Shareholder claims for reflective loss in company law and international investment law

Gulu Zada, T.

3 Shareholder Claims for Reflective Loss (SRL) in Civil Law Jurisdictions

3.1 Shareholder Claims for Reflective Loss (SRL) in the German Law

Given that the German legal system follows the civil law tradition, statutory law holds more weight than precedent law in Germany, which generally acknowledges that a shareholder can have a separate cause of action if the wrongdoer violates certain statutory provisions.[498]

However, this does not mean that a shareholder can directly recover a reflective loss incurred through the loss to the company. According to the German Federal Court of Justice (*Bundesgerichtshof*, BGH) in *Fall Girmes/Effectenspiegel*.[499] the shareholder's loss should be compensated only through a recovery to the company.

Before delving into the statutory provisions of the German company law on shareholder claims, I will discuss the landmark case (*Girmes)* in the following subsection, which gave important reasoning on the question of SRL.

3.1.1 Consideration of SRL based on the Landmark Case in Germany (Girmes [BGH])

BGH in *Girmes* held that

> "where a third party negligently damages a company, the shareholder cannot claim damages from the third party because this would run counter to the principle of capital maintenance (Kapitalerhaltung)"

498 An example is a violation of the criminal provision of section 266 of German Criminal Code (StGB) 1998, which "*prohibits someone who is entrusted with the money of others from abusing his position*". This provision is a so-called Schutzgesetz (protective act) within the meaning of section 823 Abs. 2 of German Civil Code (BGB) 1900, a general legal basis for a damage claim: "*A person who, in a manner offending common decency, intentionally inflicts damage on another person is liable to the other person to provide compensation for the damage*".

499 See *BGH NJW 1995, 516 hat im Fall Girmes/Effectenspiegel,* (BGH, German Supreme Civil Court 20 March 1995) (hereinafter *Girmes*), BGHZ 129, 136, 166; as well as the earlier cases BGH 10.11.1986, WM 1987, 13 (Dubai) and BGH 05.06.1975, BGHZ 65, 15, 21 (ITT).

and "*would conflict with the principle that the company's assets are bound for the purpose of the business* (*Zweckwidmung des Gesellschaftsvermögens*)".[500]

Further, BGH held that "*the no reflective loss rule protects the interests of the company's creditors*".[501] The creditors may be prejudiced if shareholders directly recover a reflective loss incurred through the direct loss of the company. This is because the company's assets might be depleted, leading to the risk of default on its creditors in case of insolvency.

Thereby, claims for reflective loss brought by shareholders are usually incompatible with the purpose (*Zweckbindung*) of a company's assets or business as well as the *principle of capital maintenance* (*Kapitalerhaltung*).

Although the rationale behind this was not thoroughly explained, one of its judges thoroughly examined the issue and elaborated in a highly coherent scholarly article.[502] The author contends that "*when an individual becomes a shareholder, they assume the responsibility of ensuring that the company has access to the necessary capital to achieve its objectives*".[503] Therefore, the capital of the company acts as a guarantee for the creditors in case of insolvency, and the company cannot be deprived of it.

However, BGH also directed the claimant shareholder to the other possibilities by holding that

> "the outcome of this case would have changed if the shareholder bringing the claim had first reimbursed the company for the loss it suffered, or if the shareholders would claim for any separate, direct damage, but not for reflective loss".[504]

The first part of the aforementioned court statement might also be explained by the *principle of judicial economy*, which was first introduced in US case law, *Gaubert*. However, unlike *Gaubert,* which considered the possibility of recovering such losses directly by the company itself, the reasoning for the *principle of judicial economy* under *Girmes* might imply either the possibility of derivative claims brought by the shareholders on behalf of the company or the possibility of direct claims by the company itself. In both situations, this means if the company is compensated, the value of the shareholder's shares would accordingly increase too.[505]

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500 Ibid.: See also de Wulf (2010) *supra note* 39, pp. 1537-1564.

501 *BGH NJW 1995, 516 hat im Fall Girmes/Effectenspiegel,* (BGH, German Supreme Civil Court 20 March 1995), BGHZ 129, 136, 166; See de Wulf (2010) *supra note* 39, pp. 1537-1564.

502 See Ibid. (citing Brandes, H. (1988) Ersatz von Gesellschafts- und Gesellschafterschaden. In R. Goerdeler, P. Hommelhoff, M. Lutter & H. Wiedemann (eds.), *Festschrift für Hans-Joachim Fleck*. Berlin: De Gruyter, pp. 13-22).

503 Ibid. See de Wulf (2010) *supra note* 39, p. 1545.

504 See Girmes (1995) *supra note* 499.

505 See de Jong (2013) *supra note* 40, p. 4 (citing Brandes (1988) *supra note* 502, pp. 13-22).

As for the second part of the aforementioned court statement, the shareholders' claim for separate and direct loss is not appropriate to the facts of *Girmes*; in other words, the issue of reflective loss is therefore of no relevance in this context.

Thus, even though the capital maintenance doctrine remains vibrant and still used to justify the *no reflective loss rule* in Germany, the tide has gradually turned against capital maintenance, arguing that "*legal capital is no longer [an] appropriate argument for the purpose of creditor protection*"[506] since the return of capital to shareholders in the company is no longer dependent on legal capital but rather on solvency of the company. This is because creditors are usually paid based on the solvency status of the company, which does not always correspond to the prevailing condition of the company capital.

Thereby, I will summarize *Girmes,* which prohibits shareholders from bringing direct claims for the recovery of reflective loss in the German law as follows:

1. *Principle of Capital Maintenance and Company Asset's for the Purposes of Business:* The creditors are protected by the legal capital, which ensures that the company's assets are maintained for their intended business purpose. The purpose of the capital allocated to the company's assets is to be preserved by the company and expanded in accordance with the purpose of the company business. Therefore, these principles serve the protection of creditors whose rights and/or interests cannot be prejudiced against, which has been a main reason (rationale (concern)) for the prohibition of SRL in *Girmes*.
2. *Principle of Judicial Economy:* Even though the *principle of judicial economy* is not explicitly mentioned as a principle in *Girmes*, according to the reasoning of BGH, the value of the shareholder's share would be considered recovered if the company recovers the loss either through derivative claims or through the direct claims of the company itself. As researched previously, the company's right to bring direct claims for such losses stems from the *proper plaintiff rule* established in the landmark case of the UK, *Foss v. Harbottle,* which allows only the company to recover its loss, since the cause of the action belongs to the company itself.
3. *Derivative claims:* Even though before 2006, the German company law did not explicitly provide a statutory rule for derivative claims to all shareholders or provided it under very limited conditions in the company law, BGH acknowledged the shareholder's right to bring derivative claims for the recovery of losses by holding that "*shareholders could bring claims which would first reimburse the company for such a loss*".
4. *Direct claims for the recovery of personal loss:* According to BGH, shareholders could recover their personal loss if the wrongdoer breached their personal rights, since the reflective loss occurred due to the loss to the company is not recoverable.

506 See Armour, J. (2006) Legal Capital: An Outdated Concept? *European Business Organization Law Review*, [Online] 7 (1), pp. 5-27.

Having discussed the landmark case of *Girmes* previously, the rule that a shareholder cannot directly claim for reflective loss in Germany can be further explained through the legal norms that regulate shareholder claims in publicly held corporations (AGs) and private limited liability companies (GmbHs). These companies comply with the German Stock Corporations Act 1965, last amended in 2024 (the AktG), and the German Act on Limited Liability Companies 1892, last amended in 2025 (the GmbHG), respectively.[507]

Unlike GmbHG, which was specifically designed for smaller companies by the legislature in 1892, the traditional structure of the AG has consistently been that of a large publicly traded company, with its primary role being that of a "capital reservoir" (*Kapitalsammelbecken*)[508] which might serve the best interests of the company's creditors.

Similarly to US and UK laws analysed earlier in this book, shareholders in Germany may also be allowed to pursue a derivative claim to recover their reflective losses following the standing requirements (procedural and substantive requirements). Therefore, I will explore shareholder derivative claims for reflective loss under the German law in the following subsection.

3.1.2 Shareholder Derivative Claims for Reflective Loss

Historically, derivative claims in the common law sense did not exist in Germany,[509] except for corporate groups. Similarly to UK and US laws, the German law also gave more weight to the *proper plaintiff rule* prior to the amendments in 2005. While shareholders may experience a decrease in the value of their shares, this loss is considered indirect, and they lack the right to take legal action for the recovery of such losses. Thereby, the exception to the *proper plaintiff rule* – derivative claims which is often applied in other jurisdictions, was not fully accessible for all shareholders or applicable under a different mechanism or in limited conditions in the German law.[510]

However, this situation changed on 1 November 2005, when new statutory derivative claims after the introduction of the "*the new German Act Regarding Integrity of Companies*

507 See Schmidt, J. (2008) Reforms in German Stock Corporation Law – The 67th German Jurists Forum. *European Business Organization Law Review*, [Online] 9 (4), pp. 637-656, p. 639; See also, Li (2007) *supra note* 39, pp. 199-200.

508 Ibid., p. 639; See also Bayer, W. (2008) *Empfehlen sich besondere Regelungen für börsennotierte und nichtbörsennotierte Gesellschaften?* [Are Specific Legal Provisions for Listed and Non-Listed Companies Advisable?]. München: Beck.

