Multiple Derivative Actions: Debates in Korea and the Implications for a Comparative Study

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A double or multiple derivative action has attracted little academic attention in US for decades. In Korea, after the Korean Supreme Court dismissed a double derivative action in 2004 on the ground that a shareholder in a parent company lacked standing to sue on behalf of its subsidiary, this issue has attracted much interest both academically and politically. Since many large business groups, or chaebols, in Korea now use a multi-layered holding company structure, multiple derivative actions are perceived as a means to regulate the management of unlisted subsidiaries which is insulated from the pressure of stock market. In 2016 and 2017, a number of bills that attempt to allow double or multiple derivative actions in varying scopes were submitted to the National Assembly of Korea. After an analysis of those bills and a comparative review of the laws of a few jurisdictions, this article presents a few questions to be considered before legislation and provides some answers to those questions.

First, a double or multiple derivative action is justified because it may compensate harmed shareholders and deter possible wrongdoing to subsidiaries. It is irrelevant to resort to the doctrine of "piercing the corporate veil" to justify it. Second, a standard derivative action against the directors of a parent company for failure to monitor a subsidiary's management or for failure to seek proper remedies cannot be a satisfactory alternative to a double or multiple derivative action, considering the difficulty of proving causes of action and assessing the damages. Third, double or multiple derivative actions need not be limited to situations in which the subsidiary is wholly owned or in which there is no one else who can sue. Fourth, before bringing an action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a standard derivative suit.

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Multiple Derivative Actions

Considering the increasing use of a multi-layered holding company structure, double or multiple derivative actions will be more and more important to recover the losses of a subsidiary and deter wrongdoing that may be committed at the level of subsidiaries.

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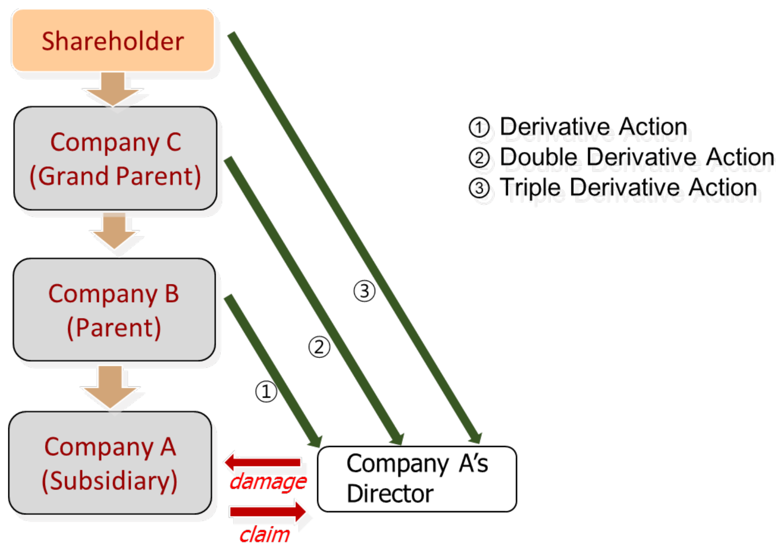
PART I: INTRODUCTION

A derivative action is a lawsuit brought by the shareholder on behalf of the corporation in order to enforce causes of action belonging to the corporation. The increasing use of a multi-layered group structure[1] gives rise to the issue of whether a shareholder of a parent company may bring a derivative action against the directors and officers of subsidiaries on behalf of the subsidiaries. An action by a shareholder of a parent company on behalf of a subsidiary is called a double derivative action and an action by a shareholder of a grandparent company on behalf of its second-tier subsidiary (i.e., a grandson company or sub-subsidiary) is called a triple derivative action, as illustrated in [Figure 1]. Collectively, such actions are referred to as multiple derivative actions. In any of these multiple derivative actions, the cause of action belongs to the company which directly suffered damage from the misconducts of the defendants.

[Figure 1] Illustration of Multiple Derivative Actions



1. "In the modern economy [. . .] business of large or moderate size is typically conducted [. . .] by a group of affiliated companies" which are "organized in the form of a dominant parent corporation with scores or hundreds of subservient sub-holding, subsidiary, and affiliated companies." Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605, 606 (2005); "[T]he modern corporate world is composed of an ever increasing number of subsidiaries and subsidiaries of subsidiaries." David W. Locascio, *Comment: The Dilemma of the Double Derivative Suit*, 83 NW. U. L. REV. 729, at 730 (1989).

For several decades, multiple derivative actions have received little academic attention. In the US, while a number of state courts have addressed multiple derivation actions throughout the 20th century based on various theories, such as the fiduciary theory, the doctrine of "piercing the corporate veil", the "instrumentality" test, and the "common control" theory,[2] academics have largely ignored the issue. UK courts admitted double derivative actions in the case of a wholly-owned subsidiary,[3] but it remains uncertain whether such a ruling will hold true when partially owned subsidiaries are concerned. In Japan, new provisions were added in its corporate law[4] in 2014 to allow multiple derivative actions, but only for wholly-owned subsidiaries in very limited occasions. All in all, even in jurisdictions known for relatively active derivative suits, multiple derivative actions have not been studied in depth as to whether they should be allowed at all, and if so, under what conditions and to what degree.

In the Republic of Korea,[5] debates began after the Korean Supreme Court dismissed a double derivative action in 2004 on the grounds that a shareholder of a parent company lacked standing to derivatively sue directors of the subsidiary. Many experts including some shareholder activists argued for amending the Korean Commercial Code ("KCC") to explicitly allow multiple derivative actions. They argued that a multiple derivative action would be a useful tool to regulate tunneling by controlling shareholders taking place at the level of unlisted subsidiaries in the form of related party transactions. Others were skeptical or even hostile to the idea of introducing multiple derivative actions by a statute.

In 2016 and 2017, a number of bills that attempt to allow multiple derivative actions in varying scopes were submitted to the National Assembly of Korea, which are still pending as of August 2018. The lively debates among scholars and the various bills submitted to the legislature in Korea give a unique comparative perspective, considering the scarcity of academic attention on this issue in other jurisdictions, and thus, this topic deserves further review. Focusing on comparative legal research, this article attempts to explore the background of such debates, compare various bills, and analyze the key issues to be determined when making a statute on multiple derivative actions. This article begins by first summarizing in Section II the current Korean law on derivative actions in comparison to the US corporate law. Next, Section III analyzes the 2004 Supreme Court ruling, related debates, and recent bills

2. For a classic explanation of these "theories," see William H. Painter, *Double Derivative Suits and Other Remedies with Regard to Damaged Subsidiaries*, 36 IND. L. J. 143, 146-155 (1961).

3. Universal Project Management Services Ltd v Fort Gilkicker Ltd [2013] EWHC 348; Bhullar v Bhullar [2015] EWHC 1943 (Ch).

4. Company Act (*Kaishaho*) of Japan (2005 Act No. 86, finally amended as 2016 Act No. 62).

5. Also known as the South Korea. Throughout this paper, it is referred to as simply "Korea."

involving multiple derivative actions. Then, Section IV provides a brief sketch of this issue from a comparative law perspective, and Section V analyzes a few key issues to be considered for legislation.

PART II: DERIVATIVE ACTIONS IN KOREA

A. Overview

Since its enactment in 1962, the KCC included detailed provisions on shareholder derivative actions. Theoretically, derivative actions were supposed to play a crucial role in protecting minority shareholders from abusive and wrongful conduct by the management. In reality, however, this remedy was dormant until the first derivative action in Korean history was filed in 1997, which then led to the first Korean Supreme Court case on derivative actions in 2002.[6] Since then, Korean courts have encountered around sixty derivative suits.

A few features of derivative actions in Korea are noteworthy. First, NGOs such as the People's Solidarity for Participatory Democracy and the Solidarity for Economic Reform played quite an important role in organizing and initiating actions against the directors of Korean conglomerates. Their main goal was improving the rigged governance of Korean companies as a part of social reform, rather than maximizing shareholder value per se. Such sociopolitical motives made them bring a number of derivative actions against the directors of a few large and famous firms in Korea, even when there was little economic incentive to do so. Second, derivative actions frequently followed criminal prosecutions or administrative inspection proceedings, based on the facts investigated and verified by such proceedings. For example, after a director is found guilty of embezzlement or 'criminal breach of trust' under the Korean Criminal Code, shareholders of the company tend to file derivative actions against the director. Absent a US-style discovery process, this is the most convenient, and almost the only possible way, to collect evidence for a derivative action.

B. Statutory Requirements

1. Company's Claim against Directors

In order to bring a valid derivative action, there must be a substantive claim that belongs to the company against a director, statutory auditor,[7] or executive

6. Supreme Court, Mar. 15, 2002, 2000da9086 (derivative action re: Korea First Bank).

7. A statutory auditor, *gamsa* in Korean, is responsible for supervision of accounting and operational matters of the corporation. A joint stock corporation of Korea must have either a statutory

officer of the company. In other words, a director or other potential defendants of the derivative action must be liable to the company. Such liability typically arises when a director causes harm to the company by breach of fiduciary duty or violation of the law.[8] For example, an underlying claim for a derivative action was recognized when (i) directors misused corporate funds for bribery,[9] (ii) directors sold corporate assets to a related party at a price far lower than fair market value,[10] or (iii) directors invested corporate funds in a distressed affiliate company even though there was little hope of survival.[11]

2. Demand on the Company to Bring an Action

Before filing a derivative action, the plaintiff shareholder must first demand that the company bring a suit against the relevant director.[12] The shareholder must submit to the statutory auditor (or the audit committee, if the company has an audit committee instead of a statutory auditor) of the company a written demand for filing a lawsuit.[13] If the statutory auditor fails to bring a suit within 30 days from the date of the demand (either by ignoring the demand or refusing to honor the demand), the shareholder may immediately bring a suit on behalf of the company.[14] If any irreparable damage is likely to arise during the demand period, the shareholder may bring a suit immediately without first making such a demand.[15]

Such a demand requirement under Korean law is different from the "demand on board requirement" under many U.S. state laws. Under the laws of the States of Delaware and New York, for example, a written demand must be submitted to the board of directors unless the case meets the "demand futility tests." Further, the board of directors has broad discretion in determining whether or not to bring a suit. In the "demand required" cases, a decision by the board of directors not to bring, or terminate, a suit would be almost impossible for a shareholder to successfully challenge.[16] Even in the "demand excused"

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auditor or an audit committee comprised of board members. A statutory auditor is elected at the general meeting of shareholders.

