012, pp. 114-124).

Continental European and other civil law countries have historically been divided as to whether they even provided for a derivative suit in the narrow sense. While France and Switzerland

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[2] *See, e.g.*, FEDERAL RULES OF CIVIL PROCEDURE, Rule 23.1(a) ("This rule applies when one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce.").

[3] FEDERAL RULES OF CIVIL PROCEDURE, Rule 23.1(b)(3).

[4] COMPANIES ACT s. 260(3) (UK) (permitting derivative suits "only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company"). A derivative suite in the UK may also be used to enjoin director's action that would violate their duties (De Dier, 2013, p. 471).

[5] Moreover, UK law includes "shadow directors." COMPANIES ACT s. 260(5)(b) (UK).

[6] Foss v. Harbottle, [1843] 67 E.R. 89. (Ch.).

provided for an individual right to enforce directors' liability claims, in Germany, Austria, Belgium, Italy and Spain suing directors was historically a collective right of shareholders that could be initiated in the shareholder meeting (Gelter, 2012, pp. 853-854; Siems, 2012, pp. 98-100; Baum and Puchniak, 2012, pp. 82-84). Under the latter system, only if the majority decided against a lawsuit, a minority exceeding a specified percentage can petition a court to appoint a special representative to enforce the claim on behalf of the corporation. As this instrument was widely considered ineffective, Germany enacted a reform in 2004, which enabled what can be considered an actual derivative suit, but still requires plaintiff shareholders to hold at least 1 per cent of the corporation's shares (e.g., Saenger, 2015, pp. 20-24). Most Continental European countries provide for some form of minority enforcement mechanism, although often it is similarly limited to a qualified minority, and to claims against directors, but not, for example, controlling shareholders.[7] The Asian civil law jurisdictions of Japan, South Korea and Taiwan have adopted the US-style derivative suit during the second half of the twentieth century, and at least Japan and Korea have seen a fair number of lawsuits (Puchniak, 2012, p. 100-111; Osugi, 2016, p. 50 [reporting 121 derivative suits in Japan between 1991 and 2011]).

Overall, derivative suits are not a necessary element of corporate law systems across jurisdictions. For example, under Chinese law, only a 2005 reform that came into force in 2006 made it clear that a derivative suit is possible, even if there was previously some debate about the issue

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[7] Note that this describes only the situation in the *Aktiengesellschaft* (public company). In the *Gesellschaft mit beschränkter Haftung*, under German law the *action pro socio* is generally accepted by the courts as a mechanism for the corporation to enforce claims against members provided that managers do not adequately pursue the claim. *E.g.*, Cabrelli (2013), pp. 307-308. The same is true in private limited companies in other European jurisdictions. Bachmann et al. (2014), pp. 65-66.

(Huang, 2012, p. 621). But maybe more to the point, Dutch law does not offer a derivative suit or similar mechanism (Schuit et al., 2002, p. 155; Gerner-Beuerle and Schuster, 2014, p. 216).

Jurisdictions are sometimes more liberal with respect to suits seeking to police the boundaries of directors' powers. For example, in the UK individual shareholders can enforce the "proper purpose" rule codified in s. 171 of the Companies Act. Directors must act in accordance with the company's constitution and only exercise powers for the purpose for which they are conferred. Since these are understood to be individual rights of shareholders under the corporate charter, individuals can bring a suit (De Dier, 2013, p. 473), even if strictly speaking the corporation is harmed. Similarly, under German law, the individual shareholders may bring a suit when directors take actions which they would have been required to submit to shareholders, for example, under the Holzmüller doctrine[8] (Saenger, 2015, p. 18). Both the UK and the German suit are not understood as individual suits and thus are not subject to particular procedural requirements.

3.2. Lawsuits addressing harm to shareholders

In the US, direct suits are distinguished from derivative suits in that the harm they address is a personal injury of a shareholder, or an entire class of shareholders. Consequently, Delaware's *Tooley* test looks at whether the corporation or the shareholders were harmed, and whether consequently the corporation or the shareholders should receive the remedy.[9] Such a suit might be brought if a right to obtain information or a right to vote is infringed upon, or in the case of a stock

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[8] The Holzmüller case BGH II ZR 174/80, BGHZ 83, 122 and subsequent case law concern the question under what circumstances shareholders must be asked to approve a spin-off of the company's main operations into a subsidiary. *See* Rock et al. (2017), pp. 199-200.

[9] Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004).

issue or merger with disadvantageous effects for (some) shareholders. From the plaintiff lawyer's perspective, direct actions have the advantage that they do not have to pass the demand requirement and thus can go into discovery without facing this additional hurdle; however, when brought as class actions, they have to meet class certification requirements. Often direct suits are brought when a merger transaction is announced. Because of the time-critical nature of mergers, firms are under strong pressure to settle, which often arguably result in disclosure-only settlements that produce few benefits for shareholders (Fisch et al., 2014, pp. 563-568).

In comparative perspective, similar suits exist for such situations in other jurisdictions.[10] In countries such as France and Germany, the distinction between derivative and other suits as said to be rather obvious, given that the relief sought is different (Baum and Puchniak, 2012, p. 11). However, as a general characteristic of civil procedure, class actions are often not available in many jurisdictions outside the US; typically, it is necessary to "opt in," which strongly reduces the bargaining power of a plaintiff lawyer acting as a "private attorney general" (for the "group litigation order" in the UK, see, for example, Armour et al., 2009, p. 693; Cheffins and Black 2006, p. 1411-1412; generally for European civil procedure, see Issacharoff and Miller, 2009, p. 202).

Especially in civil law jurisdictions, the functional equivalent to the American direct class action suit are often lawsuits seeking to rescind or nullify decisions taken in the shareholder meeting (for Germany, see Vermeulen and Zetzsche, 2010, p. 23; for Spain, Sáez and Riaño 2013, p.

[10] *See*, for instance, the French *action individuelle*, which is thought to be based on C. COM. art. L.225-253 (Fr.) in the SA. *See* De Wulf (2010), p. 1558. In the SARL, the suit is based on C. COM. art. L.223-22 (Fr.).

366, who report 188 suits against shareholder decisions between 2000 and 2011]).[11] Corporate laws often include statutes governing these types of suit, which automatically have a class-wide effect as a rescission stops a transactions for all shareholders. In some jurisdictions, these provisions also address lawsuits seeking to invalidate formal board resolutions.[12] These lawsuits tend to be fairly common across jurisdictions, and their prevalence seems to be linked to the fact that in European countries, a larger number of decisions require a shareholder vote than in the United States.[13] Besides the election of directors[14] and changes to corporate articles[15], European shareholders typically vote on the approval of financial statements[16] and virtually always on the issuance of dividends.[17]

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[11] AKTG §§ 241-57 (Ger.); C. COM. art. L. 235-1 (Fr.); C.c. arts. 2377-79 (It.); LEY DE SOCIEDADES DE CAPITAL (LSC) art. 204 (Spain); BURGERLIJK WETBOEK [BW] arts. 2:13–2:16 (Neth.).

