AJEE
ACCESS TO JUSTICE IN EASTERN EUROPE
Peer-reviewed Journal

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print)
ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

Research Article

DERIVATIVE LAWSUIT IN UKRAINE: THE ISSUE OF IMPROVING LEGAL REGULATION

Heorhii Smirnov*[1]
smirnof.goerge@gmail.com
https://orcid.org/0000-0001-6722-0030

Submitted on 02 July 2021 / Revised 27 Sept 2021 / Revised 13 Nov 2021 / Approved 13 Dec 2021 Published online: 15 Dec 2021

Keywords: derivative lawsuit, property qualification, locus standi, business judgement rule, preventive derivative lawsuit, derivative lawsuit for invalidation of a company's transaction

1 Postgraduate Student, Civil Law Department, Law School, Taras Shevchenko National University of Kyiv, Ukraine smirnof.george@gmail.com https://orcid.org/0000-0001-6722-0030
Corresponding author, solely responsible for writing, conceptualization, data curation, and methodology. Managing Editor – Dr. Olena Terekh. English editing – Dr. Sarah White.
Competing interests: No competing interests were disclosed.
Grant information: The author declared that no grants were involved in supporting this work.

How to cite: H Smirnov 'Derivative Lawsuit in Ukraine: The Issue of Improving Legal Regulation' 2022 1(13) Access to Justice in Eastern Europe. DOI: https://doi.org/10.33327/AJEE-18-5.1-a000093
Disclaimer: The author declares that his opinion and views expressed in this article are free of any impact of any organizations.

First published: 15 Dec 2021 (https://doi.org/10.33327/AJEE-18-5.1-a000093)

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

ABSTRACT

Background: *Some jurisdictions provide for the right of members of a corporation to sue on its behalf and in its interests. This remedy is called 'a derivative action' (derivative lawsuit), and the right to file such a lawsuit is granted to a company's members in case the wrongdoers are in its control, preventing the company from taking actions to protect its rights and interests – which is detrimental to the interests and rights of minority shareholders. However, derivative lawsuit's regulation differs in each jurisdiction despite sharing common features, raising a variety of issues to be resolved.*

Methods: *In this article, the author points out several issues and their possible solutions, which could be implemented in Ukrainian legislation: property qualification by itself cannot prevent abuse in filing a derivative lawsuit – extended 'locus standi' has to be implemented; holders of preferred shares have to be granted the right to file a derivative lawsuit; property qualification has to be substituted with a representation quota for members of non-entrepreneurial corporations; the circle of defendants should include major members (majority of members) and third parties, etc.*

Results and Conclusions: *The concepts of a preventive derivative lawsuit and a derivative lawsuit for the invalidation of a company's transaction and possible issues regarding them are analysed. Additionally, the necessity for implementing a 'business judgement rule' is emphasised.*

1 INTRODUCTION

The institute of derivative action originated from common law countries, namely the United Kingdom, as an exception to the precedent-based 'proper plaintiff rule' in the case of *Foss v. Harbottle*, which is worded as follows: 'In any action in which a wrong is alleged to have been done to a company, the proper claimant (plaintiff) is the company itself'.[2]

This means that the plaintiff may be the person that has the financial claim against the defendant. At the same time, there are frequent circumstances in corporate (membership) relations where the legal entity's ability to defend its violated rights on its own is ruled out due to a defect of its will: the offender is also the person who forms and (or) expresses the legal entity's will. Such persons can be a majority member (shareholder), a majority of members (shareholders), or an official. In due course, these circumstances resulted in the exception to the 'proper plaintiff rule': members of a corporation may bring a claim for and on behalf of the legal entity if a wrong has been done to the latter by the persons who manage it (both majority members and officials). This opportunity of the persons affiliated with the corporation with membership constitutes the content of a derivative action as a remedy.

A derivative lawsuit is defined as a legal remedy used to defend a legal entity's rights, which enables its members to bring and affirm claims for the legal entity if the latter does not initiate the lawsuit on its own due to the interests of its controllers.[3] A derivative action is generally used to indirectly defend the interests of members (shareholders) in connection with the value of their stock (shares) and payment of dividends or liquidation quota rather than their rights. As O. V. Bihniak rightly states:

1 D Kershaw 'The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle' (2013) 5 LSE Legal Studies Working Paper 4-5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209061> accessed 8 August 2021.

2 LA Ostrovska 'Indirect (derivative) lawsuits: international experience and legislation of Ukraine' (abstract of PhD (Law) Thesis, National University 'Odessa Law Academy' 2008) 4-5.

> regarding the use of the term "indirect" and "derivative", it comes down to the fact that the participant (shareholder) who initiated the lawsuit is not a direct beneficiary in the dispute, such a person is the company itself, but the rights (interests) of the participant are protected by protecting the interests of the company.[4]

It is essential to note that pecuniary equity rights (not to be confused with the equity rights of binding nature – such as the right to demand payment of declared dividends or right to demand payment of the liquidation quota) are not violated since their idea is to establish the holder's capability of having a property interest in the results of the corporation's activity. They do not enable the person to claim the specific volume of property: it is only a proportional interest in the future distribution of property results. At the same time, the above does not mean that a derivative action cannot be used as a remedy to defend the rights of members (shareholders) of the corporation. We agree with the opinion that a derivative lawsuit may be filed in order to indirectly protect not only the interests but also the rights of a legal entity's members.[54] In particular, indirect protection of a shareholders' rights takes place when the company's losses, resulting from the actions (inaction) of officials or a majority of members or even transactions conducted by the executive body, prevent the exercise of equity rights of a binding nature – payment of dividends or liquidation quota. Given the specific volume of dividends or liquidation quota that the shareholder is entitled to, the corporation's inability to make payments in the prescribed volumes violates the shareholders' rights.

However, a derivative action is not limited to damages. Officials (or a majority member or majority of members) are usually not able to fully pay damages caused by their actions (or inaction). In addition, there are many cases of concluding fraudulent transactions to the detriment of the interests of a minority of members of the corporation. In such cases, when the corporation cannot defend its violated rights, the rights and interests of the corporation (as well as the rights and interests of its members) are protected by invalidating the transaction on the claim of a minority participant (or participants) of the corporation, which is also a derivative claim. Regarding this type of derivative lawsuit, another instance of indirect protection of the shareholder's specific right may be presented – namely, when a transaction was concluded in breach of the preliminary approval procedure, filing a lawsuit for rendering it void will indirectly protect the shareholder's right to manage the company.

It should be noted that a derivative action is a form for implementing the doctrine of 'piercing the corporate veil' due to transferring the right to bring an action for damages held by the legal entity to its members (shareholders), even though their rights have not been directly violated. In the case of *Agrotexim Hellas SA and others v. Greece (1995),* deciding whether the shareholders could bring an action on the company's behalf and could be recognised 'victims' instead of the company in the meaning of the Convention on Protection of Human Rights and Fundamental Freedoms (hereinafter 'the Convention'), the European Court of Human Rights (ECtHR) reiterated that

> ...the piercing of the "corporate veil" or the disregarding of a company's legal personality will be justified only in exceptional circumstances, in particular where it is clearly established that it is impossible for the company to apply to the Convention institutions through the organs set up under its articles of incorporation or – in the event of liquidation – through its liquidators.[5]

4 OV Bihniak OV, 'Derivative action and corporate contract as means of corporate rights protection: experience of Ukraine' (2018) 5 (3) European Political and Law Discourse 231-232.

5 SO Koroed, VM Mahinchuk, 'Derivative (indirect) lawsuits of the founders of legal entities as a form of implementation of the doctrine of piercing the corporate veil' (2020) 44 Scientific Bulletin of the International Humanities University. Series: Jurisprudence 75.

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

In its judgement, the ECtHR repeats the equivalent stance of the UN International Court of Justice, which was presented in Paragraphs 56-58[3] and 66[4] of its judgement in the case of *Barcelona Traction, Light and Power Company Limited* dated 5 February 1970. In its judgement, the court emphasised that the independent existence of the legal entity could not be treated as an absolute, and the economic realities sometimes required protective measures and remedies in the interests of those within the corporate entity, as well as of those outside who have dealings with it, and there could be 'lifting of the corporate veil'[6] (in cases of protection of rights and interests of members, a derivative action, as noted by H. Yu.).

2 A PLAINTIFF UNDER DERIVATIVE LAWSUIT

2.1 General status of a plaintiff

In Ukrainian law, a derivative action is prescribed in Art. 54 of the Commercial Procedural Code of Ukraine (hereinafter 'the CPC of Ukraine'). According to this article, the right to bring an action is granted to the person (member, shareholder, owner) that holds 10% or more of the authorised capital or property of the legal entity.[7] According to the Draft Law of Ukraine 'On Joint-Stock Companies', namely Clause 9 of Section XIX, the right to bring a derivative action is granted to the person (member, shareholder, owner) that personally or jointly holds 5% or more of the authorised capital or property of the legal entity.[8] According to Part 2 of Art. 54 of the CPC of Ukraine (which the legislator is not planning to amend), the procedural status of a plaintiff is granted to the legal entity, while its members (shareholders) act as persons, who by law are entitled to file a lawsuit in the interests of the others. Such members (shareholders) are granted the same procedural rights and obligations as a plaintiff – a legal entity.[9] They are not the legal entity's representatives, as found in Art. 54-55, which regulates their procedural status, located before the subsection dedicated to the regulation of representatives in litigation procedure. The official against whom the claim for compensation for the losses incurred is filed may not act on behalf of such a legal entity.