509 See, generally, historical development of the German corporate law, Kuntz, T. (2018) German Corporate Law in the 20th Century. In H. Wells (ed.), *Research Handbook on the History of Corporate and Company Law* [Online].Edward Elgar Publishing, Cheltenham, United Kingdom, pp. 205-243.

510 Ibid.

and Modernization of Shareholder Claims (Gesetz zur Unternehmensintegritat und Modernisierung des Anfechtungsrechts)",[511] the so-called UMAG, came into force. The UMAG significantly amended and provided a broad scope of rights to shareholders in the German Stock Corporations Act (the AktG) in many respects[512] including in the shareholders' rights for derivative claims, especially the procedural requirements concerning the minority shareholders' right to enforce such derivative claims.

There seem to be multiple reasons behind this reform.[513] The commentaries and explanatory notes on the Reforming Act (UMAG) highlight the primary reason for the introduction of derivative claims as the improvement of the enforcement of corporate rights while ensuring that litigation is not used in an abusive manner.[514] In other words, the globalization of the economy and the need to attract investment from both domestic and foreign investors either through domestic markets or foreign capital markets incentivized this reform.[515] This reason required changing the German company law, which was considered less shareholder-friendly and lacked judicial authority over directors.[516]

Now, shareholder derivative claims under the German law may introduce limited solutions under specific rules that allow shareholders to personally enforce a claim for reflective loss:

> "1) shareholders must obtain leave from the court to bring the claim; 2) all shareholder claims must be consolidated in a single claim; and 3) the judgment or settlement in a shareholder derivative claim binds all shareholders and

511 The UMAG *means* "*Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts*"*, which is translated as* "*the German Act Regarding Integrity of Companies and Modernizations of Shareholder Suits*", https://sas-space.sas.ac.uk/1709/1/Amicus_Curiae_2007_issue_70%2C_22-24.pdf.; See generally, Schmidt (2008) *supra note* 507, pp. 637-656.

512 In terms of three important aspects of corporate governance: the liability of corporate managers and the enforcement of this liability, shareholder meetings and challenging shareholder meeting resolutions. See Noack, U., & Zetzsche, D. (2005) Corporate Governance Reform in Germany: The Second Decade. *European Business Law Review*, [Online] 16 (5), pp. 1033-1064.

513 See, for example, Baums (2002) *supra note* 513, p. 2. See also, Singhof, B., & Seiler, O. (1998) Shareholder Participation in Corporate Decision Making under German Law: A Comparative Analysis. *Brooklyn Journal of International Law*, 24, pp. 493, 563.

514 See Hüffer, U. (2012) *Aktiengesetz*. 10th ed. Munich: C.H. Beck, p. 865.

515 See Baums (2002) *supra note* 513, p. 12.; In Japan, two changes were made to the Commercial Code for derivative claims: First, the reforms lowered and fixed the filing fees required to pursue a derivative action in Japanese courts. Previously, filing fees (required before the commencement of any litigation) constituted a substantial financial obstacle to a derivative claim. The second substantive change of the 1993 reforms was the expansion of the possible recovery for shareholders. Generally, Japanese law directs the losing party to bear the litigation costs of both parties. These litigation costs include both court costs and party costs. See Art. 852 of the Kaishahō [Japanese Companies Act], 2005; *See Azai v. Iwasaki (Nikko Securities), 121 SHIRYFBAN SH6JI HOMU 149 (Sup. Ct., Mar. 10, 1994);* See also, Shintani, M. (1993) Kabunushidaihy soshō to sogaku no santei [Shareholder Derivative Suit and the Calculation of the Value of the Subject Matter of the Suit]. *Tegata Kenkyū*, 485, p. 14.

516 See, Li (2007) *supra note* 39, p. 196.

> the company. 4) creditor and non-claiming shareholder interests are also protected because recovery goes to the company rather than the claimant-shareholder".[517]

Thus, a derivative claim under the German company law may be brought by a shareholder on behalf of the company for losses that occurred because of a director's breach of duty. Directors of the company are bound in their actions (and omissions) on behalf of the company by a duty of care as well as a duty of loyalty.[518]

However, unlike UK law,[519] derivative claims in Germany are not available for claims against third parties such as a government or others.[520] Derivative claims in Germany are primarily limited to claims against corporate insiders, in other words, the management.

Thus, the legal aspects of *AGs* and *GmbHs* types of companies vary in many ways, including the rules on derivative claims:[521]

a. The AktG Law

Before UMAG, the company's claims against its directors could be brought through the procedure laid down in section 147 (1) AktG (1998). This provision stated that

> "a minority of shareholders that constituted an aggregated amount of 10 per cent of the issued share capital could force the company to file a certain claim. The company would be represented either by the management board or the supervisory board".[522]

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517 See Gaukrodger (2013) *supra note* 8, pp. 19-20. See section 148 and 149 of AktG.

518 See Hofmann, F., & Kurz, F. (eds.) (2019) *Law of Remedies: A European Perspective*. Cambridge: Intersentia, Economics of Remedies, The Perspective of Corporate Law. Klaus Ulrich Schmolke, p. 96.

519 In the UK, derivative claims against outsider third parties are possible, but only where a company director was also at fault. See section 260 (3) of UK Companies Act: "*derivative actions can [generally] only be brought in cases involving alleged misconduct by a director of the company*"; Explanatory Notes to UK Companies Act 2006: "*Derivative claims against third parties would be permitted only in very narrow circumstances, where the damage suffered by the company arose from an act involving a breach of duty etc on the part of the director*".

520 See section 147 (1) of AktG: "*listing only members of the supervisory and management boards and promoters of the company as potential defendants*"*;* See, generally, Gelter, M. (2012) *Why do Shareholder Derivative Suits Remain Rare in Continental Europe?* [Online]; See *also, Art. L.225-252 of Commercial Code* (Code de commerce *(France):* "*shareholder can only bring derivative claim against directors or the managing director*". In Japan, according to Art. 847 (1) of the Kaishahō [Japanese Companies Act], 2005, "*shareholders may only bring derivative claims against 'corporate members', defined as the directors, officers and certain auditors and accountants*".

521 See Bernd Singhof & Oliver Seiler (1998), *Shareholder Participation in Corporate Decisionmaking Under German Law: A Comparitive Analysis*, 24 Brook. J. Int'l L. 493 p. 554; section 117 (1) of the AktG.

522 See section 147 (1) of AktG (1998).

However,

> "the company could also be represented through a special representative appointed by the court at the request of a minority shareholder who held the aggregated amount of 5 percent of the issued share capital or the respective amount of 500,000 euros".[523]

Such special representative could be appointed if the company suffered due to a director's unfair behaviour or a grave violation of the law or the articles of association.[524]

Due to the inadequate performance of section 147 of the AktG (1998).[525] an amendment to the company law rules was proposed and eventually implemented in UMAG (2005).[526] The new concept of section 147 and section 148 of the AktG fundamentally changed the way a company can be forced to bring claims by its shareholders.[527]

UMAG amended section 147, which now compels the management to bring a claim for compensation within six months if a respective resolution is passed by a simple majority vote or, alternatively, it allows the court to appoint company representatives and authorize them to bring claims at the request of a minority who owns an aggregate amount of 10% of the issued share capital or the respective sum of 1 million euros.[528]

As for a new section, 148 of the AktG, it now permits minority shareholders with an aggregate amount of 1% of the issued share capital or the respective amount of 100,000 euros in the respective quorum, which is rather low to initiate derivative claims.[529]

On the one hand, UMAG significantly reduces the minimum requirement for shareholding interests to initiate a lawsuit on behalf of the company directly without the participation of any management or a special representative and empowers the court to find a balance between corporate efficiency and the interests of the company and minority shareholders.[530]

On the other hand, UMAG incorporated BJR into section 93 of the AktG in a manner similar to US law. Based on BJR a director can avoid being held responsible if

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523 See section 147(3) of AktG.

524 Ibid.

525 BT-Drs. 15/5092, p. 20, left column, this is the legislative reasoning to the UMAG; this official document is published by Parliament; available in German at http://dip.bundestag.de, left column; Hüffer, U. (2004) *AktG*. 6th ed. AktG, s.147, recital 9.; See also, generally, Gordon, J. N. (Jeffrey, N., & Ringe, W.-G. (eds.) (2018) *The Oxford Handbook of Corporate Law and Governance*. Oxford, UK: Oxford University Press.

526 See UMAG, *supra note* 511.

527 See Naruisch, T., & Liepe, F. (2007) Latest Developments in the German Law on Public Companies by the Act on Corporate Integrity and Modernization of the Right of Resolution-Annulment (UMAG) – Shareholder Activism and Directors' Liability Reloaded. *Journal of Business Law*, pp. 10-11.

528 See section 147(2) of the AktG (2006).

529 See Naruisch & Liepe (2007) *supra note* 527, pp. 10-11.

530 See, Li (2007) *supra note* 39, p. 201.

they can demonstrate that their actions or decision were in accordance with good faith and the best interests of the company. I will further review this substantive requirement under derivative claims further on.

