

Companies Act Reform: Parent and Subsidiary (Shareholders' Double-Derivative Suit)

An amendment to the Companies Act was enacted on 20 June 2014 ("Amendment") and is expected to come into effect on 1 April 2015. This briefing will focus on the amendments relating to parent and subsidiary companies. A new cause of action called the shareholders' double-derivative suit will be introduced. This new cause of action will allow shareholders holding 1% or more of outstanding shares in a parent company to bring an action against directors of its significant subsidiaries for any breach of directors' duties. It is expected that an additional category of potential claims will encourage directors to exercise their directors' duties with even greater diligence.

Also being introduced is the requirement for approval by a special majority¹ of shareholders at a shareholders' meeting for the transfer by a parent company of shares in its subsidiary which account for 20% or more of the total assets of the parent company, as would be required in a business transfer.

Shareholder's Double-Derivative Suits

Background

A shareholder of the company may claim against the directors for any breach of directors' duties that results in damage to the company by way of a shareholders' derivative suit. However, under the existing legislation, shareholders of a parent company who are not also shareholders of its subsidiary have no redress against directors of the subsidiary even if the acts of the directors of the subsidiary result in damage to the whole corporate group.

Although the existing legislation allows the parent company itself, as a shareholder of the subsidiary, to bring a derivative suit, the interests of the shareholders of the parent company may be jeopardised if the parent company itself decides not to proceed with a claim arising from the acts of the directors of the subsidiary. The Amendment establishes a new cause of action which provides the shareholders of a parent company with a direct claim against the directors² of such parent company's subsidiary. Although the amendment defines this new cause of action as "lawsuits for claims for specified liability", this briefing will refer to such actions as "(shareholders') double-derivative suits".

¹ Two-thirds or more votes with a quorum of a majority of the votings.

² In this briefing, we have focused on the liability of directors for ease of explanation.

Summary of the Amendment

Requisites for Shareholders to Initiate Double-Derivative Suits

Only shareholders of a parent company which owns all the shares in its subsidiary and is itself not a wholly-owned subsidiary of another company (the "**Ultimate Parent Company**") may bring a shareholders' double-derivative suit. As such, in the case of a multi-tiered companies group (e.g. parent – subsidiary – sub-subsidiary), only shareholders of the parent company at the top of the group may bring a shareholders' double-derivative suit.

Furthermore, while each shareholder has the right to bring a derivative suit against the directors of the company in which it owns shares, a double-derivative suit may only be brought by (i) shareholders that hold 1% or more of the voting rights of the Ultimate Parent Company, or (ii) shareholders who own 1% or more of the outstanding shares (excluding treasury shares) in the Ultimate Parent Company.

Scope of Target Subsidiaries

A shareholders' double-derivative suit may only be brought against directors of a significant subsidiary of a parent company, the book value of which accounts for 20% or more of the total assets of the Ultimate Parent Company as at the date of such act giving rise to liability by the director.

Procedure for Shareholders' Double-Derivative Suits

The procedure for shareholders' double-derivative suits is similar to the procedure for derivative suits. In essence, the shareholder who intends to claim against a director of a subsidiary is first required to request that the target subsidiary bring a lawsuit against such director. If the subsidiary does not bring a lawsuit against the director within 60 days of the date of the request, such shareholder may then bring a shareholders' double-derivative suit on behalf of the subsidiary.

As is the case with current shareholders' derivative suits, claims for improper purposes are prohibited. Also, shareholders may not bring a shareholders' double-derivative suit if no damage is incurred by the Ultimate Parent Company.

Practical Implications

As directors of a subsidiary will, following the Amendment, be subject to an expanded group of eligible claimants in the event of any misconduct of their directors' duties, it will be even more important that such directors exercise sufficient diligence in the discharge of their directors' duties.

Whilst the categories of eligible claimants will however be expanded under the Amendment, the standard to which directors are held liable for misconduct of directors' duties has not. Hence, the introduction of shareholders' double-derivative suits will not impose a standard that is higher than what is currently required of directors to discharge its directors' duties.

The Transfer of Shares in a Subsidiary by its Parent Company

Under the current Companies Act, it is not clear whether or not approval by a special majority of shareholders at a shareholders' meeting is required for the transfer by a parent company of shares owned in its subsidiary. The amended Companies Act will stipulate that approval by a special majority of shareholders at a shareholders' meeting is required, for (i) the transfer by a parent company of shares owned in its subsidiary which account for 20% or more of the total assets of the parent company and (ii) whereby, as a result of the transfer, the parent company will no longer have majority of all the voting rights in the subsidiary.

Following the Amendment, a parent company will need to check whether the requirement for special majority shareholder approval is triggered prior to any proposed transfer of shares held in its subsidiary.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.

Contacts

If you would like to know more about the subjects covered in this publication or our services, please contact:



Andrew Whan
Partner

T: +(81 3) 5561 6615
E: andrew.whan
@cliffordchance.com



Tatsuhiko Kamiyama
Partner

T: +(81 3) 5561 6395
E: tatsuhiko.kamiyama
@cliffordchance.com



Satoshi Mogi
Senior Associate

T: +(81 3) 5561 6295
E: satoshi.mogi
@cliffordchance.com

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Clifford Chance, Akasaka Tameike Tower, 7th Floor, 2-17-7 Akasaka, Minato-ku, Tokyo 107-0052, Japan

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Clifford Chance Law Office (Gaikokuho Kyodo Jigyo)

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