Regarding the issue of who must be granted the status of a plaintiff, there is no consensus among scholars. O. R. Kovalyshyn argues that members of a corporation must be given the status of a plaintiff, while the corporation itself has to act as a third party who does not make independent claims.[10] Ye. Talykin is convinced that under a derivative lawsuit, the main emphasis should be on the conflict between members of the corporation and the management – thus, members are to be deemed as plaintiffs.[11] M. K. Bogush claims that it is the corporation that has to be given the status of a plaintiff.[12]

6 Case concerning Barcelona Traction, Light and Power Company, Limited, (Belgium v Spain) [1970] I.C.J. Rep 1970 p. 3, paras 56-58, 66.

7 Commercial Procedure Code of Ukraine (as amended of 5 July 2021) <https://zakon.rada.gov.ua/laws/show/1798-12#Text> accessed 8 August 2021.

8 Draft Law of Ukraine 'On Joint-Stock Companies' register No 2493 of 25 November 2019 <http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=67468> accessed 8 August 2021.

9 CPC of Ukraine (n 7).

10 OR Kovalyshyn, 'Indirect (derivative) lawsuits as a legal remedy for participants in corporate relations' (2010) 17 Bulletin of the Academy of Advocacy of Ukraine 65.

11 Ye Talykin, 'Derivative lawsuit in commercial litigation of Ukraine: general principles of procedural construction' (2014) 4 Law Herald 164.

12 MK Bogush, 'Protection of the rights and interests of the subjects of corporate legal relations' (PhD (Law) Thesis, Taras Shevchenko National University of Kyiv 2018) 186-188.

In our opinion, the status of a plaintiff under the derivative action must be indeed granted to the legal entity whose rights and interests have been directly violated by the official's actions (or inaction). We are inclined to agree with the opinion that the legal relationship regarding the liability of officials or members of collective bodies (majority of shareholders included) arise from the material legal relationship between these persons and the legal entity (regarding the authority to act on its behalf, make its decisions, etc.).[13] The wrongdoing in question was committed against the corporation in the first place, not against a minority of its members. Therefore, a corporation must be given the procedural status of a plaintiff under a derivative lawsuit. The fact that, given the defect of will, the action is brought to court by the minority members (shareholders) rather than the legal entity itself does not contradict our statement since it is fully consistent with the definition of a plaintiff. According to Part 3 of Art. 45 of the CPC of Ukraine, plaintiffs are persons that have brought an action, or for the benefit of whom an action has been brought, to defend the right that has been violated, has not been recognised, has been challenged, or whose legally protected interest has been violated.[14] Under a derivative action, a legal entity acts as a plaintiff in the United Kingdom (Art. 206 of the Companies Act),[15] in Canada (Art. 239 of the Business Corporations Act), etc.[16] At the same time, the legal entity's members (shareholders) act as plaintiffs under derivative actions in the USA (Rule 23.1 of the Federal Rules of Civil Procedure),[17] Germany (Art. 148 of the Joint-stock Companies Act),[18] and Spain (Art. 239 Corporate Enterprises Act).[19]

2.2 Exercise of procedural rights and obligations

In Ukrainian legislation, the members of a corporation act as its procedural representatives. According to Art. 54 of the CPC of Ukraine, the legal entity exercises its procedural rights and fulfils its procedural obligations only *upon consent of the members that have brought a derivative action* and gives the latter, pursuant to Art. 55 of the CPC of Ukraine, the procedural rights and obligations of the entity for the benefit of which they have brought the action. In our opinion, however, this model is doubtful and must be reconsidered.[20]

Since the members will just *approve resolutions of the legal entity*, the latter will be adopted as a result of the traditional process of formation and expression of the company's will (via governing bodies and the majority of shareholders who committed wrongdoing or prevented the company from protecting itself) against the background of the defect of will. We believe that since the offenders control the legal entity, it would be better if the procedural legal

13 SO Koroed, VM Mahinchuk, 'Derivative (indirect) lawsuits of the founders of legal entities as a form of implementation of the doctrine of piercing the corporate veil' (2020) 44 Scientific Bulletin of the International Humanities University. Series: Jurisprudence 23-24.

14 Ibid.

15 Companies Act of United Kingdom of 2006 <https://www.legislation.gov.uk/ukpga/2006/46/contents> accessed 8 August 2021.

16 Business Corporations Act of Canada of 1985 (as amended 1 January 2020) <https://laws-lois.justice.gc.ca/eng/acts/C-44/index.html> accessed 8 August 2021.

17 Federal Rules of Civil Procedure of United States of America of 1938 (as amended 12 January 2021) <https://www.uscourts.gov/rules-policies/current-rules-practice-procedure/federal-rules-civil-procedure> accessed 8 August 2021.

18 Act of Germany 'On Joint-Stock Companies' of 1965 (as amended 3 June 2021) <https://www.gesetze-im-internet.de/englisch_aktg/index.html> accessed 8 August 2021.

19 Corporate Enterprises Act of Spain of 30 August 2010 (as amended 2015) <https://www.mjusticia.gob.es/es/AreaTematica/DocumentacionPublicaciones/Documents/Corporate_Enterprises_Act_2015_-_Ley_de_Sociedades_de_Capital.PDF> accessed 8 August 2021.

20 Commercial Procedure Code of Ukraine (n 7).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

capacity of the legal entity in this category of actions were exercised in another manner. The law already conditions the commission of any procedural action of a legal entity by the need to obtain the consent of minority participants (shareholders) who filed a lawsuit on its behalf. We suggest that members (shareholders), due to wrongdoers being in control, act on behalf of a legal entity during the litigation itself, exercising the management of the legal entity instead of its majority members (shareholders) or officials. The legal entity's ability to act via its members (shareholders) is already provided for by Part 6 of Art. 44 of the CPC of Ukraine,[21] although it is ultimately derived from Part 2 of Art. 92 of the Civil Code of Ukraine[22] and is first and foremost related to a general and limited partnership. Thus, we suggest amending Part 2 of Art. 54 of the CPC of Ukraine as follows:

> When case proceedings based on such an action are instituted, the legal entity acquires the status of a plaintiff, and its procedural rights and obligations shall be exercised for and on behalf of that legal entity by its members and (or) shareholders that have brought the action.

In suggesting such amendments, we understand that it is highly probable that the persons that have brought the action will try to prevent the defendant from obtaining relevant evidence and hinder the adversarial nature of proceedings in general. However, its procedural status is balanced by the plaintiff's burden of proof, the capability of claiming evidence, preventive mechanisms of the derivative action itself (which will be discussed later in this article – H. Yu.), and the concept of the 'business judgement rule'. The latter is the refutable presumption of the lawful nature of actions (refusal to take them) and decisions of the officials, provided that they have acted in good faith, reasonably, and for the benefit of the legal entity. We will examine this issue separately in more detail later in this article.

2.3 Persons that can file a derivative lawsuit on behalf of a legal entity

According to Art. 54 of the CPC of Ukraine, the right to file a derivative lawsuit may be granted to members of the company.[2323] Usually, the right to file a derivative lawsuit is granted to minority shareholders under the circumstances of the corporation's inability to protect itself. Ukrainian legislation does not contain a direct ban on the use of this right by a majority shareholder, establishing the minimum property quota for the right to be exercised. The same approach is used in Art. 260 of Companies Act in United Kingdom.[24] O. A. Chaban, studying the institute of a derivative lawsuit in the United Kingdom, aptly notes that despite there being no direct prohibition on filing a derivative lawsuit by a majority shareholder, other types of remedies are available to such a person, and thus the court will most likely dismiss the claim of such a plaintiff.[25] As a majority shareholder, such a person can decide that a corporation will file a lawsuit directly.

It should be emphasised that the provisions of Art. 54 of the CPC of Ukraine do not provide a clear answer to the question of whether a derivative action can be brought by a person that was not a company member when losses were sustained by the company.[26]

21 Ibid.

22 Civil Code of Ukraine of 16 January 2003 (as amended 1 August 2021) <https://zakon.rada.gov.ua/laws/show/435-15#Text> accessed 8 August 2021.

23 Act of Germany 'On Joint-Stock Companies' (n 16).

24 UK Companies Act 2006 (n 13).

25 OA Chaban, 'Institute of derivative action in England and Wales' (2020) 27 Scientific Papers of National University 'Odessa Law Academy' 21-22.

26 Commercial Procedure Code of Ukraine (n 7).

For example, according to Clause 1 of Part 1 of Art. 148 of the Joint-stock Companies Act of the Federal Republic of Germany, the person bringing a derivative action, or, in case of universal legal succession, its legal predecessor, must hold shares *before the moment they knew or could have known about the damages inflicted upon the joint-stock company.*[27]

Usually, such a requirement is due to the need to prevent abuse of the right to bring a derivative action: i.e., the purchase of shares (stock) in order to engage the legal entity in prolonged litigation based on minor claims and to make the latter 'buy off' the unconscientious applicant, who files a lawsuit on behalf of the legal entity and therefore gains the benefits.