Thus, the introduction of a new section 148 to the AktG allowed minority shareholders to enforce derivative claims in their own name on behalf of the company.

b. The Law on GmbH

Like the AG, it is typically the management board or the managing director in the GmbH who holds the right to bring company claims.[531] Therefore, it may be concluded that the *proper plaintiff rule* and the *no reflective loss rule* pertain to GmbHs type of companies.

There is no provision in the GmbHG (the GmbH, which is the most common type of company in Germany) equivalent to sections 147 and 148 of the AktG (the UMAG), which grants shareholders the right to bring derivative claims.

However, the GmbHG grants shareholders the right to bring company claims against a defaulted shareholder based on the resolution of the shareholders' meeting.[532] Accordingly, in recent years the German case law has also developed the so-called right of *actio pro socio (or actio pro societate)*, which grants individual shareholders of the GmbH the right to enforce company claims against fellow shareholders of the company in their own name, provided that the shareholders' meeting has already decided not to pursue these company claims (with the accused shareholders unable to vote regarding the decision)[533] and the decision not to sue has constituted a breach of the duty of loyalty by the shareholders who made such a decision.[534]

The strength of such claims is also that the company cannot complete and perform the challenged transaction so long as the challenge is outstanding.[535]

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531 See section 35(1) of GmbHG.

532 See section 46(8) of GmbHG; See also, Schröder-Frerkes, A., & Göhring, A. (2020) *The Limited Liability Company under German Law (the GmbH)*. Globe Law and Business, pp. 43-44.

533 See section 47(4.) of GmbHG.

534 See Hommelhoff, P. (2002) 'Protection of minority shareholders, investors and creditors in corporate groups: the strengths and weaknesses of German corporate group law', in Hopt, K.J., Jessel-Holst, C. & Pistor, K. (eds.), *Unternehmensgruppen in mittel- und osteuropäischen Ländern: Entstehung, Verhalten und Steuerung aus rechtlicher und ökonomischer Sicht*, Mohr Siebeck, Tübingen, pp. 59-78; See also, International Association of Young Lawyers & Stecher, M. W. (1997) *Protection of Minority Shareholders*. 1st ed. Alphen aan den Rijn: Kluwer Law International, p. 94; See also, Kleindiek, D. (1993) Protection of Minority Shareholders under German Law. *International Company and Commercial Law Review*, 4 (4), pp. 138-147, p. 144.

535 See Cox, J. D., & Thomas, R. S. (2018) The Evolution in the U.S. of Private Enforcement via Litigation and Monitoring Techniques: Are There Lessons for Germany? In J. N. Gordon & W.-G. Ringe (eds.), *The Oxford Handbook of Corporate Law and Governance*, [Online]. Oxford University Press, Oxford, United Kingdom, p. 923.

Hopt regards the right of *actio pro socio* as a "*subspecies of the derivative claim*".[536] In fact, he considers that the unique character of the *actio pro socio* lies in that "*it has the basis in membership, therefore, it is more correctly regarded as a personal right of the shareholder rather than a right to derivative action*".[537] The GmbH *actio pro socio* is thus hard to characterize as derivative claims in the true meaning of these claims.[538]

Therefore, Merkt remarked that "*even though shareholders or company can bring monetary claims against the other shareholders who have breached their duty of loyalty, reflective losses are not recoverable under such claims*".[539]

I will now review the *i. Procedural* and *ii. Substantive requirements* of shareholder derivative claims under the German law:

i. Procedural Requirements

To avoid "*unnecessary, unfounded or harassment actions*",[540] derivative claims provided under sections 148, 149 of AktG involve what may be described as a two-stage procedural action: while the first stage takes the form of a special action admission procedure conducted by the Regional Court at the company's seat, at the second stage, shareholders, if admitted, may bring the claim in their own name for the benefit of the company under the specific requirements.[541] However, I will briefly review the procedural requirements in a three-stage process:

1. *The petition for leave to bring derivative claims.*
2. *Actions procedure: demand rule; and*
3. *The effect of the court judgment on derivative claims.*

1. The Petition for Leave to Bring Derivative Claims.

The German law establishes a minimum capital threshold for the right to initiate derivative claims, in contrast to UK and US law, which allow minority shareholders to apply for permission to continue a derivative claim.

This happened with the introduction of UMAG, which provided the minority's stimulus section 148 of the AktG, which reduced the capital threshold significantly.

536 See Hopt, K. J. (1997) Shareholder Rights and Remedies: A View from Germany and the Continent. *CfiLR*, 261, pp. 272-273.

537 Ibid.

538 See Gelter, M., & Afsharipour, A. (eds.) (2021) *Comparative Corporate Governance*. Cheltenham, UK; Edward Elgar Publishing, Chapter 21. Direct and derivative shareholder suits: towards a functional and practical taxonomy. p. 452.

539 See Merkt, H. (2018) § 13 Juristische Person; Handelsgesellschaft. In H. Fleischer & W. Goette (eds.), *Münchener Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung - GmbHG* [Munich Commentary on the Law on Limited Liability Corporations], 3rd ed., pp. 203-204, Rn 98, Rn 200.

540 See Baums (2002) *supra note* 513, p. 18.

541 See section 148 of AktG.

Now, "*shareholders aggregately holding one percent of the capital stock, or a pro-rata amount of EUR 100,000 may bring an action to enforce corporate claims*".[542] Therefore, the right to derivative claims will now be accessible to more minority shareholders. According to UMAG, a preliminary trial is necessary to decide whether the claim on behalf of the company is allowed.[543] The experience of the civil law system demonstrates that the legislature has consistently revised the threshold percentages, in most cases, downwards and the rationale for this approach is that the ownership thresholds, which are presumed to be high, are an impediment for litigation without any practical value.[544] The court will allow the claim only if:

a. Shareholders can prove that they acquired their shares before the alleged violations or damage became public. The rationale behind this, evidently, is to ensure that litigious parties will be precluded from purchasing shares with the sole view to filing frivolous and vexatious applications for admission.[545] This may be equivalent to the contemporaneous rule analysed in the section on US law.
b. Shareholders can prove that the company failed to bring a claim within a reasonable time: A two-month term is usually reasonable.[546] This may also be equivalent to the *demand rule* analysed in the section on US law. This *demand rule* under the German company law will be further analysed in this section.
c. The court must carefully consider the facts of the case, because the shareholders must prove that there is evidence to justify the suspicion that the company has sustained damage, whether by fraud or by other gross infringement of the law or of the articles of association, and, put differently, derivative claims shall be admitted only if the court finds the claimant shareholders sufficiently to succeed on the merits

542 See section 148(1) of AktG.

543 See section 148(1) (3) of AktG (the UMAG).

544 See Gelter (2012) *supra note* 519; See also, Latella, D. (2009) Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive. *European Company and Financial Law Review*, [Online] 6 (2-3), pp. 307-323*:* "*The Spanish law maker have regulated this institution combining two different regulations (Article 100 and 134 LSA), according to which shareholders representing at least 5% of the share capital are entitled to first ask for the convocation of the general meeting in order to decide on the exertion of the liability action; In Italy, shareholders can exert the liability action if they represent at least 2.5% of the capital and 20 % of the capital in public companies and closed companies respectively (Article 2393-bis civ. Code.)*"*;* In Brazil, "*minority shareholders representing at least 5% of the corporation's aggregate stock capital may still file the claim*". (Art. 159 of Corporations Law); The Japanese law allows the owner of a single share to bring a derivative claim (Art. 847(1) of the Kaishahō [Japanese Companies Act], 2005).

545 See Paul (2010) *supra note* 80, pp. 81-115, p. 100: See also, Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 21; See Hüffer, U. (2008) *Aktiengesetz*, 8, neubearbeitete Aufl. C.H. Beck. § 148 note 1.; See Koch, J. (2006) Das Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) – ein Überblick. *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, [Online] 35 (6), pp. 3525, 3526.

546 See Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 22; Spindler, G., & Stilz, E. (2010) *Kommentar zum Aktiengesetz/herausgegeben von Gerald Spindler, Eberhard Stilz*. 2. Aufl. München: C.H. Beck. Section 148 note 48.

of the case.[547] It should, however, be noted that the reference here is specifically given to gross violation only.[548] This implies that while directors under sections 93 and 116 of AktG are liable *vis-à-vis* the company for the slight violations of their duties,[549] shareholders may not pursue these claims against directors under section 148 of AktG.[550] On the contrary, any violation of duty or the law in UK law can be subject to litigation, including cases of negligence.[551]

d. There are no predominant *(überwiegend)* grounds (i.e., the interests *(Gesellschaftswohls)* of the company) preventing the claim for damages.[552] With this disqualifying requirement, section 148 of AktG upheld the principles established by the Federal Court of Justice (BGH) in its *ARAG/Garmenbeck* decision.[553] In this judgment, the court acknowledged that the members of the supervisory board, while under a general duty to enforce meritorious claims of the company against its directors, may exceptionally waive such claims in circumstances where the grave interests of the company are concerned.[554]

But, interestingly, under the statutory rule, the reference is to overriding interests. This is to make clear that where the other preconditions are fulfilled, admission of the claim should be refused only in very exceptional circumstances.[555] In essence, this criterion is designed to function as a mechanism to efficiently eliminate trivial and unnecessary shareholder claims.[556] To achieve this, the court must rely on a proportionality test, wherein all reasons pertaining to the admission decision will be objectively evaluated and balanced against each other.[557]

Thus, the UK and German experience demonstrate that the preliminary/admission stage (*Klagezulassungsverfahren*) at the court is an effective way for early identification

547 Ibid., See also, Spindler, G., & Stilz, E. (2007) *Kommentar zum Aktiengesetz*. Verlag C. H. Beck, § 142 note 56.

548 See also, Fleischer, H. (ed.) (2023) *German and East Asian Perspectives on Corporate and Capital Market Law: Investors versus Companies*. [Online]. Mohr Siebeck GmbH & Co. KG., p. 22.