On the technical level, there is a typically distinction between resolutions that need to be rescinded and those that are null and void. This may make a difference, among other things, for standing requirements and limitation periods.

[12] *E.g.*, C. COM. art. 235-1(2) (Fr.); LSC art. 251 (Spain); C.c. art. 2388 (It.) (shareholders can challenge the validity of board decisions if they infringe upon their rights). *See also* De Dier (2013), pp. 481-487, pp. 488-490, pp. 491-493 (discussing Belgian, French, and Dutch law).

[13] *E.g.*, Hellgardt and Hoger (2011), p. 48 (pointing out that lawsuits under DGCL § 225(b), which permits stockholders to challenge the validity of the result of any vote of stockholders, likely have remained rare because shareholders have smaller decision-making powers in the US, in particular as regards increase and reduction of the number of outstanding shares, which typically can be decided by directors); *see also* Gelter (2012), p. 883.

[14] AKTG § 101(1) (Ger.); C. COM. art. L. 225-18 (Fr.); LSC art. 214 (Spain); C.c. art. 2364(2) (It.); BW arts. 2:132 (Neth.).

[15] AKTG § 179(1) (Ger.); C. COM. art. L. 225-96 (Fr.); LSC art. 285.1 (Spain); C.C. art. 2365 (It.); BW art. 2:121 (Neth.).

[16] C. COM. art. L. 225-100 (Fr.); LSC arts. 160(a), 272.1 (Spain); C.C. art. 2364(1) (It.); BW arts. 2:117(5), 2:362(6) (Neth.). In Germany, shareholders vote on financial statements only in cases of disagreements between the management and supervisory boards. AKTG § 173 (Ger.).

[17] AKTG § 58 (Ger.); C. COM. art. L. 232-11 (Fr.); LSC art. 273.1 (Spain); C.C. art. 2364bis(4) (It.).

Most importantly, they vote on increases[18] and capital reductions,[19] as well as mergers[20] and divisions.[21] This means that an issuance of new shares as well as any change to the corporation's financial structure requires a vote. Some jurisdictions, notably France, go even further and require shareholder votes for related party-transactions with directors and certain significant shareholders.[22] The EU Shareholder Rights Directive, as amended in 2017, requires a shareholder vote on remuneration policy.[23]

Given that in concentrated ownership systems where corporations are de facto controlled by a shareholder or a shareholder coalition, rescission lawsuits that are formally brought against the corporation constitute de facto a way for minority shareholders to put the brakes on the majority's actions. Based on allegations of legal impropriety of the decision, minority shareholders can bring a lawsuit, usually without having to meet a minimum ownership threshold.[24] Depending on

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[18] *See* AKTG §§ 182, 192, 202 (Ger.); C. COM. arts. L. 225-129, L. 225-130 (Fr.); LSC art. 296.1 (Spain); BW art. 2:96 (Neth.).

[19] AKTG §§ 222, 229, 237 (Ger.); C. COM. art. L. 225-204 (Fr.); LSC art. 318.1 (Spain); BW art. 2:99 (Neth.).

[20] UMWANDLUNGSGESETZ [UMWG] [Reorganization Act], §§ 13, 65 (Ger.); C. COM. art. L. 236-2 (Fr.); LEY 3/2009 DE 3 DE ABRIL SOBRE MODIFICACIONES ESTRUCTURALES DE LAS SOCIEDADES MERCANTILES [LSME], arts. 8, 40 (Spain); C.C. art. 2365 (It.); BW art. 2:317 (Neth.).

[21] E.g. UMWG § 125 (Ger.); LSME art. 73 (Spain) (both referring to the sections governing mergers); BW art. 2:234m (Neth.).

[22] C. COM. art. L. 225-38, 225-40 (Fr.). The ownership threshold for shareholders triggering a vote is 10 per cent. *See, e.g.*, Conac et al. (2007), p. 498. The EU Shareholder Rights Directive, as amended in 2017, states that Member States must require approval either by the general meeting or the administrative or supervisory board. Shareholder Rights Directive 2007/36/EC as amended by Directive 2017/828/EU, art. 9c(4).

[23] Shareholder Rights Directive, art. 9a.

[24] AKTG § 245(1) (Ger.) (providing that a shareholder who submitted a written objection in the shareholder meeting has standing); BW art. 2:15(3)(a) (Neth.) (providing that a person with a legal interest can sue); *see* Germain (2002), p. 412 (explaining that in France, the party the law intends to protect can sue).

the applicable substantive law, this may allow a court to review whether a majority shareholder in exercising his voting power violated the duty of loyalty or engaged in conduct considered abusive (Conac et al., 2007, pp. 501-502; Sáez and Riaño, 2013, p. 363; Enriques et al., 2017, pp. 161-162), even if in practice it is typically easier to bring a suit based on violations of procedural and information rules. Given the hurdles that derivative suits sometimes face in these jurisdictions, this type of lawsuit is often the main mechanism keeping controlling shareholders in check (for Spain, see Sáez and Riaño, 2013, pp. 364-365; for the annulment of decisions to retain profits in a French company, see Conac, 2013, p. 228-229).[25]

Lawsuits challenging the validity of shareholder resolutions are also fairly common in East Asia, particularly South Korea. Japan adopted the framework for rescission and "nullity"[26] lawsuits from Germany in various corporate law reforms starting in 1899, and South Korea followed the Japanese influence in reforms in 1962 and 1984 (Kim and Choi, 2016, p. 223). Between 1998 and 2013, the Seoul Central District Court recorded between 10 and 23 lawsuits against shareholder meeting decisions every year, and never more than seven derivative suits per year (in some years none or only one or two) (Kim and Choi, 2016, p. 229-230).

An advantage of rescission suits is that generally, other than in derivative suits, shareholders have standing without having to pass a minimum ownership threshold. There are some exceptions

[25] For the UK, see Ringe (2017), pp. 266, 272 (pointing out that shareholders in the UK are not subject to fiduciary duties, but merely a limited obligation to "act bona fide for the benefit of the company as a whole" when voting, which generally permits them to vote in their own interest); *see also* Conac (2013), p. 246.

