Preliminary Procedures in Shareholder Derivative Litigation: A Beneficial Legal Transplant?

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Martin Gelter
Fordham University and ECGI

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This material builds on the OECD work titled "OECD (2020), "Report on derivative litigation" in Private enforcement of shareholder rights: A comparison of selected jurisdictions and policy alternatives for Brazil", http://www.oecd.org/corporate/shareholder-rights-brazil.htm.' The additional opinions expressed and arguments employed herein are those of the author and do not necessarily reflect the official views of the OECD or of its member countries.

Abstract

Jurisdictions around the world have developed different mechanisms to balance the necessity of enforcement with the problem of non-meritorious shareholder derivative litigation. One instrument to channel shareholder litigation is preliminary procedures, which typically constitute a screening stage before fact-finding. These have been adopted in several jurisdictions in recent years. This article argues that in jurisdictions applying the “loser pays” rule, preliminary procedures can serve as cutoff points for potential plaintiffs’ litigation cost risk, which often blunts incentives to litigate. To make preliminary procedures an effective instrument, the law must find workable solutions for two questions of institutional design. First, the risk of paying litigation costs should initially be limited to the preliminary procedure. Second, at the preliminary stage, shareholders should not be required to provide evidence about the merits of the suit or whether the company would benefit from it. Instead, as in the US, the emphasis of the preliminary stage should be on conflicts of interest of directors that make it unlikely that they bring such a suit themselves. Such a system would permit courts to screen out abusive lawsuits at an early stage while at the same time reducing incentive problems that have long plagued shareholder litigation.

Keywords: derivative suits, shareholder litigation, corporate governance, comparative corporate law, discovery, pre-trial procedures, litigation cost, legal transplants

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Martin Gelter
Professor of Law
Fordham University School of Law
150 W. 62nd Street
New York, NY 10023, United States
phone: +1 646 312 8752
e-mail: mgelter@law.fordham.edu

Fordham University School of Law

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By
Martin Gelter
PROFESSOR OF LAW

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* Fordham University School of Law; Research Member, European Corporate Governance Institute. This material builds on the OECD work titled "OECD (2020), "Report on derivative litigation" in Private enforcement of shareholder rights: A comparison of selected jurisdictions and policy alternatives for Brazil", http://www.oecd.org/corporate/shareholder-rights-brazil.htm.' The additional opinions expressed and arguments employed herein are those of the author and do not necessarily reflect the official views of the OECD or of its member countries.

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1. Introduction

Shareholder derivative litigation is a perennial subject of debate. While it is often seen as a nuisance in some jurisdictions because of its ubiquity, most of all in the United States,[1] derivative suits are noted for their scarcity in practice in many countries.[2] At least in theory, derivative suits

[1] *E.g.* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions,* 86 COLUM. L. REV. 669, 698-701 (1986) (surveying evidence for excessive litigation); Adam B. Badawi & Daniel L. Chen, *The Shareholder Wealth Effects of Delaware Litigation,* 19 AM. L. & ECON. REV. 287 (2017) (finding a negative wealth effect of derivative suits).

[2] For Europe, *e.g.,* Martin Gelter, *Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?* 36 BROOK. J. INT'L L. 843, 844-46 (2012); for the UK John Armour, Bernard Black, Brian Cheffins & Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States,* 6 J.

can be a potentially valuable from a policy perspective because they create incentives for members of the governing bodies of a corporation to comply with their duties. Vigorous enforcement of fiduciary duties should increase investors' confidence and reduce agency cost.[3] However, derivative suits, which a shareholder plaintiff brings to enforce a claim of the corporation, are potentially burdened with high litigation agency cost.[4] Plaintiffs or, more likely, their lawyers, may pursue their own goals, such as coercing the defendants (and the corporation they control) into an overt or covert settlement benefiting themselves more than the entire body of shareholders.[5]

Jurisdictions around the world have developed different mechanisms to balance the necessity of enforcement with the problem of non-meritorious litigation. In many countries, derivative litigation has traditionally been inhibited by procedural disincentives resulting from the distribution of litigation cost. The law tries to balance permitting "too many" and "too few" derivative lawsuits in practice. There are a number of levers that policymakers could adjust to make derivative suits more common, including cost and fee rules that reward successful plaintiffs or their lawyers, e.g., through contingency fees.[6] However, one instrument that so far has received little attention in the comparative literature is preliminary or pre-trial procedures. These are one of several techniques to screen for meritorious lawsuits and plaintiffs, and to channel shareholder litigation by requiring a court to decide about the admission of a derivative suit, typically before the fact-finding stage.[7] In the past 25 years, these have been adopted in several jurisdictions, including Germany, Israel, Singapore, and the UK. An earlier model was the United States, where they effectively emerged through the development of the case law rather than a planned policy choice. In the leading corporate law state – Delaware – plaintiffs typically must claim demand futility to advance a derivative suit.[8] This article explores how pre-trial procedures have spread outside their original biotope into multiple jurisdictions. It argues that if they are designed well, they can be a valuable mechanism

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EMPIRICAL LEGAL STUD. 687 (2009); for Asia Dan W. Puchniak, *The Derivative Action in Asia: A Complex Reality,* 9 BERKELEY BUS. L. J. 1, 4-5 (2012) (finding that derivative suits are common in Japan, present in Korea and China, and rare in India); *see generally* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies,* in THE ANATOMY OF CORPORATE LAW 29, 41-42 (3rd ed., Reinier Kraakman et al. 2017) (contrasting the US' unique position with other countries).

[3] *But see* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 262 (1986) (criticizing the widespread assumption that derivative suits will reduce agency cost).

[4] *E.g.* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits,* 57 VAND. L. REV. 1747, 1768 (2004).

[5] Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions,* 57 VAND. L. REV. 133, 152-57 (2004) (surveying indicia of litigation agency cost).

[6] *E.g.* Gelter, *supra* note 2, at 866-869.

[7] *E.g.* Alan K. Koh & Samantha S. Tang, *Direct and derivative suits: towards a functional and practical taxonomy,* in COMPARATIVE CORPORATE GOVERNANCE 431, 449 (Afra Afsharipour & Martin Gelter eds. 2021).

[8] *E.g.* Bernard Black, Brian Cheffins, Martin Gelter, Hwa-Jin Kim, Richard Nolan, Mathias Siems & Linia Prava Law Firm, *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency),* 2008 COLUM. BUS. L. REV. 1, 29; WILLIAM T. ALLEN, REINIER KRAAKMAN & VIKRAMADITYA S. KHANNA, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 423 (6th ed. 2021) ("In an odd way, the Delaware Supreme Court has promulgated […] a rule of "universal nondemand"). On demand futility, *see* infra notes 77-79 and accompanying text.

that strikes the right balance between insufficient and excessive shareholder litigation and helps to stifle litigation of the wrong kind.

Pre-trial procedures can be considered a legal transplant.[9] Transferred from one jurisdiction to multiple others, they serve a different purpose in their host jurisdictions than the original one. In the US, they establish a barrier against the lawsuit moving into discovery, which is less of a concern in other jurisdictions. The article argues that in jurisdictions applying the "English rule" (or "loser pays rule"),[10] they can serve as the cutoff point for the risk of having to bear litigation cost for potential plaintiffs. The article suggests that this different purpose works to the advantage of derivative litigation because it blunts disincentives against bringing such suits. This does not mean that plaintiffs in countries with well-designed preliminary procedure will necessarily have high-powered incentives to bring large numbers of lawsuits. However, such procedures can remove considerable obstacles. Thus, countries would be advised to introduce well-designed preliminary procedures.

So far, most jurisdictions that introduced preliminary procedures for derivative litigation have not yet seen a substantial uptick in private enforcement of corporate law, primarily because of flaws in the system's design. First, shareholders have been saddled with a risk of bearing costs that deters them from litigating. Instead, the risk of paying litigation costs (both court fees and attorney's fees) should initially be limited to the preliminary procedure. Second, preliminary procedures often require shareholders to provide evidence (even if only prima facie evidence) that the suit is likely to prevail or otherwise "in the interest of the corporation," given that outside shareholders are typically not well-positioned to support the substance of a claim to such a degree at an early stage. Instead, as in the US, the emphasis of the preliminary stage should be on conflicts of interest of directors that make it unlikely that they bring such a suit themselves. Such a system facilitates control by the courts over potentially abusive litigation and makes for countries to abolish minimum share ownership requirements for derivative litigation (where they still exist).

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[9] The term famously originates with ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW (1974).

[10] On the distinction between the "American rule" and the "English rule" s*ee generally* A. Mitchell Polinsky & Daniel L. Rubinfeld, *Does the English Rule Discourage Low-Probability-of-Prevailing Plaintiff?* 27 J. LEGAL STUD. 519, 519-20 (1998); Kathryn E. Spier, *Litigation*, in 1 HANDBOOK OF LAW AND ECONOMICS 259, 301 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

This article, which is based on a survey of the law of nine jurisdictions (Brazil[11], France[12], Germany[13], Israel[14], Italy[15], Singapore[16], Spain[17], the United Kingdom[18], the United States [Delaware][19]), proceeds as follows. Section 2 explores the tradeoff between enforcement and abuse in shareholder litigation. Section 3 then surveys the main formal ways of dealing with it, arguing that these provide rough and problematic delineation between suits that should go forward and those that should not proceed. Section 4 documents substantive techniques of limiting litigation, namely pre-trial procedures. The section explores their international spread, starting with their country of origin – the US. Section 5 explains how pre-trial procedures interact with cost rules, most of all in countries with fee-shifting rules, which are crucial for shareholder litigation. In combination with well-designed pre-trial procedures, cost-shifting rules will no longer be an insurmountable hurdle inhibiting a functional system of shareholder litigation. Section 6 explores pre-trial procedures as a legal transplant and discusses conditions for effective pre-trial procedures. Section 7 summarizes and concludes.

2. Shareholder litigation between under- and overenforcement

Shareholder litigation and its reform are controversial across jurisdictions. Litigation is often considered a necessary right in the menu of options available to shareholders. Like anyone operating in an ineffective legal system, directors and officers not facing sanctions for violating their duties of care or loyalty may have insufficient incentives to comply with these obligations (although non-legal factors such as reputational incentives, capital markets, or managerial labor markets may play a role).[20] When such actions harm the corporation, shareholders typically only suffer a reflective loss because of the decrease of the value of their interest.[21] The proper plaintiff

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[11] Lei das Sociedades por Açoes (LSA), amended as of April, 2019.

[12] Code de commerce (C. Com.), amended as of February 14, 2020.

[13] *Aktiengesetz* (Stock Corporation Act) of 6. September 1965 (BGBl. I S. 1089), amended as of art. 1 of the Law of December 12, 2019 (BGBl. I S. 2637).

[14] Israel Companies Law, No. 5799/1999, Official Gazette No. 1711 of May 27, 1999, p. 189, amended as of Amendment No. 33 in section 42 of the Antitrust Law (Amendment No. 21), No. 5729/2019.

[15] Codice civile (C.Civ.) of March 16, 1942, Gazzetta ufficiale No 79 of April 4, 1942, amended as of June 10, 2019.

[16] Singapore Companies Act (revised ed. 1994), amended as of Act 28 of 2019, Gvt. Gaz. 2019, no. 35, October 4, 2019.

[17] Ley de Sociedades de Capital (LSC) of July 2, 2010, amended as of December 29, 2018.

[18] Companies Act 2006, 2006 ch. 46, amended as of The Risk Transformation Regulations 2017 (S.I. 2017/1212), regs. 1(2), 12(8).

[19] Delaware General Corporations Law (DGCL), amended as of January 1, 2021, 83 Del. L., c. 60.