549 See Hüffer (2008) *supra note* 545, § 93 note 4.

550 See Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 22; see also Paschos, N., & Neumann, K.-U. (2005) Die Neuregelung des UMAG im Bereich der Durchsetzung von Haftungsansprüchen der Aktiengesellschaft gegen Organmitglieder. *DB*, pp. 1779, 1780; Wilsing, H.-U. (2004) Neuerungen des UMAG für die aktienrechtliche Beratungspraxis. *ZIP*, pp. 1082, 1088.

551 See section on UK law.

552 See section 148(1) of the AktG (the UMAG).

553 See *ARAG/Garmenbeck* (BGHZ 135, 244, pp. 249-250 and pp. 252-253) 1997, the Federal Supreme Court (Bundesgerichtshof) (hereinafter *ARAG/Garmenbeck).*

554 Ibid., p. 255.

555 See Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 22; See Hüffer (2008) *supra note* 545, § 148.

556 See Spindler, G., in: Schmidt, K., & Lutter, M. (eds.) (2008) *Aktiengesetz*. Verlag Dr Otto Schmidt, section 148 note 25.

557 Ibid., See also, Paschos & Neumann (2005) *supra note* 545, pp. 1779, 1780; See Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 23.

and dismissal of unmeritorious claims. This process helps to minimize the cost and time associated with a full hearing on the merits of all parties involved in the dispute.[558]

2. Actions Procedure: Demand Rule

The general rule in Germany is that the pursuit of company claims is a business matter and should be left to the management board, which is responsible for company management.[559] By this rule, it is evident that the company's pre-eminent role in deciding on the litigation is preserved, which stems from the *principle of separate legal personality* discussed earlier in this book.

Section 148 (4) of AktG stipulates that shareholders may enforce the company's claim within three months of the court's admission decision becoming obligatory.[560] However, this provision clearly states that shareholders cannot bring a claim immediately. Shareholders must first demand that the company bring a claim against the wrongdoer before filing with the court for the authorization to initiate a claim. If the company fails to initiate such lawsuits within a reasonable time, shareholders may bring a claim in their own name on behalf of the company. Even if the court authorizes the lawsuit and the shareholders bring a claim, the company can nevertheless take over the lawsuit at any time, the shareholder may join the company claim, and the shareholder lawsuit would be discontinued.[561]

In addition, it is important to note that unlike UK and the US laws, the German law allows the supervisory board to decide whether to bring a lawsuit against a member of the management board. Supervisory boards have the right and duty to do so.[562] Since the German company law provides a two-tier system, the supervisory board supervises the management board. However, it is assumed that even though the supervisory board has the statutory authority to bring claims against the management board, the supervisory

558 See Zouridakis, G. (2016) *The Introduction of the Derivative Action into the Greek Law on Public Limited Companies as a Means of Shareholder Protection: A Comparative Analysis of the British, German and Greek Law*. ProQuest Dissertations & Theses, p. 260.

559 See section 78(1) of AktG states that "*the management board shall represent the company in and out of court*".

560 See section 148(4), first sentence of AktG.

561 See also, section 148(3) of AktG.

562 See Hirt, H. C. (2004) *The Enforcement of Directors' Duties in Britain and Germany: A Comparative Study with Particular Reference to Large Companies.* Peter Lang, New York, NY, USA,, pp. 262-266.; Section 112 of AktG provides that "*the supervisory board shall represent the company both in and out of court as against the members of the management board*". In ARAG/Garmenbeck (BGHZ 135, 244, pp. 249-250 and pp. 252-253) 1997, the Federal Supreme Court (Bundesgerichtshof) clearly held that "*the supervisory board not only has the right but the duty, based on its discretion, to decide and pursue claims against members of the management board in certain circumstances*".

board will be unlikely to initiate such claims against it since this may suggest weakness by the supervisory board, who enabled the misbehaviour or wrongdoing.[563]

But, according to the German case law, the members of the supervisory board are obliged to do it, unless it is not within the supervisory board's free discretion to bring such claims against the negligent director if the best interests of the company require it.[564] Otherwise, it may cause questions about the diligent exercise or capability of the duty of the supervisory board to effectively control the management board.[565]

The involvement of the company's governing bodies in the decision-making process to initiate lawsuits against those who have committed wrongdoing may be equivalent to the structural bias that caused the conflict of interests in derivative claims under US law.

3. The Effect of the Court Judgment on Derivative Claims

Section 148 (5) of AktG, first sentence, states that "*any judgment will bind the company and all its shareholders*".[566] On the one hand, the provision has a *res judicata* effect, which would impose a compulsory legal effect for the resolution of the same subject matter (dispute) between the same parties. However, the parties in such claims are not always the same, and, therefore, the condition of this requirement is ambiguous. Therefore, an interesting question may be whether the requirement of this section restricts the court from allowing the claims to be brought by the company or other shareholders for the same wrong in the future.

Having said this, at the same time, section 148 of AktG requires the claimant shareholder to give notice by publication either to the company or the other shareholders, pursuant to section 149 of AktG with the condition that "*it will take effect for and against the company once leave has been granted to bring an action*".[567] This ensures that the defendants will not be exposed to multiple proceedings for the same wrongdoing.[568]

563 See Cox & Thomas (2018) *supra note* 535, p. 922; See also, Baums, T., & Scott, K. E. (2005) Taking Shareholder Protection Seriously? Corporate Governance in the U.S. and Germany. *Journal of Applied Corporate Finance*, [Online] 17 (4), pp. 44-63.

564 BGH 21.4.1997, BGHZ 135, 244 = NJW 1997, 1926 – ARAG/Garmenbeck; cf. also BGH 8.7.2014, NJW 2014, 1058; BGH 18.9.2018, NZG 2018, 1301.

565 See Hofmann & Kurz (eds.) (2019) *supra note* 518, p. 101.

566 According to the section 148(5) second sentence of AktG, this also applies to any settlement agreement to be publicized under section 149(5) of AktG.

567 See section 148(5) and 149 of AktG.

568 See Explanatory Notes RegE-UMAG, BT-Drucks 15/5092, p. 23.

ii. Substantive Requirements: Business Judgment Rule (BJR)

Germany adopted the traditional principle of the American BJR.[569] Before the codification of the German BJR, BGH introduced BJR in 1997 in the case of *ARAG/Garmenbeck*.[570] BGH held that

> "management needs freedom to take decisions, however, their actions must not breach their fiduciary duties, which is not limited to unlawful acts or unjustified risk-taking, but more than acting on an uninformed basis".[571]

UMAG introduced a statutory BJR that may protect the defendant director if a derivative claim is authorized at the preliminary trial. This amendment suggested that a director's decision is not a breach of duty if it was based on an informed basis and he reasonably believed it was in the company's best interests.[572]

The new statutory provision on BJR adopted the elements which have already been established in German case law.[573] Under section 93(1) of AktG the following requirements are listed:

> "1) the duty of care and: 2) the director taking an 'entrepreneurial decision', whereas that decision is made 2) on the basis of adequate information 3) in the interest of the company, 4) in good faith, and 5) no conflict of interest (or self-dealing or any individual interest in the subject)".[574]

Derived from the preceding elements of BJR, it may be concluded that an independent judgment is a core element of both US and German BJRs.[575] The Explanatory Notes of the governmental draft and some scholars in Germany explicitly highlighted the importance of the element of an independent judgment in the assessment of BJR.[576] Therefore, it is most likely that the German courts would prefer following the same approach and require an independent judgment for the application of BRJ.[577] However, even though the German BJR is similar to US BJR (specifically Delaware), according to

569 See Seenacherry (2020) *supra note* 467, p. 12.
570 See ARAG/Garmenbeck, BGHZ 135, 244.
571 Ibid.
572 See Art. I sub-article la of the UMAG; See further on the elements of BJR.
573 See BGHZ 125, 244, judgment of 21 April 1997 (ARAG-Garmenbeck); expressly cited in BT-Drs. 15/5092, p. 11, left column.
574 See section 93(1) AktG; See also, Seenacherry (2020) *supra note* 467, p. 13.
575 See Roth, M. (2008) Outside Director Liability: German Stock Corporation Law in Transatlantic Perspective. *The Journal of Corporate Law Studies*, [Online] 8 (2), p. 356.
576 See Explanatory notes of the governmental draft, Bundestag (German parliament), printed papers, 15/5092, 11.
577 See Roth (2008) *supra note* 575, p. 356.

the German law, the wrongdoer (accused) director must prove that he has taken care of the company's interests diligently and conscientiously.[578]

This implies that the burden of proof in the German law has shifted to the wrongdoer director. The presumption component of the Delaware BJR (the US) is eliminated. Consequently, when a claim is brought against a director, the claimant does not have to challenge the presumption that the director acted in accordance with their fiduciary duties. Instead, the burden of proof is completely placed on the wrongdoer (accused) directors to demonstrate their compliance with their fiduciary duties.[579] Even though BJR may also pertain to the supervisory board, this corporate governance body is not so thoroughly involved in the daily decision-making process of the company, or it makes only a few business judgments.[580] It solely controls and supervises the main task that remains to control and supervise the management board; therefore, the management board is the most responsible corporate governance body in this context.