8. Article 399 of the KCC.

9. Supreme Court, Oct. 28, 2005, 2003da69638 (derivative action re: Samsung Electronics).

10. Seoul Southern District Court, Aug. 17, 2006, 2003gahap1176 (derivative action re: LG Chemical).

11. Seoul Central District Court, Feb. 8, 2010, 2008gahap47867 (derivative action re: Hyundai Motors).

12. Article 403(1) of the KCC.

13. Articles 403(2) and 394 of the KCC.

14. Article 403(3) of the KCC.

15. Article 403(4) of the KCC.

16. If the board refuses the demand, the shareholder may seek judicial review of that refusal, but the plaintiff bears the burden of proving that the refusal was wrongful. In addition, the relevant standard of review is the business judgement rule, and the plaintiff is not entitled to discovery. STEPHEN M. BAINBRIDGE, CORPORATE LAW (3RD ED.) 233-234 (2015).

cases where a demand on board requirement is excused, the company usually sets up a Special Litigation Committee ("SLC") composed mainly of independent directors to determine the position of the company regarding the litigation. Although states have developed varying standards, generally speaking, the SLC's decision to terminate the lawsuit is given quite strong deference by the court.[17] If the SLC was independent and disinterested, and had a reasonable basis in reaching the recommendation to terminate the action, then the derivative action will most likely be dismissed even under very shareholder-friendly state law.

Unlike US law, however, Korean law does not recognize the board's or any special committee's discretion not to bring or terminate a lawsuit. Once the 30-day demand period elapses, regardless of the board's decision, the plaintiff shareholder may legitimately file a derivative lawsuit.[18] A demand requirement under Korean law is thus more similar to granting the company with a mere "right of first lawsuit," not any further discretion to give up or terminate the lawsuit. In addition, the plaintiff shareholder does not need to wait 30 days when there is concern of irreparable harm to the company,[19] or when the company clearly rejects the demand before the elapse of 30-day period. Therefore, this requirement is not a significant barrier to filing a derivative action in Korea.

3. Requirements for Plaintiff Shareholders

Another important difference from the US law is that the KCC requires a minimum shareholding ratio to bring a derivative action while a person who owns only one share is entitled to a derivative remedy under the US law. For an unlisted company, a plaintiff shareholder must hold at least 1% of the total issued shares.[20] There is no holding period requirement for an unlisted company. For a listed company, the statutory minimum shareholding ratio is as low as 0.01%, but the plaintiff must have held the shares for at least 6 months.[21] The KCC allows a listed company to reduce the minimum

17. *Auerbach v. Bennett*, 419 N.Y.S.2d 920 (1979) for New York law (the challenged misconduct is not subject to a substantive review by the court so long as the SLC was independent and used proper procedures in reaching its decision); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del.1981) for Delaware law (the court should inquire into the independence and good faith of the SLC, reviewing not only the procedural matters but also the bases supporting the SLC's recommendations); *Joy v. North*, 692 F.2d 880 (2d Cir.1982) for a diversity case arising under Connecticut law (the court should examine whether the litigation is in the best interests of the corporation by reviewing both procedural and substantive matters).

18. Article 403(3) of the KCC.

19. Article 403(4) of the KCC.

20. Article 403(1) of the KCC. According to the pre-1998 KCC, the statutory minimum for an unlisted company was 5%.

21. Article 542-6(6) of the KCC.

shareholding ratio, or shorten the 6-month period, in its articles of incorporation.[22] The 1% or 0.01% ratio can be satisfied in aggregate by multiple shareholders.

The minimum shareholding requirement is probably one of the main barriers to bringing a derivative action in Korea. But the KCC also has some rules which render this requirement not as strict as it first appears. Once the plaintiff meets the minimum shareholding ratio at the time the derivative action is filed, any reduction in the plaintiff's shareholding ratio does not affect the plaintiff's standing as long as the plaintiff holds at least one share.[23] Moreover, unlike US law,[24] the KCC does not have a contemporaneous share ownership requirement: the plaintiff need not have been a shareholder at the time of the challenged misconduct. The underlying rationale is that the plaintiff shareholder is enforcing the company's cause of action as an agent, not as a principal, with any legal effects of the lawsuit vested with the company. Thus, it does not matter whether the plaintiff himself suffered any damage from the challenged misconduct at the time of such an event.

C. Other Procedural Aspects

Under Korean law, the company itself is neither a plaintiff nor a defendant in a derivative action. Only the shareholders are the plaintiffs,[25] and the persons who are liable to the company (usually directors who breached their fiduciary duty and caused harm to the company) are the defendants. The company is merely allowed to participate in the proceedings on the plaintiff's side if and only if it desires to.[26] Plaintiffs must notify the company of their suit without delay so that the company may participate in the proceedings.[27] This is strikingly different from US law where the company is usually named as one of the defendants.[28]

To prevent abuse of derivative actions, the KCC has a few mechanisms in place. First, the plaintiff is not allowed to withdraw or settle the case without

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22. Article 542-6(7) of the KCC.
23. Article 403(5) of the KCC.
24. US Federal Rule 23.1 (b) requires the verified complaint of a derivative action to allege that the plaintiff was a shareholder at the time of the transaction complained of.
25. In order to meet the minimum shareholding ratio requirement, multiple shareholders usually form a group of plaintiffs, often through online media. It is not a class action per se, though. Only those shareholders who are specifically named as plaintiffs in the complaint, and who signed or affixed seals on the complaint directly or through their attorneys, become the plaintiffs of a derivative action.
26. Article 404(1) of the KCC.
27. Article 404(2) of the KCC.
28. The custom of making the corporation a nominal defendant in a derivative action is survival of historical conception that a derivative suit is two suits in one: a suit against the corporation and a suit against the wrongdoer. ROBERT C. CLARK, CORPORATE LAW, Aspen (1986) 639.

court approval once the derivative action is filed.[29] Second, when a defendant director submits evidence of bad faith on the part of a plaintiff shareholder, the court may order the plaintiff shareholder to post a reasonable bond.[30] Third, if the plaintiff loses the case and it is found that the suit was filed in bad faith, then the plaintiff is liable to the company for the losses suffered by the company due to the derivative action.[31]

If the plaintiff wins the case, any proceeds collected from the defendants go to the company, not to the plaintiff, because the course of action belongs to the company. The plaintiff can demand that the company reimburse him for reasonable expenses as well as litigation costs.[32] The courts, however, have sometimes denied full reimbursement of expenses on the grounds that the attorney fees requested by the plaintiff were unreasonably high.[33] Restrictions on the reimbursable amount of attorney fees have negative impacts on the incentive of lawyers to be actively engaged in the derivative actions, and work as a deterrent for bringing a derivative action, together with the minimum shareholding ratio requirement discussed above.

PART III: MULTIPLE DERIVATE ACTIONS IN KOREA

A. Corporate Group Structure

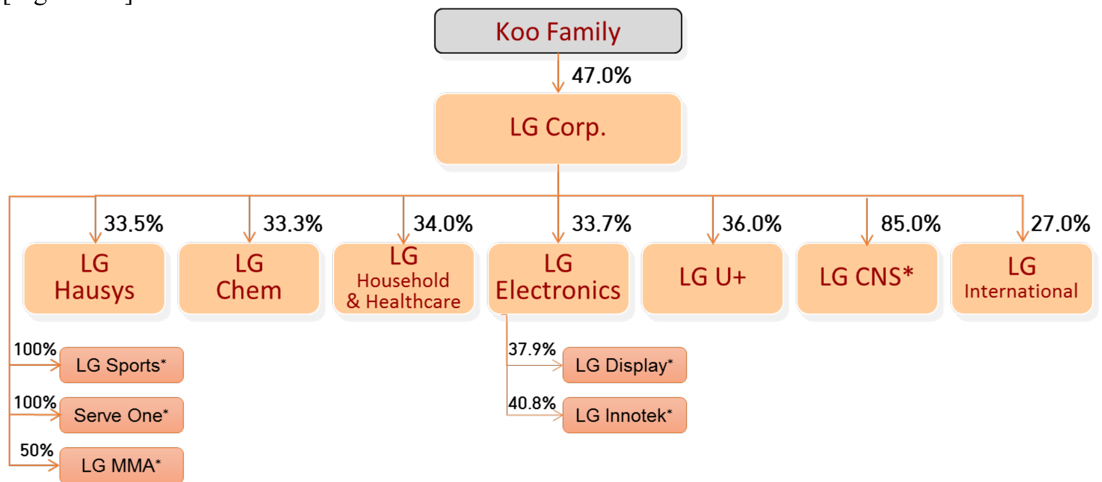
It is worthwhile to take a glance at a few distinctive features of Korean corporate governance to understand why a multiple derivative action became an issue. In Korea, a number of large business groups, commonly known as chaebol, dominate the corporate scene. Chaebol is usually defined as a large group of related corporations engaged in diverse lines of business under highly concentrated family or individual control.[34] Member companies of these business groups are legally independent but tied together by cross shareholdings, circular shareholdings, and pyramidal structures.[35] Among these structural devices, cross shareholdings and circular shareholdings are no longer allowed for a business group whose total assets exceed 10 trillion Won (approximately 9 billion USD),[36] and thus, many groups are using holding company structures that often have multi-layered, highly leveraged pyramidal