[20] *E.g.* Thompson & Thomas, *supra* note 5, at 141-42 (contrasting the role of litigation, managerial labor, capital and product market in reducing agency cost). On reputational sanctions *see* Roy Shapira, *A Reputational Theory of Corporate Law,* 27 STAN. L. & POL'Y REV. 1, 3 (2015) (suggesting that corporate law shapes behavior through reputation).

[21] On the "reflective loss" principle, *see e.g.* Hans de Wulf, *Direct shareholder suits for damages based on reflective losses,* in FESTSCHRIFT FÜR KLAUS HOPT (Stefan Grundmann et al. eds. 2010); Alan K. Koh, *Reconstructing the reflective loss principle,* 17 J. CORP. L. STUD. 373, 374 (2016); Vera Korzun, *Shareholder Claims for Reflective Loss: How International Investment Changes Corporate Law and Governance,* 40 U. PA. J. INT'L L. 189, 201-8 (2018).

to enforce the corporation's claims is the latter itself, but often the alleged wrongdoers (including directors, officers, and controlling shareholders) are still in control of the company.[22] An intuitive way around this hurdle is to create a mechanism for (minority) shareholders to initiate such litigation. Derivative suits and other instruments that give the power to enforce corporate claims against directors or controlling shareholders are intended as an exception to the general rule that assigns the ability to make corporate decisions to (managing) directors or officers.[23]

At first glance, shareholders' incentives to sue look weak. Plaintiffs only benefit from such a suit in proportion to their stake in the company, while the remaining benefits accrue to others. With plaintiffs investing time and bearing the cost and the risk, derivative suits look like another instrument blunted by the classic collective action problem in corporate governance.[24] However, in jurisdictions where we do see considerable levels of litigation, it is often fiercely criticized.[25] Not every suit is in the best interest of the corporation and its shareholders. If a suit has a small likelihood of success and the potential to generate negative publicity, the corporation and its executives could spend their money and time more productively.[26] Directors and officers are usually in the best position to gauge the advantages and disadvantages of business decisions, which makes the decision to give minority shareholders the power to initiate and pursue litigation difficult. One policy option would be to *require* boards to enforce liability claims. However, even in Germany, where such a requirement exists in principle,[27] the law allows the supervisory board to consider factors in favor and against suing, such as the suit's likelihood of sucess, the defendant's ability to pay, the availability of D&O insurance, negative publicity and the distraction of board members from running the business.[28] Since directors are likely to use this discretion in favor of individuals

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[22] *E.g.* Arad Reisberg, *Funding Derivative Actions: A Re-Examination of Costs and Fees as Incentives to Commence Litigation,* 4 J. CORP. L. STUD. 345, 367 (2004).

[23] For example, in the US, Delaware law provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. […]". DGCL § 141(a).

[24] Reisberg, *supra* note 22, at 345, 347–48 (discussing incentives to sue and free-riding); Anne van Aaken, *Shareholder Suits as Technique of Internalization and Control of Management*, 68 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 288, 289 (2004) (noting that derivative suits create a public good).

[25] For derivative suits in the US, *see* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?* 7 J.L. ECON. & ORG. 55 (1991) (criticizing the ineffectiveness of derivative suits based on empirical evidence); Jessica Erickson, *The Lost Lessons of Shareholder Derivative Suits,* 77 WASH & LEE L. REV. 1131, 1143-44 (2020) (surveying criticism of derivative litigation). For lawsuits seeking to invalidate decisions of the shareholder meeting in Germany, *see* Erik P.M. Vermeulen & Dirk A. Zetzsche, *The Use and Abuse of Investor Lawsuits*, 2010 EUR. COMPANY & FIN. L. REV. 1, 24-5, *and* Theodor Baums, Florian Drinhausen, & Astrid Keinath, *Anfechtungsklagen und Freigabeverfahren. Eine empirische Studie*, 32 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 2329–52 (2011) (both providing empirical data supporting the view that much of this litigation was abusive when it was highly prevalent).

[26] *See, e.g.,* Reinier Kraakman, Hyun Park & Steven Shavell, *When are Shareholder Suits in Shareholder Interests?* 82 GEO. L.J. 1733, 1738 (1994).

[27] BGH April 21, 1997, II ZR 175/95 (ARAG/Garmenbeck), 1997 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 1926, 1928 (finding that the supervisory board's decision whether to sue a management board member is not protected from judicial review as business judgment, but that the supervisory board is required to pursue a clam if it finds, after careful consideration, that doing so is in the best interest of the company).

[28] *See* Mathias Habersack, 19 Jahre „ARAG/Garmenbeck" – und viele Fragen offen, 2016 NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 321, 322; Jochem Reichert, *„ARAG/Garmenbeck" im Praxistest*, 37 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1189, 1190 (2016).

for whose selection and supervision they are responsible, it seems necessary to retain shareholder derivative suits as a safety valve.

Shareholder litigation can sometimes appear abusive, especially when specialized law firms are the primary beneficiaries.[29] Lawyers may hope to receive a lucrative contingency fee because of a settlement.[30] The interests of plaintiff attorneys rather than shareholders may therefore drive decisions taken during the procedure, a phenomenon called "litigation agency cost."[31] Nevertheless, keeping this in mind, some litigation agency cost may be necessary to pay to create sufficient enforcement of directors' duties and thus reduce managerial agency cost (and possibly agency costs produced by controlling shareholders). Without anyone facing strong incentives to litigate, the deterrent effects of enforcement may be too weak even in combination with other deterrents.[32] Investors may lose confidence in firms and capital markets, resulting in higher costs of capital for firms. Some may even eschew public markets entirely.

Therefore, an effective litigation mechanism needs to walk a tight line between the respective risks of over- and underlitigation. The ideal system would permit meritorious suits to go forward and shut down abusive ones at an early stage.[33] In practice, any preliminary procedure will likely only be a second-best solution workable within a given legal, economic, and political environment. This is not to say that an effective litigation system is the only way to establish an effective corporate governance system and keep agency cost in check. Some jurisdictions appear to rely mainly on ex-ante monitoring by boards and institutional investors rather than litigation, the UK being a case in point.[34] Even in the US, due to changes in the Delaware case law, shareholder litigation is becoming less important as an instrument to reduce agency cost. At the same time, other mechanisms such as monitoring by institutional investors partly take up the role.[35] Each of the two systems relies on different aspects of the corporate governance ecosystem to work well. Ex-ante monitoring by investors appears to work best under dispersed ownership with a high level of formal and informal shareholder power and the ability of key investors to coordinate.[36] An ex-

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[29] *See* Mark J. Loewenstein, *Shareholder Derivative Litigation and Corporate Governance*, 24 DEL. J. CORP. L. 1, 2, 6 (1999).

[30] Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 86 (2008); *see also* Loewenstein, *id.*, at 6.

[31] Coffee, *supra* note 1, at 679-680.

[32] *E.g.* Gelter, *supra* note 2, at 853.

[33] Harald Baum & Dan W. Puchniak, *The derivative action: an economic, historical and practice-oriented approach*, in THE DERIVATIVE ACTION IN ASIA 1, 1 (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds. 2012).

[34] *See, e.g.,* ALESSIO M. PACCES, RETHINKING CORPORATE GOVERNANCE 286-87 (2012); *see also* Marc T. Moore, *United Kingdom, in* COMPARATIVE CORPORATE GOVERNANCE 913, 925-26, 929 (Andreas Fleckner & Klaus Hopt eds., 2013).

[35] James D. Cox & Randell S. Thomas, *The Evolution of Private Enforcement via Litigation and Monitoring Techniques,* in OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 906, 915-16 (Jeffrey N. Gordon & Wolf-Georg Ringe eds. 2018).

[36] *See, e.g.* Bernard S. Black & John C. Coffee Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV.1997, 2002 (1994) (contrasting lower costs of coordination in the UK with higher ones in the US); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights,* 113 COLUM. L. REV. 863, 889 (2013) ("Fewer owners, larger positions, more

post litigation system, by contrast, requires business-savvy courts that have the institutional capacity and capability to snuff out wrongdoing by managers and controlling shareholders.[37] However, conceivably both could be two components of an effective system.

3. Formal techniques of dealing with the trade-off

Finding the right balance in the trade-off between enabling enforcement and preventing abusive (or merely costly and distracting) litigation is the key difficulty in legislating on derivative suits. Different jurisdictions employ several techniques in isolation and combination.

One can distinguish between formal and substantive limitations, which map on the distinction between rules and standards in legal theory.[38] “Rules” in this sense set out firm lines between permitted and non-permitted actions. Generally, this has the advantage of legal certainty and a lower decision-making cost because there is little discretion in applying the law.[39] By contrast, “standards” use open-textured language that requires judicial interpretation in the individual case. The latter may be better at achieving an optimally tailored result, but it puts higher demands on the court making the decision.[40]

In the context of admitting derivative suits, formal standing requirements and thresholds could be described as rules that use a rough-shot line to screen out lawsuits that are likely non-meritorious. Because the law does not permit courts to assess the merits of individual suits but uses easily observable criteria, these may be both over- and underinclusive.[41] Some beneficial cases will be prevented by formal requirements, while some non-meritorious ones may proceed.

3.1. Time-based standing requirements

The first formal technique for screening out potentially non-meritorious lawsuits is imposing time-based plaintiffs' requirements. Here, the idea could be, in principle, that plaintiffs must show their genuine commitment to the corporation by holding shares over an extended period. For example, in the United States, plaintiffs or their predecessors[42] must have been stockholders *at the time of the alleged wrongful act or omission* under the so-called “contemporaneous ownership

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sophistication—the combination should reduce coordination costs and spontaneously generate more active monitoring”); Julian Franks, *Institutional Ownership and Governance,* 36 OX. REV. ECON. POL’Y 258, 261 (2020) (discussing coordination issues between institutional investors).

[37] Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan,* 3 EUR. BUS. ORG. L. REV. 765, 775-78 (2003) (outlining criteria for an effective system of shareholder litigation).

[38] *E.g.* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

[39] *See* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law,* 109 HARV. L. REV. 1912, 1934 (1996).

[40] Hans-Bernd Schäfer, *Rules versus Standards in Rich and Poor Countries: Precise Legal Norms as Substitutes for Human Capital in Low-Income Countries,* 14 SUPREME CT. ECON. REV. 113, 119-123 (2006); Armour et al., *supra* note 2, at 33.

[41] Schäfer, *id.,* at 120.

[42] This includes only those who acquire shares by operation of the law, e.g., through an inheritance or a merger transaction.

requirement."[43] Similarly, in Germany, plaintiffs or their predecessors must have held shares before learning about the alleged breach.[44] By contrast, UK law says explicitly that it is immaterial whether the cause of action before or after the plaintiff became a member.[45] However, former members cannot sue.[46] In some other jurisdictions, statutory language permitting any shareholder to bring a suit indicates that prior ownership is unnecessary.[47] Italy has historically required that shareholders have held their stock for at least six months before the claim is brought, but this provision was repealed in 2003.[48]

In the US, plaintiffs must also hold on to their shares for the duration of the lawsuit ("continuous ownership requirement"), which follows from the requirement that the plaintiff must fairly and adequately represent the interests of shareholders.[49] There are academic debates about whether such a requirement exists in Germany[50] and Israel.[51] By contrast, in Italy, the code of civil procedure provides that a trial continues with the original parties in the case of an *inter vivos* transfer.[52] In France, according to a 2005 case, share ownership at the time of the application sufficed, and subsequent cancellation of these shares did not affect the applicant's standing.[53]

Overall, the contemporaneous ownership requirement is highly questionable. In the United States, the historical reason for its original introduction was that the federal courts wanted to end

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[43] Contemporaneous ownership must be averred in the complaint according to both federal and Delaware rules. FED. R. CIV. P. 23.1(b)(1); DEL. CHANCERY COURT RULES, Rule 23.1(a).