However, such abuse may also be enacted by a current member (shareholder) of the legal entity. We believe that it is expedient to grant the right to bring a derivative action to members (shareholders) that did not have that status as of the date of damages inflicted upon the legal entity. There are several reasons for this:

1) the right to claim damages is held by the legal entity rather than its member;

2) the losses inflicted by the official indirectly influence the rights and interests of such a member (possibility and volume of payment of dividends, whether the goals of a corporation are to be achieved, etc.) – such a person's rights and interests, having been indirectly violated, also deserve protection;

3) the abuse of the right to bring a derivative action is prevented by the expanded *locus standi* model and examination of conformity of the decision not to take action to protect the violated right to the business judgement rule.

The stance above is reflected in Part 4 of Art. 260 of the UK Companies Act, according to which it is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.[28] In the Explanatory Note to Art. 260 of the Law, the drafters explained their approach with the fact that a derivative action is used to defend the rights of the company rather than its members.[29]

Another aspect that should be taken into consideration is that upon the alienation of shares (stock) by members (shareholders) of a corporation, there is a singular succession in the rights and obligations owned by the previous owner as a member of the corporation. For example, Part 4 of Art. 260 of the UK Companies act was developed by taking into account the recommendation by the Law Commission of England and Wales, which had noted in its Shareholder Remedies Report, dated 24 October 1997, that the right to bring a derivative action was a part of the 'bundle of rights represented by a share', so it could be transferred to third parties upon the alienation of the share.[30]

While studying the institute of a derivative action, we should mention that the current legislation contains the absolute ban on the use of this remedy by holders of preference shares (Part 1 of Art. 54 of the CPC).[31] This approach has been preserved in Clause 9 of Section XIX of the Draft Law of Ukraine 'On JSCs'.[32] In our opinion, such a ban is unreasonable due to the following reasons.

27 Act of Germany 'On Joint-Stock Companies' (n 16).

28 28 UK Companies Act 2006 (n 13).

29 29 Explanatory Note to Section 260 of Companies Act of United Kingdom <https://www.legislation.gov.uk/ukpga/2006/46/notes/division/9/2/1/1> accessed 8 August 2021.

30 30 Shareholder Remedies Report of Law Commission of England and Wales as of 24 October 1997, p. 101 <https://www.lawcom.gov.uk/project/shareholder-remedies/> accessed 8 August 2021.

31 Commercial Procedure Code of Ukraine (n 7).

32 Draft Law of Ukraine 'On Joint-Stock Companies' (n 8).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

Firstly, the legal status of holders of preference shares is indeed somewhat limited compared to the status of holders of ordinary shares in terms of management. For example, according to Part 5 of Art. 28 of the Act of Ukraine 'On Joint-Stock Companies (hereinafter – Act of Ukraine 'On JSCs'), their right to participate in management is limited by specific issues they are allowed to vote on.[33] However, the same article provides for the expanded list of issues on which holders of preference shares may vote.

Secondly, in addition to protection of the legal entity's rights, the purpose of a derivative action is to protect the violated rights and interests of the shareholder. In that regard, it should be emphasised that the right to claim payment of dividends, which is held by holders of preference shares, is of priority (Clause 2 of Part 2 of Art. 31 of the Act of Ukraine 'On JSCs') compared to the same right of holders of ordinary shares.[34]

Thirdly, that the comparative legal analysis of this issue has found no examples of situations where holders of preference shares have been deprived of their right to bring a derivative action in any other country. For example, Part 1-1 of Art. 63 of the Act of Kazakhstan 'On Joint-stock Companies' gives the right to bring the action both to holders of ordinary shares and preference shares.[35] This issue is similarly regulated by Art. 148 of the German Joint-stock Companies Act.[36] Art. 261 of the UK Companies Act uses the concept of 'a member of a company', and there are no limitations as to persons that may bring the claim based on the criterion of a proper type of shares.[37]

Fourthly, if holders of preference shares are forbidden to bring a derivative action, it might be detrimental to the legal entity's interests since about a quarter of the shareholders potentially cannot defend their rights either personally or jointly. Moreover, it is easier for the offenders to arrange with the other shareholders so that they will not exercise their right to bring a derivative action.

Therefore, we believe that the ban on a derivative action brought by holders of preference shares must be lifted in Ukrainian legislation.

3 MECHANISMS TO PREVENT THE ABUSE OF THE RIGHT TO FILE A DERIVATIVE LAWSUIT

Prevention of the abuse of the right to file a derivative lawsuit is provided through *locus standi* – a procedure that establishes a person's right to bring a derivative action to court, during which conformity of submission of the derivative action to the criteria established by the law or case law is assessed. *Locus standi* itself is comprised of a set of preventive mechanisms. In common law countries, the *locus standi* criteria are established for the cases in which a derivative action may be brought, whereas it is typical of the civil law countries that the criteria are aimed at determining the group of persons entitled to bring a derivative action.[38] For example, according to Art. 263 of the UK Companies Act, the court considers

33 Act of Ukraine 'On Joint-Stock Companies' of 17 September 2008 (as amended 1 July 2021) <https://zakon.rada.gov.ua/laws/show/514-17#Text> accessed 8 August 2021.

34 Ibid.

35 Act of Kazakhstan 'On Joint-Stock Companies' of 13 May 2003 (as amended 8 June 2021) <https://online.zakon.kz/Document/?doc_id=1039594> accessed 08 August 2021.

36 Act of Germany 'On Joint-Stock Companies' (n 16).

37 UK Companies Act 2006 (n 13).

38 Z Zhang, 'The Shareholder Derivative Action and Good Corporate Governance in China: Why the Excitement is Actually for Nothing' (2020) 28 (2) Pacific Basin Law Journal 183-189.

the following facts for permission to continue the claim as a derivative claim: 1) whether the act or omission of the officials has been ratified by the company; 2) whether the act or omission gives rise to a cause of action that the member could pursue in his or her own right rather than on behalf of the legal entity (whose rights have been violated); 3) whether the company has decided not to bring an action (pursue the claim).[39] Moreover, the court also finds out whether the offenders control the company's operations and whether a derivative action will be in the best interests of the company.

The classic *locus standi* criterion in civil law is the property qualification in holding the interest in the authorised capital or the stock as a precondition to bringing a derivative action. Thus, Part 1 of Art. R225-169 of the Commercial Code of France establishes the property qualification of 5% of personal or joint holding of shares. Also, this property qualification is progressive: it decreases along with the size of the authorised capital. According to Part 2 of Art. R225-169 of the Commercial Code of France, if the authorised capital of the company exceeds 750,000 euros, for the first 750,000 euros of surplus, the property qualification is 4%, for 750,000–7,500,000 euros, it is 2.5%, and for 7,500,000–15,000,000, it is 1%.[40] In Germany, according to Ar. 148 of the Joint-stock Companies Act, the property qualification is established at the level of personal or joint holding of 1% of the company's share or under the condition of holding the shares with the value of at least 100,000 euros.[41] According to Clauses 1–2 of Art. 2393-bis of the Civil Code of Italy, the property qualification to bring a derivative action is 2.5% of the authorised capital for public joint-stock companies and 20% of the authorised capital for private joint-stock companies (unless otherwise stipulated in the articles of association).[42] As for members of limited liability companies, the right to bring a derivative action under Art. 2476 of the Civil Code of Italy is granted to each member of the company.[43] The same rule is stipulated in Part 1 of Art. 157 of the Czech Act 'On Commercial companies and cooperatives (Business Corporations Act)' (hereinafter – Czech Business Corporations Act).[44]

According to Art. 847 of the Companies Act of Japan, a person must own one share, i.e., be the company's shareholder, to have the right to bring a derivative action. This rule also requires continuous ownership of shares for six months to bring a derivative action.[45] To our mind, such a requirement is inefficient since it makes the person wait for a certain period despite losses having been incurred, thus depriving a member (shareholder) of an opportunity to respond to the event promptly. Therefore, we believe that such a preventive mechanism should not be introduced into Ukrainian law.

It should be emphasised that scholars have various standpoints regarding property qualification for bringing derivative lawsuits. Yu. Popov believes that this matter should be established by considering the specific features of each legal entity. For instance, in his opinion, since shares in the authorised capital of limited and additional liability companies are not suited for quick turnover, it is inexpedient to establish the property qualification in

39 UK Companies Act 2006 (n 13).

40 Commercial Code of France as amended 2 August 2021 <https://www.legifrance.gouv.fr/codes/texte_lc/LEGITEXT000005634379> accessed 8 August 2021.

41 Act of Germany 'On Joint-Stock Companies' (n 16).

42 Civil Code of Italy of 16 March 1942 (as amended26 October 2020) <https://www.altalex.com/documents/codici-altalex/2015/01/02/codice-civile> accessed 08 August 2021.

43 Ibid.

44 Czech Act 'On Commercial companies and cooperatives (Business Corporations Act)' of 25 January 2012 <http://obcanskyzakonik.justice.cz/images/pdf/Business-Corporations-Act.pdf> accessed 8 August 2021.

45 Companies Act of Japan of 26 July 2005 (as amended 2014) <http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=2&dn=1&yo=companies+act&x=0&y=0&ia=03&ja=04&ph=&ky=&page=3> accessed 8 July 2021.

