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Remarks of Werner R. Kranenburg, Attorney & Counselor-at-Law

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As prepared for delivery

"I am a litigator. When there is a problem, I sue first." That, as I recall it, is the quote by one of the lawyers on a panel a few years ago. These two lines have stuck with me since. They remind me at times how, or perhaps why, though the American legal system may have originated from the English one, the practice of law in one is certainly different from the way of doing things in the other.

It is great to see that among us here today there are practitioners from both sides of the pond. I went to law school here in England after which I qualified as an attorney in New York State - and I am actually Dutch – so I may technically be an 'American lawyer', but I feel I belong to one side as much as the other and I believe I am sensitive to both.

I would like to acknowledge Jonathan [Armstrong, NYSBA International Section Vice Chair] for his suggestion I co-organise this event with my fellow speaker and Daniel [Saoul, fellow speaker] for his efforts in making it happen. I would like to thank the New York State Bar Association and the Young Lawyers and Trial Lawyers Sections for their assistance and the Law Society for having us on short notice. Our original venue held thirty attendees so it was a pleasant surprise we had well over seventy registered attendees and had to relocate, with apologies to those on the waiting list.

I will briefly discuss the US and UK derivative actions - or derivative claims as they are called in the UK - the difficulties in bringing and maintaining a derivative action in the United States on behalf of a UK corporation and very briefly touch on a number of such cases. In conclusion I will submit that looking back some details may have changed and that, looking ahead, what is still the same is more relevant.

In the US, a derivative action is an action brought by one or more shareholders of a corporation or members of an unincorporated association against the corporation's directors and officers and, as nominal defendant, the corporation itself on behalf of the corporation. The plaintiff seeks to "enforce a right that the corporation or association may properly assert but has failed to enforce" or to hold directors accountable to the corporation. (*Meyer v. Fleming*, 1946; and *Lewis v. Knutson*, 1983) In doing so, the plaintiff must "fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the

right of the corporation or association."

In federal court, Rule 23.1 Derivative Actions of the Federal Rules of Civil Procedure applies to derivative actions and in each state the courts apply that state's laws. In New York, the court would have subject matter jurisdiction pursuant to New York Business Corporation Law, § 626 Shareholders' Derivative Action Brought in the Right of the Corporation to Procure a Judgment in Its Favor.

In its pleading under the federal rule, the plaintiff must allege, among other things, that it was a shareholder at the relevant time and must state with particularity "any effort by the plaintiff to obtain the desired action from the directors" and, if no effort has been made, "the reasons for not obtaining the action or not making the effort." In practice demands are made on the board to act on the corporation's behalf or it is pleaded that such demand would be futile.

The primary aim of the derivative action is not a monetary settlement for the plaintiff but implementation of or amendments to the company's corporate governance principles and practices. Corporate directors have a fiduciary duty of loyalty and care to the shareholders of the corporation. Typical allegations therefore are that present and former directors and officers breached their fiduciary duties which the action seeks to remedy.

The derivative action is different from a securities class action. A securities class action is brought not on behalf of the corporation but against it, by a lead plaintiff shareholder on behalf of the class of shareholders who are similarly situated. The primary aim is recovery of damages which do not flow back to the corporation but to the class. The leading statute in this area of law is the Private Securities Litigation Reform Act of 1995. Practically though the two types of cases are usually brought alongside each other, based on the same facts. Securities cases at times do incorporate corporate governance demands as well.

The aim of the UK Company Law Reform Bill, as it then was, was to clarify and simplify certain areas of existing company law. Enacted as the UK Companies Act 2006, Part 11 of the Act provides for a new statutory derivative action and came into force on 1 October 2007. The debate among corporate lawyers prior to its enactment had focused on those measures that were designed to further the government's objective to "enhance shareholder engagement and a long-term investment culture". 'Should these reforms should be considered as the next step towards a US-style approach of private enforcement of securities laws in the UK?'

The now-codified derivative action already existed, as did the group litigation order. For minority shareholders in particular protection could be found in the form of s.459 of the Companies Act 1985, as amended, which too may be the basis for a derivative claim. (Part 11

of the Companies Act consists of two chapters, detailing "[d]erivative claims in England and Wales or Northern Ireland" and "[d]erivative proceedings in Scotland" which are not the same.)

Under the Companies Act, the shareholder in a derivative claim does not seek relief from directors of the company for itself directly, rather on behalf of the company, like in the US, but the English court, when considering whether to continue the claim, must take into account the possibility "that the member could pursue [the claim] in his own right rather than on behalf of the company".

Another difference is the scope of limitations upon which an action can be brought, which is arguably more limited in the UK than in the US. In England it is only further to directors' acts or omissions involving "negligence, default, breach of duty or breach of trust". Still, this is wider than what it was under the principle of "majority rule" which effectively limited common law derivative claims to "fraud on the minority".

Under the new statutory claim, the shareholder bringing the claim is under the statutory duty to "promote the success of the company" and act "in good faith". What is less restrictive in England in comparison is the fact that a shareholder who was not a shareholder at the time of the complained-of acts or omissions is eligible to bring the claim.