[26] This means a lawsuit declaring that a resolution is void, as opposed to one that is merely voidable.

such as Italy, where only shareholders holding 0.1 per cent or more of voting rights may seek the nullification of a decision of the shareholder meeting of a publicly traded firm.[27] The 2003 reform introducing these thresholds has arguably made it harder to police self-dealing transactions and facilitated exploitative conduct by controlling shareholders (Enriques, 2009, p. 498). While rescission suits do not provide complete deterrence, they remain a major enforcement mechanism for those transactions subject to a shareholder vote. Thus, the possibility of rescission suits in combination with voting requirements constitutes a major mechanism to hold controlling shareholders accountable in concentrated ownership systems (Sáez and Riaño, 2013, pp. 378, 390). Similarly, since a 2014 amendment Spanish corporate law also limits standing to shareholders individually or jointly holding at least 1 per cent (0.1 per cent in publicly traded firms), except in those cases where the decision violates public policy.[28]

3.3. Appraisal rights and similar mechanisms

In addition, jurisdictions sometimes provide remedies for the dilution of share value in mergers and related transactions, which often do not require a showing a violation of a law or charter, but merely a mispricing of the compensation received by shareholders. Moreover, invalidating a merger that has already been consummated creates practical problems, which is why many jurisdictions attempt to limit redress to a repricing (e.g., Ventoruzzo, 2010, p. 883; Conac, 2013, pp. 229-230). Appraisal rights in the US provide the prime example. In Delaware, specifically, they are available for statutory mergers, whereas some states add sales of all assets or de facto mergers

[27] C.C. art. 2377 (It.). These thresholds were introduced in 2003, apparently because of concerns about excessive lawsuits. In privately held firms, the threshold is 5 per cent.

[28] LSC arts. 206.1, 206.2, 495.2(b) (Spain).

to their scope of applicability. The usefulness of appraisal rights in Delaware is limited by a number of factors. First, the scope of applicability of the provision – which depends in part on the compensation given to shareholders – appears to follow no consistent theory.[29] Second, the provision requires that dissenting shareholders submit a written demand for appraisal to the corporation before voting against it.[30] Consequently, only a limited set of shareholders will typically be able to petition for appraisal, which stands in contrast to a fiduciary duty class action against a merger, where plaintiff counsel will represent the entire class consisting of all (minority shareholders), thus vastly increasing bargaining power vis-à-vis the defendant (for a summary of the critique, see Korsmo and Myers, 2015, pp. 1560-1566).

European law, in harmonizing merger procedures, does not require appraisal or similar procedures. In contrast to US law, the Merger Directive provides for an ex ante appointment of an independent expert (appointed by a court or administrative authority) to review the valuation in the merger agreement,[31] as well as liability both of the members of company management and administrative bodies and the expert in cases of "misconduct"[32] (see Ventoruzzo, 2010, pp. 878-879). Member States are free to back up this ex ante mechanism with an ex post revaluation of shares,

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[29] DGCL § 262(b).

[30] DGCL § 262(d)(1).

[31] Directive 2011/35/EU of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies (codification), 2011 O.J. L 110/1, art. 10 [hereinafter Merger Directive].

[32] Merger Directive, art. 20, 21.

but they do not necessarily follow the US appraisal model. For example, Italian corporate law establishes withdrawal rights for shareholders under certain enumerated circumstances (such as changes to the articles or going private)[33] that do not necessarily apply in a merger (Ventoruzzo, 2010, p. 884). Under French law, a minority shareholder might either seek to have the merger voided by a court upon showing that it constitute an "abuse of majority," or by suing the majority shareholder or auditor for damages (Conac, 2013, pp. 230-231).

An example closer to the US appraisal model is the German *Spruchverfahren*, which applies to various types of structural changes under German company law, includes group restructurings, mergers, and freeze-out transactions (known as squeeze-outs in German).[34] Interestingly, dissident shareholders only need to submit a formal objection in the shareholder meeting and vote against the merger if they intend to challenge the amount of *cash* compensation they are to receive.[35] If they seek to challenge the share *exchange* ratio in a stock-for-stock merger, any shareholder can ask for a judicial reassessment.[36] This includes even shareholders who voted in favor of the transaction. This policy choice is intended to avoid incentives for shareholders to vote against a merger only because they seek a revaluation of the exchange ratio (Kubis, 2015, ¶ 6).[37]

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[33] C.C. art. 2437, 2437quater (It.).

[34] § 1 SPRUCHG (Ger.).

[35] §§ 29, 207 UMWG (Ger.).

[36] §§ 15, 196 UMWG (Ger.).

[37] Shareholders have 3 months to submit a petition for revaluation. § 4 SPRUCHG (Ger.).

The German procedure has an *erga omnes* effect, i.e. all shareholders participate from a better compensation awarded to them by the court, regardless of whether they asked for a revaluation or not.[38] Arguably, it thus has effects comparable to a class action in the US (Krebs, 2012, p. 967).[39] However, the comparison to appraisal rights as such seems more adequate as the procedure does not permit plaintiffs to "block" a transaction with an injunction. A reform enacted in 2005[40] cut of the possibility for shareholders to seek the rescission of a merger based on an incorrect valuation if the appraisal procedure is available[41] (Vermeulen and Zetzsche, 2010, p. 27; Ringe, 2015, p. 531 n.133). "Entrepreneurial" plaintiff lawyers do not appear to be as great an issue as elsewhere in the proceedings. The court is required to appoint a common representative for shareholders who were entitled to object but failed to do so.[42] Typically, the appointee will be an investor protection organization (Krebs, 2012, p. 967). Nevertheless, due to their low cost and wide availability for shareholders.

3.4. Oppression and unfair prejudice claims

Finally, some jurisdictions provide for mechanisms of litigation that addresses "oppressive" conduct that may not explicitly violate the law, but the spirit of the law or contract underlying the corporation. Delaware does not provide for a statutory oppression remedy, but many other US states

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[38] § 13 SPRUCHG (Ger.).

[39] The court has wide discretion to award litigation cost to the firm or to petitioners. § 15 SPRUCHG (Ger.).

[40] GESETZ ZUR UNTERNEHMENSINTEGRITÄT UND MODERNISIERUNG DES ANFECHTUNGSRECHTS [UMAG], September 22, 2005, BGBl. I at 2802.

[41] § 243(4) AKTG (Ger.).