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

their respect to prevent abuse of the right to bring the action. As for joint-stock companies, Yu. Popov believes that such qualification is necessary.[46] O. O. Kot notes the member's right to bring the respective derivative action should be found reasonable in case its equity rights as a member are also violated, regardless of the interest.[47]

The advantage of property qualifications in most countries of the world is the necessity for the preventive mechanism against abuse by minor shareholders (members). However, the property qualification must be reasonable. According to M. Gelter, if it is relatively large, it will be a factor restraining a derivative action rather than a tool preventing abuse.[48] On the other hand, in their research regarding the lack of popularity of derivative actions in Europe, M. Sekyra and K. Grechenig referred to the obvious connection between the property qualification giving the right to bring such claim and the level of risk of potential such a member, acting on behalf of the legal entity, being bribed by senior executives: the higher the percentage threshold for a derivative action is, the higher the risk of potential members (shareholders), who bring a derivative action, being bribed (given the small number of the latter).[49] Therefore, the optimum qualification is the one that would concurrently prevent abuse by members (shareholders) and unlawful arrangements with officials and create no unreasonable hindrance in the exercise of this right. The property qualification at 5% of the authorised capital (property of the legal entity), prescribed by Clause 9 of Section XIX of the Draft Law of Ukraine 'On Joint-Stock Companies',[50] is much more reasonable than the 10% prescribed by Art. 54 of the CPC of Ukraine,[51] and, taking into account the comparative study above, it conforms with the foreign practices. Such a size is optimal since it is capable of preventing abuse of the right to bring a derivative action by minor members (shareholders) and does not create major obstacles to exercising this right. If it was established at the level of participatory share 1%, it would be of a formal nature and perform no preventive function.

At the same time, we believe that the legislative focus on property qualification as the only mechanism to prevent abuse of a derivative action is somewhat excessive.

Firstly, it is insufficient for effective prevention of abuse since it only prevents abuse by minor members (shareholders) and fails to cover quite a wide range of participatory shares that will be held by members (shareholders) who can file a derivative lawsuit. Awareness of this fact is reflected by the case law of the Supreme Court. In its Resolution dated 17 February 2021 in case No. 910/13643/19, the court did not limit itself to establishing the existence of the property qualification and emphasised that a derivative action could only be brought in the exceptional circumstances that justify the need of the company's member to file a claim on the company's behalf if the legal entity's inability to defend its rights on its own if proven.[52]

Secondly, by using the property qualification, the legislator unreasonably deprives members of the legal entities without participation shares (condominiums, public associations, charitable organisations, etc.) of the right to bring a derivative action. The nature of this

46 46 Yu Popov 'Derivative (indirect) lawsuits: foreign experience and Ukrainian prospects' (2012) 12 Ukrainian Commercial Law 55-65.

47 47 OO Kot, 'Implementation and protection of subjective civil rights: problems of theory and judicial practice' *(Alerta 2017)* 382.

48 48 M Gelter, 'Why do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brooklyn Journal of International Law 857.

49 49 K Grechenig, M Sekyra, 'No Derivative Shareholder Suits in Europe – A Model of Percentage Limits and Collusion' (2010) 15 Discussion Paper Series of the Max Planck Institute for Research on Collective Goods 1-3.

50 50 Draft Law of Ukraine 'On Joint-Stock Companies' (n 8).

51 51 Commercial Procedure Code of Ukraine (n 7).

52 Resolution of Supreme Court in case 910/17602/19 of 17 February 2021 <https://reyestr.court.gov.ua/Review/95170089> accessed 8 August 2021.

remedy is preconditioned by the tortious act of the officials or majority of the members participating in management when the legal entity cannot file a claim to court to defend its right on its own. Since there is no participation share, another criterion should be used: per cent of the total number of members. Therefore, Part 1 of Art. 54 of the CPC of Ukraine[5353] should be supplemented with para. 2 as follows:

> In the legal entities where members have no share in authorised capital (stock, shares, equity interest, etc.) or property of the company, the right to bring an action is granted to the persons that jointly represent 1/20 of the total number of members.

Bringing a derivative action is traditionally preconditioned by the obligation of the legal entity's member to file a demand to the legal entity to act as an element of expanded *locus standi*. Such a requirement exists in the legislations of a few foreign states: Clause 2 of Part 1 of Art. 148 of the German Joint-stock Companies Act,[54] Art. 158 of the Czech Business Corporations Act,[55] Rule 23.1 of the Federal Rules of Civil Procedure in the USA, etc.[56] It is necessary to introduce such a *locus standi* element because it will perform a preventive function (prevent the members (shareholders) acting in bad faith from bringing a derivative action where there are no grounds) and the function of proving that the officials (majority of members) have failed to take action to defend the legal entity's rights. The necessity for the implementation of an obligation to file a demand was introduced by Ye. Talykin.[57] To prevent minority shareholders from any abuse in the form of deliberate determination of the shortest possible period of time, the law should provide for a reasonable period of time within which the majority of shareholders (corporation's officials) may decide on the filed demand. In our opinion, this period should be one month from the day of the receipt of a demand.

Given the above, the model of expanded *locus standi* is proposed to be introduced into Ukrainian law. In addition to a property qualification, a derivative action should be preconditioned by the following requirements: 1) the person holds a required volume of share in authorised capital or property of the company or represents 1/20 of members of a non-entrepreneurial company; 2) the person has already demanded the legal entity to take action to defend the legal entity's rights and interests that have been violated (have not been recognised, have been challenged); 3) the legal entity, contrary to its interests, has failed to take any action to defend its rights and interests for one month, or has rejected the person's demand (is unable to defend its rights and interests on its own); 4) there are no other grounds that would prevent a derivative action from being brought.

4 OTHER TYPES OF DERIVATIVE LAWSUIT

4.1 Preventive Derivative Lawsuit

A traditional derivative lawsuit is not without its own shortcomings. For example, the losses may not have been inflicted by the official's actions (omission) yet, or, as M. O. Sukhanov aptly notes, such a legal remedy may be ineffective in Ukraine in cases where the director's

53 Commercial Procedure Code of Ukraine (n 7).

54 Act of Germany 'On Joint-Stock Companies' (n 16).

55 Czech Business Corporations Act (n 43).

56 Federal Rules of Civil Procedure of United States of America (n 15).

57 Ye Talykin, 'Derivative lawsuit in commercial litigation of Ukraine: general principles of procedural construction' (2014) 4 Law Herald 21-22.

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

property is insufficient to enforce the court's decision to satisfy the claim.[58] In cases when the losses have not yet been inflicted, the point at issue is the so-called 'preventive derivative action' – the ability to eliminate the real threat of causing damages – the need for which was first emphasised by M. K. Bogush.[59] In suggesting this remedy, Bogush foresaw the risk of abuse of the right to bring a preventive derivative action, so she found it necessary to introduce the obligation of the members of the corporation to deposit some money (make a pledge) to the judicial saving account as counter security.

In our opinion, such a proposal is somewhat ambiguous. Despite being aimed at preventing the abuse of the right to file a derivative lawsuit, the obligation to deposit money will constitute an additional property qualification (alongside the qualification of holding stock, shares, or equity interest in a certain volume), so it will equally (or even further) prevent both abuse and the capability of bringing a derivative action itself. We believe that introduction of such a preventive mechanism is unlikely to positively influence the already rare practice of derivative actions.

On the other hand, Bogush reasonably notes that reduced term for hearing of the cases based on preventive derivative actions would be expedient. She suggests that the hearing of such cases should be limited to one month 'since the prompt application of respective remedies to eliminate the threat of violation of the subjective corporate right/interest itself is a precondition for a preventive derivative lawsuit to be effective'.[6060] In general, we agree with her suggestion since, for instance, economic operations, both entrepreneurial and non-entrepreneurial ones, are associated with the need to promptly respond to changes in the economic environment to efficiently reach the goals in full (to increase profit, to perform statutory tasks, etc.). If our purpose is to prevent the corporation's losses, the court must also promptly respond to the existing threat by ruling to cease the action/obliging to act as soon as possible. The need above also exists in respect of derivative actions in general: the legal entity that has sustained losses because of the official's actions (omission) or majority shareholder's decision must receive the compensation as soon as possible, to replenish its property on time at least to a certain extent and to use it for statutory objectives/ business development, etc.

Therefore, we consider it necessary to improve the suggestion by Bogush: the reduced term for hearing should be introduced not only for preventive derivative actions but also derivative actions in general. To our mind, the above-mentioned term of one month is reasonable.

4.2 Derivative lawsuit to challenge company transactions

A claim filed by the member of the corporation for and on behalf of the latter for challenging the transaction conducted by the executive body of the corporation is deemed to be another type of derivative lawsuit. The logic of the concept is quite simple: just as a defect in the will of a corporation to protect its rights by compensating it for damages is a ground for filing a derivative lawsuit by its members, in the same way, the protection of the corporation's rights, violated through a transaction being conducted contrary to its interests, may require bringing a derivative action when a defect of corporation's will precludes it from filing a lawsuit by itself. Moreover, when it comes to the prevention of losses, an offence can be terminated by invalidating the transaction and terminating the legal relationship before the

58 MO Sukhanov, 'Analysis of the practice of the supreme court regarding judicial protection of corporate rights of members of a limited liability company' (2020) 6 Law and Society 21-24.