Two important differences in general between the US and UK are attorney's fees and the loser pays principle. Attorney's fees are specifically provided for in the Federal Rules of Civil Procedure and state laws for bringing and continuing an action, but not in the Act, or in the UK's civil procedure rules governing a group litigation order, a procedure that allows for consolidation of claims and which contains a specific rule for derivative claims.

In the US, securities class actions and derivative actions are funded by lead plaintiff's counsel and the fee is contingent on, and in case of a plaintiff's win at trial or negotiated settlement paid for by, damages awarded or the settlement fund. The plaintiff or class are not out of pocket, win or lose. Though the group litigation order does provide for the court's discretion in awarding the claimant indemnity against costs incurred in the claim, counsel's inability to fund an action for contingency fees here is a significant practical difference.

Among other issues, there are at least four issues in particular that plaintiffs will have to deal with when bringing a derivative action on behalf of a foreign corporation in the US: standing, the forum non conveniens defence, the internal affairs doctrine and res judicata. Four ways of saying, "Can't bring it, not you, not here, not anymore."

One specific defence argument in US derivative actions is the lack of standing of plaintiffs who are ADR holders. An American Depository Receipt is an indirect form of share

ownership in a non-US corporation. Foreign corporations whose main listing is outside of the US do not list their equity directly on American stock exchanges as well; instead, ADRs represent shares which are listed and traded. ADRs are governed by a deposit agreement.

In the 1998 derivative action of *Batchelder v. Kawamoto et al* concerning Honda of Japan, the Court of Appeals for the Ninth Circuit referred to the ADR agreement. A clause in this agreement stated that Japanese law must apply to shareholder actions:

> "[T]his Deposit Agreement and the [American Depositary] Receipts and all rights hereunder and thereunder and provisions hereof and thereof shall be governed by and construed in accordance with the laws of the State of New York, United States of America. It is understood that notwithstanding any present or future provision of the laws of the State of New York, the rights of holders of Stock and other Deposited Securities, and the duties and obligations of the Company in respect of such holders, as such, shall be governed by the laws of Japan."

Japan allows such actions to be brought by registered shareholders only, which an ADR holder is not, so the Appeals Court dismissed the case on a lack of standing.

In the 2006 case of *Tomran Inc. v. William M. Passano, Jr. et al*, involving Allied Irish Bank, the Court of Appeals of Maryland affirmed an appeal from a lower court; both decisions extensively review the *Batchelder* decision. From the Court of Appeals decision:

> "The issue of whether Tomran has a cause of action to sue derivatively on behalf of AIB is not governed by the Deposit Agreement or the ADR Receipts and thus, the choice of law clause does not apply. As such, under the internal affairs doctrine [which I will come to in a moment], an analysis of Irish law determines whether Tomran possesses a right to bring a derivative suit on behalf of AIB. We find that under the current state of Irish law Tomran would not be entitled to pursue this derivative action as a beneficial shareholder... Therefore, we shall affirm."

Case dismissed for lack of standing.

In the case of *Sinochem Int'l Co., Ltd. v. Malaysia International Shipping Corp.*, the US Supreme Court held in 2007 that "dismissal for forum non conveniens reflects the court's assessment of a range of considerations, most notably the convenience of the parties" and that "a [federal] district court has discretion to respond at once to a defendant's forum non conveniens plea, and need not take up first any other threshold objection." So a court may grant a foreign defendant's motion to dismiss on this "non-merits" ground before its determination of its subject matter or personal jurisdiction in the case.

A court's enquiry whether it is the convenient forum includes "private interest" and "public interest" factors. It may consider the convenience of the forum for the parties and the location and availability of evidence and witnesses; consider the court's docket and its own familiarity with the controlling law; and it may weigh the interests of the "two competing

forums", whether the US interest in the dispute is stronger than the foreign jurisdiction's interest.

In New York, under the internal affairs doctrine, the law of the state of incorporation adjudicates a corporation's internal affairs since only one state has the authority to regulate – and has the greatest interest in regulating - a corporation's internal affairs. The law of that jurisdiction is applied to its corporate matters. (*Galef v. Alexander; Hart v. General Motors Corp.;* and *Edgar v. MITE Corp et al*)

There is however an exception to that rule, the public policy exception. So the internal affairs rule is not applied automatically. The local law of the jurisdiction in which the action is filed may be applied where it has an overriding interest in the controversy. (*Koury v. Xcellence, Inc.*; *Greenspun v. Lindley; Stephens v. Nat'l Distillers & Chem. Corp.; Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of America Sec., LLC*)

A plaintiff will want to rely on the public policy exception, the defendants will want to show that the shareholders have sufficient avenues to address malfeasance under the laws of the country of incorporation. If that's England, defendants will point out that the Companies Act limits its application to the English courts (s.260).

Finally, there is the doctrine of res judicata. It would arguably prevent a US action on behalf of a UK corporation to proceed if and when the parties had settled or the defendants been tried in a UK court.