29. Article 403(6) of the KCC.
30. Article 403(7) of the KCC.
31. Article 405(2) of the KCC.
32. Article 405(1) of the KCC.
33. E.g., Seoul Central District Court, June 20, 2008, 2007gahap43745.
34. Hwa-Jin Kim, *Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea*, 17 BERKELEY J. INT'L. L. 61, 63 (1999).
35. Kyung-Hoon Chun, *Korea's Mandatory Independent Directors*, *in* INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL AND COMPARATIVE APPROACH (D. PUCHNIAK, H. BAUM AND L. NOTTAGE ED.) 18 (Cambridge University Press, 2017).
36. Monopoly Regulation and Fair Trade Law of Korea, Articles 9 and 9-2.

structures. Another noteworthy feature of Korean corporate governance is that even listed companies tend to have controlling shareholders, most of them being controlling minority shareholders.[37]

[Figure 2-1] shows ownership structures of a few key companies of LG Group, which converted into a holding company structure from a circular ownership structure. Other large business groups of Korea such as SK, CJ, GS and Hanhwa Groups adopted similar structures, while Samsung, Hyundai Motors, and Hyundai Heavy Industry Groups are still maintaining circular ownership structures. [Figure 2-2] shows ownership structures of Hana Financial Group, one of the largest financial groups in Korea. Other large financial groups in Korea such as KB and Shinhan adopted similar structures where each member companies are wholly or almost wholly owned by a holding company, which is owned by dispersed shareholders.

[Figure 2-1]



(*: non-listed companies)

[Figure 2-2]

37. *See* Ok-Rial Song, *The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol*, 34 LAW & POL'Y INT'L BUS. 183 (2002).

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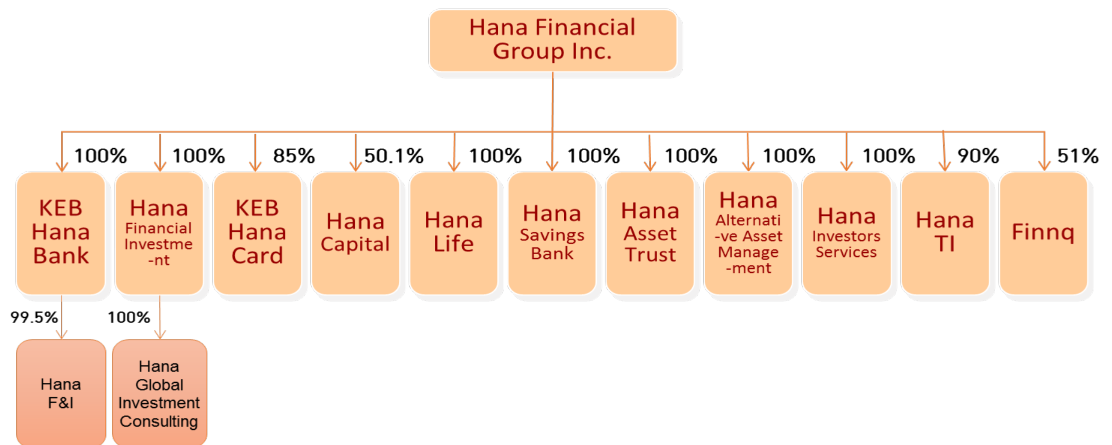

In these business groups, tunneling or other types of breach of fiduciary duty may take place at the level of unlisted subsidiaries by their directors while dispersed shareholders own shares in the holding company or listed subsidiaries. For example, a chaebol family member may set up a separate corporate vehicle and have it enter into transactions with unlisted subsidiaries of the group as a means of asset diversion from such subsidiaries. The directors of these unlisted subsidiaries are out of the reach of disciplinary power of the capital market or monitoring by the active shareholders. Nor do they have any fear of losing control of the subsidiary through a hostile takeover or a proxy fight.[38] In this context, multiple derivative actions were regarded, at least by some experts and activists, as tools for regulating the directors and officers of the unlisted subsidiaries. Without multiple derivative actions, directors and managers could insulate themselves from liability simply by adding another corporate layer.[39]

B. Supreme Court Case in 2004

The issue of a double or multiple derivative action began to attract the attention of certain shareholder activists in Korea in the early 2000s. They were in the midst of preparing to file derivative actions against controlling shareholders (who were usually board members as well) of certain chaebol companies because of committed crimes such as bribery or accounting fraud. In some instances, such wrongdoings were proved in a series of preceding criminal actions, and it was quite evident that such wrongdoings caused losses to the companies where the potential defendants were directors. In some cases, however, the direct victim of such misconducts was an unlisted subsidiary

38. Locascio, *supra* note 1, at 757.
39. *Id.*

rather than the listed parent company for which the activists could mobilize to-be-plaintiff shareholders. It raised the necessity of double or multiple derivative actions.

In 2004, while the activists were preparing to file a double derivative action against the directors of SK Shipping, an unlisted subsidiary of the SK Group, for using corporate funds for bribery,[40] the Supreme Court ruled in another case that a double derivative action is not allowed under Korean law.[41] This ruling itself involved a small private company which was not a part of a chaebol or large business group, but its effect was strong enough to dissuade the activists from seeking double derivative remedies against chaebol family members and management in other cases such as SK Shipping.[42]

Details of this 2004 Supreme Court case warrant a review. The defendant was a director of both a parent company and its subsidiary (the parent company held 80.55% of the issued voting stock of the subsidiary and both companies were unlisted ones). At the trial court, the plaintiff, who owned a 29.24% stake of the parent company, brought a standard derivative suit on the grounds that the defendant, as a director of the parent company, breached the fiduciary duty owed to the parent company and caused harm to the parent company. After this claim was dismissed by the trial court for lack of evidence, the plaintiff added a new cause of action in front of the appellate court by arguing that the defendant, as a director of the subsidiary, breached his fiduciary duty owed to the subsidiary and caused harm to the subsidiary (he allegedly embezzled assets of the subsidiary).[43] This added portion was a double derivative action because the plaintiff was a "shareholder of a shareholder of" the subsidiary that suffered alleged damage.

The appellate court held that a double derivative action was legitimate.[44] It stated that, ". . .it is difficult to prevent the indirect damage of the parent company caused by the wrongdoings of the subsidiary's director only by demanding that the parent company file a derivative action or by filing a derivative action against the directors of the parent company. . .," and further noted that ". . .a double derivative action may deter the wrongdoings of a subsidiary's directors, and indirectly reduces the losses of the parent company and its shareholders." It clearly took a practical approach by highlighting the

40. Jooyoung Kim, *Meaning of Introducing Double Derivative Actions Observed through Real Cases*, 25(4) COMMERCIAL LAW REVIEW 62, at 63 (2007) (in Korean). Jooyoung Kim, a famous litigation attorney practicing in Seoul, was the key member of People's Solidarity of Participatory Democracy, the NGO that organized and brought many derivative actions against chaebol companies.

41. Supreme Court, Sep. 23, 2004, 2003da49221.

42. Jooyoung Kim, *supra* note 40, at 64.

43. This new addition of a cause of action was neither time barred nor otherwise procedurally barred under Korean law.

44. Seoul High Court, Aug. 22, 2003, 2002na13746.

purposes of a derivative action, namely "deterrence of wrongdoing" and "recovery of loss."

The Supreme Court, however, reversed the appellate court's decision.[45] The court's logic was very simple and even blunt, as it stated, ". . .since the Article 403 of the KCC limits the standing of a derivative action to the shareholders of the company where the defendant is a director, the shareholder of a parent company lacks standing to bring a derivative action against the director of a subsidiary." While the appellate court took a functional approach by focusing on policy issues, the Supreme Court stuck to a literal interpretation of the KCC. It is one of many examples of the formalistic and faithful-to-the-letter attitudes of the Korean Supreme Court that is often witnessed in the field of corporate law.[46]

C. Debates

Debates on this case were two-folds. The first issue was whether the ruling of the Supreme Court was proper interpretation of the KCC. The second issue was whether the KCC should be amended to allow multiple derivative actions. With regards to the first issue, while certain commentators supported the appellate court decision,[47] more commentators in Korea agreed with the holding of the Supreme Court. The majority believed that, at least as a matter of interpreting current statutes, a double derivative action could not be allowed because the KCC limited the standing of a derivative action to the shareholders of the harmed company.[48]

However, even among those who agreed with the Supreme Court's decision, many were in favor of the idea that the KCC should be amended to explicitly allow double or multiple derivative actions. These commentators generally relied on policy arguments. Just as the appellate court of the 2004 case did, they pointed out the practical necessity of allowing multiple derivative

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45. Supreme Court, Sep. 23, 2004, 2003da49221.