[42] § 6 SPRUCHG (Ger.).

do.[43] In these jurisdictions, courts typically have the discretion to dissolve the corporation if "those in control of the corporation" (i.e. directors or controlling shareholders) have acted "in a manner that is illegal, oppressive, of fraudulent."[44] Often the right to petition for an involuntary dissolution on grounds of oppression is limited to shareholders holding a relatively high percentage of shares (e.g., 20 per cent in New York and 1/3 in California[45]), thus rendering the mechanism useful basically only in deadlocked closely held corporations. The default remedy envisioned in US statutes is typically dissolution. While it is a drastic measure that could conceivably enhance a minority shareholder's bargaining power, its actual imposition is in the hands of a court that will likely hesitate to actually impose it except in the most unusual of circumstances. However, in recent decades a number of states have amended their oppression statutes to permit alternative remedies, particularly buyout of the minority, and some courts have asserted to equitable power to fashion appropriate remedies, including buyout (Moll, 2005, pp. 892-895; O'Neal and Thompson, 2016, §§ 9.36, 9.37).

In jurisdictions whose corporate law is derived from the English common law, including the UK, Australia, Canada, and India, what is called the "unfair prejudice remedy" (historically also called "oppression"[46]) is often thought to be much more important than the derivative suit (for Canada, see, for instance, Dine and Cheffins, 1992, pp. 89-92; for the UK, see Ringe, 2017, p. 278).

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[43] *But see* DGCL § 273 (dissolution following a deadlock between two shareholders owning 50 per cent each).

[44] RMBCA § 14.30(a)(2)(ii). *See, e.g.* NYBCL § 1104-a(a)(1); CAL. CORP. C. § 1800(b)(4).

[45] NYBCL § 1104-a(a); CAL. CORP. C. § 1800(a)(2).

[46] COMPANIES ACT 1948, s. 210 (UK).

In part, the reason is likely that English company law has historically limited derivative suits to a small set of circumstances.[47] Minority shareholders could not normally bring a derivative suit against a board that had violated its duties without conferring an advantage to a controlling shareholders, given that majority rule would apply absent a conflict (Armour, 2009, p. 80). Derivative suits were therefore of relatively little use in public companies (without a controlling shareholder) (Armour, id.). At least previously, the unfair prejudice remedy appears to have been used somewhat more than the derivative suit even in public companies, although none of the reported suits were successful (Armour, id., at 83). In any event, while the limitations on derivative suits were somewhat liberalized in the Companies Act 2006[48], the unfair prejudice remedy[49] has generally remained the more popular mechanism. It benefits from its wide scope of application,[50] which encompasses any action by those controlling the firm unfair to those not in control. The language of

[47] Foss v. Harbottle, [1843] 67 E.R. 89. (Ch.).

[48] COMPANIES ACT (2006), s. 260-264 (UK).

[49] COMPANIES ACT (2006), s. 994-999 (UK). According to s. 994(1), "[a] member of a company may apply to the court by petition for an order under this Part on the ground (a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."

[50] COMPANIES ACT (2006), s. 994(1) (UK) provides that only a member of a company may bring an unfair prejudice petition. However, the standing to sue has been broadened by extending the concept of 'membership' to include (i) those to whom shares have been transferred but whose names have not been registered in the register of members (*Re Quickdrome Ltd* (1988) BCLC 370), (ii) those to whom shares have been transmitted by operation of law and whose names have not been registered in the register of members (s.112), and (iii) a person who is only a nominee shareholder (*Re Brightview Ltd* (2004) BCC 542). Although the petitioner must be a member of the company when the petition is presented, he may rely in support of the petition on events which occurred before he became a member.

It has also been held that while the petitioner needs to be member at the time of bringing the unfair prejudice petition, the petitioner may rely on events that occurred before such petitioner became a member (*Lloyd v Casey* (2002) 1 BCLC 454). There is also no requirement to be a minority shareholder in order to bring an unfair prejudice petition.

the 2006 Companies Act[51] clarified that an unfair prejudice can result from a single act or omission and does not necessarily require a sustained conduct or scheme. English courts have applied an objective test as to what is considered unfair, holding that "it is not necessary for the petitioner to show that the persons who have de facto control of the company have acted as they did in the conscious knowledge that this was unfair to the petitioner or that they were acting in bad faith; the test, I think, is whether a reasonable bystander observing the consequences of their conduct, would regard it as having unfairly prejudiced the petitioner's interests."[52] The test is typically whether the "legitimate expectations" of the minority shareholder have been disappointed.[53] This could be because of an informal agreement by the parties outside the company's articles.

Unlike the oppression remedy in a few US states[54], in the UK the unfair prejudice remedy does not require plaintiffs to surpass an ownership threshold, and even a majority shareholder can bring it if the firm is controlled by a minority.[55] The courts have permitted unfair prejudice actions even where in principle derivative suits would have been available (Davies and Worthington, 2016, ¶ 20-14). Another advantage is the court's wide discretion regarding remedies; it has been held that

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[51] COMPANIES ACT (2006), s. 994(1)(b) (UK).

[52] *See Re Bovey Hotel Ventures Ltd* unreported but quoted and followed in *RA Noble & Sons Clothing Ltd* (1983) BCLC 273 at 290.

[53] *E.g.*, *O'Neill v. Philipps* [1999] 2 BCLC 1; *see also* Davies and Worthington (2016), ¶ 20-8.

[54] *E.g.*, NYBCL § 1104-a(a) (requiring a 20 per cent minority).

[55] *Re Ravenhart Service (Holdings) Ltd (2004) 2 BCLC 376*. However, the court will not grant a majority shareholder any remedy if the unfair prejudice can be avoided by exercising other rights available to such majority shareholder (*Re Baltic Real Estate* (1993) BCLC 503). Further, the prejudicial conduct need not affect the interests of the petitioners in their capacity as members. An unfair prejudice petition may be brought so long as the prejudicial conduct is sufficiently connected with membership. Accordingly, exclusion of a member from the board of directors was held to amount to an unfair prejudice (*Re a Company* (1986) BCLC 376).

an appropriate remedy is one that would “put right and cure for the future the unfair prejudice which the petitioner has suffered at the hands of the other shareholders of the company,”[56] and the Companies Act 2006 now provides that the court may make “such order as it thinks fit for giving relief in respect of the matters complained of.” [57] In particular, the court’s order may also (a) regulate the conduct of the company’s affairs in the future, (b) require the company to refrain from doing or continuing an act complained of, or to do an act that the petitioner has complained it has omitted to do, (c) authorize civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the court may direct, (d) require the company not to make any, or any specified, alterations in its articles without the leave of the court, or (e) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company’s capital accordingly.[58] Moreover, the court’s wide discretion sometimes may include monetary payments as well as mandatory buyouts of the aggrieved shareholder, which is used most frequently in practice (Davies and Worthington, 2016, ¶ 20-19; for Australia, see Koh, 2015, p. 388). Maybe most importantly, bringing an unfair prejudice claim allows a plaintiff shareholder to avoid the procedural requirements for a derivative claim (Keay, 2016, p.60). Since the remedy can be either direct or derivative, the unfair prejudice mechanism appears to have left little space for the derivative actions in the UK. In practice, unfair prejudice have become an all-purpose instrument in privately held firms, whereas courts have not traditionally been receptive to admitting them in publicly

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[56] *Re Bird Precision Bellows Ltd* (1986) Ch 658 at 669.