[44] AktG § 148 I 2 no. 1. Germany does not require this for suits under the law of corporate groups. Holger Altmeppen *in* 5 MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, § 317, ¶52 (Wulf Goette & Mathias Habersack eds., 5th ed. 2020)

[45] Companies Act, s. 260(4).

[46] PAUL L. DAVIES & SARAH WORTHINGTON, GOWER'S PRINCIPLES OF MODERN COMPANY LAW ¶17-16 (10th ed. 2016).

[47] For Singapore: Singapore Companies Act, s. 216A(1)(a); For Israel: Israel Companies Act, § 194(a). *See* Arad Reisberg, *Israel: promoting the use of derivative actions,* 24 COMP. LAW. 250, 251 (2003). For France: *See* Cass. com., 26, 1970, n° 67-14787. *See also* FRANCIS LEFEBVRE, MEMENTO PRATIQUE FRANCIS LEFEBVRE: SOCIETES COMMERCIALES ¶ 14073 (2020 ed.); for Spain: Jesús Quijano, *Comentario al artículo 239*, in COMENTARIO DE LA LEY DE SOCIEDADES DE CAPITAL 1711-1712 (Ángel Rojo & Emilio Beltrán eds.).

[48] Dario Latella, *Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive*, 2009 EUR. COMP. & FIN. L. REV. 307, 319.

[49] ALLEN ET AL., *supra* note 8, at 418. *See* Lewis v. Anderson, 477 A.2d 1040, 1046 (Del. 1984) (Delaware Supreme Court case first adopting this requirement). For earlier Chancery cases, *see* Harff v. Kerkorian, 324 A.2d 215, 219 (Del. Ch. 1974), aff'd in part, rev'd in part, 347 A.2d 133 (Del. 1975) ("But Delaware law seems clear that stockholder status at the time of the transaction being attacked and throughout the litigation is essential"); Dell v. Grimm, No. CIV.A. 5785, 1979 WL 175247, at *2 (Del. Ch. July 17, 1979). For the proposition that the Delaware Supreme Courts' adoption of the rule grew out of an imprecise analysis of prior case law, *see* Urdan v. WR Capital Partners, LLC, No. CV 2018-0343-JTL, 2019 WL 3891720, at *10 (Del. Ch. Aug. 19, 2019).

[50] *See* UWE HÜFFER & JENS KOCH, AKTIENGESETZ § 148, ¶16 (13th ed. 2018) (providing cites to conflicting authorities in the scholarly literature).

[51] In Israel, there appears to be at least some academic debate about the possibility. *See* Reisberg, *supra* note 47, at 251.

[52] C.P.C., art. 111.

[53] Cass. com., Dec 6th, 2005, n° 04-10287. Rev. sociétés 2006 p. 570, note A. Cerati-Gauthier, RTD Com. 2006 p.141, note P. Le Cannu. The case concerned the parallel issue of the appointment of an independent expert.

the practice of transferring stock to create diversity jurisdiction.[54] Outside of this idiosyncratic forum shopping issue, there is no reason to see why it should be problematic to "buy a lawsuit."[55] The purchase price of a stock will typically reflect the benefits and risks of lawsuits borne by the corporation, thus ruling out the possibility of a windfall for the purchaser.[56]

The continuous ownership requirement seems at first glance more justifiable as a mechanism to ensure that the plaintiff's incentives remain aligned with those of other shareholders. However, given that the real driving force behind a suit is usually an attorney who stands to gain from a successful lawsuit or settlement, it appears to be an easily surmountable hurdle.

3.2. Minimum ownership thresholds

Another technique is to require plaintiffs to surmount a minimum ownership threshold. The theory behind it is that such a threshold screens out abusive lawsuits: the expected benefit to a small shareholder for a derivative suit is minimal, which is why such a person is unlikely to sue for a legitimate reason.[57] Minimum ownership thresholds exist, for example, in Brazil, Germany, Italy, and Spain. In Brazil, the current threshold is 5% of the equity for privately-held companies. For listed companies, the ownership requirement is further reduced depending on the amount of capital stock stated in the company's articles.[58] In Germany, the cutoff is a capital share of 1% or EUR 100,000 of the firm's capital.[59] In both countries, there is no minimum ownership requirement for the special derivative suit against the controlling enterprise under the law of corporate groups.[60] Additionally, in Brazil, any individual shareholder can sue if the company fails to file a lawsuit requested by the shareholders' meeting within three months.[61] In Italy, the threshold is 2.5% for publicly traded firms and 20% for others; the articles of incorporation can modify this threshold,

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[54] Urdan v. WR Capital Partners, LLC, No. CV 2018-0343-JTL, 2019 WL 3891720, at *9 (Del. Ch. Aug. 19, 2019) (citing Hawes v. Oakland, 104 U.S. 450, 461 (1881)).

[55] ALLEN ET AL., *supra* note 8, at 418.

[56] On this issue, *see* J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 DEL. J. CORP. L. 673, 684-688 (2008).

[57] *E.g.*, Susanne Kalss, *Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonization by Means of a European Model Code,* 6 EUR. COMPANY & FIN. L. REV. 324, 341 (2009); Klaus Ulrich Schmolke, *Die Aktionärsklage nach § 148 AktG*, 40 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 398, 425 (2011). In the US, the "fair and adequate representation" requirement could be considered an analogue. The Federal Rules of Civil Procedure (as well many state statutes and rules), requires that the plaintiff must "fairly and adequately represent the interests of shareholders." FED. R. CIV. P. 23.1(a). *See* DEBORAH DEMOTT, SHAREHOLDER DERIV. ACTIONS L. & PRAC., § 4:4 (2019-2020). In practice, this almost never screens out lawsuits.

[58] LSA, art. 159, paragraph 4, and art. 246, paragraph 1. Pursuant to article 291 of the LSA, the capital markets regulator has the authority to reduce the thresholds for larger listed companies, based on the capital stock stated in the company's bylaws, and it has effectively done so in 22 June 2020 through CVM Rule 627. The percentage is now 5% for the first BRL 100,000,000, 4% for the bracket from BRL 100,000,000 to BRL 1,000,000,000, 3% for the bracket from BRL 1,000,000,000 to BRL 5,000,000,000, 2% for the bracket from BRL 5,000,000,000 to BRL 10,000,000,000, and 1% for all capital above BRL 10,000,000,000.

[59] AktG § 148 I.

[60] For Brazil SA, art. 246, paragraph 1, item b; for Germany AktG §§ 317 IV, 309 IV.

[61] LSA, art. 159, paragraph 3. In the analogous situation in Spain, the minimum percentage must still be met..

although they can only reduce it in publicly traded firms.[62] In Spain, the threshold is the one necessary to call a general meeting, namely 5% (or lower if stipulated in the articles).[63] The amount is reduced to 3% in publicly traded firms.[64]

The US, the UK[65], Singapore[66], Israel[67], and France allow shareholders to sue individually without regard to their ownership stake.[68] However, in France, creating a group of litigants will enable shareholders to make agreements to share and reduce litigation costs, including attorney fees and discovery costs.[69] To do so, shareholders must unanimously appoint a representative (or representatives).[70] However, this is permissible only when shareholders hold 5% of the outstanding shares.[71] This minimum amount is reduced if the company's capital exceeds EUR 750,000.[72]

Even though multiple shareholders can act jointly to meet the threshold, this cutoff mechanism often makes derivative suits very difficult for small shareholders without a corresponding benefit, especially when a judicial screening phase helps eliminate non-meritorious claims. Theory suggests that a higher ownership threshold makes it easier for the firm's insiders, who would likely be the defendants or close to them, to engage in wrongful actions. The reason is that with a smaller number of eligible shareholders surpassing the threshold, the number of individuals or entities that need to be coopted in an illicit scheme or "paid off" to stop asking questions dwindles.[73] While minimum ownership thresholds surely eliminate some non-meritorious suits, they do so (typically) at the expense of any meaningful enforcement of fiduciary duties.[74]

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[62] Codice civile, art. 2393-bis(1), (2).

[63] LSC, art. 239.1, 168.

[64] LSC, art. 495.2(a).

[65] In the UK, the enforcement of directors' liability for unauthorized political expenditure is governed by special provisions. In this case, a suit must be brought by an authorized group of shareholders that normally must hold at least 5% of the company's capital. Companies Act, s. 370(3).

[66] Singapore legislators considered introducing a minimum ownership requirement when s. 216A of the Singapore Companies Act was drafted, but decided against it. Samantha S. Tang, *The Anatomy of Singapore's Statutory Derivative Action: Why Do Shareholders Sue – Or Not?* 20 J. CORP. L. STUD. 327, 338 (2020).

[67] Israel Companies Law, §194(a) (allowing every shareholder or director to bring a suit).

[68] In Singapore, the plaintiff does not even have to be a shareholder. Meng Seng Wee & Dan W. Puchniak, *Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth*, in DERIVATIVE ACTION IN ASIA, *supra* note 33, at 323, 341, 342.

[69] *See* MÉMENTO PRATIQUE FRANCIS LEFEBVRE, *supra* note 47, ¶ 14077.

[70] *See* C. civ., art. 1984.

[71] C. Com. R.225-169, al. 1.

[72] For details, *see* C. com., art. R.225-169, al. 2.

[73] Kristoffel Grechenig & Michael Sekyra, *No derivative shareholder suits in Europe: A model of percentage limits and collusion,* 31 INT'L REV. L. & ECON. 16 (2011)

[74] Even in South Korea, where the percentage limit is 1% in non-listed firms and 0.01% in listed firms, the number of derivative suits remains small. *See* Kon-Sik Kim & Moon-Hee Choi, *Declining Relevance of Lawsuits on the Validity of Shareholder Resolutions in Korea,* in GERMAN AND ASIAN PERSPECTIVES ON COMPANY LAW 217, 229-230, 241 n.82 (Holger Fleischer, Hideki Kanda, Kon Sik Kim and Peter Mülbert eds. 2016).

While minimum ownership requirements are a problematic and imprecise screening instrument for non-meritorious suits, their absence does not guarantee that a country will see a high level of litigation. For example, France has few suits even without a formal minimum threshold, likely because of a lack of incentives and access to information.[75]

4. The international spread of preliminary procedures

4.1. Purpose and basic features

The previous section surveyed formal rules-based mechanisms intended to screen out derivative suits that are likely not beneficial. The section explores and assesses standards-oriented filtering devices that give a court the discretion, based on specific criteria, to allow a derivative suit to go forward. The main reason is that the decision to bring a lawsuit on behalf of a corporation would generally rest with the board of directors (or another decision-making body within the company), and derivative suits, therefore, must remain an exception.[76] Litigation where shareholders arrogate this power from the board must therefore undergo particular scrutiny.

Pre-trial procedures serve the critical function of weeding out non-meritorious lawsuits and plaintiffs. In the United States, this is particularly significant because only after a derivative suit has passed the "demand futility" stage will plaintiffs be granted discovery, thus giving them access to a substantial amount of information.[77] In theory, while plaintiffs are required to demand that the board sue, they usually do not favor demand because it allows the board to stall the suit further. In Delaware, because it puts potential plaintiffs at a procedural disadvantage, plaintiffs seldom actually make demand but bring a derivative lawsuit claiming that it would be futile to make demand on the board.[78] This rule of "universal nondemand" has effectively turned demand futility into a pre-screening mechanism for derivative suits.[79]

Unlike in the US, where the requirement for such a decision developed out of the demand requirement in the case law, several countries have deliberately introduced preliminary procedures about the admission of a derivative suit during the past decades. In the UK, Singapore, Israel, and Germany, legislatures introduced preliminary procedures by statute that play a similar role as a

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[75] *See* Bernard Grelon, *Shareholders' Lawsuits against the Management of a Company and its Shareholders under French Law*, 6 EUR. COMPANY & FIN. L. REV. 205, 212-13 (2009) (explaining that plaintiff shareholders are not fully reimbursed); *see also* Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. COMPANY & FIN. L. REV. 491, 508-9 (2007).