Three litigated cases illustrate some of these issues: BP, Shell and ABN Amro.

In 2006, several pension funds brought a derivative action in an Alaska state court on behalf of BP against then-chief executive Lord Browne and other directors. The action was for "intentional, reckless or negligent breach of fiduciary duty and corporate waste", in relation to various fines against BP for safety and environmental violations and the oil leak at the Prudhoe Bay oil field in Alaska, in particular. It was initally filed by US pension funds, BP defended also on the ADR and standing basis but failed as a UK pension fund ordinary shareholder became involved.

The plaintiffs demanded money damages against the individual defendants, punitive damages and directing to put forward for a shareholder vote a host of reforms of its corporate governance and internal control procedures, such as for the establishment of an environmental and litigation exposure oversight committee, for the reform of executive compensation and to permit shareholders to question all executive directors of BP at the Annual General Meeting and establish a more transparent process for receiving and evaluating shareholder proposals.

The court denied BP's motion to dismiss the complaint after which the parties settled the case. Notably, the court had denied BP's motion to dismiss on the grounds that Alaska law is applicable and that the case should not be dismissed on the basis of forum non conveniens. (*Unite Here National Retirement Fund et al vs. The Lord John Browne of Madingley et al,* 3AN-06-11929CI)

Then last year, we all know what happened in the Gulf of Mexico. Securities class actions as well as new derivative actions have been filed among the many others. The derivative ones were consolidated and transferred to a Texas federal district court and are currently being litigated; one of the plaintiffs is a holder of 'common stock', that is, ordinary shares. The consolidated amended complaint was filed on the 4th of this month.

You may be familiar with the ground breaking securities class action settlement Shell entered into with European and other non-US investors in relation to a restatement of its oil reserves. It is less well known that based on the same facts – the 2004 recategorisation - there were four derivative actions filed in state and federal courts that year and consolidated in New Jersey federal district court.

At the time, Shell operated as two parent companies, the Royal Dutch Petroleum Company, listed in Amsterdam, and The "Shell" Transport and Trading Company plc listed in London. The allegations against members of both parents' boards included claims of breach of fiduciary duties and abuse of their control over the two nominal corporate defendants.

The derivative action settled the following year as did the securities case eventually, in 2007. The derivative settlement resulted in the establishment of its documented corporate governance principles. The subsequent unification into a single English corporation, Royal Dutch Shell plc, fulfilled one of the corporate governance terms. (*In re Royal Dutch/Shell Transport Derivative Litigation, Civil Action No. 2:04-cv-03603 (DMC-MF) (D NJ))*

In the 2006 case on behalf of ABN Amro Holding NV of the Netherlands and its boards' members (*Seybold v. Groenink et al*), the Manhattan federal district court applied the New York internal affairs doctrine and concluded that the plaintiff lacked standing to bring such a suit on behalf of the bank. The court didn't decide on the issue of the action having been brought by an American ADR holder and the defence's claim that the plaintiff didn't own actual ABN Amro shares.

The parties had agreed that Dutch law would apply and Dutch law, according to an expert declaration submitted by the defendants as conceded by the plaintiff, "affords shareholders no right to bring a claim on behalf of a corporation against members of its Managing or Supervisory Boards for breach of duties owed to shareholders since, under Dutch

law, members of these boards do not owe fiduciary duties directly to shareholders." The court rejected that the public policy exception should apply, holding that "Dutch law provides different avenues for shareholders to address malfeasance by members of corporate... [b]oards than does New York law." Motion to dismiss granted.

In June last year, in the securities class case *Morrison v. National Australia Bank*, the US Supreme Court held that the relevant federal securities law's "focus is not on the place where the deception originated, but on purchases and sales of securities in the United States... [and that the law] applies only to transactions in securities listed on domestic exchanges and domestic transactions in other securities." It effectively put an end to so-called 'f-cubed' or 'foreign-cubed' securities class actions, where both the lead plaintiffs as well as the defendants were from outside of the United States. The various lower federal courts are now referring to *Morrison* to dismiss or partially dismiss cases such as recently against the Royal Bank of Scotland.

Though it is too early to tell how this is going to develop, since the federal courts are no longer a viable venue to bring these 'f-cubed' claims, plaintiffs may look to state securities laws and state courts as a forum, as well as the jurisdictions of their home country, to bring their claims instead.

"I sue first." That quote is from the founding partner of a US law firm focused on securities fraud class action litigation and derivative actions. This is the US approach to litigation as private enforcement of rights and a mechanism for negotiation. Though a petitioner demands a jury trial when commencing an action, in reality most cases are either dismissed or settled. Settlements require negotiation between the parties, hence "I sue first". The action reserves one's seat at the table.

The law may have changed in the past few years but that philosphy hasn't. I submit that until there is a derivative action equivalent of *Morrison* and such in state laws, derivative actions will be filed in US courts on behalf of foreign corporations, including those situated in the UK.

Before handing you over to Daniel, I would be happy to answer any of your questions. Thank you.