[57] COMPANIES ACT (2006), s. 996(1) (UK).

[58] COMPANIES ACT (2006), s. 996(2) (UK).

traded companies (Armour et al., 2009, pp. 695-696; *see also* Cheffins & Black 2006, pp. 1409-1410).

Some scholars claim an influence of the UK model on Chinese company law in this respect (see Hawes et al., 2015, pp. 560-563). Article 20.2 of the Chinese Companies Law laconically provides that shareholders abusing their rights shall be liable to the company or other shareholders in accordance with the law. An empirical analysis of the cases under this "oppression" remedy has revealed that it is used as a catch-all mechanism by the courts that use it as the basis for a variety of remedies (Hawes et al., 2015, pp. 569-570). In contrast to the usual structure of the unfair prejudice mechanism under English and similar laws, the suit can be brought both by minority shareholder and by the company itself (if it has been harmed). However, the harm must have been caused by a shareholder (and not, for instance, by a director) (Hawes et al., 2015, pp. 581-584).

Another mechanism that shares some features with oppression remedies is the "inquiry proceeding" in the Netherlands although it might also be characterized as judicial supervision mechanism. Under Dutch law – which does not provide for a derivative suit – minority shareholders can petition the enterprise chamber (*ondernemingskamer*), a division of the Amsterdam Court of Appeals, to launch an investigation into the company's management or financial statements.[59] Shareholders must hold at least €225,000 or a 10% share, but the advocate general or a labor union can also bring a petition[60] (see generally Schuit et al., 2002, p. 157; Vermeulen and Zetzsche, 2010, p.

[59] BW art. 2:345(1), art. 2:447 (Neth.).

[60] BW art. 2:345(2), 2:346(b), 2:347 (Neth.).

16; de Dier, 2013, pp. 493-495). The enterprise chamber will then determine whether any misconduct occurred. One major featured share with the unfair prejudice remedy is the flexibility of remedies: the court can decide to dismiss board members or appoint temporary ones, rescind shareholder resolutions, or even dissolve the company[61] (see Schuit et al., 2002, p. 159). In spite of the high ownership threshold for shareholders the mechanism is understood to be effective and widely used (see Vermeulen and Zetzsche, 2010, p. 17).

4. Common policy issues

4.1. Institutional preconditions for effective shareholder litigation

Across jurisdictions, we can observe a tradeoff between litigation as an effective enforcement mechanism for corporate law, and their potential for rent-seeking conduct by entrepreneurial plaintiffs and their even more entrepreneurial lawyers. There are a number of preconditions for a particular type of lawsuit to become a frequently used enforcement mechanism, which can be put into three categories. First, shareholders must have *standing to sue* or be able to obtain standing to sue collectively, or use a form of lawsuit that has collective effects, without facing significant hurdles, against a defendant to whom the suit matters. Second, the *allocation of cost and litigation risk* – both at the ex ante and ex post stages, must not set strong incentives against shareholder litigation.

[61] BW art. 2:356 (Neth.).

Third, shareholders must be able to obtain the *information* needed to bring a suit in order to surmount the applicable evidentiary standard (which may vary by issue or form of litigation).[62]

4.1.1. Standing to sue

Where shareholder derivative litigation and similar mechanisms to enforce directors' liability are concerned, US law stands out in that it is very liberal with respect to standing.[63] In public limited companies, many civil law jurisdictions require a minimum percentage of share ownership of those bringing or otherwise initiating the lawsuit (typically ranging between 1 per cent and 10 per cent).[64] The intuition behind these thresholds seems sound at first glance, since a shareholder holding only a minute stake in the firm likely only has an incentive to sue if his interest in the suit is a personal rather than a collective one (for example, because it enables him to "blackmail" firm into a lucrative settlement). Contrary to this view, Grechenig and Sekyra (2011) show in a mathematical model that with an ownership threshold, potential defendant managers only need to discourage large shareholders above the threshold from suing, which is considerably easier and may mean that corporate law is not enforced even if a suit would be socially desirable. While in some

[62] Gelter (2012) describes these factors as jointly constituting the "Anna Karenina Principle" of shareholder litigation: all of these factors are necessary conditions for shareholder litigation to emerge, but none of them by itself appears to be sufficient.

[63] In some states, the plaintiff may be required to post a bond, which can be a severe limitation. *E.g.*, CAL. CORP. CODE § 800(c).

[64] Gerner-Beuerle & Schuster (2014), p. 217 provide a recent overview of the EU member states, and report that Belgium, the Czech Republic, Germany, Italy, and Portugal require an ownership stake of more than one share, but less than 5 per cent. Bulgaria, Hungary, Latvia, Romania, Slovakia, and Spain range from 5 per cent to less than 10 per cent, whereas Austria, Croatia, Denmark, Finland, Greece, Slovakia, and Sweden require 10 per cent or more. Estonia, Luxembourg, and the Netherlands do not have a derivative suit, whereas in Cyprus, France, Ireland, Lithuania, Poland, and the UK a single share suffice to bring a suit.

China establishes no threshold in the LLC, but requires that plaintiffs have held 1 per cent for more than 180 days in a Joint Stock Limited Company (Huang, 2012, p. 623).

cases it may be desirable to disallow likely non-meritorious litigation by small shareholders, in other cases only large or controlling shareholders complicit in wrongdoing will have standing to sue because of the minimum threshold. Notably, in the UK, France, Switzerland, and Japan there is no ownership threshold for derivative suits, but in the first three countries these remain uncommon. Korea has a very low threshold of 0.01 per cent in publicly traded firms, but this is still considered a major impediment to derivative litigation (Kim and Choi, 2016, p. 241). In China, the 1 per cent threshold is seen as a reason why as of 2011, only one derivative suit had been filed against a publicly traded firm (Zhang, 2011, p. 193).

Another aspect of standing is having standing against the right kind of plaintiff. With the exception of the US, where a derivative suit can be brought to enforce any "right of the corporation,"[65] other jurisdictions (including the UK) tend to be more restrictive. Typically, derivative suits and similar mechanisms are established in the respective corporate law to enforce *liability claims against directors* only.[66] This means, first, that only liability claims are possible, but not normally injunctions. Second, derivative suits sometimes cannot be used as a mechanism to discipline controlling shareholders (for China, see Huang, 2010, p. 253; *but see* Huang, 2012, p. 623,

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[65] FED. R. CIV. P. 23.1(a).