[76] ROBERT CHARLES CLARK, CORPORATE LAW 640-41 (1986) (citing the board's prerogative to make business decisions as well as judicial economy as reasons for the demand requirement).

[77] *E.g. Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004) (noting that "derivative plaintiffs [in general] are not entitled to discovery in order to demonstrate demand futility"). The Delaware courts have thus encouraged plaintiffs to use books and records requests under DGCL § 220. *Rales v. Blasband*, 634 A.2d 927, 935 n.10 (Del. 1993); Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996) (noting that plaintiffs should use the "tools at hand," including § 220, before making demand. *See* James D. Cox, Kenneth J. Martin & Randall S. Thomas*, The Paradox of Delaware's 'Tools at Hand' Doctrine: An Empirical Investigation,* 75 BUS. LAW. 2123, 2134-35 (2020).

[78] *Infra* notes 102-103 and accompanying text.

[79] ALLEN ET AL., *supra* note 8, at 423 (describing Delaware as having a "universal nondemand rule").

gateway to litigation. Plaintiffs must ask for the court's "permission" or "leave" to bring a derivative claim in the UK and Singapore.[80] In the UK, the Companies Act 2006 liberalized derivative suits by abandoning the restrictive requirements of *Foss v. Harbottle*.[81] Singaporean law gradually expanded the statutory derivative action and balanced the expansion with the leave requirement.[82] Germany established a "lawsuit admission procedure" that plaintiffs need to go through to proceed in 2005.[83] A preliminary procedure was introduced as a new legislative tradeoff in all three jurisdictions.[84] What otherwise would have been an expansion of litigation options was mitigated by new procedural obstacles.

Preliminary procedures are often linked to a requirement that prospective plaintiffs request that directors bring the suit before going to court. In the US, Germany, Israel, and Singapore, shareholders, at least in theory, first must ask the company's board to prosecute the claim in question before initiating a pre-trial procedure in court. Procedural rules in Delaware require that the "complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."[85] In Singapore, demand must be made on the directors.[86] In Germany, plaintiffs must request that the corporation sue, whereas Israeli law specifies that the demand must give reasons and be in writing, and it must be addressed to the chairman of the board.[87] In general, the mere fact that the board refused to sue neither precludes a derivative suit by a shareholder, nor does it establish that the plaintiff can sue instead because the board is invariably conflicted.

Most jurisdictions require that directors be given a specific timeframe to comply with the shareholders' request. Under Israeli law, the company must respond within 45 days.[88] The company can either take an action or reach a decision that eliminates the cause of action brought forward

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[80] For the current law in the UK, *see* Companies Act 2006, s. 261 and 262.

[81] *Foss v. Harbottle*, (1843) 2 Hare 461; *e.g.,* Carsten A. Paul, *Derivative Actions under English and German Corporate Law – Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference,* 2010 EUR. COMP. & FIN. L. REV. 81, 87 (noting that the Companies Act 2006 superseded the common law in the UK); John Armour, *Derivative Actions: A Framework for Decisions,* 135 L. Q. REV. 412, 412-13 (2019).

[82] In Singapore, this historical common law mechanism still applies in parallel to the statutory derivative suit of s. 216A, 216B of the Singapore Companies Act. The latter was introduced in 1993 and initially excluded firms listed on the Singapore Exchange and foreign incorporated companies. Meng Seng Wee & Dan W. Puchniak, *Derivative actions in Singapore: mundanely non-Asian, intriguingly non-American and at the forefront of the Commonwealth*, in DERIVATIVE ACTION IN ASIA, *supra* note 33, at 323, 331. The restriction on listed companies (but not foreign companies) was removed in 2014. Dan W. Puchniak & Tan Cheng Han, *Company Law,* 16 SINGAPORE ACAD. L. ANN. REV. 255, 263-264 (2015); Tang, *supra* note 66, at 340.

[83] AktG § 148 I, as amended by Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts [UMAG – Business Integrity Act], Sept. 22, 2005, BGBL. I at 2802 (Ger.).

[84] In Germany, the reform of 2005 reduced the minimum threshold from 5% to 1%.

[85] DEL. CHANCERY COURT RULES, Rule 23.1(a); *see also* FED. R. CIV. P. 23.1(b)(3).

[86] Singapore Companies Act, § 216A(3)(a).

[87] Israel Companies Act, § 194(b), (c).

[88] Israel Companies Act, § 196.

by the plaintiff, rejects the plaintiff's demand providing reasons for that decision, or brings the action.[89] The response must detail the action taken, name the participants in the decision, and disclose their conflicts if any participant in the decision or officeholder of the company had a personal interest in the decision.[90] In Singapore, the complainant must have "given 14 days' notice to the directors of the company of his intention to apply to the Court" "if the directors of the company do not bring, diligently prosecute or defend or discontinue the action or arbitration."[91] In some circumstances, the court has the discretion to grant leave to the complainant to pursue a derivative action even when the formal notice requirements have not been satisfied.[92] In Germany, plaintiffs must show that they have given the corporation a reasonable time to bring a suit.[93] The exception to this pattern is Delaware law, which is explained by the fact that plaintiff shareholders rarely actually make demand.[94] Even within the US, this "rule of universal nondemand" contrasts with the Revised Model Business Corporation Act (RMBCA), which requires that shareholders always must make written demand on the board and wait for 90 days before suing.[95]

4.2. Criteria for the court's decision

All five jurisdictions with a pre-trial procedure require a court decision determining whether a derivative suit can proceed. In Delaware, because plaintiffs typically do not make demand, the court will take this decision when deciding about whether it would have been futile for plaintiff shareholders to make demand. The five jurisdictions differ as to whether the court's decision turns primarily on the directors' conflicts of interest (Delaware) or whether the suit is likely in the corporation's best interests (Germany, Singapore). In Israel and the UK, both issues matter, although the emphasis is arguably on company interests.[96]

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[89] Israel Companies Act, § 195.

[90] Israel Companies Act, § 196(1). § 1 defines "personal interest" as "a personal interest of a person in an act or transaction of a company, including a personal interest of a relative or another corporation in which such a person or a relative have a personal interest, and excluding a personal interest arising from shareholding in the company; but where the personal interest of a person voting under a power of attorney given to him by another person (even if the former person has no personal interest), and where the vote of a person who has been granted the power to vote on behalf of the person having a personal interest shall be deemed to be a vote of the beneficial owner, regardless of whether the voting discretion is in the voter's hands or not." The term relative is defined as "a spouse, sibling, parent, grandparent, descendant, and descendant, sibling, parent of the spouse, or spouse of any of the above."

[91] Singapore Companies Act, s. 216A(3)(a).

[92] Singapore Companies Act, s. 216A(4). *See,* Dan W. Puchniak & Tan Cheng Han, *Company Law,* 12 SINGAPORE ACAD. L. ANN. REV. 143, 158-159 (2011); Dan W. Puchniak & Tan Cheng Han, Company Law, 14 SINGAPORE ACAD. L. ANN. REV. 179, 187-188 (2013); see also Alan K. Koh, *Excusing Notice under Singapore's Statutory Derivative Action*, 14(2) AUST. J. ASIAN L. art. no. 3, 7–13 (2013) (proposing guidelines for when notice should be excused and how the court may permit a derivative claim to proceed notwithstanding formal non-compliance with the notice requirement).

[93] AktG § 148 I 1.

[94] For the reasons, *see infra* notes 97-103 and accompanying text.

[95] The court can relieve plaintiffs of this requirement if waiting would cause irreparable harm to the company. REVISED MODEL BUSINESS CORPORATION ACT § 7.42. In theory, in Delaware the board must give its response within a reasonable time once demand has been made. See JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW 468 (5th ed. 2020).

[96] In Israel, Singapore and the UK, the court additionally must assess the plaintiffs' motives (good faith).

In the US, the Delaware Supreme Court developed a two-part test for demand futility that was used for more than 35 years.[97] In its 2021 decision in *Zuckerberg*, the court refined the test into a framework under which courts should evaluate demand futility "on a director-by-director basis" using three criteria:

> "(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;
>
> (ii) whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and
>
> (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand." [98]

If any of these questions is to be answered positively for at least half of the board members on which demand would have to be made, then demand is futile.[99] The new three-part test makes it clear that the objective of the analysis is to determine whether any director has a personal interest in the outcome in the decision whether a derivative suit should be brought, either because of risk of personal liability or because the director is close to someone with a personal interest (e.g., a controlling shareholder). As previously, the court does not conduct a trial on demand futility but makes its determination based on the plaintiff's pleadings. Plaintiffs must "plead with particularity facts creating "a reasonable doubt that a director is ... so 'beholden' to an interested director ... that his or her 'discretion would be sterilized."[100] For purposes of futility, the court must accept reasonable inferences that can be drawn from the alleged facts.[101]

Despite the principle that plaintiffs should make demand, they are in practice ill-advised to do so in Delaware because the court found that "[b]y electing to make a demand, a shareholder plaintiff tacitly concedes the independence of a majority of the board to respond.[102] Therefore, when a board refuses a demand, the only issues to be examined are the good faith and

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[97] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Levine v. Smith*, 591 A.2d 194, 205 (Del. 1991) (establishing that the plaintiff's pleadings must either rebut the threshold presumption of director disinterest, or "create a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment"); *see also Rales v. Blasband*, 634 A.2d 927, 933 (Del. 1993) (applying the test in cases where defendants do not constitute the majority of the board and finding that the plaintiff then must create reasonable doubt that the board could apply its independent business judgment in responding to the demand); *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000) (overruling *Aronson* and *Smith* in that the Supreme Court must make this determination *de novo* on appeal).

[98] *United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund v. Mark Zuckerberg, et al.*, 2021 WL 4344361, at 17.

[99] *United Food v. Zuckerberg*, *id.*, at 17.

[100] *United Food v. Zuckerberg*, *id.*, at 18; *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004); *Rales v. Blasband*, 634 A.2d at 936.

[101] *Beam v. Stewart,* 845 A.2d 1040, 1048 (Del. 2004).

[102] *E.g.* John C. Coffee, Jr., *New Myths and Old Realities: The American Law Institute Faces the Derivative Action,* 48 BUS. LAW. 1407, 1413 (1993) (describing the plaintiff's dilemma as a "Catch 22").

reasonableness of its investigation."[103] This contrasts with the other jurisdictions, where an unsuccessful demand does *not* prevent plaintiff shareholders from proceeding with a derivative case, and demand futility claims are not typically an issue.

As we have seen, Delaware law looks at conflicts of interest of board members at this preliminary stage. This contracts with other jurisdictions, which jurisdictions look primarily toward the claim's merits and whether it is in the company's best interest to pursue it. In Germany, plaintiff minority shareholders must show facts that justify the suspicion that the corporation suffered an injury because of dishonesty or *serious* violations of the law or the articles of incorporation; and that there are no predominant reasons relating to the interests of the corporation that tip the balance against the lawsuit.[104] In other words, the courts will examine the severity of the alleged breach of duty and whether the suit is in the corporation's interest.[105] After approval of the court, the case has to be filed within three months.[106] Under Singapore's law, courts will grant leave to pursue a derivative claim if the complainant is acting in good faith, and it must appear "to be *prima facie* in the interests of the company that the action or arbitration be brought, prosecuted, defended or discontinued."[107] To show the latter, plaintiffs must have a prima facie case;[108] moreover, the company must stand to gain substantially if the action succeeds,[109] and there must be no other remedy available.[110]

In the UK, if plaintiffs cannot establish a prima facie case for permission to be granted,[111] the court may dismiss the application or give directions regarding evidence to be provided by the company and adjourn the case.[112] The court *must* refuse permission either if a person seeking to

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[103] *Spiegel v. Buntrock*, 571 A.2d 767, 777 (Del. 1990).

[104] AktG § 148 I 2 and 3.