46. Kon-Sik Kim, *The Role of Judges in Corporate Governance – The Korean Experience*, *in* TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA (ED. HIDEKI KANDA, KON-SIK KIM AND CURTIS J. MILHAUPT), 126-127 (Rutledge, 2008).

47. Tae-Jong Lee, *Double Derivative Actions under US Corporate Law*, 2 COURT PRACTICE RESEARCH 497, 510 (Suwon District Court, 1997) (in Korean) (stating that the concept of 'shareholder' can be interpreted to include 'shareholder of shareholder'); Ok-Rial Song, *Whether Double Derivative Actions are Allowed Under Current Korean Commercial Code*, 28 JOURNAL OF PRIVATE CASE LAW STUDIES 529, 543-551 (2006) (in Korean) (stating that the shareholder of a parent company falls under the concept of the shareholder of the company so long as their interests are aligned).

48. For example, CHUL-SONG LEE, LECTURE ON CORPORATE LAW 813 (Pakyoung-sa, 25 ed. 2017) (in Korean); BOK-KI HONG AND SE-HWA PARK, LECTURE ON CORPORATE LAW 541(Beobmun-sa, 5 ed. 2017) (in Korean); Jae-Yeol Kwon, *A Comparative Review of Whether a Double Derivative Suit is Recognized under the Current Laws of Korea*, 11(2) THE JOURNAL OF COMPARATIVE PRIVATE LAW 443, 470-471 (2004) (in Korean); Hong-Ki Kim, *Study of the Derivative Suit Cases*, 48(1) PUSAN NATIONAL UNIVERSITY LAW REVIEW 1079, 1099 (2007) (in Korean).

actions when a subsidiary and its parent willfully or negligently failed to enforce the subsidiary's cause of action against the wrongdoing directors. It would be even more necessary if the subsidiary had no other shareholder than the parent company. They argued that multiple derivative actions will help protect the interest of minority shareholders of the listed parent company and help improve corporate governance at the level of non-listed subsidiaries.[49]

Of course, certain commentators, as well as members of business community, were strongly against this "new statute" idea. They relied on a few arguments: (i) it will increase the number of frivolous lawsuits like in US and will create too many burdens and inefficiencies for the companies; (ii) it is against the doctrine of separate legal entities and unduly demurs the distinction between the parent and the subsidiary; (iii) a standard derivative action is sufficient because the parent's shareholders may demand the director of the parent file a derivative suit against the subsidiary's wrongdoing director, and if he doesn't follow that demand, then he can be sued derivatively by the parent's shareholders;[50] and (iv) allowing double derivative actions is inconsistent with the policy of the Korean government for the last 15 years, which recommended "a holding company structure" instead of "a circular ownership structure."[51]

Such a debate was not just academic or theoretical. In 2006, the Ministry of Justice of the Republic of Korea ("MOJ") released a draft KCC reform bill that

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49. For example, Jae-Bum Kim, *Legislation of Double Derivative Suit*, 25(4) COMMERCIAL LAW REVIEW 27, 52-53 (2007) (in Korean); Young-Hoa Son, *A Derivative Action of Parent Corporation Shareholder and Director's Business Judgement*, 17 COMMERCIAL CASES REVIEW 3, 47 (2004) (in Korean); Mi-Kyung Yum, *A Study on Introduction of Double Derivative Suit*, 13(4) THE JOURNAL OF COMPARATIVE PRIVATE LAW 467, 497-498 (2004) (in Korean); Jin-Hee Ryu, *Legislative Consideration on the Introduction of Double Derivative Suit*, 19(4) COMMERCIAL CASES REVIEW 121, 147-148 (2006) (in Korean); Hun-Jong Lee, *A Study on Legislation of the Multiple Derivative Suit*, 13(3) LAW AND POLICY REVIEW 1031, 1040 (2013) (in Korean); Byung-Seok Jeong, *Admissibility of the Double Derivative Suit*, 19(1) BUSINESS LAW REVIEW 343, 361 (2005) (in Korean); Eung-Ki Jung, *Who Should Have the Right of Derivative Suit for the Damages of a Corporation?*, 26(2) CHUNGNAM LAW REVIEW 151, 166-169 (2015) (in Korean).

50. For example, Jae-Yeol Kwon, *A Review of 2016 Proposed Amendments to Articles Regarding Derivative Actions under the Korean Commercial Code : In Comparison With Delaware Law and Cases*, 27(1) JOURNAL OF BUSINESS ADMINISTRATION & LAW 135, 156-158 (2016) (in Korean) (stating that multiple derivative action is not compatible with Korean law because it disregards distinction of legal personality between the parent company and the subsidiary); Jeong-Ho Kim, *A Study on the Path to Introduce the Multiple Derivative Suit in Korea*, 23(4) JOURNAL OF BUSINESS ADMINISTRATION & LAW 209, 248-250 (2013) (in Korean) (opposing to the idea of new legislation because it is better to wait case laws to evolve for fact patterns such as wholly-owned subsidiaries and piercing corporate veil); Wan-Jin Choi, *A Legal Study on the Double Derivative Suit*, 18(2) JOURNAL OF BUSINESS ADMINISTRATION & LAW 255, 271 (2008) (in Korean) (preferring case laws to evolve for specific fact patterns); June-Sun Choi, *Double Derivative Action*, 18(3) SUNGKYUNKWAN LAW REVIEW 433, 462 (2006) (in Korean) (opposing to the idea of new legislation because it can be acknowledged by piercing corporate veil).

51. It is true that for the last 15 to 20 years the Korean government has recommended chaebol groups to deconstruct circular ownership structures and adopt holding company structures because the latter is generally more transparent and less problematic (in terms of the gap between cash flow rights and control) than the former. However, if double/multiple derivative actions are allowed, business groups that converted into a holding company structure will be more vulnerable to those actions.

included a new provision explicitly allowing double/multiple derivative actions.[52] It provided that shareholders who own at least 1% (0.01% in the case of a listed company) of the issued shares of the parent company may bring a suit against the director of the subsidiary, after submitting a written demand to sue to the subsidiary and waiting 30 days. It also granted a right to inspect books and records of the subsidiary to the shareholders who own at least 3% of the issued shares of the parent company. Since a subsidiary of a subsidiary is defined as a "subsidiary" of the parent company under the KCC,[53] the proposed draft in effect also allowed multiple derivative actions not only double derivative actions. The MOJ's bill faced strong criticism from the business community, especially the Federation of Korean Industries, a main trade association for large business groups.[54] As a result, it was omitted from the final bill submitted by the MOJ to the National Assembly in late 2006.[55]

In 2012, the issue of double and multiple derivative actions arose again because of the so-called "Economic Democratization,"[56] the main campaign agenda of Presidential Candidate Park Geun-Hye. The "Economic Democratization" included various proposals for corporate governance reform. "Allowing multiple derivative actions" was one of Park's campaign promises and was even contained in a campaign leaflet of Park's camp as an item of economic democratization. After Park won the presidential election in 2012, the MOJ once again proposed an amendment to the corporate law chapter of the KCC that included multiple derivative actions pursuant to Park's campaign promises.[57] Apparently in the face of organized resistance from the business community, however, the MOJ stopped the entire process of amending the KCC.[58]

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52. Ministry of Justice, Public Notice 2006-106 (Oct. 4, 2006).

53. Article 342-2(3) of the KCC.

54. Kon-Sik Kim, *supra* note 46, at 127.

55. Hyeok-Joon Rho and Kon-Sik Kim, *Invigorating Shareholder Derivative Actions in South Korea*, *in* THE DERIVATIVE ACTION IN ASIA (DAN PUCHNIAK, HARALD BAUM, MICHAEL EWING-CHOW ED.) 199 (Cambridge University Press, 2012).

56. Its exact meaning is still (maybe inherently) unclear, but it generally encompassed various "progressive" smaller agenda items such as stronger regulation of conglomerates, distribution of market power, protection of minority shareholders, assistance to small and medium enterprises, and so on. Ironically, this agenda was preempted and fully utilized by Park Geun-Hye, the candidate of the conservative party, in 2012 presidential election.

57. Ministry of Justice, Public Notice 2013-162 (Jul. 17, 2013). Other items for proposed changes included mandatory cumulative votes, mandatory electronic votes, separation of the board chair and the CEO, and separate election of directors who will be audit committee members. All of these changes were proposed for the large listed firms exceeding certain size thresholds.

58. After the MOJ's announcement of the draft amendment on July 17, 2013, major newspapers in Korea opposed the amendment through editorials. On August 27, 2013, the chairmen (controlling shareholders) of the top ten Korean chaebols were invited to a meeting with the President, and the President was reported to have said that, "I understand your concerns about the amendment of the KCC and the government will be more cautious in proceeding." After that meeting, the MOJ did not take any further action for the amendment of the KCC until a new President was elected in 2017.

In 2016 and 2017, the debate surfaced again when dozens of bills were submitted to the National Assembly to amend the corporate law chapter of the KCC. This time, dozens of congressmen submitted various bills on corporate governance issues, and at least six bills specifically included double/multiple derivative actions. They are still pending at the National Assembly as of August 2018.