[66] *See, e.g.*, COMPANIES ACT (2006), s. 260(3) (UK): "A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The cause of action may be against the director or another person (or both)."

The second sentence may permits impleading another person (for example, a third party who improperly received funds because of the directors' wrongdoing, but does not include cases where a controlling shareholder's fiduciary duty is at issue). Civil law jurisdictions often do not permit this extension.

regarding "any other person"; for Japan, see Oda, 2011, p. 342; for European jurisdictions, see Gelter, 2012, pp. 875-880). There are exceptions to this, such holding controlling shareholders accountable for violations of directors' duties they were involved in, qualifying controlling shareholders as de facto or shadow directors (for Italy, see Galgano and Genghini, 2006, p. 483; for France, see Cozian et al., 2009, ¶ 262; for the UK, see Companies Act § 260(5)(b)), as well as the German law of corporate groups, which explicitly permits a derivative suit against the "controlling undertaking."[67] However, there are no known cases where such a suit has been brought (in spite of the absence of a percentage standing threshold in this special case) (Ulmer, 1999, p. 300; Hirt, 2005, pp. 191-192).

In the US, the main hurdle for a potential plaintiff to overcome to establish standing in a derivative suit is the demand requirement, which seeks to ensure that directors are given the opportunity to pursue the claim before the ability to sue devolves to shareholders. This mechanism has become a model for other jurisdictions. Under the UK Companies Act of 2006, a shareholder must seek the court's leave to pursue a derivative claim.[68] Interestingly, the court must consider, among other things, whether a person seeking to promote the best interests of the company would bring the suit,[69] and whether the plaintiff is acting in good faith;[70] in other words, the court will to some

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[67] AKTG §§ 317(4), 309(4) (Ger.).

[68] COMPANIES ACT s. 261 (UK).

[69] COMPANIES ACT s. 263(2)(a) (UK).

[70] COMPANIES ACT s. 263(3)(a) (UK).

extent have to evaluate whether the suit is in the interest of the company (Paul, 2010, p. 89). Similarly, when Germany reformed its derivative suit mechanism in 2005, it created a "lawsuit admission procedure" that requires plaintiffs to show that they took steps to induce that directors bring the suit.[71] A major problem under German law is that the plaintiff has to establish a "gross violations of the law or the charter" and the court would have to determine whether the suit is in the best interests of the corporation (Saenger, 2015, p. 26). In China, plaintiffs must either permit the board 30 days to consider the suit, or establish that the delay would result in irreparable harm to the company (Huang, 2012, pp. 624, 638). Similarly, in Japan shareholders can bring a suit after waiting for 60 days after filing a request with the company without having to ask for the court's leave to do so (Oda, 2011, p. 343). By contrast, French law does not have a demand requirement for its derivative suit (De Wulf, 2010, p. 1558).

Note that these standing requirements seem to be mainly an issue in derivative suits and similar mechanisms, but not in other forms of shareholder litigation. Most likely the reason is the particular salience of the suspicion raised by a suit by a shareholder on behalf of a corporation from which she will only draw a minute proportionate benefit. There are typically fewer limitations on standing for direct suits and for rescission suits challenging the validity of decisions of the shareholder meeting, given that these tend to remedy harm inflicted on shareholders directly.

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[71] AKTG § 148(1) Nr. 2 (Ger.).

4.1.2. Allocation of cost and risk

For shareholder litigation to be viable, the allocation of cost and litigation risk must set the right incentives, both at the ex ante and ex post stages. At the *ex ante* stage, up front court fees may deter shareholder litigation, in particular if these amounts are measured as percentages of the amount in dispute. This can be a strongly deterrent factor, especially if it is measured as a percentage of the harm to the company (for China, see Huang, 2012, p. 651). Arguably, a court decision that reduced the filing fee for derivative suits from a percentage to a modest flat fee opened the floodgates for derivative litigation in Japan in 1993 (West, 1993, pp. 1463-1465; West, 2001, p. 353; Osugi, 2016, p. 53; *contra* Puchniak and Nakahigashi, 2012, pp. 48-50, 54-56).

A "security for expense statute," which permits the corporation or other defendants to request that plaintiffs that do not exceed a minimum ownership threshold (usually 5 per cent) post security for litigation expenses has a similar effect. At present, nine states in the US have such a requirement for derivative suits (DeMott, 2016, ¶ 3.02).[72] Japanese law pursues similar objectives when it gives the court the discretion to require derivative plaintiffs to provide a significant deposit to cover the defendant's cost, provided that it believes that the plaintiff acted in bad faith (Oda, 2011, p. 344; Osugi, 2016, p. 53). However, ex ante fees cannot alone explain the pervasiveness of

[72] These states are Alaska, Arkansas, California, Colorado, Nevada, New Jersey, New York, North Dakota, and Pennsylvania. Many states also have general "security for costs statutes" applicable to all suits, but limited to only certain classes of expenses such as non-residents (DeMott, 2016, ¶ 3.03).

a particular type of litigation. For example, in Germany ex ante fees for derivative suits and rescission lawsuits are similar (several thousand euros), and yet these two types of suits differs vastly in prevalence (Gelter, 2012, pp. 869, 887).

The *ex post* stage of litigation also plays a significant role, in particular whether the "loser pays" or "English" rule creates a deterrent against lawsuits with uncertain prospects,[73] as well as the availability of some form of contingency payment for lawyers (e.g., Keay, 2016, p. 44). Both UK and German law, however, allow the court to shift the plaintiff's expenses in a derivative suit to the corporation in an unsuccessful suit under certain circumstances (Paul, 2010, pp. 96, 101-102, 110). In any event, the incentive effects of the "English rule" should not be overestimated, however, since in many jurisdictions, the reimbursement of the plaintiff is limited to court fees or to attorney fees according to the bar association's official rate (see Gelter, 2012, pp. 862-866; for the UK, see Huang, 2010, p. 254, reporting "between two-thirds and four-fifth of the actual rate"). In some jurisdictions only court fees but not lawyers' fees are typically reimbursed (for France, see Gelter, 2012, p. 864; for China, see Huang, 2012, p. 641). Some form of contingency fee or conditional fee system likely plays a role in incentivizing some lawsuits; apparently conditional fees arrangements contributed to the rise of derivative litigation in Japan in the 1990s (West, 2001, p. 369-370). In the UK, conditional fees are limited to 100 per cent of hourly fees, which greatly attenuates the effectiveness of the mechanism in creating incentives; it is thus not a strong substitute for contingency fees (Cheffins and Black, 2006, p. 1405). However, as the example of German rescission

[73] On the use of the "American rule" in China, see Clarke (2009), pp. 253-255.

lawsuits shows, contingency or conditional fees are clearly not a necessary condition for lawsuits to arise, even if they may be a strong contributing factor.