[105] *See, e.g.* Michael Arnold, in 3 MÜNCHENER KOMMENTAR ZUM AKTIENGESETZ, § 148 ¶46 (Wulf Goette & Mathias Habersack eds., 4th ed. 2018) (noting that the court has full discretion in this decision).

[106] AktG § 148 IV 1.

[107] Singapore Companies Act, s. 216A(3)(b), (c). *See also* Dan W. Puchniak & Tan Cheng Han, *Company Law,* 17 SINGAPORE ACAD. L. ANN. REV. 235, 244-254 (2016) (summarizing important recent developments in the law surrounding the good faith and interest of the company requirements); Tang, *supra* note 66, at 339-340 (noting that courts have required plaintiffs to show that they are acting in good faith); Alan K. Koh, *Searching for Good Faith in Singapore's Statutory Derivative Action: Much Ado About Something?*, 36 COMP. LAW. 207, 208–09 (2015) (pointing out practical difficulties in application of this requirement).

[108] *Teo Gek Luang v. Ng Ai Tiong*, [1998] SGHC 164; [1998] 2 SLR(R) 426.

[109] *Agus Irawan v. Toh Teck Chye*, [2002] SGHC 49; [2002] 1 SLR(R) 471, para. 8

[110] *Pang Yong Hock v. PKS Contracts Services Pte Ltd*, [2004] SGCA 18; [2004] 3 SLR(R) 1, [22]. On all this, *see* Wee & Puchniak, *supra* note 68, at 346. It has been observed that the Singapore approach risks making the most motivated plaintiffs ineligible to proceed with derivative claims for failure to satisfy the good faith requirement. Samantha S. Tang, *Corporate Avengers Need Not Be Angels: Rethinking Good Faith in the Derivative Action*, 16 J. CORP. L. STUD. 471, 490–91 (2016).

[111] Companies Act 2006, s. 261(2)(a).

[112] Companies Act 2006, s. 261(3).

promote the success of the company[113] would not bring the claim,[114] or if the act or omission potentially giving rise to liability has been authorized or ratified by the company.[115] If none of these mandatory reasons for dismissal apply, the court must consider seven factors in deciding about a *discretionary* grant of permission. These include whether the plaintiff is acting in good faith, the importance that a person pursuing the best interests of the company would give to the claim and whether the member could pursue the claim in his own right rather than the company's.[116] In addition, it also matters whether the company has already decided to enforce the claim.[117] Finally, the court will also examine whether the act or omission could be or would, given the circumstances, likely be ratified by the company.[118]

Conflicts of interest matter in the context of whether non-conflict directors or shareholders validly approved or ratified the underlying action or omission in question,[119] as well as in considering the views of members without a personal interest in the matter.[120] Otherwise, the court's substantive assessment about the company's best interest looms large both for mandatory and discretionary refusal. While courts may not always be comfortable with such an assessment,[121] they essentially perform a cost-benefit analysis.[122] The court's decision is made based on written evidence, without cross-examination of witnesses or disclosures.[123]

The country that comes closest to the US approach is Israel, which takes an intermediate position among the jurisdictions surveyed. Under Israeli law, the plaintiff is excused from demand if half or more of the members of the deciding body have a personal interest in the decision, or if there is reasonable concern that demand will prejudice the possibility of obtaining relief.[124] The

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[113] The statute here refers to the duty to promote the success of the company under Companies Act 2006, s. 172.

[114] Companies Act 2006, s. 263(2)(a).

[115] Companies Act 2006, s. 263(2)(b). In contrast to the common law prior to the 2006 Act, mere ratifiability does not hinder a claim. EVA MICHELER, COMPANY LAW: A REAL ENTITY THEORY 244 (2021).

[116] Companies Act 2006, s. 263(3)(a), (b), and (f).

[117] Companies Act 2006, s. 263(3)(e).

[118] Companies Act 2006, s. 263(3)(d). If the act or omission has NOT already occurred, the court must look at whether the act or omission would likely be authorized or ratified by the company. s. 263(3)(c). The court can also adjourn proceedings to allow the matter to be ratified. Companies Act 2006, s. 261(4)(c).

[119] *See* Armour, *supra* note 81, at 423-426 (discussing in particular the issue of wrongdoer control).

[120] Companies Act 2006, s. 263(4) (requiring the court to "have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter").

[121] *See Iesini v. Westrip,* [2009] EWHC 2526 (Ch) ("The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case").

[122] MICHELER, *supra* note 115, at 246 (discussing how judges have carried out cost-benefit analysis in the case law). The *Iesini* court mentions the following factors: "the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim is pursued; whether the prosecution of the claim would damage the company in other ways."

[123] MICHELER, *id.*, at 249-50.

[124] Israel Companies Act, § 194(d)(1), (2). On the definition of personal interest, *see supra* note 90.

plaintiff may proceed if the corporation decides against bringing a suit or not bringing one within 75 days.[125] In admitting the derivative action, the court must be persuaded *prima facie* that the pursuit of the claim would be in the company's best interests and that the plaintiff is not acting in bad faith.[126]

Overall, US law stands out in that the preliminary decision to let a derivative suit go forward is based primarily on whether the board has a conflict of interest, which must be established by pleading particularized facts. Ultimately most of the jurisdictions surveyed here emphasized the substantive merits of the case. In making a *prima facie* case to be granted permission to proceed with the suit, there is an emphasis on the merits of the claim and o whether the suit is in the corporation's best interests. US courts are generally reluctant to assess the substantive merits of a business decision,[127] and bringing a lawsuit can be considered one. Under Delaware law, courts must determine whether the suit is in the best interests of the corporation only in the context of assessing the decision of a special litigation committee to dismiss or settle a claim, which is constituted only at a later stage when the derivative suit already has passed the demand futility test.[128]

A possible explanation for why US law de-emphasizes the substantive merits of a derivative claim is the fact that the discovery mechanism in the US can be unusually productive for derivative plaintiffs, thus significantly enhancing the evidentiary basis of the suit. In addition, discovery is unusually burdensome for corporate defendants.[129] Other jurisdictions may be less inhibited in assessing business decisions. However, they generally have a lower level of shareholder litigation that would allow them to make such a determination.[130]

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[125] Israel Companies Act, § 197.

[126] Israel Companies Act, § 198(a).

[127] Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability,* 58 STAN. L. REV. 1055, 1111 (2006). *See, e.g.* In re Oracle Corp. Derivative Litig., 824 A.2d 917, 928 (Del. Ch. 2003) (V.C. Strine describing the court's 'oxymoronic judicial "business judgment"' in the context of whether a derivative suit should go forward after a special committee decision against it).

[128] Under *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del 1981), the court "should inquire into the independence and good faith of the committee and the bases supporting its conclusions," for which the defendant has the burden of proof. If it is satisfied with this analysis, it "should determine, applying its own independent business judgment whether the motion should be granted." Some courts apply the second step rather reluctantly. For example, then Vice Chancellor (and later Delaware Chief Justice) Leo Strine stated that the law required him to apply his "oxymoronic judicial 'business judgment.'" In re Oracle Corp. Derivative Litig., 824 A.2d 917, 928 (Del. Ch. 2003).

[129] *See* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story about the "Genius of American Corporate Law',* 83 EMORY L.J. 1383, 1420-24 (2014) (discussing the cost of discovery in the context of shareholder litigation).

[130] *See* John Armour, Luca Enriques, Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure: The Interests of Shareholders as a Class,* in ANATOMY, *supra* note 2, at 49, 70 (noting that the US, as the jurisdiction with the most private enforcement of corporate law, has also developed the strongest protection of good-faith business decisions in the form of the business judgment rule).

5. The interaction between preliminary procedures and cost rules

5.1. Distribution of litigation cost in derivative suits

The distribution of the risk of bearing litigation cost is significant for derivative litigation. Because shareholders only benefit proportionately from the remedy to the corporation increasing the value of their stock, the deterrent effect of high litigation cost can potentially set strong incentives against bringing such a suit.[131]

Most jurisdictions have some form of a "*loser pays*" system (often called the "English rule" in the US). Under French, German, Israeli, Italian, Singapore, Spanish, and UK law, the loser must reimburse the winner for the cost of a suit, which typically includes court fees, lawyers' fees, and other expenses.[132] The method of calculatin reimbursable fees varies accross countries. Sometimes, court fees are computed as a fraction of the amount in dispute, which can be very high and strongly discouraging for minority shareholder plaintiffs. However, where lawyers' fees are reimbursable, they will typically be repaid only according to the official rate set by law, the government, or a bar association or estimated by the court.[133] Given that law firms with expertise in corporate law often charge higher rates, this may undercut the effects of the loser pays rule to a certain extent.

The leading international outlier in litigation cost is the US, which does not have a "loser pays" system. The Delaware Court of Chancery will only use its equitable power to award attorneys' fees to the successful party in extreme cases, such as when a defendant was found to have engaged in a pattern of bad faith conduct.[134] In practice, one could argue that in shareholder litigation, "the starting point is not the American Rule, under which each side bears its own costs, but rather the Delaware Rule, under which the corporation always pays" following settlement of the

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[131] *See generally* Kathryn E. Spier, *Litigation*, *in* 1 HANDBOOK OF LAW AND ECONOMICS 259, 301 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (describing how the English rule may dilute "the value of low-probability-of-prevailing cases" and enhance "the value of high-probability-of-prevailing cases").

[132] For Germany ZPO § 91; For France C.P.C. (France), art. 696; art. 700; for Italy Cod. proc. civ. (Italy), art. 91, 92; for Singapore *see Tullio Planeta v Maoro Andrea G,* [1994] SGCA 76, [1994] 2 SLR (R) 501; Tang, *supra* note 66, at 348 (noting in particular that costs could be particularly high if the court grants leave to pursue the derivative suit); for Spain, LEC, art. 394.1; for the UK, Civil Procedure Rules, SI 1998/3132, Rule 44.2(2).

[133] In France, attorneys' fees are only compensated in all cases according to an official rate. C.P.C. art. 695 no. 7. The court has the discretion to award additional amounts under C.P.C. art. 700, but this still often means that the winning party will not be compensated for a substantial portion of their attorneys' fees. *See, e.g.,* for Germany, where the principle of "necessity" applies under ZPO § 91 II, *see Andreas Schulz*, *in* 1 MÜNCHENER KOMMENTAR ZUR ZIVILPROZESSORDNUNG § 91, ¶ 61 (Wolfgang Krüger & Thomas Rauscher eds., 5th ed. 2016). For Italy *see* Paolo Giudici, *Representative Litigation in Italian Capital Markets: Italian Derivative Suits and (if ever) Securities Class Actions,* 2009 EUR. COMP. & FIN. L. REV. 246, 253. While the law stipulates that the losers must payer the winners' costs of defense, judges will usually refer to the official rates set out in a government decree. Decreto 10 marzo 2014, n. 55, modified by Decreto 8 marzo 2018, n. 37, Decreto 10 Marzo 2014 n. 55. In Spain, the losing party is normally only required to indemnify the winning party for attorney's and other professional fees up to a maximum of one third of the amount in dispute (in addition to other fees). The reimbursement may be higher if the losing party acted recklessly. LEC, art. 394.3. In the UK, the court has discretion regarding the amount of costs to be reimbursed. Civil Procedure Rules, SI 1998/3132, Rule 44.2(1)(b). In Israel, fees are reportedly based on the courts' rough estimate rather than a full account of expenses, which is why courts rarely impose meaning full fees on plaintiffs.

[134] *Gatz Properties, LLC v. Auriga Capital Corp.,* 59 A.3d 1206, 1221-22 (Del. 2012) (Chancery Court awarding attorneys' fees to plaintiffs against a fellow member controlling an LLC).

case.[135] Consequently, it is extremely rare for plaintiffs to have to saddle their own litigation expenses.