59 MK Bogush 'Protection of the rights and interests of the subjects of corporate legal relations' (PhD (Law) Thesis, Taras Shevchenko National University of Kyiv 2018) 95-97.

60 Ibid 95-97.

parties start to take the actions that might result in losses by the corporation. Additionally, an official is not always able to compensate for the losses resulting from his or her actions (omission), whereas restitution will enable the protection of the corporation's rights and interests to a larger extent. In other words, a classic derivative action for claiming damages is imperfect in the above-mentioned cases. The proposals to introduce such a concept of a derivative action in the national law have been made by O. S. Dotsenko[61] and Yu. Popov.[62] M. K. Bogush rightly treats the claim filed by the member (shareholder) of the corporation for invalidation of the transaction conducted by the latter as a kind of a derivative action.[63] For example, the shareholder's right to challenge an interested party transaction is prescribed by Part 12 of Art. 72 of the Law of Ukraine 'On JSCs'. However, not only does the law not mention anything about it being possible only when a legal entity cannot file such a lawsuit by itself, it also does not contain such a provision regarding major transactions.

In Ukraine, when it comes to major transactions, analysis of Parts 1 and 2 of Art. 46 of the Law of Ukraine 'On LLCs'[64] and Parts 1–2 of Art. 72 of the Law of Ukraine 'On JSCs' [65] shows that a major transaction and an interested party transaction, concluded in violation of the procedure established by law – without a resolution to grant consent for its conclusion – creates, changes, and terminates civil rights and obligations of a joint-stock company and limited and additional liability companies only in cases where the transaction is approved by the company thereafter. Due to the imperfection of the legal drafting, the wording above may drive the interpreting entity to the conclusion that such a transaction is void. However, the rules contain no direct indication that the transaction is invalid, so it is impossible to state the voidness of major transactions and interested party transactions. It appears that the legislator provided for voidability of such transactions in the way: for instance, it is done in respect of approval of transactions by the minors conducted beyond their legal capacity or transactions conducted by representative *ultra vires* (Arts. 221 and 222; Art. 241 of the Civil Code of Ukraine).[66] This conclusion can also be drawn based on the analysis of the Explanatory Note to the Draft Law of Ukraine 'On Limited Liability and Superadded Liability Companies'. The authors note that Art. 46 of the Draft Law prescribes non-conclusion of the major transaction in case the procedure for approval thereof has been breached.[67] However, in the authors' opinion, the transaction will be concluded by virtue of Clause 2 of Part 3 of Art. 92 of the Civil Code of Ukraine. It should be remembered that, according to Part 1 of Art. 638 of the Civil Code of Ukraine, a contract is deemed to be concluded if parties thereto have agreed upon all the materials terms and conditions.[68] Accordingly, if the provisions of Part 1 of Art. 638 are not fulfilled – the parties have not agreed on the essential terms – only then should the contract be deemed not concluded. The director's transaction concluded *ultra vires* does not comply with Part 2 of Art. 203 of the Civil Code of Ukraine. Thus, there are grounds for invalidating it and deeming it voidable. This approach is used in Part 1 of Art. 74 of the Law of Kazakhstan 'On Joint-stock Companies'.[69] It allows for the defence not

61 OP Dotsenko 'Invalidation of a transaction committed by the executive body of a business company in excess of its powers as a way to protect corporate rights' (2020) 3 Entrepreneurship, Economy and Law 74.

62 Yu Popov, 'Derivative (indirect) lawsuits: foreign experience and Ukrainian prospects' (n 45) 10-11.

63 MK Bogush 'Protection of the rights and interests of the subjects of corporate legal relations' (n 56) 162.

64 Act of Ukraine 'On Limited Liability and Additional Liability Companies' of 16 February 2018 (as amended 16 July 2020) <https://zakon.rada.gov.ua/laws/show/2275-19#Text> accessed 8 August 2021.

65 Act of Ukraine 'On Joint-Stock Companies' (n 32).

66 Civil Code of Ukraine (n 23).

67 Explanatory Note to the Draft Law of Ukraine 'On Limited Liability and Additional Liability Companies' <http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=59093> accessed 8 August 2021.

68 Civil Code of Ukraine (n 23).

69 Act of Kazakhstan 'On Joint-Stock Companies' of 13 May 2003 (as amended 8 June 2021) <https://online.zakon.kz/Document/?doc_id=1039594> accessed 8 August 2021.

only of rights and interests of the legal entity (and its members) but also the turnover of goods, rights, and interests of third parties acting in good faith.

However, it should be noted that the director's transaction concluded *ultra vires* violates, first, the rights and obligations of the corporation, rather than its members (their interests are also violated, but indirectly). Thus, bringing a direct action in this case seems to be erroneous. The opposite approach will undermine the concept of a legal entity as an independent subject of the legal relationship, different from its members. The same stance is expressed by the ECtHR in the case of *Feldman and Bank Slavyansky v. Ukraine*, which reiterated that the shareholder could not be considered a proper plaintiff if the legal entity's rights had been violated: it required exceptional circumstances of the legal entity's inability to claim defence of its rights via the governing bodies.[70] In Ukraine, such an opinion was first expressed by the Grand Chamber of the Supreme Court in its Resolution dated 8 October 2019 in case No. 916/2084/17, where the court also permitted representation of the legal entity by its member (shareholder) if the entity was unable to defend its rights on its own[71] (the court does not specify this directly, but it is regarding the concept of a derivative action – H. Yu.). Henceforth, the above-mentioned approach became the established law enforcement practice and was reflected in Resolution of the Supreme Court dated 14 May 2021 in case No. 904/9839/16[72] and Resolution of the Supreme Court dated 23 June 2021 in case No. 913/344/20.[73] At the same time, as we have stated before, the rights and interests of members of the corporation are violated, so it would be somewhat erroneous for the Supreme Court to deprive them of remedies in general. In this category of cases, the court should rely on somewhat different reasons.

When the legal entity's transaction is challenged, the point at issue is not only internal relations between the corporation, its members, and officials authorised to manage the corporation – invalidation of the corporation's transaction directly affects the rights and interests of third parties (contracting parties). Thus, it is necessary to maintain stable civil turnover as well as the adequacy of the legal consequences of the selected remedy. The property qualification, along with the obligation to file a demand for the corporation to act (challenge the transaction), will prevent abuse of derivative action (as well as any of the other types of derivative actions), but rights of a third party that did not know and could not have known about the limited authority of the sole or collective executive body must not be violated. Under these circumstances, Clause 2 of Part 3 of Art. 92 of the Civil Code of Ukraine must be used.[74] According to it, in relations with third parties, the restriction on the powers of representation of a legal entity has no legal force, except when the legal entity proves that the third party knew or in all circumstances could not have been unaware of such restrictions. The reasoning for the legislator's decision is that mere failure to adhere to the approval procedure does not have to result in such harsh implications as invalidation of the transaction. The plaintiff must only prove the circumstances in connection with which the transaction may be invalidated or an action for applying the consequences of invalidity is brought: 1) it is a major (interested party) transaction; 2) the transaction has not been approved or has been approved in breach of the established procedure.

70 Feldman and Slovyanskyy Bank v Ukraine App No 42758/05 (ECtHR, 21 December 2017) <https://hudoc.echr.coe.int/eng# {%22f ullte xt%22:[%22slovyanskyy%22] ,%22documentcollectionid2%22:[%22GRANDCHAMBER%22,%22CHAMBER%22],%22itemid%22:[%22001-179557%22]}> accessed 8 August 2021.

71 Resolution of Grand Chamber of the Supreme Court in case 916/2084/17 of 8 October 2019 <https://reyestr.court.gov.ua/Review/84911545> accessed 8 August 2021.

72 Resolution of the Supreme Court in case 904/9839/16 of 14 May 2021 <https://reyestr.court.gov.ua/Review/96342397> accessed 8 August 2021.

73 Resolution of the Supreme Court in case 913/344/20 of 23 June 2021 <https://reyestr.court.gov.ua/Review/98170295> accessed 8 August 2021.

74 Civil Code of Ukraine (n 23).

As for the burden of proof that the third party was aware of the executive body's (director's) limited authority, it should be noted how the awareness and the person's ability to find out about the director's limited power are established. In its Resolution dated 20 July 2021 in case No. 911/1605/20, the Supreme Court reiterated that the contracting parties' examination of the scope of authority of the legal entity pursuant to the articles of association is within ordinary care during the conclusion of a contract. Limitation of the authority to act on behalf of a legal entity enters into force for a third party in case it has acted in bad faith and unreasonably – in particular, knew for sure that the company's executive body did not have the necessary scope of authority or must have known that if it had exercised at least reasonable care.[75] In other words, if the third party did not exercise due care by requesting a copy of articles of association, for instance, when data in the Unified State Register is incomplete or missing, the transaction concluded with such party in excess of the director's authority (*ultra vires*) may be invalidated on the claim of the legal entity or based on the derivative action of its member. Due care should also be exercised when a contract is signed: if it contains the clause where it is stipulated that the contract is signed by the person acting under the articles of association, the court will rely upon the fact that the signatory's contracting party has been informed of the identity and authority of the signatory. Such stance was expressed by the Supreme Court in its Resolution dated 9 June 2021 in case No. 911/3039/19.[76]

5 DEFENDANTS IN A DERIVATIVE LAWSUIT

After it is determined who can bring a derivative action for and on behalf of the legal entity, the defendant's identity must also be established. According to Art. 54 of the CPC of Ukraine, a defendant is the official of a legal entity.[77] However, this clause does not offer a unified definition of an 'official'. The problem is that a group of people covered by the notion of an 'official' differs depending on the type of the business company (the legal entity in itself). According to Part 2 of Art. 23 of the Act of Ukraine 'On Business Partnerships', officials include: the chairman and members of the executive body, the audit committee, the auditor of the company, as well as the chairman and members of another body of the company who are authorised to manage the company if such body is established in accordance with the company's statutory documents (constitutional documents).[78] According to Part 1 of Art. 42 of the Law of Ukraine 'On LLCs', officials of the limited liability or additional liability company are members of the executive body and the supervisory board, as well as other persons under the company's charter.[79] According to Clause 27 of Art. 2 of the Draft Law of Ukraine 'On JSCs',[80] the status of an official may be prescribed in the charter the same way as provided for by the Law of Ukraine 'On LLCs'. Also, officials include a corporate secretary and members of the liquidation committee.