The allocation of cost and risk also entails the necessity of collective effect. To have an incentive to sue, shareholders would normally need a strong personal benefit from successful litigation that outweighs the cost. This is normally the case in any type of suit in closely-held firms, but often not in publicly traded firms. US law overcomes this obstacle both in the derivative suit and in direct (class action) suit by providing powerful incentives for plaintiff lawyers. Thus, the collective benefits of the suit are achieved by concentrating high-powered incentives in a single party. By contrast, appraisal rights were traditionally thought not to be particularly effective because the collective effect was absent, as shareholders had to opt into them. Incentives only came into being with appraisal arbitrage (Korsmo and Myers, 2015). Rescission lawsuits in Continental European jurisdictions automatically have a collective effect as to their results; the cost-sharing problem is mitigated by the fact that the cost for the plaintiffs are relatively limited.

4.1.3. Access to information

Another necessary element of an effective litigation system is a solution for the information asymmetry between the parties. However, this is a much more significant issue for some types of suits than for others. For example, it is highly significant for derivative actions based on allegations of violations of fiduciary duties, where plaintiffs might have to establish wrongdoing by directors. It is far less important for lawsuits challenging the validity of shareholder decisions, since much of litigation of this type revolves around violations of procedural and information requirements.

In suits alleging wrongdoing by managers or directors, the company will typically have records that might substantiate the suit to which plaintiffs usually will not have access. US law addresses this issue by providing pre-trial discovery, which requires that the parties disclose pertinent information to each other[74] (for a comparison, see generally Stürner, 2001).[75] Moreover, the nuisance value of a suit is greater if discovery is available (Osugi, 2016, p. 55). Thus, in the US the struggle between the parties to pre-trial motions to dismiss often takes place before discovery, particularly in the context of the demand requirement for derivative suits (on the significance in the context of corporate governance, see Gorga and Halberstam, 2014). One possible functional equivalent in several European jurisdictions is the "special audit," which a minority of shareholders exceeding a particular percentage may be able to initiate (see Paul, 2010, pp. 103-105; Gelter, 2012, pp. 873-875). It is generally not thought to be widely used or effective. A more realistic functional equivalent could be a shift in the burden of proof on directors in a number of jurisdictions, specifically Germany, Austria, the Czech Republic, Italy, Slovenia and Portugal (Gerner-Beuerle and Schuster, 2014, p. 203). In this case, the defendant director or manager has to show that she acted with due care. Note that this shift does not, however, extend to issues of whether a decision was subject to a conflict of interest. Moreover, in Germany, for example, the effect of this is mitigated by the primary hurdle in the "lawsuit admission procedure" for the plaintiff to establish facts indicating dishonesty or serious violations of the law or the corporate charter.[76] Paradoxically, plaintiffs must first surpass this higher hurdle to obtain standing before benefiting from the shift in the burden of proof.

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[74] FED. R. CIV. P. 26.

[75] Regarding more limited pre-action disclosure in the UK, see Paul (2010), pp. 94-96.

[76] AKTG § 148(1) Nr. 3 (Ger.).

In some other jurisdictions, the lack of discovery procedures may be circumvented by plaintiffs making use of information brought to light in public enforcement actions. West (2001, p. 380-381) reports that this is a significant factor in Japan, and it may also play a role in jurisdictions such as France, where minority shareholders can initiate criminal enforcement actions to obtain damages (Conac et al., 2007, p. 518). Another example in this category are likely securities lawsuits in China, which have an administrative or criminal sanction as a prerequisite (Huang, 2013, p. 764).

4.2. German rescission lawsuits as an example

Germany provides an example for a homegrown style of shareholder litigation that in some ways resembles, but in other ways differs, from litigation in the US. While shareholder derivative suits have remained relatively uncommon in spite of the 2005 liberalization, shareholder litigation has focused on the area of rescission lawsuits, which are discussed frequently both in legal scholarship and in the business press. It is frequently claimed that these types of lawsuits are dominated by a group often described as “professional plaintiffs” (*Berufskläger*) or “predatory shareholders” (*räuberische Aktionäre*) that bring lawsuits for personal gain. The number of lawsuits is considerable. Vermeulen and Zetzsche (2010, pp. 24-25) report that 135, 164, and 163 suits were brought in the years 2006 through 2008, respectively. Given that 752 companies were traded in regulated markets at that time, and about 450 in non-regulated markets, this implies that about 12 per cent of publicly traded firms were hit with a suit each year. Baums et al. (2011, p. 2331) estimate that there were 580 suits in publicly traded firms between 1 July 2007 and 30 July 2011. Most suits were brought by a small circle of repeat plaintiffs. The most active individual, Klaus Zapf, brought 32 suits in 27 companies. The most litigious legal entity, Pomoschnik Rabotajet GmbH, which brought 42 suits against 37 firms, was also controlled by Mr. Zapf (Baums et al., 2011, p. 2334). Baums et al. (2011) reviewed the types of shareholder decisions challenged by the plaintiffs, as shown in Table 1.

Type of resolution challenged	Lawsuits
Discharge of supervisory board or its members	83
Discharge of management board or its members	73
Amendment of articles	44
Election of supervisory board members	40
Repurchase of own shares	33
Election of the auditor	30
Use of profits (dividend or retention)	29
Authorized capital	28
Squeeze out	27
Approval of group integration	25
Capital increase	25
Issuance of (certain) financial instruments	14
Confirmation of prior shareholder decisions	12
Capital reduction	12
Creation or elimination of conditional capital	12
Mergers, transformations, divisions	12

Table 1: Types of shareholders resolution challenged (only showing types with 10 or more law suits) [Source: Baums et al., 2011, p. 2337]

A number of the top positions in the table are taken by lawsuits against routine resolutions, such as elections and discharge resolutions, where suits are mainly an unwelcome distraction that may inflict reputational harm on the company. However, as with merger litigation in the US, there was considerable concern that a pending lawsuits would impede important transactions (such as a merger or issuance of new shares). This may create allegations of shareholders bringing badly founded suits in order to coerce a corporation into a financial lucrative settlement to let the transaction proceed. Lawsuits against capital increases and reductions and related changes to the company's capital structure are obviously more bothersome, as they can in principle delay or disrupt important transactions, thus creating bargaining power for plaintiffs. The same may apply to mergers and similar transactions, which also figure on the list. Most academic commentators believe that much of this litigation, which became common in the late 1970s (Hopt, 1997, p. 267), was not meritorious (e.g., Vermeulen and Zetzsche, 2010, p. 60). Baums et al.'s empirical study appears to confirm that this is indeed a significant problem, arguably because many cases settle. In the 2007-2011 time window, 45 per cent of cases settled, but 72 per cent when one of the known repeat plaintiffs was involved (Baums et al., 2011, p. 2343). This appears to be particularly often the case when the suit is brought against an important transaction such as a capital increase or merger (Baums et al., 2011, p. 2344). The provisions of the settlements vary, but besides, for instance, increased information disclosures or improved compensation for shareholders in a freeze out transaction, settlements appear often to include agreements about compensation of the plaintiffs' expenses. The authors suggest that there are strong hints that not only lawyers, but plaintiffs themselves received significant payments (Baums et al., 2011, p. 2347).