Thereby, on the one hand, UMAG, in fact, provided more protection for corporate directors, while, on the other hand, it also significantly improved minority shareholders' right to derivative claims. This means that UMAG tried to strike a balance between corporate efficiency and the protection of shareholders' rights or interests.[581]

Thus, despite the amendments made by UMAG to the rules on derivative claims, the distinct principles of company law between common law and civil law systems can still lead to certain differences.[582] For example, even though there are obvious conceptual similarities in the jurisdictions of the UK and Germany on derivative claims, UK law may be largely characterized by great discretionary powers of the courts, compared with the German law, which focuses mainly on predictability and legal certainty.[583]

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578 See section 93 of the AktG. "*The German law differentiates between 'the breach of duty' (the objective aspect of the director's behavior) and 'negligence' (the subjective aspect of the director's behavior). The issue of breach of duty concerns what a director must do or should have done; while the issue of negligence concerns how a director should act, that is, the level of care. As soon as the plaintiff can show that the defendant director has breached his duty (the objective aspect) and that the company has suffered damages as a result, then the burden of proof is reversed, and the director must prove that he did comply with his duty (the subjective aspect). Nevertheless, as to the subjective aspect, the German law takes an objective standard, the standard of a prudent businessperson*". See Stengel, A. (1998) Directors Powers and Shareholders: A Comparison of Systems. *International Company and Commercial Law Review*, p. 52.

579 See Seenacherry (2020) *supra note* 467, p. 15.

580 See Naruisch & Liepe (2007) *supra note* 527, p. 10; Schäfer, ZIP 2005, 1253, 1258; Ihrig, WM 2004, 2098, 2106 (with examples).

581 See Paul (2010) *supra note* 80, p. 114. See also, Li (2007) *supra note* 39, p. 201.

582 See Paul (2010) *supra note* 80, p. 114.

583 Ibid.

3.1.3 Relevance of Section 117 of AktG for the Recovery of Reflective Loss

Despite its narrow scope, German courts and scholars applied section 117 of AktG to support the broader application of the reflective loss rule.

> "Anyone who intentionally compels, by exploiting their influence on the company …, act to the detriment of the company or its stockholders will be under obligation to provide compensation to the company for the damage it has suffered as a result".[584]

The German courts and scholars have used this statutory provision to support the argument that section 117 of AktG is simply an example of a broader principle. This principle allows for the conversion of direct claims for shareholder losses, which could potentially be based on general tort and company law principles, into derivative claims.[585] In this regard, De Wulf stated: "*a derivative claim is the solution in the German law for the avoidance of double duties (jeopardy)*".[586]

In addition, section 117 of AktG provides that

> "the wrongdoer will be under obligation to compensate the shareholders for the damage they have suffered as a result, insofar as they have suffered damage above and beyond the loss result for them by the damage caused to the company".[587]

This implies that direct claims for reflective losses are excluded from the scope of the recovery.

Based on two earlier judgments of BGH, De Wulf believes that

> "when a derivative action is not possible because the company itself could not have sued in the first place, individual shareholders should be allowed to claim personal damages under general tort or contract law".[588]

However, this provision has long been a subject of debate, and many German experts believe that they have been overturned by subsequent judgments such as *Girme,* which I previously addressed in this section.

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584 See section 117 of AktG.

585 See de Wulf (2010) *supra note* 39, p. 1560 (cited *K. Hopt § 93 AktG in* Hopt, K., &Wiedeman, H. (eds.) (1999). *Großkommentar Aktiengesetz*. 4th ed. Berlin: De Gruyter. p. 487).

586 Ibid.

587 See section 117(1) of AktG.

588 See de Wulf (2010) *supra note* 39, p. 1561; BGH WM 1967, 287 and BGH WM 1969, 1081.

Besides, in terms of reflective loss, the German laws of obligations allow only for the compensation of damages to people or property; pure economic loss is, in principle, not subject to compensation.[589] That is why it may be implied that the lawsuit brought due to tort causing a loss in the value of shares may be recovered through a derivative claim, which may compensate the company and the shareholders.

Thus, the legal standard under section 117 of AktG grants shareholders the right to seek compensation for direct loss but not for reflective loss. Therefore, I will not delve into the analysis of these rights here due to the insignificant relevance of such direct claims to SRL.

3.1.4 Summary of the Section

In this section I analysed the approach to the question of SRL under the German law. As a part of the civil law system, the German statutory law does not provide a right for the recovery of reflective losses directly by shareholders. According to the German law, shareholders suffer from the loss in value of the shares, but the loss is no more than shareholders' indirect loss incurred through the company's direct loss; therefore, shareholders cannot bring direct claims for such losses.[590] The rule that a shareholder cannot claim for reflective loss directly applies both to the AG and the GmbH types of companies.[591] It is typically prohibited for an individual shareholder to directly and individually seek compensation for reflective losses.[592]

Similarly to UK and US law, the German law also upholds the *proper plaintiff rule* and establishes that only the injured company can bring a lawsuit to enforce its claims. According to *Girmes,* shareholders are not allowed to recover the reflective loss directly due to the reason (rationale [concern]) related to *prejudice to the protection of creditors* based on the *principle of capital maintenance* (*Kapitalerhaltung*) and *the company assets for the purposes of business (*Zweckbindung).

Even though the German law also provides the same reason (rationale [concern]) for the prohibition of SRL as UK and US law did, the German law justifies its positions

589 See section 823 of II BGB and section 826 of BGB: Unless "*[t]he same duty is incumbent on a person who commits a breach of a statute that is intended to protect another person. If, according to the contents of the statute, it is possible to violate it also without fault, then liability to compensation only exists in the case of fault*". (Section 823 of II BGB) or "*A person who, in a manner offending common decency, intentionally inflicts damage on another person is liable to the other person to provide compensation for the damage. someone intentionally harms someone else in a way*" (Section 826 of BGB).

590 See Li (2007) *supra note* 39, pp. 199-200, p. 202.

591 Ibid.

592 See generally, de Jong (2013) *supra note* 40, p. 3: "*The basic rule in most jurisdictions, including the United Kingdom, Germany and the Netherlands, is that a shareholder cannot recover a loss which is simply reflective of the company's loss*".

on the prohibition of SRL, focusing specifically on the reason (rationale [concern)]) related to *prejudice to the protection of creditors* through the application of the *principle of capital maintenance (Kapitalerhaltung)* and *the company assets for the purposes of business (Zweckbindung).*

Nevertheless, even though *Girmes* strongly follows the *no reflective loss rule*,[593] it also reminds the shareholders of alternative legal avenues such as derivative claims for the recovery of reflective losses. *Girmes* revealed that the shareholders' economic losses can be recovered through the recovery of the company's loss directly by the claims brought by the company itself or through derivative claims on behalf of the company by shareholders, which guarantees the application of the *principle of judicial economy* set out in the landmark US case, *Gaubert.*

Therefore, I further analysed derivative claims under the German law. According to the AktG rules after UMAG, almost all minority shareholders of AG companies are permitted to bring derivative claims. However, such a right is not provided for the GmbH type of companies under the German statutory law.

The research shows that derivative claims, subject to limited conditions (requirements), address solutions for concerns raised against the admissibility of SRL related to consistency and/or prejudice to the protection of creditors.[594] These solutions may include court intervention at the preliminary stage, the requirement for consolidation, the effect of the judgment on the company and other shareholders as well as the recovery directly by the company rather than the claimant shareholder, which may eventually mitigate (or avoid) double recovery and double duties (jeopardy) and protect the creditors.[595]

The two main components of SRL, which is the possibility to bring direct claims against third parties – wrongdoers and the direct recovery of the loss by shareholders – are absent in the German derivative claims. This means, similarly to US law, the possibility to bring derivative claims by shareholders against third parties who injure the company but are not involved in its governance, such as governments, outside tortfeasors, or co-contractors, are generally unavailable under the German law.[596] Also, similarly to UK and US law, the recovery (compensation) directly goes to the injured company but not to the injured shareholder.

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593 See de Jong (2013) *supra note* 40, p. 8.

594 See Ibid., p. 4 (citing Brandes (1988) supra note 502, pp. 13-22).

595 See Gaukrodger (2013) *supra note* 7, pp. 19-20. See section 148 and 149 of AktG.

596 See Gelter (2012) *supra note* 519, p. 877: "*derivative claims against outsider third parties are not permitted in Continental Europe: "possible defendants in Continental European [shareholder] derivative claims are limited to directors (including supervisory board members) and in some cases corporate officers, auditors, or the founders of the corporation*" (citations omitted). Except the UK (according to the *UK Companies Act s. 260 (3))*, in the US, defendants in derivative claims are also usually directors, officers or other corporate insiders although there is no legal limit on the targets of derivative claims; See also, Clark (1986) *supra note* 452, pp. 643-644.