In the mid-2010s, a debate about fee-shifting bylaws arose in Delaware. In a 2014 case, the Delaware Supreme Court permitted a so-called fee-shifting bylaw, which required the (unsuccessful) plaintiff in a lawsuit against the corporation and its members to reimburse the corporation and its members for all fees, costs and expenses (including reasonable attorney's fees) incurred by the parties in connection with such a claim.[136] The Delaware legislature subsequently amended the DGCL to prohibit both fee-shifting bylaws and such provisions in the articles of incorporation concerning "internal corporate claims."[137]

The US system also provides plaintiff lawyers with high-powered incentives to bring derivative and other representative suits. In practice, often the leading proponent of a lawsuit is a specialized law firm working closely with repeat plaintiffs.[138] Attorneys receive a percentage from a "common fund" that represents the pecuniary and non-pecuniary benefits for the corporation.[139] Percentages vary and depend on several factors, including the time spent on and complexity of the litigation and at what stage the case is settled.[140] In recent years, there have been discussions about so-called "no pay" bylaws that prohibit the firm from reimbursing plaintiffs for legal fees, which a number of firms have adopted.[141]

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[135] Sean J. Griffith, *Correcting Corporate Benefit: How to Fix Shareholder Litigation by Shifting the Doctrine on Fees,* 56 B.C. L. REV. 1, 30 (2015).

[136] *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 556 (Del. 2014). The case concerned a nonstock corporation, but essentially the same would have be true in a regular for-profit corporation.

[137] 2015 DELAWARE LAWS CH. 40 (S.B. 75) (inserting §102(f) and § 109(b) into the DGCL). "Internal corporate claims" are defined in § 115 as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." On the definition see in particular *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020).

[138] *See, generally,* Jessica Erickson, *The New Professional Plaintiffs in Shareholder Litigation,* 65 FLA. L. REV. 1089 (2013).

[139] *E.g. Saks v. Gamble*, 154 A.2d 767, 770 (Del. Ch. 1958); *Bosch v. Meeker Coop. Light & Power Ass'n*, 101 N.W.2d 423, 426 (Minn. 1960). Griffith, *supra* note 135, at 41 (noting that this approach has been widely adopted by state and federal courts).

[140] *See, e.g.* DEMOTT, *supra* note 57, § 6:18 (noting that 30% is a common percentage); *In re Emerson Radio S'holder Derivative Litig.*, No. CIV.A. 3392-VCL, 2011 WL 1135006, at *2 (Del. Ch. Mar. 28, 2011) (discussing the factors used in determining the percentage); *Americas Mining Corp. v. Theriault*, 51 A.3d 1213, 1261-62 (Del. 2012) (Delaware case where a rate of 15% was used, resulting in an attorney's fees award of more than USD 300 million out of a judgment of about USD 2 billion.

[141] *See* Sean J. Griffith, *Private Ordering Post-Trulia,* in THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 292, 304-309 (Steven Davidoff Solomon & Randall Thomas eds. 2019) (proposing that companies should use no-pay bylaws could be used to stymy excessive merger litigation); Anthony Rickey & Benjamin P. Edwards, *"No Pay" Bylaws May Threaten Shareholder Lawsuits,* CLS BLUE SKY BLOG, March 27, 2017, https://clsbluesky.law.columbia.edu/2017/03/27/no-pay-bylaws-may-threaten-shareholder-lawsuits/ (listing companies that have adopted such bylaws).

Other jurisdictions tend to be cautious in allowing contingency fees.[142] The UK has allowed "damages-based agreements," which are analogous to contingency fees in the US, only since 2013,[143] but they have reportedly not been used in derivative litigation.[144] Singapore prohibits contingency and conditional fee arrangements,[145] whereas Germany permits them only in circumstances not relevant for derivative litigation.[146] Some jurisdictions, including the UK,[147] Italy, [148] and France[149], occasionally use conditional fees, but they have not become significant for derivative litigation. Arguably, conditional fee arrangements are far less useful in incentivizing derivative suits than contingency fees because they do not relieve minority plaintiffs of the financial risk, especially under a "loser pays" system.[150]

An exception in the civil law world is Brazil, where the winning lawyer is granted a fee payable by the losing party instead of reimbursement. The judge sets this fee, which typically corresponds to between 10% and 20% of the award.[151] However, in the derivative action against controlling shareholders, the fee is always 20%, without any discretion for the judge.[152]

Unconventionally, Israeli law states that the court *may* remunerate the plaintiff who successfully initiated a derivative suit.[153] This is particularly relevant because it might improve

[142] For Spain, *see* Estatuto General de la Abogacía Española (Real Decreto 658/2001, de 22 de junio), art. 44.3. In Spain, the Supreme Court has in recent years established in several cases that the traditional prohibition, which has not been formally repealed. Tribunal Supremo, STS 6610/2008 of November 4, 2008; Tribunal Supremo, STS 314/2013 of May 17, 2013.

[143] Courts and Legal Services Act 1990, c. 41, art. 58AA, as amended by Legal Aid, Sentencing and Punishment of Offenders Act 2012 (c. 10) (amendment coming into force 2013). On conditional fees in the UK, *see also* Koh & Tang, *supra* note 7, at 437.

[144] Neshat Safari, *A blended approach to derivative litigation costs in the UK: lessons from New Zealand and the US,* 29 INT'L COMPANY & COMM. L. REV. 558, 561-62 (2018).

[145] Singapore Legal Profession Act, s. 107(1)(a) and (b) respectively. *See* also Tang, *supra* note 66, at, at 347-48.

[146] Rechtsanwaltsvergütungsgesetz (Attorneys' Compensation Act), § 4a (permitting contingency fees only to pursue claims for plaintiffs who otherwise would not be able to get judicial recourse).

[147] *See* Courts and Legal Services Act 1990 c. 41, art. 58(2)(a), (b), as amended by the Access to Justice Act 1999 c. 22, s. 27 (permitting success fees that are "payable only in specified circumstances").

[148] Legge 31 dicembre 2012, n. 247, Nuova disciplina dell'ordinamento della professione forense, Gazzetta Ufficiale n. 15 del 18 gennaio 2013 (permitting fees based on the value of a claim or other asset, whereas lawyers may not be promised a portion of a litigated claim).

[149] R.I.N. art. 11.3; see also Loi n°71-1130 December 31st, 1971, art. 10 al. 5 (prohibiting the "*pacte de quota litis"*); *but see See* NICOLAS CAYROL, PROCÉDURE CIVILE 800 (2nd ed. 2019) (noting that French lawyers sometimes arrange in advance for a fixed bonus in case of a success).

[150] Reisberg, *supra* note 22, at 380.

[151] Novo Código de Processo Civil, article 85, paragraph 2. The judge will define the lawyer's fees taking into account his or her dedication, the place where the service was rendered, the nature and relevance of the claim and the services performed by the lawyer as well as the time taken to perform such services.

[152] In addition, the plaintiff shareholder is automatically awarded 5% of the claim. LSA, article 246, paragraph 2.

[153] Israel Companies Act, § 201.

incentives for small shareholders to bring such claims, given that their benefit is otherwise only the compensation of their reflective loss.[154]

5.2. Advance court fees and security for expenses statutes as financial hurdles

In the comparative corporate law literature, requirements for plaintiffs to advance court fees or provide security to the corporation for possible litigation expenses have been discussed extensively as potential hurdles that can discourage derivative litigation. A court decision that reduced the filing fee for derivative suits from a percentage to a modest flat fee likely contributed to a considerable increase in Japanese derivative litigation in 1993.[155]

In the United States, nine states presently allow the corporation to require the plaintiff shareholder to provide it with security for reasonable expenses, including court fees.[156] While this list includes important states such as New York and California, Delaware is a notable absentee. As a matter of historical context, the statutes were recommended in the Wood report of 1944[157] as an instrument of curbing excessive derivative litigation[158] and formerly included in the Model Business Corporations Act.[159] Since the 1980s, the trend has been to repeal such laws.[160]

Some jurisdictions have requirements of this type that can deter derivative suits, especially if they are measured in terms of the amount in dispute for the entire corporation. For example, in Germany the plaintiff always must advance part of the court fees to pursue a suit.[161] Measured in terms of the amount in dispute, this fee could, in principle, be excessively high and thus deter derivative litigation, given that the injury to the corporation will often be in the millions, while a small shareholder will only benefit with a small percentage from compensation. However, for the "lawsuit admission procedure" to enforce director liability, the amount is capped at EUR 500,000 for purposes of calculating court fees, resulting in affordable advance fees of only a few thousand Euros.[162]

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[154] Arad Reisberg, *Access to Justice or Justice Not Accessed: Is There a Case for Public Funding of Derivative Claims?* 37 BROOK J. INT'L L. 1021, 1034-36 (2012).

[155] Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 NW. U. L. REV. 1436, 1463–5 (1994); Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 353 (2001); Kenichi Osugi, *Directors' Liability and Enforcement Mechanisms in Japan*, in GERMAN AND ASIAN PERSPECTIVES, *supra* note 74, at 47, 53; *contra* Dan W. Puchniak & Masafumi Nakahigashi, *Japan's Love for Derivative Actions: Irrational Behavior and Non-Economic Motives as Rational Explanations for Shareholder Litigation*, 45 VAND. J. TRANSNAT'L L.,1, 48-50, 54-56 (2012).

[156] These states are Alaska, Arkansas, California, Colorado, Nevada, New Jersey, New York, North Dakota, and Pennsylvania. AK Stat § 10.06.435(h); Ark Stat Ann § 4-26-714(c); Cal Corp Code § 800(c), (d); Colo Rev Stat § 7-4-121(3); Nev Rev Stat § 41.520(3), (4); NJ Rev Stat § 14A:3-6(2), (3); NY Bus Corp Law § 627; ND Bus Corp Act § 10-19.1-86(2); PA Bus Corp Law § 1782(c).

[157] F. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS (1944).

[158] *See, e.g.* A.F. Conard, *Winnowing Derivative Suits through Attorneys' Fees*, 47 L. & CONT. PROBS. 268, 284 (1984).

[159] MODEL BUS CORP ACT ANN 2D §§ 49, 3 (1971).

[160] DEMOTT, *supra* note 57, § 3:2.

[161] GKG (Gerichtskostengesetz) § 12 I.

[162] On the amounts, see *infra* section 5.3.2.

In Brazil, a requirement to advance fees only applies when a minority representing less than 5% of the company's capital files a derivative suit against a controlling corporation. Plaintiffs must provide security for the legal costs (including court fees and attorney fees) when there is an adverse ruling.[163] Such a guarantee is not required when the plaintiffs against a controlling shareholder represent at least 5% of the stock or when officers and directors are the defendants. CVM (the Brazilian securities regulator) in 2020 enacted a regulation (Rule 627) decreasing the ownership percentage required to file the lawsuit.[164]

By contrast, in Israel, the law explicitly stipulates that the plaintiff must only pay part of the usual court fee at a rate set by the minister.[165] This means that plaintiffs only need to pay a modest amount when setting the derivative action in motion; once approved, the company reimburses the plaintiff shareholder, which will also pay the remaining fees.[166]

5.3. Preliminary procedures as a gateway toward an effective distribution of litigation risk

5.3.1. "Loser pays" regimes without preliminary procedures

A preliminary screening procedure often has the effect of limiting the plaintiff's exposure to financial litigation risk. Success in a preliminary procedure can serve as a cutoff point after which the corporation (for whose benefit the derivative suit is brought) must bear litigation cost. Court fees that a shareholder plaintiff will have to advance, or security for litigation expenses a plaintiff must provide, may be limited to the smaller amount at stake in the pre-trial procedure. Thus, financial incentives against the pursuit of such suits by smaller shareholders may be limited. This is particularly apparent in jurisdictions without any pre-trial stage, such as Brazil[167], Italy[168], France[169], or Spain,[170] but also in the litigation procedure of the German law of corporate groups.[171]

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[163] LSA, article 246, paragraph 1, item b.

