How Should Multiple Derivative Actions Be Reformed ?

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Abstract

This paper discusses how to make meaningful use of multiple derivative actions, on the premise that the factors preventing the filing of multiple derivative actions will be neither abolished nor mitigated by legislation. The 2014 amendments to the Companies Act introduced multiple derivative actions in Japan but imposed various restrictions that prevented them from being brought. However, the immediate abolition or mitigation of such restrictions is impractical in view of the legislative history and current situation. Therefore, this paper makes two reform proposals. First, it proposes that the damage requirement (one of the limiting factors for bringing multiple derivative actions), should be interpreted as referring not to cases of profit transfer from the subsidiary to the parent company, but to cases where the damage to the subsidiary is so small that it is not cost-effective to bring an action against the subsidiary directors. Second, based on the inconsistency between the systems concerning multiple derivative actions, it contends that while a resolution of the parent company's board of directors is sufficient to exempt the directors of a subsidiary from liability, there should be an objection procedure for minority shareholders of the parent company. It also argues that while the settlement requires not only the approval of the subsidiary but also the approval of the parent company, there should be a right of objection for minority shareholders of the parent company for the settlement.

I Introduction

A Multiple Derivative Action is an action brought by a shareholder of a parent or holding company on behalf of its subsidiary company against the directors[1] of that subsidiary company. In Japan, the 2014 amendments to the Companies Act introduced a system of multiple derivative actions (referred to as "Action to Enforce Specific Liability" in the Companies Act), mainly

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1 Under the Japanese Companies Act, the possible defendants in a Derivative Actions are "officers, etc." (this means "a director, accounting advisor, company auditor, executive officer or financial auditor". Article 423(1) of the Companies Act). In this paper, however, I will refer to them collectively as "director".

referring to the US law.[2]

A single derivative action[3] is an action by a shareholder to pursue the liability of a director to the company for breach of their duty, whereas multiple derivative actions are actions by a shareholder of a parent company to pursue the liability of a director of the subsidiary company. Thus, multiple derivative actions differ from single derivative actions in that the shareholder is seeking to hold the directors of the subsidiary, rather than the directors of the (parent) company in which they have directly invested, responsible.

The parent company and its subsidiaries have separate legal personalities. It is true that the parent company owns shares in its subsidiaries, and that the parent company's shareholders "indirectly" own shares in the subsidiary. However, the party of multiple derivative actions is not a shareholder of the company against whom the action is brought. For this reason, multiple derivative actions were once not permitted in Japan. Multiple derivative actions were introduced on the grounds that their absence would not adequately protect the interests of the parent company's shareholders.

However, the current requirements for multiple derivative actions are extremely strict, making the actions very difficult to use. As a result, there have been no known cases of multiple derivative actions being brought between the entry into force of the amended Companies Act 2014 and the date of this manuscript, January 2022. If this trend continues, there is some concern that the idiom "Unused treasure is a waste of treasure" will apply; others argue that there are in fact a relatively large number of parent–subsidiary relationships where it is possible to bring multiple derivative actions in Japan.[4] Therefore, reforming the factors that make it difficult to bring multiple derivative actions could encourage them to be brought and, as a result, could help to recover damages or deter misconduct at the subsidiary company level.

Hence, this paper will discuss how to make meaningful use of multiple derivative actions; it does so on the premise that the factors preventing the filing of multiple derivative actions will not be abolished or mitigated by legislation. The various restrictions preventing the filing of

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2 During the legislative process, it was recognized that multiple derivative actions are permitted in the US and France (Minutes of the 6th Meeting (20 October 2010) of the Companies Act Subcommittee of the Legislative Council, available at <https://www.moj.go.jp/content/000057493.pdf> accessed 4 January 2022) (in Japanese).
In contrast, at the time, several countries already had statutory multiple derivative actions, such as Canada, New Zealand, Australia and Hong Kong, but there is no indication that attention has been turned to those countries.

3 Japan, unlike the UK and other countries, does not belong to the common law sphere of law, so when the term "derivative actions (multiple derivative actions)" is used, it refers to those under statute law. Regarding multiple derivative actions in the UK, see Izumi Kawashima,'Multiple Derivative Actions in English Company Law' in Tatsuo Uemura et al. (eds), *Contemporary Issues in Corporate Law: Professor Shosaku Masai's 70th Anniversary* (Seibundo 2015) 163 (in Japanese).

4 It was already recognized at the stage of the proposed amendments to the Companies Act 2014 that only a few large, listed companies would be subject to multiple derivative actions, while unlisted SMEs would be relatively more likely to meet the requirements and be subject to such actions (Nihon Keizai Shimbun 3 December 2012, available at <https://www.nikkei.com/article/DGKDZO49062430R01C12A2TCJ000/> accessed 4 January 2022) (in Japanese). However, it is said that this would not be in accordance with the purpose of the new system and would be a case of "put[ting] the cart before the horse".); Minutes of the 23rd Meeting (18 July 2012) of the Companies Act Subcommittee of the Legislative Council, 13 (statement by Member Masao Ito), available at <https://www.moj.go.jp/content/000101603.pdf> accessed 4 January 2022) (in Japanese). In addition, the potential of multiple derivative actions for listed companies will be discussed in Section III.2.

multiple derivative actions are not deemed legislatively necessary.[5] However, it is not realistic to abolish them immediately in view of the legislative history and current situation of multiple derivative actions. Therefore, this paper seeks to derive practical solutions to promote the meaningful use of multiple derivative actions.