However, the definition of an official given in the Law of Ukraine 'On LLCs' and the Draft Law of Ukraine 'On JSCs' should be interpreted in such a manner that discretion as to the establishment of the group of officials in the articles of association is not and may

75 75 Resolution of the Supreme Court in case 911/1605/20 of 20 July 2021 <https://reyestr.court.gov.ua/Review/98523674> accessed 8 August 2021.

76 Resolution of the Supreme Court in case 911/3039/19 of 09 June 2021 <https://reyestr.court.gov.ua/Review/97926318> accessed 8 August 2021.

77 77 Commercial Procedure Code of Ukraine (n 7).

78 78 Act of Ukraine 'On Business Partnerships' of 19 September 1991 (as amended of 3 July 2020) <https://zakon.rada.gov.ua/laws/show/1576-12#Text> accessed 08 August 2021.

79 79 Act of Ukraine 'On Limited Liability and Additional Liability Companies' (n 61).

80 80 Act of Ukraine 'On Joint-Stock Companies' (n 29).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

not be unlimited. Thus, according to the Letter of the Ministry of Justice of Ukraine dated 22 February 2013 No. 1332-0-26-13/11, an official should be the person that holds the office associated with the discharge of organisational, executive, administrative, and economic functions.[81] If the person's duties do not include the above-mentioned functions, or he or she does not act on behalf of the legal entity, he or she is not and shall not be treated as an official.

However, when considering a defendant in the derivative action, the focus should also be placed on some inaccuracy of Art. 54 of the CPC of Ukraine. Although the effective version of Art. 54 of the CPC of Ukraine refers to a claim for compensation for damages against the official, lack of detail creates a formal legal opportunity for such person to avoid liability if he or she no longer has the status of an official as of the date of the action.[82] Thus, according to Part 3 of Art. 372 of Czech Business Corporations[83] an official, against whom a derivative action can be brought, means without limitation the person who had that status as of the date of the damages inflicted upon the legal entity. Similarly, Sub-clause a) of Clause 5 of § 260 of the UK Companies Act defines the director as a former director as well.[84]

Therefore, Part 1 of Art. 54 of the CPC of Ukraine should be amended and supplemented with para. 3 as follows:

> for the purposes of this article, "officials" include members of the executive body, supervisory board, audit committee, chairperson and members of another governing body, or persons with the status of officials pursuant to the statutory document, by virtue of their administrative, economic, organisational, and executive functions, including the ones who had the status as of the date of the damages inflicted upon the legal entity.

Losses are sometimes inflicted upon the legal entity by its majority members and shareholders rather than its official. The need to expand the circle of persons against whom a derivative action can be brought by including the company's members has already been emphasised by Yu. K. Chelebiy-Kravchenko.[85] However, a legal entity's losses may also be inflicted upon it by third parties as to which governing bodies do not make a decision to bring an action. Losses can also be inflicted by full members of unlimited and limited partnerships with no governing bodies, so the concept of a derivative action in the existing form will be 'dead' in their respect. A suggestion to expand the circle of defendants under a derivative lawsuit by including third parties has already been expressed by O. V. Bihniak.[86] The opportunity to bring a derivative action against other members of the legal entity was recognized by the Supreme Court of Virginia in the case of *Cattano v. Bragg*.[87] In another case, *James Talcott, Inc. v. McDowell*, the court of appeal reiterated that the member/shareholder could bring a derivative action for compensation for the losses inflicted upon the company by a third party.[88] Each member's opportunity to bring a derivative action for compensation for the losses inflicted by another member is provided for by Art. 108 of Czech Business Corporations Act [89]

81 81 The Letter of the Ministry of Justice of Ukraine No 1332-0-26-13/11 of 22 February 2013 <https://zakon.rada.gov.ua/laws/show/v13_1323-13#Text> accessed 8 August 2021.

82 82 Commercial Procedure Code of Ukraine (n 7).

83 83 Czech Business Corporations Act (n 43).

84 84 UK Companies Act 2006 (n 13).

85 85 YuK Chelebiy-Kravchenko, 'General overview of participants of a legal proceeding brought by a derivative claim' (2018) 2 Entrepreneurship, Economy and Law 87-88.

86 86 OV Bihniak, 'Derivative action and corporate contract as means of corporate rights protection: experience of Ukraine' (n 3).

87 *Cattano v Bragg*, 727 S.E.2d 625 (Va. 2012).

88 *James Talcott, Inc v McDowell,* 148 So.2d 36, 37 (Fla. App. Dist. 3 1962).

89 Czech Business Corporations Act (n 43).

Thus, to our mind, the circle of persons against whom a derivative action may be brought must be expanded: *there must be an opportunity to bring this action against officials, members (shareholders) and third parties (provided that the legal entity is unable to protect its rights on its own).*

5.1 The issue of financial (civil) and employment (material) liability of company's officials

The grounds for holding officials liable are prescribed by Part 2 of Art. 89 of the Commercial Code of Ukraine, according to which they include inflicting losses due to actions (omission) if they are inflicted by: 1) actions taken by the official *ultra vires* or by abusing his or her official authority; 2) actions of the official taken in breach of the preliminary approval procedure or another decision making procedure for such actions; 3) actions taken in accordance with the approval procedure or another decision making procedure, but based on the false data furnished by the official; 4) failure to act by the official in case he or she had to take certain actions pursuant to his or her official duties; 5) other guilty actions of the official.[90] Based on the above-mentioned list of the grounds for the financial liability of officials, one can conclude that some of them are rather abstract and broad.

In particular, Clause 4 of Part 2 of Art. 89 of the Commercial Code of Ukraine does not specify which duties of the official are meant.[91] For example, officials of a corporation, namely the director or members of the executive body, can enter into employment contracts, so this is a liability for violating employment duties. Violation of employment duties entails financial liability under employment law, and such cases are heard by general courts. In turn, according to Clause 12 of Part 2 of Art. 20 of the CPC of Ukraine, the cases based on a derivative action are considered by commercial courts and entail civil (property) liability.[92] Therefore, the question is whether a derivative action for compensation for the losses inflicted upon the legal entity by the official with the employment contract may be brought.

A. Didenko and O. Nesterova have reasonably noted that where there are no criteria to divide the civil and labour liability of officials, there will be an absurd situation when officials with the same status will bear different liability depending on the type of their contract, either an employment one or civil law one.[93] O. Koltok believes that when civil financial and employment material liability is divided, one should consider which duties have been violated by the official.[94] Yu. Popov suggests that despite the existing employment relationship, the legal entity's members must have an opportunity to bring a derivative action due to the nature of relations between the legal entity and its senior executive (official).[95]

In comparison with other employees, officials have a special legal status and concurrently have employment and civil legal relations to discharge legal entity management functions. As noted by the Supreme Court in its Resolution dated 9 December 2020 in case No. 487/2178/19, the

90 Commercial Code of Ukraine of 16 January 2003 (as amended of 1 August 2021) <https://zakon.rada.gov.ua/laws/show/436-15#Text> accessed 8 August 2021.

91 Ibid.

92 92 Commercial Procedure Code of Ukraine (n 7).

93 93 AG Didenko, EV Nesterova 'Financial (civil) liability of officials of joint-stock companies' (2012) 7 Lawyer 7.

94 94 OI Koltok 'Derivative claims: innovations that are worth paying attention to' (2016) 16 Law and Business 21-28.

95 Yu Popov, 'Derivative (indirect) lawsuits: foreign experience and Ukrainian prospects' (n 45).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

above does not establish the priority of employment regulation over the civil one.[96] However, we should emphasise that since an official is a subject of civil and employment relations that exist concurrently and in parallel to each other, civil legal regulation to the extent of the losses inflicted by the employed official cannot fully displace the employment regulation. In cases where the person does not act on behalf of the legal entity and does not discharge management functions, the official acts as a subject of employment relations, so the legal labour rules on financial liability are to be applied. The point at issue is the losses sustained in connection with failure to take actions to avoid downtime, improper registration and storage of valuables, other employment duties, or damages to the property of such legal entity, etc. In cases where the opposite approach is used, the line between legal regulation of civil and employment relations is erased, and the mechanism for holding officials liable becomes unclear.