Thereby, the judge in Germany is responsible for evaluating the seriousness of the management's (directors') wrongdoings against the company's interests in derivative claims. This is done through a system that closely resembles the preventive trial process in US courts, which assesses the legitimacy of the dispute or the claim.[597]

However, it is difficult and inappropriate to compare the German law on shareholder rights and remedies with UK and US law. Because shareholder-oriented systems are common law, countries focus on strong protection of shareholder rights, which particularly protect minority shareholders.[598] On the contrary, in the corporate governance-oriented systems, such as Germany (and Japan), the rights of shareholders are more equally distributed into corporate governance of the company, pertaining to the *principle of* "*checks and balances*".[599]

Additionally, I examined and found that since section 46(8) of GmbHG ("*the right to commence a corporate lawsuit against a defaulted shareholder ['actio pro socio']*") and section 117 (1) of AktG ("*duty to provide compensation for damages*") concern the recovery of direct losses by shareholders based on breaches of their personal rights, they are of insignificant relevance to SRL.

Thus, derivative claims under the German law conceivably remain the only alternative legal avenue for recourse to seek the recovery of reflective losses of shareholders, albeit in limited conditions.

I will now explore the question of SRL under the French law in the following section.

597 See Latella (2009) *supra note* 544, p. 318.

598 See Bottenberg, K. et al. (2017) Corporate Governance between Shareholder and Stakeholder Orientation: Lessons from Germany. *Journal of Management Inquiry*, [Online] 26 (2), p. 167; See Li (2007) *supra note* 39, p. 235.

599 See Latella (2009) *supra note* 544, p. 318.

3.2 Shareholder Claims for Reflective Losses (SRL) in the French Law

This section explores SRL (*Réclamations des actionnaires pour pertes répercutées* in French) in France. Similarly to the German law, the French law, as a part of the civil law tradition, does not generally allow shareholders to directly recover reflective losses. However, unlike the laws of the UK, US, and Germany, the French law justified its position for the prohibition of SRL based on the compensation rules. Therefore, I will first explain the reasons (rationale [concerns]) for the prohibition of SRL based on the compensation rules under the French law in the following subsection.

3.2.1 Reasons (Rationale [Concerns]) for Prohibition of SRL in the French Law

The French law establishes extremely strict compensation rules. The reason why the French law approaches the question of SRL based on the compensation rules might be explained by the possibility of the recovery of pure economic loss[600] through the general legal norms of the laws of obligations.[601] This is not the case in the German law.[602] The rules equivalent to the UK *proper plaintiff rule* and the prohibition of reflective loss only apply to liability claims for compensatory damages.[603]

According to the French case law, the damage, to be compensated, must fulfil three fundamental characteristics: it must be personal, certain, and direct.[604] But, in the case of contractual liability, the damage must also be foreseeable.[605]

Thereby, the French law explains its position to SRL for two reasons*: i. Lack of certainty.* ii. *Lack of personal loss.*

i. Lack of Certainty

The shareholders' losses suffered from the devaluation of their shares are not recoverable. In France, the *principle of compensation* applies to all civil law actions, such as tort and

600 See Hoebanx, O., & Le Grand de Belleroche, D. (2006) L'Evaluation Contentieuse Du Prejudice. *Quelles Regles?* 5, pp. 37-47.

601 See Art. 1382 of the Civil Code: "*Any act whatever of man, which causes damage to another, obliges the one by whose fault it occurred, to compensate it*". The concept of duty has no role in French tort law.

602 See section 826 of BGB and section 823 of II BGB.

603 See De Dier, S. (2013) Friends with Benefits: A Comparative View on Legal Standing to Challenge Board Decisions. *European Company and Financial Law Review*, [Online] 10 (3), p. 499.

604 See, for example, among many others of this long-standing requirement, Court of Cassation, Second Civil Chamber, 12 November 1986, appeal no. 85-14.486).

605 See, for example, Court of Cassation, Commercial Chamber, 11 March 2020, appeal no. 18-22.472.

contract matters. Its objective is to restore victims to the same position they would have been in if the wrongdoing had never occurred.[606]

Usually, the court must establish the amount of compensation to be awarded either for the current losses suffered or for future losses that may occur.[607] In terms of future loss, the court can decide the wrongdoer to compensate for the loss of business opportunities (e.g., *profit*) in tort or in contract matters.[608] An essential factor to consider during the calculation of the loss is the actual likelihood of the victim obtaining *profit* in the first place[609] or, in other words, the lost profit.

The issue with reflective loss is that in contrast to damage resulting from the loss of *profit,* this type of loss is not always apparent. The value of this lost *profit* can be calculated when a company is unable to engage in a contract.[610] Chaisse & Zhuoyue Li argue that "*the loss of share value that may result from the company's wrongdoings is difficult to calculate, as shareholders may never transfer their shares in the future*",[611] but I would disagree with this statement, since the assessment of the loss in share value is not based on the sale transaction alone. The impact of the company's loss on the share's value might likely be calculated based on the valuation methods – for example, "*asset valuations*, *earnings valuations,* and *discounted cash flow valuations*".[612] But I agree that the adverse impact experienced by the company's loss does not always result in a decrease in the value of shareholders' shares, even in the case of a lost profit.[613]

ii. Lack of Personal Loss

The personal nature of the loss means that the claimant can get compensation only to the extent he suffered from the loss. This approach adapts the rule outlined in Article 31 of the Code of Civil Procedure on liability, according to which "*the plaintiff must have a legitimate interest in the success of his claim*".[614] This rule is usually not complicated except in the case of so-called *pertes par ricochet* reflective (indirect) loss.

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606 See Hoebanx & Le Grand de Belleroche (2006) *supra note* 600, pp. 37-47.

607 See Chaisse & Li (2016) *supra note* 4, p. 56.

608 Ibid.

609 Ibid.

610 See, for example, *Cour de Cassation*, commercial division, appeal no. 19-12.342, 4 November 2021: "*[t]he mere fact that this partner is acting on the basis of contractual liability is not sufficient to establish the personal nature of the alleged loss*".

611 See Chaisse & Li (2016) *supra note* 4, p. 56.

612 See Mitchell, C. (2004) Shareholders' Claims for Reflective Loss. *Law Quarterly Review*, 120, pp. 457, 475-476.

613 See Chaisse & Li (2016) *supra note* 4, p. 56.

614 See Art. 31of the French Code of Civil Procedure (Code de procédure civile) 2007: "*The action is open to all those who have a legitimate interest in the success or rejection of a claim, subject to cases in which the law attributes the right to act only to persons who 'it qualifies to raise or combat a claim, or to defend a specific interest'* ".

The French Supreme Court (*Cour de Cassation)* held that

> "a drop in value of shares caused by directors is not a loss suffered personally by the shareholder but is only a corollary of the damage suffered by the company (dommage en corollaire").[615]

This means that according to the French law, shareholders do not suffer a personal loss due to the direct loss of the company. The notion of *reflective loss* is more precisely understood as the loss suffered by "*the community – which is represented by the legal entity –, and that all of its members (shareholders) suffer, because of their membership in this community, only by repercussion*".[616]

The individual shareholder's personal loss is distinct and "*directly affects the shareholder's assets without at the same time implying an attack on the corporate assets*".[617] The individual shareholder's loss cannot therefore constitute

> "a simple replica, at the level of this shareholder, of the corporate loss, which he or she would suffer by the mere fact that he or she is a member of the company, in proportion to the shares he or she holds".[618]

This implies that

> "the criterion for determining loss specific to the shareholder is not the absence of loss to company interests and assets, but rather the presence of a loss that is distinct from the loss experienced by the company".[619]

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615 See *Court of Cassation*, Criminal Chamber, Nos. 97-80664, 99-80387, 99-84855 (13 December 2000) *(three decisions)* rejecting shareholder claims because "*the depreciation of the securities of a company resulting from the criminal actions of its directors constitutes, not damage specific to each partner, but damage suffered by the company itself"; Versailles Ct. App. No. 04-1262 (13 September 2005) (Sat). See also, Court of Cassation*, Commercial Chamber, No. 97-10886 (15 January 2002)*:* "*the damage invoked by Mr. 'had no personal character*"*;* See also, Likillimba, G.-A. (2009) Le préjudice individuel et/ou collectif en droit des groupements. *RTDCom. Revue trimestrielle de droit commercial et de droit économique*. 1, p. 6.*:* "*The commercial court has determined that when a corporation is profitable, requests for compensation for individual suffering are often rejected, as long as they are regarded to be part of company loss*".

616 See Danos F. (2008) *La réparation du préjudice individuel de l'actionnaire*. 5 Revue De Jurisprudence De Droit Des Affaires 473, p. 7.

617 Ibid., p. 13; See also, Barbièri, J.-F. (2012) Préjudice social du fait d'un tiers versus préjudice personnel d'un associé [Social Harm Caused by a Third Party Versus Personal Harm Caused by an Associate]. *Bulletin Joly des Sociétés*, 9, 634, p. 5: "*The personal reparable harm must be understood as that which the interested party feels directly, in his person or in his assets, and not exclusively in a reflective manner, by the sole repercussion of a damage caused in the first place to the legal entity*".