This paper will proceed as follows. Chapter II presents an overview of multiple derivative actions and how they were introduced in Japan. Chapter III discusses the limiting factors that make it difficult to bring multiple derivative actions and points out the issues in the view of promoting multiple derivative actions. Based on the preceding discussion, Chapter IV discusses how reforms should be made to the constraints on multiple derivative actions and then presents the reform proposal. Chapter V concludes this paper.

For the sake of brevity of expression, general terms such as multiple derivative actions, parent company, and subsidiary company, will be used in this paper rather than the formal terms used in the Companies Act, such as "Action to Enforce Specific Liability," "Wholly Owning Parent Company, etc.," and "Wholly Owned Subsidiary Companies, etc.". In addition, when this paper uses the term "Companies Act," it refers to the Japanese Companies Act enacted in 2005.

II Overview and Background of Multiple Derivative Actions

1 What Is Multiple Derivative Actions?

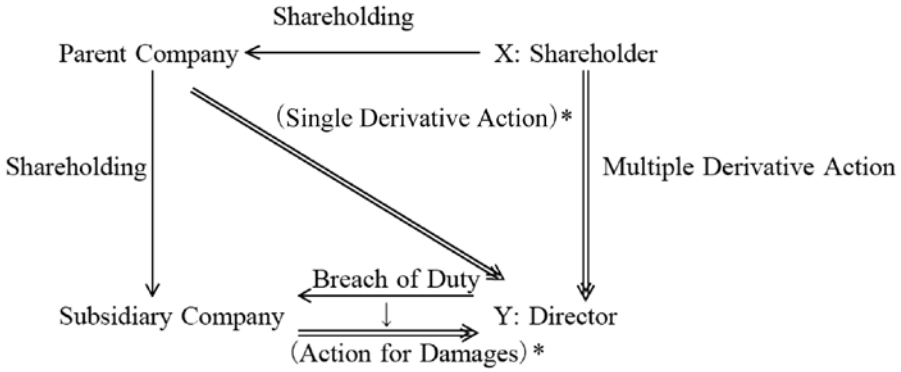
Multiple derivative actions can be described as follows. When a director of a subsidiary breaches their duty and causes damage to wa subsidiary, the subsidiary itself should pursue the director's liability.

However, there is a possibility that the subsidiary may fail to pursue a liability due to personal considerations between directors, etc. Even in such a case, the parent company, as a shareholder of the subsidiary, should be able to either urge the subsidiary to pursue its liability or directly pursue the liability of the directors of the subsidiary by filing a derivative actions. However, due to the personal relationship between the directors of the parent company and its subsidiary, etc., the parent company may also neglect seeking such enforcing liability of the subsidiary's directors. If left unchecked, the damage caused by the subsidiary will spread to the parent company, ultimately to the detriment of the parent company's shareholders. Therefore, it is said that the shareholders of the parent company should be granted the right to bring an action to hold the director of the subsidiary liable.

The specific mechanism is as follows (<Figure 1>). First, suppose there is a parent company P and its subsidiary S. Suppose then that Y, a director of S, breaches their duty and causes S a loss of ¥1 billion JPY. Therefore, P's shareholder X files an action against Y for damages against S. In that case, as in single derivative actions, X asks S (if S is a company with auditors, the auditors) to sue Y prior to the filing of the multiple derivative actions. If 60 days then elapse without S suing Y, X can bring multiple derivative actions against Y. If X wins the case, Y must pay ¥1 billion JPY in damages to S. If Y pays compensation to S, the damage caused to S will be recovered. As a result, the value of S's shares as an asset of P increases, which will in turn

5 Yoichi Takahashi, *The Ideal Way of Multiple Derivative Actions: Necessity and Institutional Design* (Shoji-Homu 2015) 261 ff (in Japanese).

Figure 1 Parties involved in Multiple Derivative Actions



*It shall be assumed that the action in brackets is not brought.

increase the corporate value of P, which in turn benefits X, a shareholder of P.

In this way, through multiple derivative actions, the subsidiary's damage is recovered, and the interests of the parent company's shareholders are protected in turn. At the same time, the foreseeability of such a situation will deter to a certain extent the illegal behavior of the directors of the subsidiary. However, as will be described in the next chapter, strict requirements are imposed on the filing of multiple derivative actions in Japan.