The above-mentioned stance is also confirmed by the fact that the grounds for holding officials liable under Part 2 of Art. 89 of the Commercial Code of Ukraine are associated with the losses inflicted during the management of the legal entity.[97] Part 4 of Art. 92 of the Civil Code of Ukraine,[98] which also provides for holding officials liable for losses inflicted upon a company, is dedicated to the legal capacity of the legal entity, so it is associated with the formation and expression of its will (management thereof) and does not provide for the opportunity to bring a derivative action on the grounds other than losses resulting from a discharge of management functions.

In its Resolution, the Grand Chamber of the Supreme Court reiterated that employment relations between the legal entity and its official did not influence the determination of jurisdiction of such dispute, and it had to be heard in accordance with Clause 12 of Part 1 of Art. 20, Part 1 of Art. 54 of the CPC of Ukraine.[99] The cause of action was the losses resulting from illegally accrued salaries (excessive payments to the staff). At first glance, this case seems to be within the competence of general courts by virtue of the direct legal rule, and the official's liability must be financial (under employment law). Thus, the Resolution of the Grand Chamber of the Supreme Court contradicts the law. However, it is not that unambiguous. Firstly, according to the facts of the case, the director's powers to determine the labour remuneration form and system were provided for by the articles of association, so these duties arise not so much from his or her status as an employee, but from his or her managerial position. Secondly, the powers to accrue salaries are rather of administrative nature since they provide for the disposal of the legal entity's funds (property). Under such circumstances, the official (director) acts as a competent governing authority of the legal entity in the first place rather than an employee.

The approach we have presented is used as a basis for the regulation of derivative actions in the legislations of other countries. For example, according to Arts. 147 and 148 of the German Joint-stock Companies Act, shareholders may bring a derivative action only for compensation for the losses inflicted *'during the management of the company's affairs'*.[100] Similarly, it is stipulated in Arts. 236 and 239 of the Spanish Business Corporations Act that the cause of a derivative action is losses resulting from actions (omission) of the director(s) in breach of the law, statutory documents, or official duties.[101] Moreover, Part 2 of Art. 239 of

96 Resolution of the Supreme Court in case 487/2178/19 of 9 December 2019 <https://reyestr.court.gov.ua/Review/93879586> accessed 8 August 2021.

97 Commercial Code of Ukraine (n 89).

98 Civil Code of Ukraine (n. 23).

99 Resolution of the Supreme Court in case 910/12217/19 of 14 April 2020 <https://reyestr.court.gov.ua/Review/88815574> accessed 8 August 2021.

100 Act of Germany 'On Joint-Stock Companies' (n 16).

101 Corporate Enterprises Act of Spain of 2010 (as amended July 2015) <https://www.spenceclarke.com/wp-content/uploads/Tax%20treaties%20etc/Company-law.pdf> accessed 8 August.

the Law that governs the procedure for several members or shareholders to bring a derivative action uses the concept of 'corporate interest',[102] which can only be breached when losses are inflicted upon the legal entity by the official as a subject of administrative powers rather than an employee.

Therefore, a derivative action against the official with the employment contract, given the specific legal status and in accordance with the effective law, does not depend on the existence of employment relations themselves and depends on how such an official acted, as a subject of employment or civil (managerial) relations, when he or she inflicted losses upon the legal entity. If losses result from a violation of the duties associated with management of the legal entity (management decisions taken, transactions conducted on behalf of the legal entity, etc.), a derivative action may be brought. If losses result from the official's actions (omission) as an employee (are not associated with management of the legal entity), the liability of such officials is financial, and a derivative action cannot be brought.

As for conditions for officials' liability, the following should be noted. In its Resolution in case No. 904/982/19 dated 24 February 2021, the Supreme Court reiterated that a person might be held liable in a derivative action only when four elements of the civil offence are proven, which include: 1) unlawful conduct; 2) losses; 3) cause-and-effect relationship between the unlawful conduct and losses incurred; 4) guilt.[103] The burden of proof is borne by the plaintiff, and if one of the elements of the offence is missing, the official cannot be held liable. We would like to avail of an opportunity and draw attention to Part 4 of Art. 92 of the Civil Code of Ukraine in respect of the liability of officials.[104] The point is that this rule provides for joint and several liability of officials for the losses sustained by the legal entity. However, the wording of this rule does not enable a clear understanding of whether the persons who, for instance, have not voted for the resolution that has resulted in the losses are also held liable. This issue was also raised by O. O. Kot in his study of a derivative lawsuit in Ukraine.[105]

According to the special rule, Part 3 of Art. 40 of the Law of Ukraine 'On LLCs', an official (namely, the member of the supervisory board or executive body) is released from liability if he or she proves that he or she is not guilty of the damages; in other words, individual liability of each official is established.[106] This rule can be interpreted so that the officials who have not voted for the resolution that has resulted in the company's losses will not be held liable. The same individualistic approach is also demonstrated by Art. 293 (in limited liability companies) and Art. 483 (in joint-stock companies) of the Commercial Companies Code of Poland, Part 3 of Art. 187 of Commercial Code of Estonia.[107] The effective Law of Ukraine 'On JSCs' does not contain an equivalent rule,[108] but it is stipulated in Part 2 of Art. 86 of the Draft Law of Ukraine 'On JSCs' that only the officials who have voted for the resolution in the collegiate bodies of the joint-stock company are held liable for the losses inflicted upon by the body's resolution.[109]

102 Ibid.

103 Resolution of the Supreme Court in case 904/982/19 of 24 February 2021 <https://reyestr.court.gov.ua/Review/95240657> accessed 8 August 2021.

104 Civil Code of Ukraine (n 23).

105 OO Kot, 'Derivative lawsuit as a remedy for protection of corporate rights' (2016) 5-6 Bulletin of Economic Justice 21-27.

106 Act of Ukraine 'On Limited Liability and Additional Liability Companies' (n. 61).

107 The Commercial Companies Code of Poland of 19 September 2000 (as amended 2014) <https://supertrans2014.files.wordpress.com/2014/06/the-commercial-companies-code.pdf> accessed 8 August 2021; the Commercial Code of Estonia of 01.09.1995 (as amended 4 April 2014) <https://www.riigiteataja.ee/en/eli/504042014002/consolide> accessed 8 August 2021.

108 Act of Ukraine 'On Joint-Stock Companies' (n. 32).

109 Draft Law of Ukraine 'On Joint-Stock Companies' (n.8).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

In our opinion, such an approach is ambiguous. It is absolutely wrong to hold the official who has voted against the respective resolution liable for the losses sustained by the company. However, there is still an open question of how to qualify actions of the official in the collective body who has not voted against and has abstained from voting: as passive approval of the unlawful resolution of the governing body or as a ground for being released from liability? On the one hand, such an official does not vote for the unlawful resolution. On the other hand, such conduct may be treated as a violation of the official's fiduciary duties by omitting to take the actions that would prevent the adoption of a resolution that will inflict damages upon the corporation. Moreover, such person's attendance can, for instance, procure quorum at the general meeting in a joint-stock company and their power to adopt a resolution.

In our opinion, this is the very reason why only those officials who have directly disagreed with the resolution and voted against it should be released from liability. This approach is implemented in the laws of a number of foreign jurisdictions. For example, according to Clause d) of Art. 316 of the Corporations Code of California, abstaining from voting is considered to be a passive approval of the respective resolution, so a director is jointly and severally liable together with the other members of the executive body.[110] According to Clause 2 of Part 6 of Art. 63 of the Act of Kazakhstan 'On Joint-stock Companies', abstaining from voting is treated as 'unlawful omission' that has resulted in losses.[111] According to §123 of the Canada Business Corporations Act, a director who is present at a meeting of the executive body is deemed to have consented to any resolution passed unless he or she directly expresses his or her dissent.[112]

6 BUSINESS JUDGEMENT RULE

However, it should be noted that the circumstances under which a resolution (action or omission) is adopted by officials are usually unclear, the scope of information is insignificant, and the time is limited. Therefore, it is extremely difficult to foresee consequences in advance, so there is quite a high probability of the resolution or transaction that will not only fail to meet the expectations but also will do damages, despite good-faith estimates of its performance and economic feasibility. The above constitutes risk as an integral attribute of any economic operations in which it is necessary to promptly respond to internal and external factors, which will not be ensured if officials keep doubting their decisions all the time for fear of liability for their bona fide actions – in the end, it is the corporation that will suffer.[113][114] Judges and participants of litigation are often unable to tell apart negligence as the improper discharge of the official's duties and competent management under the conditions of limited information, time, resources, etc., which, due to the risky nature thereof, entailed unfavourable results.[114] There are several reasons for the above: 1) the judge does not have the sufficient level of knowledge and experience in the business sphere to assess economic aspects of the officials' resolution; 2) there is a frequent basis for the so-called hindsight bias:

110 Corporations Code of California of 1947 (as amended 1 January 2021) <https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=CORP&division=1.&title=1.&part=&chapter=3.&article=> accessed 8 August 2021.