D. Bills of 2016 and 2017

Bill No. 645, submitted by Congressman Jong-In Kim,[59] was the initial bill that proposed to amend the KCC. It states that, ". . .a shareholder who owns at least 1% (0.01% in the case of a listed company) of the issued shares of the parent company may demand the subsidiary bring a suit against the director of the subsidiary. . .," and, if the demand period of 30 days elapses, a shareholder can file a double derivative action against the subsidiary's director on behalf of the subsidiary. Here, the subsidiary is defined as a company in which the parent company holds more than 50% of the total number of issued shares pursuant to the KCC.[60]

Bill No. 3254, submitted by Congressman Jong-Geol Lee,[61] has two additional features on top of the foregoing bill. First, shareholders who own 1% or more of the issued shares of the parent company have a right to inspect the books and records of a subsidiary ("double inspection right"). Second, those shareholders of a parent company may ask the court to appoint an examiner who is authorized to examine the business affairs and assets of the subsidiary when there is suspicion of a material violation of the law or the articles of incorporation by the management of a subsidiary.

Bill No. 1463, submitted by Congressman I-Bae Chae,[62] recognizes double/multiple derivative actions when one company has more than 30% (as opposed to 50% in the bills of Jong-in Kim and Jong-Geol Lee) of the issued shares of the other company. It also lowers the minimum shareholding requirement for a listed company to 0.001% (for six months) and acknowledges inspection rights of the parent company's shareholders into the books and records of the subsidiaries.

59. Bill No. 645, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated July 4, 2016.

60. Article 342-2(1) of the KCC.

61. Bill No. 3254, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated November 3, 2016.

62. Bill No. 1463, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated August 8, 2016.

Bill No. 2091, submitted by Congressman Hoe-Chan Roh,[63] proposes the most shareholder-friendly scheme.[64] It proposes to abolish the minimum shareholding ratio requirement for derivative actions in general. Thus, any shareholder holding at least one share (as opposed to 1% or 0.01%, as the current law says) of a company for 6 months may bring a derivative action. Also, it recognizes a "parent-subsidiary" relationship when a company has more than 30% of the issued shares of the other company, or otherwise has "de facto control" over the other company. Thus, if Company A has "de facto control" over Company B, then a person who has held one share of Company A for at least 6 months may bring a double derivative action against a director of Company B.

In contrast to the shareholder-friendly schemes proposed by the other bills, Bill No. 7863, submitted by Congressman Sang-Jik Yoon,[65] reflects the opinions of the business community.[66] It allows double derivative actions only for wholly-owned subsidiaries (similar to Japanese law as discussed below in IV.2) and requires court approval before bringing a suit. Thus, if the subsidiary has any shareholder other than the parent company, then a shareholder of the parent company is barred from bringing a double derivative action against the directors of the subsidiary. The minimum shareholding requirement for double derivative actions is 1% for both listed and unlisted companies, the highest ratio among the bills.

The key features of these five bills can be summarized as below:[67]

[Table 1] Key Features of Recent Bills Regarding Multiple Derivative Actions

	Kim's Bill	Lee's Bill	Chae's Bill	Roh's Bill	Yoon's Bill
Plaintiff Requirement	1% (unlisted); 0.01% + 6 months (listed)		1% (unlisted); 0.001% + 6 months (listed)	1 share + 6 months (listed and unlisted)	1% (listed and unlisted) + court approval
Parent-Subsidiary Requirement	more than 50%	more than 50%	more than 30%	more than 30% or de facto	100%

63. He is a member of Justice Party, currently the most progressive party in the National Assembly.

64. Bill No. 2091, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated September 2, 2016.

65. He is a member of Liberty Korea Party, currently the most conservative party in the National Assembly.

66. Bill No. 7863, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated July 10, 2017.

67. In addition to the five bills discussed above, Bill No. 5633, amendment to the KCC (*Sangbeon-ilbu-gaejeong-beobryul-an*), dated February 14, 2017 was submitted by Congressman Shin-Hwan Oh. However, so long as the multiple derivative action is concerned, this bill is almost same as the bill submitted by Jong-In Kim.

				control	
Multiple Inspection Right	No	Yes	Yes	Yes	No
Court Appointed Examiner	No	Yes	No	No	No

A glance at these bills reveals that, despite the quite technical nature of multiple derivative actions, dynamic debates are being conducted on a political, rather than theoretical, dimension. Congressmen from a progressive party propose bringing down the hurdle as low as possible, while congressmen from a conservative party propose stricter requirements. To find benchmarks beyond mere reflection of political stances, we need to look at the laws of other major jurisdictions for reference.

PART IV: A COMPARATIVE SKETCH

A. United States

The courts of many states in US have allowed double or multiple derivative suits since the late 19th century without any statutory grounds.[68] A double or multiple derivative action has "met with nearly universal acceptance"[69] and "has not been judicially challenged since [its recognition]."[70] Although the

68. "The double derivative action is a long-standing doctrine of equity jurisprudence, having been woven into the quiltwork of equitable principles covering shareholder-corporate relations over a century ago." Brown v. Tenney, 125 Ill. 2d 348, 359 (Supreme Court of Illinois, 1988). Earlier literatures on this subject include: Note, *Remedies of Stockholder of Parent Corporation for Injuries to Subsidiaries*, 50 HARV. L. REV. 963 (1937); Note, *Suits by a Shareholder in a Parent Corporation to Redress Injuries to the Subsidiary*, 64 HARV. L. REV. 1313 (1951); Note, *Corporations - Triple Derivative Suit Allowed in Absence of Controlling Interest*, 25 FORDHAM L. REV. 140 (1956); Comment, *Corporation – A Multiple Derivative Action is Valid in Certain Instances Though the Corporation in Which Plaintiff Holds Shares Does Not Own a Controlling Interest in the Corporation Which Controls the Corporation in Whose Behalf Plaintiff Sues*, 44 GEO. L.J. 334 (1956); Note, *Corporations – An Examination of the Multiple Derivative Suit and Some Problems Involved Therein in Light of the Theory of the Single Derivative Suit*, 31 N.Y.U.L. REV. 932 (1956).

69. Brown v. Tenney, *Id.*, at 359 (adding that "[cases] which assertedly have not recognized the double derivative cause of action do not involve a holding company-subsidiary company context; rather, they involve survival of actions after a corporate merger").

70. BLUMBERG, STRASSER, GEORGAKOPOULOS, AND GOUVIN, BLUMBERG ON CORPORATE GROUPS (SECOND EDITION), Wolters Kluwer (supplemented in 2013), §44.02 (44-4). Contrary to this firm statement, a ruling of Southern District Court of New York is cited as a case that disallowed a double or multiple derivative action (Locascio, *supra* note 1, at 730-734). It held that a shareholder of a corporation which owned all of the stocks of an issuer did not have standing to bring a suit on behalf of the issuer to recover short-swing profits based on section 16(b) of the Securities Exchange Act of 1934. However, at issue in this ruling was how to interpret the statutory requirements under section 16(b) rather than whether to allow a multiple derivative action in general. The court also said that "[t]he

doctrine itself was firmly established, the underlying theory was neither clear nor consistent.

In the early 20th century, certain courts have justified double derivative suits by relying on the theory of "piercing the corporate veil" – in other words, by treating the parent company and subsidiary as one entity.[71] However, the veil-piercing theory severely limits the application of double derivative suits, because courts tend to pierce the corporate veil only in exceptional circumstances where (i) the corporation and its owners are so commingled that they cannot be regarded as separate personalities and (ii) continued separate corporate existence would result in a fraud or injustice.[72] Also, there is no logical basis for double derivative suits being only allowed when the parent company and the subsidiary are so commingled that their respective corporate entities are disregarded. Therefore, for the past several decades, it appears that US courts have no more required "piercing the corporate veil" as a precondition for allowing a double derivative suit.[73]

Certain other courts justified double derivative actions by a theory of common control. In United States Lines,[74] the second circuit court found the justification to be the control exercised by the alleged wrongdoers over both the parent and the subsidiary. It stated that "the justification for allowing a double derivative suit [. . .] is that both the original corporation that is said to have suffered wrong and its shareholder corporation which had the right to bring a derivative suit were in the control of those charged with inflicting the corporate injury."[75] Under such circumstances, "it would be naïve to expect those on the board of directors of either corporation to vote in favor of either a direct or a simple derivative action."[76] However, while the court seriously considered the situation where both a parent and a subsidiary were under the control of the wrongdoer, it is questionable whether the court strictly required such a situation as a prerequisite for allowing a double derivative action. Subsequent court rulings focused on the practical necessity of a double derivative action instead

validity of multiple derivative suits in other contexts does not justify circumvention of section 16(b)'s specific standing requirements." Untermeyer v. Valhi, Inc. 665 F. Supp. 297, 299 (S.D.N.Y. 1987).

71. For example, Hirshhorn v. Mine Safety Appliances Co., 54 F. Supp. 588, 592 (W.D. Pa. 1944); Martin v. D.B. Martin Co., 10 Del. Ch. 211, 88 A. 612, 614 (1913). However, as to *Hirshhorn*, Professor Painter commented that "[it relied] on the concept of disregard of the corporate entity [. . .] as an alternative ground for the holding rather than an exclusive test of the right to bring a double derivative action." Painter, *supra* note 2, at 149.

72. Painter, *supra* note 2, at 147-150; Locascio, *supra* note 1, at 744-745.

73. BLUMBERG ET. AL., *supra* note 70, at §44.02 [D] (44-7) ("[i]t is plain today that the basis of the multiple derivative action does not rest on the lack of a separate and distinct existence of the subsidiary").

74. United Stated Lines, Inc. v. United States Lines Co., 96 F.2d 148 (2nd Cir. 1938).

75. *Id.* at 151.