2 Background to the Introduction

The multiple derivative actions system was originally brought in Japan as a case law doctrine in US law.[6] However, the debate on the introduction of multiple derivative actions in Japan became more active during the debate on the "reduction of shareholder's right" triggered by the lifting of the ban on Pure Holding Companies under the 1997 amendment to the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade and the introduction of the Share Exchange and Share Transfer system under the 1999 amendment to the Commercial Code (Predecessor of the Companies Act).[7]

A "reduction in shareholder's right" means that, as a result of a Share Exchange or Share Transfer, the shareholders of the holding company or parent company will not be able to control, supervise, or investigate the business activities of the subsidiary, which significantly impacts the value of their shares. This argument was based on the awareness of the unfairness of the fact that, at that time, the shareholders of the plaintiff became shareholders of the parent company (holding company) as a result of Share Transfer during the pendency of the shareholders' derivative actions, which resulted in the loss of the plaintiff's standing and the termination of the suit.[8]

Following the enactment of the Companies Act in 2005, in 2010, the Company Law Committee of the Legislative Council, in response to a request from the Minister of Justice,

6 Regarding an early Japanese reference on multiple derivative actions, See ibid. 7 and its footnote 5.
7 Takahashi (n 5) 8-9.
8 The introduction of multiple derivative actions was advocated as a drastic measure against the plaintiff's loss of standing due to the share transfer (Takahashi (n 5) 9-11).

initiated discussions and work on revising the Companies Act. From the outset of the revision process to the end, as part of the review of the rules governing parent and subsidiary companies, the pros and cons of introducing a multiple derivative actions system were debated. In the debate at the Legislative Council, there was a fierce disagreement over multiple derivative actions. That is, while there were positive arguments for the introduction of multiple derivative actions, there was also strong opposition to the introduction of multiple derivative actions, mainly from the business community, which argued that the establishment of multiple derivative actions would affect companies' choice of organization and hinder the efficient management of business groups.[9] Finally, the multiple derivative actions was legislated in the 2014 amendments to the Companies Act; however, in consideration of the opposition, very strict restrictions were imposed.[10]

As can be seen from the above, the current multiple derivative actions system is the product of a compromise with the opposition.[11] It is therefore extremely difficult and impractical to amend the system of multiple derivative actions in favor of plaintiffs in the future (i.e., to make it easier to bring such actions). The liability of the directors of the subsidiary that is the subject of the multiple derivative actions should not be an issue if the parent company owes a duty to manage the subsidiary and if the group internal control system is functioning well. Therefore, the Legislative Council proposed the former as an alternative to the multiple derivative actions,[12] but this also faced opposition from the business community, who argued that the scope of the obligation was unclear and so on.[13] As a result, the latter was eventually clarified in the Companies Act in place of the former (e.g., Article 362(4)(vi) and (5) of the Companies Act).[14] Even if scandals occur at the subsidiary level in the future, the reform of multiple derivative actions will unlikely be discussed because such a problem can be absorbed by the issue of group internal control, which has an alternative function to multiple derivative actions. In that sense as well, it is also difficult to change the system in the direction of relaxing the requirements for filing multiple derivative actions.

III Limiting Factors of Multiple Derivative Actions

1 Standing to Sue

First, to bring a multiple derivative action, the plaintiff must meet the following requirements. They must be continuously over six months a shareholder who holds votes of one-hundredths

9 For example, Japan Economic Federation, 'Opinion on the "Interim Draft on the Review of the Company Law System"' (24 January 2012) 11 ff (in Japanese).

10 Takahashi (n 5) 3; 'Amendments to the Companies Act to be decided on the 1st, The business community accepts the draft' Nihon Keizai Shimbun, 25 July 2012 (available at <https://www.nikkei.com/article/DGXNASDF24013_U2A720C1PP8000/> accessed 4 January 2022) (in Japanese).

11 Tomotaka Fujita, 'Protection of Parent Company Shareholders' (2014) 1472 Jurist 34 (in Japanese).

12 Minutes of the 15th Meeting (16 November 2011) of the Companies Act Subcommittee of the Legislative Council, 17 ff, available at <https://www.moj.go.jp/content/000082984.pdf> accessed 4 January 2022 (in Japanese).

13 Minutes of the 20th Meeting (16 May 2012) of the Companies Act Subcommittee of the Legislative Council, 20 ff, available at <https://www.moj.go.jp/content/000099708.pdf> accessed 4 January 2022 (in Japanese).

14 The Draft Outline for the Companies Act Reform, 13, available at <https://www.moj.go.jp/content/000100819.pdf> accessed 4 January 2022 (in Japanese).