Given that a delay of a significant transaction can inflict harm on the company, in a few cases plaintiffs have been held liable for damages to the company. In the *Nanoinvests* case,[77] Mr. Zapf was held liable for damages caused by frivolous litigation. Allegedly, he had used the threat to bring a suit to coerce the company to assign to him (and to a handful of other shareholders that he represented) a vastly disproportionate number of preemptive rights in the company's shares.

Given that the plaintiff's actions are rarely as blatantly abusive and easy to prove as they were in this case, liability lawsuits were not considered a solution for the "predatory shareholders"

[77] OLG Frankfurt, January 13, 2009, 5 U 183/07, review denied by BGH, August 10, 2010, VI ZR 47/09; *but see* OLG Hamburg, October 20, 2010, 11 U 127/09 (denying liability of a plaintiff in an allegedly abusive suit to an individual who was expected to become a shareholder of the corporation as a result of the transaction).

problem. To reduce plaintiffs' ability to coerce the company into a settlement, a reform enacted in 2005[78] created a "clearance procedure" (*Freigabeverfahren*) for the increase and reduction of capital and group integration agreements. In these cases, the corporation may ask the court to permit the registration of the transaction while the suit is pending, thus relegating the plaintiff to damages in the case of success. The 2005 law permitted a "clearance" only where the suit appeared to be "obviously without foundation" *and* the advantages of letting the transaction go forward outweighed the disadvantages (e.g., Naruisch and Liepe, 2007, pp. 231-232). A 2009 reform[79] expanded the procedure further and permits a clearance even if the suit was not "obviously without foundation" when the plaintiff holds less than EUR 1000 of the nominal value of the firm's stock, but also in cases where the court finds that harm from the delay outweighs disadvantages to the shareholder (see Krebs, 2012, pp. 966-967; Ringe, 2015, p. 506). In Baums et al.'s (2011, p. 2349) study, 48 out of 61 clearance requests were approved by the courts. According to Bayer and Hoffmann (2013), the 2009 reform helped to reduce the number of defendant firms considerably (down to 55 in 2012), and had a particularly strong impact on the activities of repeat plaintiffs, even if the fundamental problem has not been completely resolved (*see also* Bayer and Hoffmann, 2014).

For the objective of the chapter, there are three key takeaways. First, even if rescission lawsuits are not formally equivalent to (direct) shareholder class actions in the United States, they often perform a similar function in policing controlling shareholders' decisions that might dilute

[78] AKTG § 246a (Ger.), introduced by GESETZ ZUR UNTERNEHMENSINTEGRITÄT UND MODERNISIERUNG DES ANFECHTUNGSRECHTS [UMAG], September 22, 2005, BGBl. I at 2802.

[79] AKTG § 246a (Ger.), as amended by GESETZ ZUR UMSETZUNG DER AKTIONÄRSRECHTERICHTLINIE [ARUG], July 30, 2009, BGBl. I at 2479.

the minority's stake. At the same time, they raise similar problems by permitting non-meritorious suits to go forward and creating the possibility for plaintiffs to coerce the corporation into a settlement.

Second, we can see that rescission lawsuits are widespread because the preconditions for shareholder litigation outlined in section 4.1 are met (whereas they are not for derivative suits in Germany). Rescission lawsuits have liberal standing rules and do not require a minimum ownership threshold. Moreover, the allocation of cost and risk is favorable for plaintiff shareholders. The amount in dispute used to measure court fees is normally limited to the lower of 10 per cent of the corporation's nominal capital and €500,000,[80] which keeps the risk for plaintiffs within bounds.[81] Finally, suits of this type tend to be easier to bring because they often are based on allegations of inadequate information of shareholders rather than violations of fiduciary duties. Hence, plaintiffs do not need to be privy to internal information of the company to establish a colorable claim (compare for Spain Sáez and Riaño, 2013, p. 367).[82]

Third, it is difficult to set up a legal regime that maintains incentives for meritorious suits while eliminating those for abusive ones. Arguably, the discretion granted to the court in 2009 reform to weigh the interests affected by the suit against each other does just that, especially because the clearance procedure permits suits to go forward but eliminates plaintiffs leverage over the company. In general, it is hard to determine to what extent high-powered incentives to bring

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[80] AKTG § 247(1) (Ger.).

[81] Baums (2000), p. 296 therefore suggests that only "occasional," but not "professional," plaintiffs will be deterred by cost risk.

[82] In fact, it is sometimes alleged that plaintiffs deliberately overuse shareholder rights in the annual meeting in order to provoke violations of formal requirements (Bayer, 2013, pp. 92-93).

suits that are potentially not meritorious are generally necessary to maintain incentives to sue at all, which in turn will create incentives to comply with the law. In the German case, however, most rescission suits relate mainly to procedural and disclosure requirements and therefore likely do little to police firm's and controlling shareholders' conduct.

5. Conclusion

The chapter has surveyed functionally equivalent shareholder litigation mechanisms to the derivative and direct suits familiar from US corporate law. Overall, we can see that in the UK, and to some extent in other jurisdictions influenced by the UK, the unfair prejudice remedy is used as an all-purpose mechanism for shareholder grievances, especially in privately held firms. In some civil law jurisdictions, lawsuits challenging the validity of shareholder resolutions are particularly important, given the types of issues that are subject to a shareholder vote. At least in those areas, it is safe to say that, for example, German corporate law is certainly not underenforced, even if these lawsuits have given rise to a problematic group of "entrepreneurial" plaintiff shareholders that arguably often attempt to coax corporations into settlements when planning significant transactions. As in the United States, it has proven difficult to find the right balance between ensuring the appropriate level of enforcement and preventing nuisance litigation that distracts from gainful economic activity and sometimes entail costly buyouts of litigants.

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