76. Painter, *supra* note 2, at 151.

of requiring a "theory" that would justify it such as veil piercing or common control.[77]

Another issue is how much ownership the parent company must have over the subsidiary in order to justify double derivative suits. Many courts have allowed double derivative suits when the parent company had less than complete ownership over the subsidiary.[78] One court clearly stated that " [s]uit by the stockholder of a parent corporation need not be limited only to situations in which the subsidiary is wholly owned or in which there is no one else who can sue."[79] However, no court dared to specify the parent's ownership threshold as a number, and certain courts explicitly declined to specify a minimum stock ownership ratio required for bringing a double derivative suit.[80]

Cases and theories of US discussed thus far are rather old, but courts have continued to acknowledge double or multiple derivative actions. In the 2010s, for example, a double derivative suit (the Lambrecht case)[81] and a triple derivative suit (the Sagarra case)[82] were allowed for wholly owned subsidiaries in Delaware. The Lambrecht case deserves a closer review.

It involved actions brought by the shareholders of a company which was later acquired by another company by way of a stock-for-stock merger.[83] The

77. For example, ". . . realities have brought recognition of the right of the stockholder to bring suit not only for wrongs inflicted directly on the corporation in which he holds stock, but for wrongs done to that corporation's subsidiaries which make indirect, but nonetheless real, impact upon the parent corporation and its stockholders." Kaufman v. Wolfson, 1 A.D.2d 555, 556-557 (1956); "Unexamined observance to rigid and outmoded theories may result in inequitable decisions that fail to comport with the realities of corporate structure. For these reasons, we believe that double derivative suits should become part of the law of this State." Brown v. Tenney, 155 Ill. App.3d 605, 609 (1987).

78. Birch v. McColgan, 39 F. Supp. 358 (S.D. Cal. 1941) (49% ownership); Hirshhorn v. Mine Safety Appliances Co., 54 F. Supp. 588 (W.D. Pa. 1944) (60%); Craftsman Fin. & Mortgage Co. v. Brown, 64 F. Supp. 168 (S.D.N.Y. 1945) (50%); Kaufman v. Wolfson, 1 A.D.2d 555 (1956) (not specifying the percentage, but stating that "the guiding consideration must be control"); Issner v. Aldrich, 254 F. Supp. 696 (D.Del. 1966) (implicitly recognizing the right of a shareholder of a Virginia corporation to bring a double derivative action on behalf of the corporation's 50% owned subsidiary); Carlin v. Brownfield, 1985 WL 10327 (Oh. Ct. App. June 18, 1985) (98%).

79. Kaufman v. Wolfson, 1 A.D.2d 555, 557 (1956).

80. Painter, *supra* note 2, at 150; Saltzman v. Birrell, 78 F. Supp. 778, 784 (S.D.N.Y. 1948) (stating "nor does it appear a wise course to establish [. . .] a minimum requisite stock ownership by the parent in the subsidiary for institution of a multiple derivative suit").

81. Lambrecht v. O'Neal, 3 A.3d 277 (Del. 2010).

82. Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074 (Del. 2011).

83. Lambrecht v. O'Neal, 3 A.3d 277, 280-281 (Del. 2010). Originally, shareholders of Merrill Lynch filed standard derivative actions against the senior management and directors of Merrill Lynch for breach of their fiduciary duties to recover losses Merrill Lynch suffered. While the actions were pending, Merrill Lynch became a wholly-owned subsidiary of Bank of America through a stock-for-stock merger and the plaintiffs' Merrill Lynch shares were converted to shares of Bank of America. The US District Court for the Southern District of New York ("S.D.N.Y.") dismissed the standard derivative actions because the plaintiffs were no longer shareholders of Merrill Lynch, but without prejudice to plaintiffs' repleading their actions as double derivative actions. After the dismissal, one of the original plaintiffs repled the claim to be double derivative, and the other plaintiffs filed a new lawsuit that took the form of a double derivative action. Since the Merrill Lynch was a Delaware corporation, the S.D.N.Y. certified a question of law to the Supreme Court of Delaware. *Id.* at 279. The main holding of

court categorized double derivative actions into two distinct groups. The first are lawsuits that are brought originally as double-derivative actions from the beginning, where the parent company has a pre-existing subsidiary at the time of the alleged wrongful conduct at the subsidiary level.[84] The second category involves cases where the action is brought originally as a standard derivative action on behalf of a company, but the company is later acquired by another corporation by way of a stock-for-stock merger.[85] In the second category, the plaintiff was a shareholder of the company at the time of filing a suit, but becomes a shareholder of the parent of the company after the stock-for-stock merger. The Lambrecht case fell under the second category (which is not a main concern of this article), but it did, in dictum, summarize the nature and reason for a double derivative action in the first category:

> [M]ismanagement and breaches of fiduciary duty by the directors of the subsidiary [. . .] resulted in harm to the subsidiary and, consequently, to the parent as the subsidiary's only shareholder. In these circumstances, our law recognizes a right to proceed double derivatively. Otherwise, there would be no procedural vehicle to remedy the claimed wrongdoing in cases where the parent company board's decision not to enforce the subsidiary's claim is unprotected by the business judgment rule.[86]

Although courts in other states such as California, New York, and Pennsylvania have allowed double or multiple derivative suits to be brought and maintained when the parent company owns less than 100% shares of the subsidiary,[87] the Delaware court has not opined as to whether this is allowed. In Lambrecht, the court intentionally avoided this issue:

> Within this first category there is a subset of cases where the parent owns a controlling – but not 100% – of the subsidiary. In those cases a minority shareholder of the subsidiary [. . .] could bring a standard derivative action on the subsidiary's behalf. In that scenario, a question that logically arises is whether, in addition to that standard remedy, a shareholder of the parent company could assert a double derivative claim. [Courts of some states recognize such right.] To date, the Delaware courts have not addressed this specific question nor do we purport to do so, expressly or implicitly, in this Opinion.[88]

B. Japan

In Japan, the need for double or multiple derivative actions was generally recognized as a means to control the directors and officers of the unlisted

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the Lambrecht decision was that, in the cases falling under the second category, "the shareholders were not required to demonstrate that they owned stock in acquiring corporation and that acquiring corporation owned stock in acquired corporation at the time of alleged wrongdoing." *Id.* at 277. In other words, the contemporaneous ownership requirement is not strictly applied in the second category cases.

84. *Id*. at 282.
85. *Id*.
86. *Id.* at 282-283.
87. *Supra* note 78.
88. 3 A.3d 277, at 283.

subsidiaries of listed firms. After a long process of review and discussion, the Japanese Corporate Law (kaishaho) was amended on June 20, 2014 with, among others, a complicated new provision (Article 847-3) on multiple derivative actions. However, its scope is very limited.

First, a shareholder bringing a claim must be part of a "final complete parent company (FCP)."[89] For example, if Company A owns 100% of Company B, and Company B owns 100% of Company C, then Company A is the FCP of Company C. If Company B owns 100% minus one share of Company C, then Company A is not the FCP of Company C and a shareholder of Company A cannot bring a multiple derivative suit on behalf of Company C. FCP can be recognized by aggregating intermediary subsidiaries' shareholdings. For example, if Company A wholly owns Company B and Company C, and each of Company B and Company C owns 50% of Company D, then Company A is the FCP of Company D.[90] Again, if one single share of Company D is owned by an outsider, Company A ceases to be the FCP of Company D.

Second, the plaintiff must have owned at least 1% of the total voting rights, or 1% of the total issued shares, of the FCP for at least 6 months.[91] Japanese corporate law, unlike Korean law, allows a shareholder who has owned any share of the company for at least 6 months to bring a standard derivative action without requiring a minimum shareholding ratio.[92] However, in a double or multiple derivative action setting, Japanese law requires the minimum shareholding ratio.

Third, only those subsidiaries which are "material" in size compared to the size of the FCP are subject to the multiple derivative actions. Materiality or size of the subsidiary is measured by the book value of its shares. That is, multiple derivative actions are allowed only when the book value of the shares of the relevant subsidiary exceeds 20% of the total assets of the FCP at the time when the cause of action occurred.[93] Thus, even if a director of Subsidiary A willfully caused serious damage to Subsidiary A (and indirectly harmed the FCP), if the book value of the shares of Subsidiary A is less than 20% of the

89. Article 847-3(1) of the Company Act of Japan (*Kaishaho*).

90. Article 847-3(2)(ii) of *Kaishaho*.

91. Article 847-3(1) of *Kaishaho*. The six-month holding period is not required when the FCP is a "closed company," meaning that transfer of the shares of the FCP requires the FCP's approval in accordance with its articles of incorporation. Articles 847-3(6) and 2(v).

92. Article 847(1) of *Kaishaho*. The six-month holding period is not required when the company is a "closed company," meaning that transfer of the shares of the company requires the company's approval in accordance with its articles of incorporation. Articles 847(2) and 2(v).

93. Article 847-3(4) of *Kaishaho*.

total assets of the FCP, then the shareholders of the FCP are barred from bringing a multiple derivative suit against such a director.[94]

There are further details to note in this Japanese version of multiple derivative suits,[95] but the foregoing three requirements are already quite restrictive and criticized by some commentators.[96] In Korea, those who oppose the idea of adopting multiple derivative actions by statute highly praise the Japanese law as a "considerate and careful approach."