(1/100) or more of the votes of all shareholders of the "Ultimate, Wholly Owning Parent Company, etc." [15] of a stock company or a shareholder who holds shares at or more than one-hundredths (1/100) of issued shares of the "Ultimate, Wholly Owning Parent Company, etc."(Article 847-3(1) of the Companies Act). The important point here is to bring a Multiple Derivative Action, both being a shareholder of such a wholly owning parent company ((i) wholly owning parent company requirement) and holding 1% or more of the shares of that parent company ((ii) minority shareholder's right requirement) must be satisfied. The former means that multiple derivative actions are not permitted where a subsidiary has minority shareholders other than the parent company. This is because if a subsidiary has minority shareholders other than the parent company, those minority shareholders can bring derivative actions against the directors of the subsidiary, entailing no need to allow shareholders of the parent company to bring multiple derivative actions.[16] The latter means that, unlike single derivative actions, multiple derivative actions are minority shareholder's right. This is because, in the case of multiple derivative actions, the relationship between the shareholders of the parent company as plaintiff and the directors of the subsidiary as the defendant is indirect through the parent company and subsidiary, and therefore the shareholders of the parent company should have the right to bring the action only if they have a stronger interest.[17]

However, both requirements (i) and (ii) were only added as a result of a compromise with the business community, which opposes multiple derivative actions, and their theoretical and policy justification is questionable.[18] This is also essentially true for (iii) important subsidiaries requirement below.

2 Liability to Be Pursued

Second, even if the above requirements for plaintiffs are met, only the following liabilities (Specific Liability; TOKUTEI-SEKININ) can be pursued in multiple derivative actions. That is a liability of a director of the relevant stock company in the case where the book value of the shares of the relevant stock company in the "Ultimate, Wholly Owning Parent Company, etc." exceeds one-fifth of the total assets of the parent company on the date when the event causing the liability of a director of the relevant stock company occurred (Article 847-3(1) and (4) of the Companies Act; Article 218-6 of the Regulations for Enforcement of the Companies Act). Such a subsidiary is referred to as a "specified wholly-owned subsidiary company.[19] This means that in multiple derivative actions, only the liability of the directors of subsidiaries that are important to the parent company can be pursued((iii) important subsidiary requirement).

As explained by the drafter of the revised Companies Act 2014 (hereinafter called the "drafter"), the reason for this is that some directors of smaller subsidiaries are in effect only employees of the parent company, and it is thus not very likely that they will not be held liable

15 "[T]he Ultimate, Wholly Owning Parent Company, etc." means "the Wholly Owning Parent Company, etc. of the Stock Company which itself has no Wholly Owning Parent Company, etc." (Article 847-3(1) of the Companies Act).

16 Saburo Sakamoto (ed.), *One Question and One Answer [Ichimon Ittou]: The Revised Companies Act 2014* (Shoji-Homu 2015) 161 (in Japanese).

17 ibid 165.

18 Takahashi (n 5) 261 and its footnote 342.

19 Companies with such subsidiaries are required to include certain information in their business reports (Article 118 (1) of the Regulations for Enforcement of the Companies Act).

for the subsidiary.[20] This is not at all convincing. However, from the point of view of the degree of impact on the parent company due to the size of the subsidiary and its cost-effectiveness, it seems that there is a certain rationality to this requirement. In addition, the numerical criterion of (iii), one-fifth of total assets, was in accordance with the simplified organizational restructuring under the Companies Act.

It is said that requirement (iii), together with requirements (i) and (ii) above, is an obstacle to the filing of multiple derivative actions, but the impact of this requirement on the operation of multiple derivative actions is debatable. When the Companies Act was amended in 2014, it was expected that only a few dozen listed companies, including financial holding companies and some telecommunications companies, would have specified wholly owned subsidiaries.[21] However, in practice, it is estimated that there are more specified wholly owned subsidiaries than expected, even among listed companies.[22] In addition, as mentioned above,[23] the requirements for multiple derivative actions are relatively easier to meet in unlisted small- and medium-sized enterprises (SMEs). Therefore, it is possible that several derivative actions may be brought in Japan in the future. Moreover, depending on the status of the remaining requirements (i) and (ii) and other limiting factors, the number of such cases is likely to increase further.

3 Proceedings

Basically, the procedure for multiple derivative actions is set out in accordance with the procedure for single derivative actions. That is to say, the demand to file an action in advance (Article 847-3(1) of the Companies Act), the filing an action after 60 days has elapsed (Article 847-3(7) of the Companies Act), the notification of reasons for not filing an action (Article 847-3(8) of the Companies Act), the costs of the lawsuit (Article 847-4(1) of the Companies Act), the provision of security (Article 847-4(2) (3) of the Companies Act), the exclusive jurisdiction (Article 848 of the Companies Act), etc., are the same as in single derivative actions.

On the other hand, it differs from single derivative actions in the following four respects.
(1) Multiple derivative actions do not cover the liability of the recipient of property benefits (Article 120(3) of the Companies Act), the liability of the subscribers for shares for subscription in collusion with directors (Article 212(1) and 285(1) of the Companies Act), or the liability of subscribers for shares for subscription falsifying payments (Articles 102-2(1), 213-2(1), and 286-2(1) of the Companies Act).
(2) In multiple derivative actions, not only in cases where the Action is to seek unlawful benefits of the shareholder or a third party or to inflict damages on the Company or the Parent Company

20 Sakamoto (n 16) 170.

21 Kenichi Osugi, 'Parent and Subsidiary Companies' (2015) 12 Chuo Law Journal (3) 21, 29 (in Japanese).

22 One website estimates that 8% of listed companies have a specified Wholly Owned Subsidiary Companies (Nobuyuki Kawai, 'Regarding the Number of Listed Companies With Wholly Owned Subsidiaries That Are Subject to Multiple Derivative Actions' (Lawyers Nobuyuki Kawai's Corporate Legal (Business Law) Note, 17 September 2015) available at <http://blog.livedoor.jp/kawailawjapan/archives/8147206.html> accessed 4 January 2022) (in Japanese).
Therefore, multiplying the number of listed companies as at December 2021 (3,822) by 0.08 gives a figure of approximately 306, which is a larger than envisaged at the time of the introduction of multiple derivative actions (For the data, see the Tokyo Stock Exchange website, available at <https://www.jpx.co.jp/listing/co/index.html> accessed 4 January 2022) (in Japanese).