[164] The legal basis is LSA, article 291 and Audiência Pública SDM Nº 07/19.

[165] Israel Companies Act, § 199(a).

[166] Reisberg, *supra* note 154, at 1031-32.

[167] While not requiring demand on directors, Brazilian law requires that plaintiffs bring a case to the shareholder meeting first. LSA, article 159

[168] *See* Giudici, *supra* note 133, at 252.

[169] *See also* Cass. com. Sept. 6th, 2016, n° 14-27082 (finding that at this stage the shareholder is not required to prove injury to the corporation).

[170] Spain does not require demand on directors, but normally requires that the question is submitted to the shareholder meeting for a vote unless the allegation involves a violation of the duty of loyalty. Otherwise, minority shareholders can only sue when the directors do not convene the meeting, the company does not bring the suit within a month after an affirmative resolution, or when the meeting decides against liability. *See* LSC, art. 239.1.

[171] There is some debate whether the demand procedure applicable to directors' liability suits should apply by analogy. Altmeppen, *supra* note 44, § 317, ¶¶61-66. At least one court of appeals has permitted a minority to request the appointment of a special representative pursuant to the procedure discussed above. OLG Köln, decision of September 3, 2017 – 18 U 19/16. This suggests that the demand procedure for a suit brought derivatively by a minority shareholder could apply in the corporate group context as well.

Despite the seemingly simple procedure, derivative suits by minority shareholders are uncommon under these legal regimes. Part of the explanation may be that plaintiffs are exposed to the full financial litigation risk. Shareholders are typically exposed to normal rules of litigation fees and cost, which are sometimes measured in terms of the total amount in dispute for the corporation overall (not just the plaintiff's percentage). This is true, for example, for the derivative suit against a controlling entity under the German corporate group law, which means that the fee is measured relative to the total amount of the corporation's claim.[172] This type of suit is seldom brought.

Occasionally, these regimes alleviate the financial burden on plaintiffs. In Italy, the law stipulates that a minority shareholder plaintiff can be reimbursed for litigation cost and the cost of ascertaining the facts.[173] However, scholars point out that the exact amount of reimbursement is up to the court, which cannot consider the amounts on which plaintiffs have agreed with his "appraisers and advisors." Consequently, a considerable risk of not being fully reimbursed remains.[174] Likewise, regular "loser pays" rules apply to a derivative plaintiff in Brazil and Spain.[175] However, Spanish corporate law favors such derivative plaintiffs ex-post in stating that the corporation must reimburse shareholder plaintiffs if they are at least *partially* successful.[176] In other words, a small award suffices to trigger full reimbursement. However, reimbursement is also limited to *necessary* fees.[177]

5.3.2. "Loser pays" regimes with preliminary procedures

Jurisdictions using preliminary procedures sometimes modify cost rules for derivative suits. At least in theory, Germany appears to be plaintiff-friendly in terms of this issue. While shareholders petitioning for the admission of a derivative claim still must bear the cost of an application,[178] the corporation must compensate them not only in the case of success: shareholders will also be indemnified if the reason for the rejection relates to the best interest of the corporation's interest and the corporation could have, but did not inform the shareholder about it prior to the application.[179] Moreover, if the suit advances past the preliminary stage, shareholders are compensated for their cost even if it is unsuccessful unless the shareholder supported the application with false information and, in doing so, acted intentionally or with gross negligence.[180] Plaintiffs are also

172 *See* GKG § 34 (above EUR 500,000, the base fee increases by EUR 180 per EUR 50,000). Moreover, under GKG, Anlage 1, Nr 1210, a multiplier of 3. is applied to the fee. This contrasts with the admission procedure, which has a multiplier of 1.0 according to GKG, Anlage 1, Nr 1640.

173 Codice civile, art. 2393-bis(5).

174 Giudici, *supra* note 133, at 254.

175 For Brazil Novo Código de Processo Civil, arts. 82 and 85; For Spain Blanca Villanueva García-Pomareda, *El Contenido del Acuerdo de la Junta General Sobre el Ejercicio de la Acción Social de Responsabilidad contra los Administradores de las Sociedades de Capital*, 65 CUADERNOS DE DERECHO Y COMERCIO 134 (2016).

176 LSC, art. 239.2.

177 LSC, art. 239.2.

178 AktG § 148 VI 1.

179 AktG § 148 VI 2.

180 AktG § 148 VI 5.

favored in the admission procedure because the amount in dispute is typically capped, thus reducing court fees.[181]

Israel is the next most plaintiff-friendly jurisdiction in terms of cost. If the court approves a derivative suit, the company *must* compensate the plaintiff for her fees. It *may* also order the company to advance future payments and hold it liable for the defendants' expenses.[182] However, the plaintiff's attorney's fees (in the claim being pursued derivatively) are not freely negotiated but determined by the court; the company subsequently pays them.[183] If the derivative suit is admitted but ultimately not successful, normally, the company must still indemnify the defendant; exceptionally, the court may impose the cost on the individual who initiated the derivative suit.[184]

The UK and Singapore appear to favor plaintiffs less in terms of cost. In both countries, under the respective statute, the court *may* order the company to indemnify plaintiffs for litigation cost (without specifying a connection with the success of the claim).[185] In the UK, in a case preceding the current Companies Act and Civil Procedure Rules, the Court of Appeal held that the company should normally be liable for the costs of the claim, even where the litigation is unsuccessful.[186] In practice, the courts seem reluctant to award costs to derivative plaintiffs: writing in 2016, Andrew Keay reports that shareholder plaintiffs had been awarded cost only in two out of the eight successful cases since the enactment of the Companies Act 2006, and in none of the cases was the award unlimited.[187] Similarly, for Singapore, Samantha Tang notes that the rarity and uncertainty of such orders make it unlikely that they will improve incentives for shareholders that are stacked against litigating.[188]

In addition to the preceding, Israeli law also provides that plaintiffs in a publicly traded corporation *may* ask the securities regulator to participate in the expenses when bringing a suit. The decision is made by the Israeli securities regulator, which must be persuaded that the claim is in the public interest and that there is a reasonable chance that the court will approve it as a derivative claim. The court may order the indemnification of the regulator in its final ruling.[189]

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[181] GKG § 53(1)5 normally caps the amount in dispute at EUR 500,000, which corresponds to a fee of EUR 3,536 under GKG, Anlage 2.

[182] Israel Companies Act, § 199(B).

[183] Israel Companies Act, § 200a.

[184] Israel Companies Act, § 200. *See* Reisberg, *supra* note 154, at 1032 (noting that the wording suggests that the success of the case will likely play a role in this decision).

[185] For the UK, *see* Civil Procedure Rules, SI 1998/3132, Rule 19.9E (the court "may order the company […] to indemnify the claimant against liability for costs incurred in the permission application or in the derivative claim or both"); for Singapore, *see* Singapore Companies Act, s. 216B(3). The court may also order interim measures, *see* Singapore Companies Act, s. 216A(5)(c).

[186] *Wallersteiner v. Moir (No 2)*, [1975] Q.B. 373 C.A. *See* DAVIES & WORTHINGTON, *supra* note 46, 17-27.

[187] Andrew Keay, *Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006*, 16 J. CORP. L. STUD. 39, 57 (2016); *see also* Safari, *supra* note 144, at 560 (noting that courts generally do not follow *Wallersteiner* in granting an indemnity order).

[188] Tang, *supra* note 66, at 348-49 (noting that out of 23 applications only two were granted).

[189] Israel Companies Act, § 205a.

6. Making pre-trial procedures a beneficial legal transplant

6.1. The key issues in designing a new system for "loser pays" jurisdictions

All of the pre-trial procedures surveyed create a cut-off point for derivative suits that may stop or proceed prior to the fact-finding stage. They share the common feature that plaintiffs do not have the burden to persuade the court of the validity of the claim. In Delaware, demand futility provides the crucial cutoff for discovery, which is particularly important for successful litigation. Only cases that survive a motion to dismiss will go forward into discovery. The four jurisdictions that adopted preliminary procedures during the past decades (Israel, Germany, the UK, and Singapore) significantly differ from the US regime in their distribution of cost and risk in civil procedure general. As discussed in section 5.3.1, "loser pays" jurisdictions often stack the deck against plaintiffs whose cases hard to prove. This is a particular challenge in representative litigation, where plaintiffs are exposed to the risk of a potentially ruinous amount of litigation expenses without compensating advantages. As we have seen, while not all jurisdictions presently make use of the advantages of preliminary procedures, they potentially provide a way of limiting the exposure to cost risk to a more manageable amount if shareholders are initially limited to the risk of having to pay court fees for the preliminary procedure only. Additional cost risk only arises when the suit advances to the next stage, but then the chance of success is already greatly improved. However, in the latter case, a case is to be made that the company should bear the cost.

Thus, it is easy to see that preliminary procedures, if designed right, have the potential to create an effective regime for derivative litigation in jurisdictions generally following the "loser pays" principle. Two key issues need to be addressed to make such a policy work. First, what cost risk should shareholder plaintiffs face after the suit has been admitted? And second, what criteria should the court apply in deciding about the policy?

Regarding the first issue, preliminary procedures have great potential in mitigating the negative incentives against derivative litigation set by the English rule (even if they do not set positive incentives). German and Israeli law, which stipulate that the firm must normally take up litigation cost arising *after* a derivative suit has successfully passed the preliminary stage, are – at least in theory – models for this. By contrast, as we have seen, the UK and Singapore do not share this advantage because of the uncertainty involved for plaintiffs even *after* the preliminary stage. If derivative suits are to become effective instruments, the law should set a default rule that plaintiffs will not have to bear their expenses at this stage. Plaintiffs should be required to do so only in exceptional cases, for example, when they used fraudulent means to obtain an admission of their claim from the court at the preliminary stage.

The difficulty here is to ensure that plaintiffs will still have an incentive to pursue the claim while preventing lawyers from running up an excessive amount of fees. In principle, there are multiple ways to accomplish this. First, reimbursable litigation fees could be set according to the official rate, which is the case in several countries using the "loser pays" rule anyway.[190] Alternatively, the rate could be set by the court ex-ante (as in Israel), considering not only an official rate but the

[190] *Supra* note 133 and accompanying text.

specific context of the case, including the difficulty of the legal issues.[191] Third, the rate could be negotiated between the parties (as part of a settlement or between the plaintiff and their counsel) and require the court's ex-post approval. Fourth, as in Germany,[192] the law could permit the company to take over the lawsuit even after admission of the suit. If this option is coupled with a requirement imposed on plaintiffs to periodically report expenses to the company, the latter could put a stop to litigation agency cost if they seem excessively high.

Between these four options, the last one seems least desirable because the company's option creates ample opportunity to stall the prosecution of the claim.[193] The first option – reimbursing lawyers according to a preset rate – will sometimes make it difficult to retain top counsel and significantly reduce the incentive for lawyers to represent clients pursuing such claims. This leaves court-imposed fees (option 2) and negotiated fees approved by the court (option 3). Option 2 may again blunt incentives if courts tend to err on the low side. Option 3 seems preferable because courts are most likely not reluctant to award generous fees if a generous award has been reached for the company. They will hesitate to approve a large claim if little or nothing has been achieved, thus incentivizing plaintiffs' counsel to pursue cognizable benefits for their clients.