C. United Kingdom

In the UK, derivative claims were originally developed by the common law as an exception to the rule in Foss v Harbottle[97] that only the company itself has standing to pursue a claim for its losses. In 1990s, the Law Commission reviewed whether a multiple derivative action should be recognized as a remedy for shareholders in addition to a standard derivative action. While it noted that double derivative actions are available in Canada under the Canada Business Corporations Act of 1985 and multiple derivative actions are available in New Zealand,[98] the Law Commission decided not to include multiple derivative actions in developing the Companies Act of 2006 on the ground that situations calling for its use would be "extremely rare" and that it would not be helpful or practical to include such a provision.[99] Although the Company Law Review Steering Group suggested that "rules for a double derivative action should be devised,"[100] the Companies Act of 2006 ("Act") has no provisions on

94. This "materiality" requirement was introduced to balance the liability of subsidiaries' directors and that of the senior employees of the parent company. In terms of hierarchy within a corporate group, directors of small subsidiaries are often in a status corresponding to, or even lower than, the senior employees of the parent company. If the former is exposed to the risk of being sued while the latter is not, the balance would be impaired. It was the reason for introducing "materiality" requirement. YOICHI TAKAHASHI, IDEAL MODEL OF MULTIPLE DERIVATIVE ACTION SYSTEM 269 (Shojihomu, 2015) (in Japanese).

95. For example, the shareholders of the FCP have to first demand the relevant subsidiary to file a suit against the wrongdoing directors, and if the subsidiary fails to file a suit within 60 days, then the demanding shareholders of the FCP are allowed to file a suit on behalf of the relevant subsidiary. Article 847-3(7) of *Kaishaho*.

96. For example, a monograph on this issue written in Japanese opposes such a restrictive approach. Yoichi Takahashi, *supra* note 94, at 266 (criticizing restriction to "completely owned subsidiaries"), at 271 (criticizing "size of subsidiary" requirement), at 276 (arguing that a holder of one share should be allowed to bring a suit).

97. *Foss v Harbottle* (1843) 2 Hare 461.

98. Law Commission, *Shareholder Remedies* (Consultation Paper No. 142, 1996), Appendix F para 2.6 and 4.3.

99. Law Commission, *Shareholder Remedies* (Law Commission Report No. 246, 1997), para 6.110.

100. Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (March 2000), para. 4.133.

double or multiple derivative actions.[101] Silence of the Act on this issue was criticized by some commentators.[102]

Contrary to the Law Commission's projection, such situations were far from "extremely rare." In Fort Gilkicker, the High Court had to determine two issues: whether the English common law recognized double derivative actions prior to the enactment of the Act and, if it did, whether the common law double derivative actions were abolished upon the introduction of the Act.[103] As for the first issue, the court noted that common law derivative actions typically involved conferral of locus standi upon members of the wronged company and that there were reported examples where locus standi was conferred upon a member of its holding company, when the holding company was itself subject to the same wrongdoer control as the company. As for the second issue, the court found that the Act did not abolish common law double derivative actions.[104] Two years later, in Bhullar, the High Court reaffirmed that the Act has not taken away the power of shareholders to bring a double derivative action and recognized one brought by a shareholder of a parent company against a director of a wholly owned subsidiary.[105]

These decisions in UK affected a famous multiple derivative action in Hong Kong, brought by a minority shareholder in a parent company for wrongs allegedly done to the parent company's sub-subsidiary.[106] The parent company was a Bermuda company and the subsidiary and the sub-subsidiary were incorporated under the law of the British Virgin Island ("BVI"). The defendant raised a defense that the BVI law should govern the case and that the multiple derivative action is not maintainable under the BVI law. The Court of Appeal ruled that such defense was too late to be raised, and further ruled that, even if such a defense was not time-barred, the merit of the case would not change because the BVI court would most probably acknowledge a multiple derivative

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101. Chapter 1 of Part 11 of the Act prescribes the conditions for bringing a derivative claim. Section 260 of the Act provides that the Chapter applies to proceedings "*by a member of a company*" seeking relief on behalf of the company in respect of a cause of action vested in the company.

102. ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE 202 (Oxford University Press, 2007) states that such silence of the 2006 Company Act is "regrettable" and argues for acknowledging multiple derivative actions. Lord Millett, writing in an extra-judicial capacity, wrote that abolition of double derivative claims would give potential fraudsters a simple moral, "*choose an English company and be careful to defraud its subsidiary and not the company itself*" (Millett, *Multiple Derivative Actions*, THE GORE-BROWNE BULLETIN, July 2010, pp. 1-4).

103. Universal Project Management Services Ltd v Fort Gilkicker Ltd [2013] EWHC 348.

104. Statute will be construed as taking away common law rights only if it does so expressly or by necessary implication (*Islington Borough Council v Uckac* [2006] 1 WLR 1303). In this case, according to the court, while the Act abolished common law rights in relation to the derivative claims by members, the abolition was neither express nor a necessary implication in relation to the double derivative claims by members of the holding company.

105. Bhullar v Bhullar [2015] EWHC 1943 (Ch).

106. Waddington Ltd v Chan Chun Hoo Thomas & Ors [2016] (CACV 10/2014).

action at common law. The Fort Gilkicker decision was cited as an important authority.

Thus, like the US, the UK courts acknowledged double derivative actions as a matter of common law without statutory grounds. It is not certain, however, whether such a ruling will be valid when the parent owns less than 100% of the shares issued by the subsidiary.

PART V: ISSUES TO BE CONSIDERED FOR LEGISLATION

Based on the above comparative review, we note that there are a few issues to be considered and addressed when preparing a law on multiple derivative actions. The first issue would be whether any statute is necessary at all – whether the doctrine of "piercing the corporate veil" is sufficient to protect the shareholders of a parent company from wrongdoings done at the level of subsidiaries. Arguments that a standard derivative action against the parent company's directors is sufficient also warrant a review. The question of whether multiple derivative actions should be allowed when the parent has less than complete ownership of the subsidiaries is still an open question, as considered in many US cases. Whether the subsidiary must be "material" in size as required under Japanese law is another point to consider.

A. Is "Piercing the Corporate Veil" Sufficient?

A number of Korean scholars still argue that multiple derivative actions can and should be allowed only when the corporate personality of a subsidiary is disregarded in accordance with the doctrine of "piercing the corporate veil."[107] They argue that there is no need to explicitly allow multiple derivative actions by statute. A few US cases based on such a doctrine[108] are cited to support their arguments.

This is based on a misunderstanding of the nature of multiple derivative actions. When a subsidiary suffers losses due to a breach of fiduciary duty by its director or officer, the claim (or cause of action) belongs to the subsidiary. Whether (i) the subsidiary itself enforces the cause of action, (ii) the parent company derivatively enforces the cause of action, or (iii) a shareholder of the parent company double-derivatively enforces the cause of action, the intended result is the same: transfer of wealth from the defendant to the subsidiary for the recovery of the losses incurred by the subsidiary. The difference among these three instances is merely who brings the case to the court as a plaintiff, and the derivative or double-derivative plaintiff is more like an agent than a principal because the substantive claims, or causes of action, are not vested

107. *Supra* note 50.
108. *Supra* note 71.

with the plaintiff. Thus, if a standard derivative action does not pierce the corporate veil of the company, neither does a multiple derivative action.

We pierce the corporate veil of the subsidiary when we attempt to pursue the liability of someone standing behind the veil. In the context of a multiple derivative action, however, we are not seeking payment from behind the veil, but authorizing someone higher up in the ownership chain to enforce the subsidiary's claim. There will be many situations where multiple derivative actions are necessary to protect the shareholders of the parent company even though the corporate veil of the subsidiary cannot be pierced under the doctrine. Therefore, resorting to the doctrine of "piercing the corporate veil" to justify a double derivative suit is simply irrelevant.[109]

B. Is a Standard Derivative Action Sufficient?

There are also arguments that a standard derivative action is sufficient to address wrongdoings done at the subsidiary level. According to this argument, the shareholders of a parent company may pursue the liability of the directors of the parent company for failure to monitor the subsidiary's management or for failure to seek proper remedies against such wrongdoers on behalf of the relevant subsidiary.[110]

Theoretically, this argument could have merit given that it is the directors of a parent company who owe a fiduciary duty to the shareholders of the parent company. The fiduciary duty of the directors of a parent company include monitoring the directors of a subsidiary and, if the directors of a subsidiary commit wrongdoing, seeking proper remedies such as filing a standard derivative action on behalf of the subsidiary.

Practically speaking, however, seeking the liability of a parent's directors for the wrongdoings of a subsidiary's directors would be very difficult, and almost impossible under the current civil practices of Korea. In order to seek the liability of a parent's directors for the wrongdoings of a subsidiary's directors by way of a standard derivative action, the plaintiff shareholder must prove (i) that the parent's directors breached their fiduciary duty by failing to monitor the subsidiary's directors or by failing to seek proper remedies, (ii) that the parent incurred losses, and (iii) causation between the parent's losses and the breach of fiduciary duty by the parent's directors. On the contrary, in order to seek the liability of a subsidiary's directors by way of a double derivative action, the plaintiff shareholder must prove (i) that the subsidiary's directors breached their fiduciary duty through the wrongdoings in question, (ii) that the

109. See also *supra* note 73.

110. See Locascio, *supra* note 1, at 735-739 (focusing on the failure to take remedies to protect a parent's investment in a subsidiary). Locascio's article introduces such an argument, but does not support it.

subsidiary incurred losses, and (iii) causation between the subsidiary's losses and the wrongdoings of the subsidiary's directors. The latter is much easier to prove than the former.