23 See note 4 above.

(proviso to Article 847(1) of the Companies Act, TORI-KAGAI-MOKUTEKI) but also in cases where the parent company does not suffer damages by the fact of causing the Specific Liability (Article 847-3(1) of the Companies Act, damage requirement) provided as a case in which an action cannot be brought.
(3) In multiple derivative actions, not only the company or its shareholders but also the shareholders of the parent company may intervene in a suit (Article 849(1) and (2) of the Companies Act).
(4) In multiple derivative actions, the exemption of directors from liability requires the consent of all shareholders of the parent company in addition to the consent of all shareholders of the subsidiary (Article 847-3(10) of the Companies Act).[24]

There is little justification for excluding liability under (1) from the scope of multiple derivative actions,[25] but for the purposes of this paper we will not enter further into this issue. In addition, there is no problem with (3), which is a measure to prevent collusive actions.

Noteworthy in relation to this paper are points (2) and (4). Regarding (2) above, it is an important question when an action cannot be brought for lack of the damage requirement, namely what is meant by "no damage to the parent company." This is because its understanding greatly affects the usability of multiple derivative actions.

Regarding point (4), under a full parent–subsidiary relationship, the only shareholder of the subsidiary is the parent company, which in effect means that the exemption of the subsidiary directors from liability only requires the consent of all shareholders of the parent company. However, this is not consistent with the fact that the standing to sue in multiple derivative actions is a minority shareholder's right. The next chapter discusses this issue in more detail.

In addition, what is strange from the point of view of the structure of multiple derivative actions is that (5) only the approval of the subsidiary is required for a settlement, not the approval of the parent company (Articles 850 and 849-2 of the Companies Act).

In a single derivative actions, if there is to be a settlement of the derivative actions to which the company is not a party, the court shall inform the company of the terms of the settlement and demand that it states its objections, if any, within two weeks (Article 850(2) of the Companies Act). If the company does not object within that period, the shareholders are deemed to have approved the settlement in the terms of the notice (Article 350(3) of the Companies Act). In this case, the settlement has the same effect as a final and binding judgment (Article 350(1) of the Companies Act) and the consent of all shareholders, which is a requirement for the exemption of directors, is not required (Article 350(4) of the Companies Act). In the case of a company with corporate auditors, the consent of all auditors is required to approve the settlement (Article 849-2(i) of the Companies Act).

Exactly the same is true in the case of multiple derivative actions, although it is worth noting here that there is no procedure for notifying the parent company and obtaining its approval in the event of a settlement. In other words, the settlement of multiple derivative actions requires only the consent of all the auditors of the subsidiary, not of all the auditors of

24 As in the case of (4), the partial exemption of directors' liability also requires certain procedures not only in subsidiaries but also in parent companies (Article 425(1)-(3), 426(2)(5)(7) and 427(3)(4) of the Companies Act). But the procedures are not exactly the same for the parent company and the subsidiaries.
25 Takahashi (n 5) 278.

the parent company. This deprives the shareholders of the parent company the opportunity to question whether the auditors' decision to settle was justified. Such treatment is also inconsistent with the fact that the exemption of subsidiary directors from liability in (4) above requires—in addition to the consent of all shareholders of the subsidiary—the consent of all shareholders of the parent company.

In other words, although they both have the effect of exempting the subsidiary directors from liability, they are treated differently in that the exemption requires the approval of the subsidiary and the parent company, whereas settlement requires only the approval of the subsidiary. This issue is discussed further in the next chapter.

IV How Should Multiple Derivative Actions Be Reformed?

1 Direction of Reform

This chapter will discuss how Japan's multiple derivative actions system should be reformed. However, in doing so, it is assumed that the restrictions on the filing of multiple derivative actions will not be relaxed by legislation, with a view to seeking practical solutions to promote the meaningful use of multiple derivative actions. This is because, as mentioned above, to some extent there are specified wholly owned subsidiaries that satisfy requirement (iii) even among listed companies in Japan (i.e., the constraint of (iii) is relatively weak), whereas it is currently difficult to relax or abolish requirements (i) and (ii) by legislation. Thus, it will not develop a legislative argument concerning the requirements (i)–(iii) above, which are an obstacle to multiple derivative actions. Instead, the following discussion will focus on the interpretation of the damage requirement and the inconsistencies between the regulations on multiple derivative actions.