618 See Danos (2008) *supra note* 616, p. 7.

619 Ibid., p. 13: "*The criterion for distinguishing social damage from reparable individual damage consists of the fact that the latter will directly affect the value of the securities or the financial situation of the shareholder*

As Fréderic Teffo summarizes, "*the shareholder disappearing behind the company can only justify an individual prejudice if it differs from that which would have affected the legal person itself*".[620]

Such a distinction made by the scholars between shareholders' personal loss and company loss stems from the French case law. According to the French courts, the admissibility of a shareholder's claim alleging personal loss is subject to the demonstration not only of the "*strictly personal nature of such loss, but also of the fact that it is distinct from that which could be caused to the legal entity*".[621]

The French Supreme Court (*Cour de Cassation)* held that "*the alleged negligence of the bank only caused loss to the company as an independent legal entity, but not to its shareholder*",[622] which is distinct from the personal loss that might be occurred to the shareholders by the bank.

Further in this regard, Guy-Auguste Lilikimba points out that "*the consideration of individual harm is only considered in exceptional cases, meaning that it must be demonstrated as personal and separate from the collective (company) harm*".[623] Also, Vatinet observes that

> "[r]eparation of the shareholder's individual prejudice has become highly exceptional. It is not compensable as such if it appears to be included in the social prejudice (company's loss). The rare cases of distinct prejudice that can be envisaged are not free of ambiguity".[624]

Thereby, "*the shareholder's success in obtaining compensation for their damages is rare, as it is difficult to differentiate between their personal damages and those of the company*".[625]

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without the company's assets having been affected. Reparable individual damage is that which directly affects the shareholder's assets without at the same time implying an attack on the company's assets".

620 See Teffo, F. (2019) Réflexions sur le fondement de la reconnaissance du préjudice individuel de l'associé. 4 *Revue Des Sociétés* 237, p. 3.

621 Ibid., Frédéric Teffo states that the case law has "*established the solution that an action seeking compensation for a partner's individual prejudice is admissible only if proof is provided that this prejudice is personal to the partner and distinct from that which could be suffered by the partnership itself. The Cour de cassation will interpret this requirement of an individual and distinct prejudice strictly … the plaintiff must establish not only that the prejudice he has suffered is of a strictly personal nature, but also that it does not merge with the prejudice suffered by the legal entity*".

622 See Cour de cassation [Cass.] [supreme court for judicial matters] com., 28 January 2014, Bull. civ. IV, No. 12-27901.

623 See Likillimba (2009) *supra note* 614.

624 See Raymonde, V. (2003) La réparation du préjudice causé par la faute des dirigeants sociaux, devant les juridictions civiles. *Revue des sociétés*, (2), p. 15: "*Compensation for individual shareholder losses has become the exception rather than the rule*".

625 See Jullian, N. (2021) À la recherche de l'introuvable préjudice personnel de l'associé. *Recueil Dalloz* (n° 38)p. 1.

Thus, the French company law allows shareholders to initiate lawsuits against the wrongdoer both in their personal capacity and on behalf of the company.[626] The French Commercial Code (*Code de Commerce*) of France states that

> "[a]part from actions for personal loss or damage, shareholders may either individually or in an association fulfilling the conditions laid down in Article L.225-120, or acting as a group in accordance with conditions to be laid down by an Order approved by the Conseil d'Etat, bring an action for liability on behalf of the company against its directors or managing director. The plaintiffs shall be authorized to sue for compensation for the full amount of the loss or damage suffered by the company, to which damages shall be awarded if necessary".[627]

As is evident above, Articles L. 225-251 and 225-252 of the French Commercial Code (*Code de Commerce*) make a distinction between *action sociale ut singuli* and *action individuelle*.[628] This means the French company law provides the rules mainly for the two types of shareholder claims:

1. *action individuelle,* which is the claim brought by an individual shareholder for a personal loss.[629] This might be referred to as a direct claim for a breach of personal rights by shareholders, and
2. *action sociale ut singuli* – a specific provision is made for derivative claims by shareholders on behalf of the company to enforce the civil liability of directors (breach of fiduciary duties) individually or collectively.

Nonetheless, the basic *proper plaintiff rule* established in *Fos & Harbottle* is still alive and remains in effect in France as well.[630] In other words, the *action sociale* (claims

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626 See Chaisse & Li (2016) *supra note* 4, p. 55: See Thomas, R. S. et al. (2023) 'Shareholders' Inspection and Investigation Rights in France. In P. Giudici, R. S. Thomas, & U. Varottil (eds.), *Research Handbook on Shareholder Inspection Rights*. [Online]. Edward Elgar Publishing Limited., Cheltenham, UK: "*Shareholder could file a derivative suit (action sociale ut singuli) against the company and the directors and managers*": See Art. L. 225-252 of the French Commercial Code (Code de Commerce) for the public limited liability company; Art. L. 223-22 of the Commercial code (Code de Commerce) for the private limited liability company. On the contrary, the German private limited liability companies ("GmbH") do not hold such an explicit right under the German company law; see the section on the German law.

627 See Art. L. 225-252 of the French Commercial Code (Code de Commerce) for the public limited liability companies.

628 See also, de Wulf (2010) *supra note* 39, p. 1558; (cited D. De Marez (2004) De afgeleide schade van aandeelhouders van een naamloze vennootschap, Unpublished Doctoral Thesis, pp. 130-194 (on file with the author and available in all Belgian law school libraries).

629 See Boyle (2002) *supra note* 217, p. 45: For example, "*an action for fraudulent misrepresentation by directors inducing shareholders to subscribe for additional shares on the basis of false balance sheets*".

630 See de Wulf (2010) *supra note* 39, p. 1558.

brought by the company itself) is also one of the claims brought by the company against its directors for the damage they have inflicted upon the company.[631]

Thus, I will explore shareholders' derivative claims for reflective loss under the French law in the following subsection.

3.2.2 Shareholder Derivative Claims for Reflective Loss

Action sociale ut singuli is the derivative claim initiated by any shareholder (or shareholder association or group of shareholders) against directors for the recovery of the company loss. The claimant shareholder must prove that a loss "*(i) direct, certain and personal damage, in this instance, suffered by the company, (ii) management deficiency, and (iii) causal connection*".[632] In most cases, a derivative claim may be brought only if the company fails to exercise its "*action sociale* rights".[633] Similarly to US and German laws, the French law does not allow shareholders to bring derivative claims against third parties such as governments and contractors.[634]

Since the claim is derivative, any compensation for the loss is awarded to the company,[635] and the shareholder who initiates a lawsuit must claim compensation for all losses the company suffered and not just for a percentage that corresponds to the loss value of the shareholder's shares. In this scenario, "*the 'prejudice' experienced by the individual shareholder appears as the 'reflective' loss to their share caused by the reduction in company assets*".[636] This loss is perceived as a "spread" due to the nature of the share.[637] As some French scholars believe that this element of derivative claims can reduce initiatives of shareholders, since the shareholder cannot receive, at least not directly, any compensation paid to the company.[638] This is why an individual shareholder claim (direct claim) would be preferable for shareholders which guarantees

631 See Art. L225-251 of the French Commercial Code: "*The directors and managing director shall be individually or jointly and severally liable to the company or third parties either for infringements of the laws or regulations applicable to public limited companies, or for breaches of the memorandum and articles of association, or for tortious or negligent acts of management*".

632 See Grelon, B. (2009) Shareholders' Lawsuits Against the Management of a Company and its Shareholders under French Law. *European Company and Financial Law Review*, [Online] 6 (2-3), p. 212.

633 Ibid.; See also, de Wulf (2010) *supra note* 39, p. 1558.

634 See Art. L.225-252 of the French Commercial Code.

635 See Arts. 1843-5 of Code Civil: "*In addition to an action for compensation for the loss personally suffered, one or several members may institute an action on behalf of the firm against the directors. The claimants are entitled to seek compensation for the loss suffered by the firm; in case of award, the damages shall be allocated to the firm*".

636 See Latella (2009) *supra note* 544, p. 315 (cited Guyon, Y. (2001) *Droit des affaires. Tome 1. Droit commercial général et Sociètés*. XI ed. Paris, France, p. 496).

637 Ibid.

638 See Grelon (2009) *supra note* 632, pp. 212-213.

that if a claim is successful, they will get paid directly.[639] However, reflective losses are not recoverable under such direct claims in the French law.

Thus, I will, in what follows, review the *i. Procedural* and *ii. Substantive requirements* (limitations) of shareholders' derivative claims under the French law.

i. Procedural Requirements

Article L.225-252 requires a lawsuit to meet the procedural requirements for derivative claims stipulated in Article 225-120 as follows:

> "1) Holding at least 5% of the voting rights; 2) Admission of shares to trading on a regulated stock market and Registration of shares at least for two years; 3). Notification to be sent to the company and the Commission des Operations de Bourse [Securities and Investments Board] of their legal status."