The second important question is what criteria should be used to admit a derivative action in the first place. German law, which looks promising concerning how costs are allocated, stands out negatively on this point. Besides still requiring plaintiffs to hold a minimum percentage of shares, plaintiffs must establish facts indicating a *suspicion* that board members were "dishonest" or responsible for "serious violations" of the law or the articles.[194] Reportedly, this is a hurdle that few plaintiffs can surmount based on the scant informational basis available at the preliminary stage, and that therefore deters litigation.[195]

Leaving these problematic and onerous requirements aside, the critical issue is whether courts should focus on conflicts of interest among directors to bring a suit or whether the derivative claim has merit in substance. In this respect, Delaware is preferable in its emphasis on conflicts of interest among directors. The demand futility test[196] requires the plaintiff to plead particularized facts why the board is not disinterested in deciding about the lawsuit. Whether this is the case – for example, because its members are being sued or because it is beholden to a controlling shareholder

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[191] A possible model here would be the "lodestar" method used in securities litigation in the US. Here, the court multiplies the number of hours worked by plaintiff's counsel by a "reasonable hourly rate and a discretionary multiplier." Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards,* 7 J. EMPIRICAL LEGAL STUD. 811, 832 (2010). The multiplier depends on "particularities of the case, such as the number of parties involved, the complexity of the legal issues involved, and the like." Thomas S. Ulen, *An introduction to the law and economics of class action litigation,* 32 EUR. J. L. & ECON. 184, 192 (2011); *see also* DEMOTT, *supra* note 57, § 6:17.

[192] AktG § 148 III.

[193] *See* Martin Peltzer, *Das Zulassungsverfahren nach § 148 AktG wird von der Praxis nicht angenommen! Warum? Was nun?* In FESTSCHRIFT FÜR UWE H. SCHNEIDER 953, 959-960 (Ulrich Burgard et al. eds. 2011) (noting the discouraging effect of the firm's ability to take over a derivative suit).

[194] AktG § 148 I 3.

[195] Ingo Saenger, *The Best Interests of the Corporation, Procedural Questions of Enforcing Individual and Corporate Rights and Legal Actions against Board Members,* 26 EUR. BUS. L. REV. 13, 22, 26 (2015) (surveying German literature that considers this requirement a major hurdle); Julia Redenius-Hövermann & Eva Henkel, *Eine empirische Bestandsaufnahme zur Aktionärsklage nach § 148 AktG,* 2020 DIE AKTIENGESELLSCHAFT 349, 352.

[196] *Supra* notes 97-103 and accompanying text.

– is a fact that a court can ascertain relatively easily. By contrast, whether a lawsuit serves the corporation's best interest is difficult for the court to determine. Therefore, following the US model on this point[197] seems desirable from a policy perspective. Using such a criterion would incentivize boards to develop best practices, such as independent litigation committees, to decide about possible suits to avoid being found by the court to be insufficiently disinterested.

6.2. Preliminary procedures as a beneficial legal transplant?

Preliminary procedures in derivative litigation thus provide an interesting twist on the concept of a "legal transplant" in comparative law. Because it is relatively easy and costless to borrow laws from another jurisdiction, it is common for jurisdictions to adopt laws from elsewhere and integrate them into their own legal system.[198] However, sometimes legal transplants are assessed rather negatively and thought of as ineffective in the context in which they are received.[199] Some scholars argue that laws are rooted in a particular local context, which is why although they may be adopted superficially or formally, their practical effect or function in the context of the host legal system may be quite distinct.[200] Here, in the context of derivative litigation, the transplanting mechanism at least potentially serve a positive function in jurisdictions where shareholder litigation has mainly remained dormant.

While it is difficult to obtain comparable evidence on the number of derivative suits across jurisdictions, the existing evidence suggests that the reforms had only a modest effect on increasing the number of derivative cases. In Germany, empirical research has identified only a small number of suits since the 2005 reform.[201] Likely reasons include, as discussed above, the minimum ownership limit to bring a lawsuit and the requirement to show facts raising the suspicion of dishonesty and "serious" violations of the law or articles.[202] In the UK, there has been a modest uptick of cases after the Companies Act of 2006, but the number still stays behind some other jurisdictions, including Delaware.[203] Apparently, cost issues and the uncertainty of reimbursement play a role there.[204] In addition, John Armour suggests that one inhibitory factor is the courts' reluctance to determine

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[197] Not including the problematic rule in *Spiegel. See supra* notes 102-103 and accompanying text.

[198] WATSON, *supra* note 9, at 21; Alan Watson, *Legal Change: Sources of Law and Legal Culture*, 131 U. PA. L. REV. 1121, 1125 (1983). For a literature review, see *e.g.* John Cairns, *Watson, Walton, And The History Of Legal Transplants*, 41 GA. J. INT'L & COMP. L. 637, 672 (2013); David Cabrelli & Mathias Siems, *Convergence, Legal Origins, and Transplants in Comparative Corporate Law: A Case-Based and Quantitative Analysis,* 63 AM. J. COMP. L. 109, 124-25 (2015).

[199] For a radical perspective denying legal transplantation because of the necessity to interpret rules, *see* Pierre Legrand, *The Impossibility of 'Legal Transplants,'* 4 MAASTRICHT J. EUR. & COMP. L. 111 (1997).

[200] *E.g.* Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect,* 51 AM. J. COMP. L. 163, 171-172 (2003) (suggesting that countries with transplanted law are less likely to develop effective legal institutions); Hideki Kanda & Curtis Milhaupt, *Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law,* 51 AM. J. COMP. L. 887, 889-91 (2003).

[201] *See* Peltzer, *supra* note 193, at 955 n.7 (finding only a handful of cases); Redenius-Hövermann & Henkel, *supra* note 195, at 356 (finding only six cases since the procedure was introduced).

[202] *E.g.* Peltzer, *id.* at 958-59 (noting that plaintiffs will not normally be able to meet their burden to show these factors without first initiating a special audit).

[203] Armour, *supra* note 81, at 428.

[204] Keay, *supra* note 187, at 43-44, 48-50

whether proceeding with a suit would be in the company's best interest (i.e., whether a director following s. 172 of the Companies Act would pursue it).[205] Armour, therefore, suggests that UK courts should understand this criterion more closely in line with Delaware's inquiry into the board's independence in evaluating a derivative claim.[206] There is a "steady trickle of leave applications from private companies" in Singapore. Still, so far, there have been none for publicly traded firms since the statutory mechanism was extended to them in 2014,[207] arguably because of the latter's extensive government ownership.[208] Israel seems to generate a relatively large number of cases, especially after a 2010 reform that established a specialized business division within the Tel Aviv district court.[209] This is not surprising, given that Israel's cost regime makes it likely that derivative plaintiffs will be reimbursed and that (unlike Germany) Israel does not set up other major hurdles against derivative suits at the preliminary stage.

Arguably, some corporate governance systems have done reasonably well without providing for many derivative suits in the past. This relates to how shareholders can safeguard their interests in different jurisdictions. In the UK, institutional investors have historically relied on direct engagement and representation on the board to monitor management ex-ante, compared to a higher level of litigation in the US.[210] Arguably, with the growing significance of foreign shareholders in the UK and thus higher coordination cost, derivative suits could become a more valuable corporate governance tool for outside shareholders.[211] With the more concentrated ownership structure in the other three jurisdictions, large shareholders would typically have kept management largely in check at the expense of agency cost in the relationship between blockholders and outside investors.[212] However, with ownership increasingly dispersing, it seems that economies could benefit from a broader investor base. A litigation enforcement strategy strongly relies on courts to be

[205] Armour, *id.,* at 423.

[206] Armour, *id.,* at 431-35.

[207] Tang, *supra* note 66, at 347.

[208] Tang, *id.,* at 349-50.

[209] Yifat Aran & Moran Ofir, *The Effect of Specialised Courts over Time* 17 (2020), at http://ssrn.com/abstract=2802353 (comparing data between 2006 and 2010, and 2010 respectively and showing 108 derivative suits, the majority after the 2010 reform).

[210] *See* Deborah M. DeMott, *Corporate Litigation in the US and the UK,* 51 AM. J. COMP. L. 229, 233 (2003); Christopher M. Bruner, *Power and Purpose in the "Anglo-American" Corporation,* 50 VA. J. INT'L L. 580, 593-611 (2010); CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD 37-42 (2013) (comparing shareholder powers in the US and the UK); ALESSIO M. PACCES, RETHINKING CORPORATE GOVERNANCE 286-87 (2012) (discussing policing of activities of controlling shareholders by boards in the UK); *see also* Marc T. Moore, *United Kingdom, in* COMPARATIVE CORPORATE GOVERNANCE 913, 925-26, 929 (Andreas Fleckner & Klaus Hopt eds., 2013) (discussing the relatively larger powers of UK shareholders).

[211] Armour, *supra* note 81, at 419.

[212] *E.g.* Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy,* 19 HARV. L. REV. 1641, 1651 (2006). *See also* Sergey Stepanov, *Shareholder Protection and Outside Blockholders: Substitutes or Complements?* 169 J. INST. & THEOR. ECON. 355 (2013) (discussing more concentrated ownership structure and corporate law as possible substitutes in enforcement); María Guttiérrez & Maribel Saéz Lacave, *Strong shareholders, weak outside investors,* 18 J. CORP. L. STUD. 277, 290-93 (2018) (discussing difficulties in enforcing claims against controlling shareholders, including inadequate litigation mechanisms).

institutionally qualified to litigate complex cases.[213] In some jurisdictions, this may require courts to shed their formalism and closely analyze the conflicts of interest of directors who would normally decide about litigation.

Like in the US, much of the litigation will likely happen in preliminary procedures, after which the case will be settled or taken over by the company. An essential legal design question relating to this point is whether the court, in deciding to admit a derivative suit, should be required to look at the substantive merits of the case, as in the UK, Singapore, and Germany, or at the conflict of interest of boards seeking to bring such a suit, as in the US (with Israel occupying the middle ground). In line with the tenets of the business judgment rule, courts in the US tend to look at conflicts of interest. They are usually thought not to be in a good position to evaluate the merits of a business decision. Although there has been some controversy about the issue,[214] generally, this applies as to whether a suit is in the best interests of a corporation as well. Other jurisdictions, which have historically had far smaller numbers of suits, would also be well-advised to heed this warning, given that their courts are unlikely to be better suited to evaluate business decisions than the Delaware courts. Courts are generally "far-better placed to assess evidence about independence than they are to assess the commercial merits of a litigation decision."[215]

7. Conclusion

This article has provided a set of recommendations for derivative litigation. First, countries seeking to improve corporate law enforcement should eliminate formal hurdles to litigation such as percentage limits. Instead, the task of screening meritorious from meritless suits should be concentrated in a preliminary procedure, as the UK, Singapore, Israel, and Germany have done following the US example. This has the advantage of permitting a court to screen out abusive lawsuits early. It also has the potential to solve incentive problems that have long plagued the law of derivative suits in many jurisdictions. Initially limiting the plaintiff's exposure to cost risk to the preliminary procedure would reduce disincentives against bringing meritorious suits. At the same time, because courts can reject the admission of a non-meritorious claim, the system does not lend itself to excessive litigation. However, as some of the examples show, such a procedure must be designed well. Plaintiffs should not be required to provide evidence about the merits of the suit or whether it is in the company's best interests. As in the United States, the emphasis of the preliminary procedure should be conflicts of interests of boards and other corporate bodies that would otherwise decide about litigation.

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[213] *E.g.* Enriques, *supra* note 37 (discussing excessive formalism in Italian courts); John Armour & Priya Lele, *Law, Finance, and Politics: The Case of India,* 43 L. & SOC. REV. 491, 508-511 (2009) (discussing enforcement problems in Indian corporate law relating in particular to overburdened courts); Guangdong Xu, Tianshu Zhou, Bin Zeng & Jin Shi, *Directors' Duties in China,* 14 EUR. BUS. ORG. L. REV. 57, 66-69 (2013) (discussing the lack of flexibility of Chinese courts in analyzing duty of loyalty issues).

[214] *See* Joy v. North, 692 F.2d 880, 892 (2d Cir. 1982) (discussing the court's function and ability to assess the likelihood of the success of a lawsuit in the context of a special litigation committee's motion to dismiss).

[215] Armour, *supra* note 81, at 435.

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