2 Interpretation of Damage Requirement

(1) Meaning of Damage to a Parent Company

First, the question arises as to what is meant by a case where a parent company does not suffer damages by the fact of causing the Specific Liability. If no damage has been caused to the parent company, the parent company shareholders may not bring a multiple derivative actions. This means that the more narrowly (or vague) the scene of the parent company's damage is perceived, the more difficult it will be for the parent company's shareholders to bring the action. It follows that, to facilitate the use of multiple derivative actions, the damage to the parent company should be captured as broadly and clearly as possible.

Regarding the content of the damage requirement, the following views have been argued:

a) Sakamoto,[26] a drafter of the revised Companies Act 2014, considers that this is the case when a parent company obtains profits from a subsidiary or when profits are transferred between subsidiaries. It is said that this is because, even if the subsidiary suffers damage in this case, the value of the parent company's shares held by the parent company's shareholders has not changed.

b) Fujita,[27] a corporate law scholar, said that the scope of multiple derivative actions should

26 Sakamoto (n 16) 168.
27 Fujita (n 11) 35.

be limited to the damage caused by the decline in value of the subsidiary's shares, and that the damage suffered by the parent company for reasons other than the decline in the value of the subsidiary's shares (for example, the damage caused by the loss of reputation of the corporate group) should not be subject to multiple derivative actions because the damage is suffered directly by the parent company and not through the subsidiary. This example seems to assume that the directors of the subsidiary have caused damage directly to the parent company (not through the subsidiary).[28] However, there seems to be no reason to deny multiple derivative actions if "simultaneously" the subsidiary directors have been negligent in their duties toward the subsidiary.

c) Takahashi,[29] a corporate law scholar, argued that, in the case of a transfer of profits from a subsidiary to a parent company, the parent company shareholders are in a kind of conflict of interest, and it may be questionable whether they can be expected to pursue the lawsuit properly and that allowing the parent company shareholders to file a lawsuit in this case may lower the social reputation of the multiple derivative actions system. However, this view does not apply to minority shareholders of parent company.

The specific differences between these views are not clear, but they all share a common emphasis on the event of a decline in the value of the parent company's shares through a decline in the value of the subsidiary's shares. Thus, in the following, we will mainly examine the views of the drafter on the premise that these views are not contradictory.

In the view of the drafter, it is assumed that there may be cases where the consequences of the performance of duties by a subsidiary director are detrimental to the subsidiary but not necessarily to the parent company. Typically, this is the transfer of profits from a subsidiary to its parent company through a transaction between a parent and a subsidiary, or to a sibling company through a transaction between siblings.

However, there are problems with this explanation given by the drafter.

First, disallowing remedies for the transfer of profits from a subsidiary to its parent would be tantamount to recognizing the primacy of group interests in a corporate group. Group interest priority means that the directors of a subsidiary can put the interests of the parent company or group ahead of those of the subsidiary. However, such treatment is incompatible with the basic value of current Japanese company law, which holds that directors owe a duty of care "to the company".[30]

Second, if subsidiary directors were allowed to put the interests of the group ahead of those of the subsidiary, then subsidiary directors who transfer profits to the parent company

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28 In this case, the parent company can pursue liability against the subsidiary directors in tort (Article 709 of the Civil Code) or under Article 429(1) of the Companies Act.

29 Takahashi (n 5) 279-280.

30 Article 330 of the Companies Act, Article 644 of the Civil Code. And see Kenjiro Egashira, *Laws of Stock Corporations [Kabushiki-gaishaho]* (7th edn, Yuhikaku 2017) 435-436 (in Japanese); Shigeyuki Maeda, 'Chapter 5: Protection of Subsidiaries in Parent-Subsidiary Relationships' in Financial Law Study Group, *Legal Issues Concerning Banking Groups From the Perspective of Financial Regulations* (Report of Financial Law Study Group No.23 2013) 87, 94-95 available at <https://www.zenginkyo.or.jp/fileadmin/res/abstract/affiliate/kinpo/kinpo2010_1_6.pdf> accessed 4 January 2022 (in Japanese); Even assuming that the directors of the subsidiary are nominee directors sent by the parent company, a nominee directors cannot give precedence to their nominator's interests. At best, they can 'consider' that interest even in various countries other than Japan.

should not be liable for breach of their duty.[31] Hence, no multiple derivative actions can be brought against such subsidiary directors. In other words, it is not that multiple derivative actions cannot be brought despite breach of duty by the subsidiary directors but that there is no breach of duty itself.