For example, when a director of a subsidiary embezzles its money, a plaintiff who is double-derivatively bringing an action has only to prove that the defendant (director of the subsidiary) embezzled the subsidiary's money and that this caused harm to the subsidiary. In other words, in a double derivative action, the defendant and the initial wrongdoer is the same person, so the plaintiff has only to prove the wrongdoing and its monetary impact on the subsidiary. On the other hand, a plaintiff who is seeking the liability of a parent's directors has to prove that the defendants (parent's directors) failed to properly monitor, or to take proper actions against, the subsidiary's director and that the parent incurred losses due to such failure. Here, the defendants and the initial wrongdoer are different, so the plaintiff must prove the wrongdoing of the subsidiary's director, the defendants' breach of fiduciary duty in preventing or taking actions against the wrongdoing, and its monetary impact on the parent company.

When a plaintiff relies on a standard derivative suit, the defendants (directors of the parent company) may argue that they could not detect and prevent the wrongdoings of the subsidiary's director even though they performed their fiduciary duty. Or the defendants may argue that only a portion of the embezzled money can be attributable to the breach of fiduciary duty of the parent's directors. Another difficult problem is measuring damages – because the subsidiary and not the parent actually suffers the direct injury, valuation of the indirect harm to the parent is more difficult than assessing the direct harm to the subsidiary.[111] It would be very difficult to overcome these arguments and finally prove that the parent's losses were caused by a breach of fiduciary duty of the directors of the parent with respect to the wrongdoings committed by the subsidiary's directors.

Considering such difficulties, double or multiple derivative actions are necessary to recover the losses of a subsidiary (which will indirectly benefit the parent, and then the parent's shareholders)[112] and deter wrongdoings that may be committed at the level of subsidiaries.[113] A standard derivative action against the parent's directors cannot be a satisfactory alternative.

111. Locascio, *supra* note 1, at 735-736.
112. Locascio, *supra* note 1, at 755-756.
113. Locascio, *supra* note 1, at 756-758.

C. Must There Be Complete Ownership?

It is true that multiple derivative actions are easier to justify when there is no other shareholder of the subsidiary. If there is a shareholder of a subsidiary other than its parent company, then such a shareholder may exercise a derivative remedy against the subsidiary's director, in which case the need for a double derivative remedy decreases.

Such an argument, however, cannot form reasonable grounds to require complete ownership by the parent company over the subsidiary, such as in Japanese law. First, it is only a possibility that such an outside shareholder would exercise a derivative remedy. If that outside shareholder does not enforce the subsidiary's claim derivatively, then the need for a multiple derivative remedy still exists. In particular, if such an outside shareholder is a related party to the controlling shareholder of the parent company or the potential defendants, the existence of such an outside shareholder does not affect the need for a multiple derivative action. In addition, since Korean law requires a 1% shareholding ratio for filing a derivative action regarding an unlisted company, the outside shareholders must own at least 1% to bring a derivative action. Second, if we allow multiple derivative actions only for wholly owned subsidiaries, companies can easily circumvent the risk of litigation by selling just one share to a party other than the parent company.

Therefore, as cited above, "[s]uit by the stockholder of a parent corporation need not be limited only to situations in which the subsidiary is wholly owned or in which there is no one else who can sue."[114] Then, the next issue is how to define a parent-subsidiary relationship where multiple derivative actions are allowed. There could be a few legislative alternatives: (i) clearly providing a shareholding ratio number, or (ii) providing a flexible standard such as "de facto control" or "complete control." In this regard, the KCC already defines a "Subsidiary" as a company where another company ("Parent") owns more than 50% of the issued shares.[115] Although this definition in the KCC does not by itself anticipate double or multiple derivative actions, it would be reasonable to allow double or multiple derivative actions when the parent-subsidiary relation as defined under the KCC exists.

However, even if such a relationship exists, double or multiple derivative actions need not be allowed for a listed subsidiary whose shares are publicly traded on the stock exchange, because there are a number of non-related shareholders of the subsidiary who can bring standard derivative actions. Also, the directors and management of listed subsidiaries are under the disciplinary

114. Kaufman v. Wolfson, 1 A.D.2d 555, 557 (1956).

115. Article 342-2(1) of the KCC, which prohibits a Subsidiary from acquiring the shares of a Parent. Also, under Article 342-2(3), if Company A's Subsidiary (Company B) is a Parent of Company C, then Company C is deemed a Subsidiary of Company A.

pressures of the stock market and the monitoring of shareholders, including active institutional investors, which makes the deterrence effect of the double or multiple derivative actions less critical.

D. Should It Be Limited to Material Subsidiaries?

The "size" or "materiality" requirement for a subsidiary, as adopted in Japan, has no corresponding concept or precedent in other jurisdictions. Whether or not the book value of a subsidiary exceeds 20% of the total assets of the ultimate parent company has no relevance at all to the question of whether to allow the shareholders of a parent company to enforce a subsidiary's claim. The necessity of standard/double/multiple derivative actions depends on the importance of the claim that is derivatively enforced, rather than the size or importance of the subsidiary itself. A claim may be important even if a subsidiary is insignificant, and furthermore, a claim may be frivolous even if a subsidiary represents almost all of the parent company's assets. Therefore, there are no reasonable grounds for limiting double or multiple derivative actions to subsidiaries exceeding certain size thresholds.

E. To Whom Should the Demand Be Directed?

Before filing a standard derivative action, the plaintiff shareholder must first demand that the company bring a suit against the relevant director. In double or multiple derivative actions, the same requirement should be applied. But there is a technical issue: to which entity should a plaintiff direct their demand for action?

There are three alternatives: the demand may be directed at the parent, the subsidiary, or both. Various bills in Korea[116] and Japanese corporate law[117] provide that the demand must be directed at the subsidiary. However, the Lambrecht ruling states that, "the plaintiff owns stock only in the parent. Therefore, [a] demand could only be made [. . .] at the parent, not the subsidiary, level."[118] Some commentators in Korea argue that the demand must be directed at both parent and subsidiary, in order to urge the subsidiary to bring an action and the parent to bring a derivative action.[119] This view is also found in some rulings of US courts.[120]

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116. Article 406-2 of the various bills in Korea indicated in Table 1.

117. Article 847-3(1) of *Kaishaho*.

118. 3 A.3d 277, at 282.

119. Tae-Jong Lee, *supra* note 47, at 510; Young-Hoa Son, *supra* note 49, at 44; Mi-Kyung Yum, *supra* note 49, at 496; Jin-Hee Ryu, *supra* note 49, at 145; Hun-Jong Lee, *supra* note 49, at 1046.

120. Fischer v. CF & I Steel Corp., 599 F. Supp. 340, at 346 (S.D.N.Y. 1984) (holding that, when a shareholder of a parent company became a shareholder of a newly incorporated grandparent company as a result of a stock-for-stock merger between the parent company and a third party company, demand must be also made to the new grandparent company so that "the newly-constituted [. . .] board should be

Considering that a claim enforced via a double or multiple derivative action belongs to the subsidiary, any demand to bring a suit must be first directed at the subsidiary. In other words, the subsidiary must have the first opportunity to carry out the cause of action that it has. Then should a demand be also made at the parent? The parent is able to enforce the cause of action only derivatively because the cause of action belongs to the subsidiary. If a demand should be made at the parent to urge derivative enforcement of the cause of action before double-derivative enforcement, then logically, such a demand should be made at other shareholders of the subsidiary as well to urge their derivative enforcement before double-derivative enforcement. Such a procedural requirement would be cumbersome without any contribution to protecting shareholders or enhancing corporate value. Therefore, before bringing a double or multiple derivative action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a derivative suit as well.

PART VI: CONCLUDING REMARKS

Double or multiple derivative actions have attracted hardly any academic attention in US for decades, but have attracted much interest in Korea both academically and politically because it could have a significant impact on the management of many unlisted subsidiaries of large corporate groups. Since many Korean chaebols now use a multi-layered holding company structure, multiple derivative actions are perceived as a real threat to management. Based on a review of many bills submitted to the National Assembly of Korea and a comparative review of the laws of a few jurisdictions, this article presented a few questions to be considered before enacting legislation and provided some answers to those questions.

First, a double or multiple derivative action is justified because it may compensate harmed shareholders and deter possible wrongdoing to subsidiaries, and it is irrelevant to resort to the doctrine of "piercing the corporate veil" to justify it. Second, a standard derivative action against the directors of a parent company for failure to monitor a subsidiary's management or for failure to seek proper remedies cannot be a satisfactory alternative to a double or multiple derivative action, considering the difficulty of proving causes of action and assessing the damages. Third, double or multiple derivative actions need not be limited to situations in which the subsidiary is

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given the opportunity to take a fresh look at the issues raised by plaintiffs and to decide whether or not it wishes to pursue the claims"); Brown v. Tenney, *supra* note 69, at 361 ("a double derivative action may be maintained by a shareholder of record in a holding company, on behalf of a subsidiary controlled or dominated by the holding company, after due demand is made to, and rejected by, the subsidiary and the holding company").

wholly owned or in which there is no one else who can sue. Fourth, before bringing an action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a standard derivative suit.

In addition to the issues discussed above, there are many other points that need to be reviewed. Should there be a minimum shareholding ratio and minimum shareholding period requirement for plaintiffs to bring a multiple derivative action? Should there be any limit to the number of layers downward when allowing a multiple derivative action? Should the shareholder of a parent have a right to inspect or access the records of a subsidiary in order to make a multiple derivative action meaningful? Should the shareholder of a parent be given a right to an injunction to stop wrongdoing by the directors of a subsidiary?

It is not the purpose of this article to make a thorough list of questions and answers. Each of these questions will open up different arguments and reveal the need for comparative and empirical research. Regardless of what would happen in Korea as a result of the debates at the National Assembly, it will provide another interesting source for comparative studies in the field of corporate law.