1. Contrary to the laws of the UK and the US, the French law requires a threshold of 5% of the share capital for derivative claims.[640] In other words, only the shareholders with 5% voting rights ("*in listed companies « at least 5% of those having the right to vote»: Art. L. 225 -120, par. 1, cod. comm.; in* "*closed*" *companies, the «twentieth part of the share capital»: Art. 200, l.d. n. 67 -236*")[641] are allowed to bring derivative claims.[642]

Even a 5% share may be a significant obstacle for large-listed companies to initiate such lawsuits. However, this rule provides an interesting feature and applies only to the claims brought in an association by shareholders. The percentage for voting rights varies depending on the scale of capital[643] which might be considered as a solution for the large-listed companies.

"*The more widespread the capital between the shareholders, the lower the percentage request*"[644] could enhance the smooth and efficient implementation of shareholders'

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639 Ibid.

640 See Art. 245 of the French Commercial Code (Law No. 66-537).

641 See Latella (2009) *supra note* 544, p. 315.

642 See De Dier (2013) *supra note* 603, pp. 487-488: "*However, no thresholds apply. The value of a shareholder's interest thus is irrelevant (Art. L223-22/225-25 French Commercial Code ('FCC') and 1850 CC)*"; See also, Germain, M., & Magnier, V. (2011) *Les sociétés commerciales*. 20th éd. France: L.G.D.J./Lextenso, p. 577ff; Grelon, B. (2009) Shareholders' Lawsuits Against the Management of a Company and Its Shareholders Under French Law. *European Company and Financial Law Review*, [Online] 6 (2-3).

643 See Art. L225-120 of the French Commercial Code (Order No 2000-916 of 19 September 2000 Art. 4 and Annex II Official Gazette of 22 September 2000, in force on 1 January 2002): "*Where, however, the company's capital exceeds 5,000,000 F, the share of voting rights to be represented pursuant to the preceding paragraph is reduced according to the number of the voting rights relating to the capital, as follows: 1.4% over 750,000 euros and up to 4,500,000 euros; 2.3% over 4,500,000 euros and up to 7,500,000 euros; 3.2% over 7,500,000 euros and up to 15,000,000 euros; 4. 1% over 15,000,000 euros*".

644 See Latella (2009) *supra note* 544, p. 320.

rights.[645] As for individual shareholders, they do not have to hold at least 5% voting rights to initiate derivative claims.[646]

2. An additional requirement for the permission of derivative claims is established by the French law, which is absent from the laws of the UK, the US, and Germany. According to this additional requirement, derivative claims may be initiated by shareholders only if the shares have been traded on a regulated stock market for a minimum of two years.[647] These two-year holding requirements have been included in the law to prevent abusive and vexatious claims, which might also imply that the French law adheres to the same *contemporaneous rule* examined in the examples of the US and Germany. The claimant must be a shareholder at the time of the lawsuit and remain so during the whole course of legal proceedings.[648] Otherwise, the lawsuit is transferred to the original claimant, which is the company itself.[649]
3. However, in contrast to the laws of the US and Germany, shareholders under the French law do not have to first demand that the company bring derivative claims against the wrongdoers. Shareholders simply must send a prior notification to the company, and their claim must be brought before any lawsuit by the company has been initiated.[650] The purpose of this rule is to prevent multiple proceedings and ensure predictability in such claims.

ii. Substantive Requirements: Business Judgment Rule (BJR)

In France, there is no explicit provision that specifically addresses the rights of directors to justify their position to avoid liability for the wrongdoing based on BJR. Nevertheless, the claimant shareholder has a duty to prove evidence that a mistake has been committed. This means that the burden of proof of wrongdoing belongs to the claimant, as in US law. However, even though the French law does not explicitly provide this type of justification for the wrongful actions of directors if the claimant shareholder is not able to prove a

645 Ibid. (cited Latella (2005) *L'azione sociale di responsabilità esercitata dalla minoranza*, Torino. passim).

646 See Art. L225-252 of the French Commercial Code (Law No 2001-420 of 15 May 2001, Art. 107(8) Official Gazette of 16 May 2001): "*Apart from actions for personal loss or damage, shareholders may either individually or…*".

647 See Art. L225-120 of the French Commercial Code: "*In companies whose shares are admitted to trading on a regulated stock market, shareholders whose shares have been registered for at least two years…*".

648 See Grelon (2009) *supra note* 632, p. 212.

649 Ibid.

650 See de Wulf (2010) *supra note* 39, p. 1558 (cited as examples, Ripert, G., Roblot, M., Germain, M., & Vogel, L. (1998) *Traité de droit commercial*, vol. I. Paris: Montchrestien, pp. 1308, 1765; Cour d'appel Douai, 29 April 1997, JCP, la Semaine Juridique, note J.-J. Daigre. The court held that "*if the company decides to bring an* "*action sociale*" *after a shareholder has initiated the derivative action, the latter lapses and cannot proceed anymore*". Some French authors criticize this approach and consider that both claims should exist completely independently: See, for example, Barbieri, J.-F. (2001) Exercice ut singuli de l'action sociale par un associé: étendue du droit de formuler des demandes pour la société et d'exercer les voies de recours en son nom. *Bulletin Joly sociétés*, p. 509; Raymonde (2003) *supra note* 624, 251 (12).

wrong has been committed, it would mean the directors are exempted from the liability. Therefore, I would not state that BJR does not completely exist in France.

I will now review the interaction between Article 1382 of the French Civil Code and Article L225-252 of the French Commercial Code in the following subsection, which has been a subject of debate on the question of SRL.

3.2.3 Interaction Between Article 1382 of the French Civil Code and Article L225-252 of the French Commercial Code in the Case of Reflective Loss

The aim of this subsection is to address an issue that has been acknowledged within the French legal system, namely the lack of conformity between the general rules of the French Civil Code and the rules of the French Commercial Code.

According to Article 1382 of the French Civil Code, "*anyone who negligently causes damage can be held liable by any victim*",[651] which means shareholders might be allowed to bring direct claims for the loss in share value that constitutes reflective loss. This is the case in France since the French law does not require the establishment of "duty" for the wrongdoing between the victim and the wrongdoer.

However, while acknowledging the overall issue of reflective loss, shareholders may nevertheless face discrimination in comparison to other possible victims of tort violations.[652] Therefore, there is a disagreement among the French authors on whether Article 225-252 of the French Commercial Code should exempt the basic legal principles of tort law (Art. 1382 of the French Civil Code) in case of reflective loss.[653]

Thus, on the one hand, due to Article 225-252 of the French Commercial Code, it seems the recovery of reflective losses directly by shareholders is not possible. On the other hand, individual shareholders as victims as mentioned in Article 1382 of the French Civil Code who have suffered financial losses should be allowed to bring direct claims for the recovery of reflective loss if the loss is certain, direct, and personal.[654]

3.2.4 Summary of the Section

In this section I analyse the approach to the question of SRL under the French law. In contrast to the laws of the US, UK, and Germany, France approached the question of SRL in accordance with the compensation rules since the law allows the recovery of

651 See Art. 1382 of the French Civil Code 1804: "*Any act whatever of man, which causes damage to another, obliges the one by whose fault it occurred, to compensate it*".
652 See de Wulf (2010) *supra note* 39, p. 1558.
653 Ibid., p. 1559.
654 Ibid., p. 1563.

pure economic loss through the general rules of the Civil Code. According to the French law, to seek compensation, particularly for the reflective loss, the loss must be personal, certain, and direct. Therefore, the French law justified its position based on the two reasons which pertain to the elements of the compensation:

1. Based on the first reason, a reflective loss is uncertain since it is not possible to precisely calculate the loss of the share's value. I personally disagree with this viewpoint, since there are a few valuation methods for the loss of the share value mentioned earlier in this section.
2. The second reason is justified by the absence of personal loss in case of reflective loss. The French Court held that "*shareholders are restricted from directly recovering reflective loss, as this type of loss is a loss suffered by the company itself*".[655] This implies that the French courts focused on the nature of loss as the determining criterion, rather than on the concerns related to double recovery, double duties (jeopardy), and prejudice to protection of creditors that have been raised under US, UK, and German law.

Nevertheless, similarly to the laws of the US, UK, and Germany, the French law likewise provides an alternative legal avenue to seek the recovery of reflective loss through derivative claims. Therefore, I analysed shareholder derivative claims under the French Commercial Code too. While the French Commercial Code sets forth rules for derivative claims that could alternatively result in recovering reflective loss, it also establishes specific procedural and substantive requirements for bringing such claims.

I further reviewed the interaction between Article 1382 of the French Civil Code and Article L. 225-252 of the French Commercial Code, which causes ambiguity in situations involving reflective losses. The main question was whether Article L. 225-252 of the French Commercial Code (derivative claims) precludes the general rights of shareholders as a victim to recover reflective loss, which might potentially be pursued in accordance with Article 1382 of the French Civil Code (tort liability) in the event of a fault (wrong). This analysis showed that the French law has not yet provided a definitive and unambiguous response to these questions, which requires further research on this issue. Therefore, derivative claims currently remain the most suitable alternative legal avenue to seek the recovery of reflective losses in France.

Thus, I will provide a summary and conclusion of Part II on the question of SRL in the following chapter.

655 See Chapter 3 (Sections 3.2 and 3.2.1) of Part II of this book.