Third, under current law, which states that directors owe a duty of care to the company, it is prohibited for a parent company to instruct its subsidiary directors to transfer profits from a subsidiary to the parent company. If the parent company obtains profits from the subsidiary in breach of this, the parent company must return the profits to the subsidiary.[32] In addition, the parent company should naturally bear the expense of returning such profits. This is exactly the damage to the parent company in cases of profit shifting from the subsidiary to the parent company. In other words, assuming the current law, if there is a transfer of profits from the subsidiary to the parent company, there is damage not only to the subsidiary, but also to the parent company to restore the illegal status. This also means that multiple derivative actions can act as a deterrent against unfair transactions between parent and subsidiary companies.[33]

Fourth, according to the view of the drafters, who judge the eligibility to file based on whether the parent company has benefited from its subsidiary, it follows that, among cases in which a subsidiary suffers damage due to a detrimental instruction of the parent company, multiple derivative actions cannot be brought in the case of unfair parent–subsidiary transactions, while actions can be brought in other cases. However, I do not see the point in making such a distinction. Of course, such a distinction cannot be also explained in terms of the prevention of abusive prosecutions.[34]

Considering the above, it should be interpreted that the transfer of profits from a subsidiary to its parent company through transactions between parent and subsidiary companies, etc., does not fall under the category of cases where no damage has been caused to the parent company.

In contrast, there is no need to allow multiple derivative actions to be brought if they are clearly disadvantageous to the parent company in terms of cost-effectiveness. This applies to cases when the whole process from the filing of multiple derivative actions to victory for plaintiffs, the enforcement of the judgment, and the receipt of compensation by the subsidiary does not bring any positive economic benefit (even if nominally or formally) to the parent company. For example, this is the case when the damage caused by the subsidiary is so small that it is not worthwhile to pursue liability through multiple derivative actions. Such an understanding is also consistent with the purpose of the important subsidiary requirement (iii) above. Therefore, the absence of damage to the parent company should be understood only in such cases.

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31 Masahiro Maeda, 'Protection of Parent Company Shareholders' (2012) 1439 Jurist 41 (in Japanese).

32 It may be interpreted that the parent company is obliged to make restitution to the subsidiary due to a breach of the prohibition of property benefits under the Companies Act (Article 120(1) and (3) of the Companies Act).

33 Conversely, it is only the (minority) shareholders of the parent company that may be able to rectify such a transaction. As regards the fact that multiple derivative actions are designed to protect minority shareholders of the parent company, see Shinichi NEMOTO, 'The Particularity and Universality of "Multiple Derivative Actions"'85 Horitsu Ronso (2012) (1) 267, 290–291 (in Japanese).

34 Moreover, the necessity of this damage requirement is even more questionable when one considers that such a limitation is not provided for in countries that have statutory multiple derivative actions, such as Canada, New Zealand, Australia, Hong Kong, South Korea, and so on.

(2) Burden of Proof

The next question is who will prove that there has been no damage to the parent company. If the burden on the plaintiff in this respect is too great, the use of multiple derivative actions will still be difficult. The discussion in the Legislative Council stated that the plaintiff shareholder in multiple derivative actions does not have to prove its case with regard to another obstructive factor of filing an action (TORI-KAGAI-MOKUTEKI; proviso to Article 847(1) of the Companies Act, III.3. above) ;[35] so, what about the damage requirement?

It is difficult for parent company shareholders to prove whether the parent company has suffered any damage as this relates to the situation of the parent company and its subsidiaries and the relationship between them. On the other hand, it may be difficult even for subsidiary directors to prove that the case falls under the category of no damage to the parent company[36] (especially if the subsidiary director is not also a director of the parent company). However, based on the close relationship between parent and subsidiary companies, and especially the full parent–subsidiary relationship required by multiple derivative actions, this is not necessarily considered an excessive burden.

Therefore, regarding the damage requirement, it should be interpreted that the directors of subsidiary company have the burden of proving that no damage has been caused to the parent company.

3 Inconsistencies between Regulations

As mentioned above, only parent company shareholders who hold 1% or more of the parent company's shares are entitled to bring multiple derivative actions ((ii)minority shareholder's right requirement). On the other hand, the exemption of the directors of a subsidiary from liability requires the consent not only of all the shareholders of the company concerned but also of all the shareholders of the parent company (III.3.(4) above).

The two systems are inconsistent; the reasons for this are as follows. In single derivative actions, individual shareholders have the right to bring an action (no minimum share ownership requirements), and thus in principle, the consent of all shareholders is required to exempt directors from liability. In contrast, although the right to bring multiple derivative actions is a minority shareholder's right, the consent of all shareholders of the parent company is required to exempt a subsidiary director from liability. If the right to bring multiple derivative actions is a minority shareholder's right, then it would be more coherent to provide that the liability of the directors of a subsidiary can be discharged unless the minority shareholders of the parent company object. The current Companies Act already provides for a system of objections by minority shareholders in relation to partial exemption from liability of directors, which would be help to resolve this issue (Article 426(3)-(7) of the Companies Act).

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35 Minutes of the 17th Meeting (22 February 2012) of the Companies Act Subcommittee of the Legislative Council, 32 (statement by Hideo Tsukamoto [Civil Affairs Bureau, Ministry of Justice]), available at <https://www.moj.go.jp/content/000097367.pdf> accessed 4 January 2022) (in Japanese).

36 At the Legislative Council, even a member representing the business community stated that he was "somewhat felt strange with the idea that a subsidiary must prove that no damage has been caused to the parent company" (Minutes of the 14th Meeting (26 October 2011) of the Companies Act Subcommittee of the Legislative Council, 6 (statement by Member Hosei Sugimura), available at <https://www.moj.go.jp/content/000081570.pdf> accessed 4 January 2022) (in Japanese). This would rather suggest the unreasonableness of the damage requirement itself.

Therefore, I would like to propose that referring to the partial exemption from liability by resolution of the board of directors (Article 426 of the Companies Act), the liability of directors of a subsidiary company can be exempted by the board of directors of the parent company and that the procedure for objection by minority shareholders of the parent company should be obliged in order to ensure transparency to shareholders of the parent company.

In addition, as mentioned above, there is a contradiction between the fact that in multiple derivative actions, a settlement can be satisfied only with the approval of the subsidiary (III.3.(5) above) and the fact that the exemption of the subsidiary directors from liability requires the consent of the shareholders of both the parent company and the subsidiary (III.3.(4) above). Furthermore, it has been pointed out that there are procedural deficiencies in the settlement of Derivative Actions because the proposed settlement is not disclosed to shareholders.[37] This also applies to multiple derivative actions. This contradiction and the deficit of settlement system should be resolved.

Therefore, to promote disclosure of information to shareholders of the parent company and to complement the problems of the current settlement system, I would like to propose that the right of objection for minority shareholders of the parent company should be introduced in the settlements of multiple derivative actions. That mechanism is essentially the same as in the above-described case of the exemption of subsidiary directors from liability.

4 Reform Proposals

Specifically, the Companies Act should provide for the following:

(1) Exemption From Liability of Subsidiary Directors

(i)Exemption from liability of the directors of a specified Wholly Owned Subsidiary Companies shall require a resolution from the board of directors of the parent company, but not of all shareholders of the subsidiary. (ii)Following the resolution by the board of directors of the parent company, the parent company shall give public notice or notice the details of the exemption from liability to the shareholders of the parent company to the effect that any objections to the exemption from liability ought to be stated within a specified period. (iii)The exemption from liability of the directors of a subsidiary company shall not be granted if shareholders holding more than one-hundredth of the parent company object.

(2) Settlement of Multiple Derivative Actions

(i)If there is to be a settlement of multiple derivative actions and the company is not a party to the settlement, the court shall inform the parent company and subsidiary company of the terms of the settlement and demand that it states its objections. (ii)The approval of the settlement requires both the consent of all auditors of the subsidiary company and the consent of all auditors of the parent company. (iii)Following the resolution by the board of directors of the parent company, the parent company shall give public notice or notice the details of the settlement to the shareholders of the parent company to the effect that any objections to the settlement ought to be stated within a specified period. (iv) (4) Same as (1) (iii) above.

37 Wataru Tanaka, ‘Reduction of Liability of Directors and Derivative Actions’ (2002) 1220 Jurist 36 (in Japanese).

In this way, the shareholders of the parent company can access information about the exemption from liability of the directors of the subsidiary and the settlement, and thus have the opportunity to question whether the directors and auditors' decision of the parent company and its subsidiaries was justified.

The above proposals favor subsidiary directors in terms of relaxing the requirement for exemption from liability for subsidiary directors from the consent of all shareholders of the subsidiary and all shareholders of the parent company to a resolution of the board of directors of the parent company (only). Therefore, despite requiring legislative reform, it would be feasible because more acceptable even for the business community, which has a negative stance toward multiple derivative actions.

V Conclusion

This paper discussed how to make meaningful use of multiple derivative actions, on the premise that the factors preventing the filing of multiple derivative actions will be neither abolished nor mitigated by legislation. The 2014 amendments to the Companies Act introduced multiple derivative actions in Japan but imposed various restrictions that prevented them from being brought. As a result, no multiple derivative actions have yet been brought in Japan. However, the immediate abolition or mitigation of such restrictions is impractical in view of the legislative history and current situation. Therefore, this paper makes two reform proposals. First, it proposes that the damage requirement (where no damage has been caused to the parent company), which is one of the limiting factors for bringing multiple derivative actions, should be interpreted as referring not to cases of profit transfer from the subsidiary to the parent company but to cases where the damage to the subsidiary is so small that it is not cost-effective to bring an action against the subsidiary directors. Second, based on the inconsistency between the systems concerning multiple derivative actions, it contends that while a resolution of the board of directors of the parent company is sufficient to exempt the directors of a subsidiary from liability, there should be an objection procedure for minority shareholders of the parent company. It also argues that while the settlement of multiple derivative actions requires the approval of both the subsidiary and parent company, there should be a right of objection for minority shareholders of the parent company, like in the case of the exemption of subsidiary directors from liability.

These proposals favor subsidiary directors in a sense. Therefore, despite requiring legislative reform, it would be feasible because more acceptable even for the business community, which has a negative stance toward multiple derivative actions. Doing this, the shareholders of the parent company will be able to access information that enable them to challenge the validity of decisions taken by the directors and auditors of the parent company and its subsidiaries.