111 Act of Kazakhstan 'On Joint-Stock Companies' (n 68).

112 Business Corporations Act of Canada (n 14)

113 L McMillan, 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 (2) Wm. & Mary Bus. L. Rev. 567.

114 A Ponta, RN Catana, 'The business judgement rule and its reception in European countries' (2015) 4 (7) The Macrotheme Review 132, 137.

a tendency to perceive the facts and events that have occurred as evident and predictable ones as well as reversible ones, despite the fact that the initial information before occurrence thereof was insufficient to foresee them; in other words, a resolution of the officials that was reasonable when it was adopted might seem unreasonable in the course of time.[115] Therefore, there is an actual probability that the officials' actions can be misjudged as negligence, and they can be held liable. It is necessary to create guarantees to protect the latter from liability for risky actions (non-actions), provided that their fiduciary duties are discharged.

Given the above, the common law was the first to develop the refutable presumption called *'business judgement rule'*, a refutable presumption that the officials acted in good faith, reasonably (on an informed basis), and for the benefit of the legal entity. The burden of proof is generally borne by the plaintiff, although in some jurisdictions, the defendant has to prove that the resolution, actions, or omission meet the applicable criteria (Germany, Austria, etc.).[116] However, while assessing risk factors in good faith, they can arrive at a reasonable conclusion on the feasibility of not conducting a transaction or adopting a resolution, which can also inflict losses upon the corporation in the future (including as lost profit). The doctrine of the business judgment rule covers the above-mentioned cases. According to Part 3 of Art. 180 of the Australian Corporations Act business judgement rule applies to any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.[117]

According to the judgement of the Delaware Supreme Court in the case of *Smith v. Van Gorkom*, the duty of care should mean that the corporation's officials acted in an informed manner the same way as any reasonable person would do under the same circumstances. In its turn, an informed manner means that officials must take a decision only after they have examined all the information, both available and obtainable.[118] The law enforcement practice then confirmed that the duty of care was only associated with the requirement for the procedure for decision-making by the informed person. In particular, an official will not be held liable for the decision that would not be made by an ordinary reasonable person, which means that the decision as an outcome is not assessed.[119] However, it does not mean that the decision taken in the process is of no significance at all. If the decision taken is obviously irrational or is an abuse of discretion, i.e., the one that cannot be taken by any other person, the official enjoys no immunity in this case. Given the above, one can conclude that the courts rather assess how unreasonable the decisions taken are. However, it does not mean that reasonableness of the decision is ignored when it is resolved whether to use the business judgment rule: when lack of reasonableness is assessed, 'reasonableness' of the decision is indirectly assessed as well.

According to the judgement of Delaware Supreme Court in the case of *Aronson v. Lewis*, the duty of loyalty means that when a decision was made, the official acted in the best interests of the company, did not have a personal interest therein, was not a party to the transaction or did not gain indirect personal benefit from the decision made, and was independent of external influence in the decision made.[120]The court defined independence as follows in its judgement:

115 D Despotovic 'Fiduciary Duties and the Business Judgment Rule (with the Emphasis on the Citigroup Case)' (Master Thesis, University of Tilburg 2010) 12-13.

116 P Nimmerfall, LJ Peissl, 'The Business Judgment Rule and its Impact on Austrian Law' (2015) 4 Časopis pro právní vědu a prax 354-357.

117 Corporations Act of Australia of 2001 (as amended 2017) <https://www.legislation.gov.au/Details/C2018C00031> accessed 8 August.

118 *Smith v Van Gorkom*, 488, A.2d 858 (Del. 1985).

119 C Hansen, 'The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project' (1993) 48 (4) The Business Lawyer 1357.

120 *Aronson v Lewis*, 473 A. 2d 805 (Del. 1984).

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

> While directors may confer, debate, and resolve their differences through compromise, the end result, nonetheless, must be that each director has brought his or her own informed business judgment to bear without regard for or succumbing to influences that convert an otherwise valid business decision into a faithless act.121

Still, it should be noted that a separate 'duty to act in good faith' is fairly criticised in the USA. A. Gold argues that even when the director has misled the members (shareholders) of the corporation and has been confident that his actions will be in the interests of the corporation, ultimately, it is the duty of loyalty that is breached since deceit by the official, no matter the motives, can hardly be in the interests of the company.[122] Gold suggests that the business judgement rule must be limited to checking adherence to two duties only: duty of care and duty of loyalty, in the broad meaning of the latter. The same stance can be found in the Judgement of the Delaware Supreme Court in the case of *Stone v. Ritter*.[123] In civil law countries, the duty to act in good faith is generally not separated from other fiduciary duties of the officials. According to Art. 93 of the Joint-stock Companies Act of the Federal Republic of Germany, 'failure to discharge their duties by members of the governing body does not take place if the latter reasonably assumed while taking a decision that they acted based on sufficient information and in the best interests of the company'.[124] According to the laws of France, the grounds for holding officials liable are erroneous actions, violation of the law or articles of association (Art. L. 225–251 of the Commercial Code of France), and taking actions contrary to the company's interests.[125]

Fiduciary duties that comprise a business judgment rule as a refutable presumption are implemented in Part 3 of Art. 92 of the Civil Code of Ukraine, which prescribes the duty of the company's officials to act in good faith, reasonably, and in the company's interests.[126] The same rules can be found in Part 1 of Art. 40 of the Law of Ukraine 'On Limited Liability Companies'[127] and Parts 1 of Art. 63 of the Law of Ukraine 'On JSCs'.[128] It is worth noting that the courts determine the unlawfulness of the official's conduct as a condition for holding him or her liable for the losses sustained by assessing the actions taken in pursuance of the fiduciary duties established by the above-mentioned rules. Combined with the fact that the burden of proof lies within the plaintiff, we can argue that a kind of business judgment rule is implemented in case law. For example, according to the Resolution of the Supreme Court in case No. 904/3852/18 of 26 February 2020, unlawful conduct constitutes certain improper and unscrupulous actions, without adherence to the limits of normal business risk, with personal interests or abuse of official duties on purpose (at own discretion), obviously negligent and wasteful decisions taken deliberately for the benefit of the official.[129] The equivalent extended interpretation of the concept of 'unlawfulness' can be found in the Resolution of the Supreme Court in case No. 904/982/19 dated 24 February 2021.[130]

However, it should be noted that the main shortcoming of the above legal rules is that they do not detail the content of the fiduciary duties of officials. This issue has been remedied in

121 Ibid.

122 AS Gold, 'The New Concept of Loyalty in Corporate Law' (2009) 43 UC Davis Law Review 12-15.

123 *Stone v Ritter*, 911 A.2d 362 (Del. 2006).

124 Act of Germany 'On Joint-Stock Companies' (n 16).

125 Commercial Code of France (n 39).

126 Civil Code of Ukraine (n 23).

127 Act of Ukraine 'On Limited Liability and Additional Liability Companies' (n 61).

128 Act of Ukraine 'On Joint-Stock Companies' (n 32).

129 Resolution of the Supreme Court in case 904/3852/18 of 26 February 2020 <https://reyestr.court.gov.ua/Review/87735735> accessed 8 August 2021.

130 Resolution of the Supreme Court in case 904/982/19 of 24 February 2021 <https://reyestr.court.gov.ua/Review/95240657 > accessed 8 August 2021.

the Draft Law of Ukraine 'On JSCs'. In particular, Art. 85 of the Draft Law establishes the extended list of the fiduciary duties imposed on the official and details their content.[131] At the same time, the duty to take independent decisions is not defined precisely enough. Part 4 of Art. 85 attempts to describe this duty in more detail: the duty will not be breached if the limitation of the official's discretion is stipulated in the contract between him or her and the company.[132] However, the question is whether an official can take a decision independently if it has consulted or actively debated with another, possibly qualified person. The legislator gives no answer to this question, but, according to the case of *Aronson v. Lewis*, the official's actions (omission) are independent in case he or she ultimately takes his or her own informed decision, which may be based without limitation on consulting, debating, etc.[133] Therefore, to our mind, the equivalent definition of this duty should be introduced since the director will otherwise be considerably deprived of an opportunity to make an informed decision and discharge his or her duty to act in good faith.

We should note another shortcoming inherent both to Part 3 of Art. 92 of the Civil Code of Ukraine, Art. 40 of the Law of Ukraine 'On LLCs', and Art. 86 of the Draft Law of Ukraine 'On JSCs'. In all these articles, the duties to act in good faith, the duty of care and the duty of loyalty are established in respect of the officials' actions, their active conduct.[134] However, as we have emphasised before, adherence to the above-mentioned fiduciary duties may also occur when the officials, acting in the legal entity's interests and with due care, take a decision not to conduct a transaction or adopt a resolution. It should be noted that Part 2 of Art. 40 of the Law of Ukraine 'On LLCs'[135] and Art. 86 of the Draft Law of Ukraine 'On JSCs'[136] provide for the officials' liability for the omission, but it is not a question of omission under the above circumstances since omission is associated with failure to discharge official duties while informed decisions not to take certain actions result from the discharge of the official's duties. Thus, we suggest supplementing Part 3 of Art. 92 of the CC of Ukraine, Part 1 of Art. 40 of the Law of Ukraine 'On LLCs', and Art. 86 of the Draft Law of Ukraine 'On JSCs' with para. 3 as follows: 'Officials are not liable for the losses inflicted upon the legal entity if the decision to act (or not to act) has been taken in accordance with the duties of care and duty of loyalty'. We are also critical about the establishment of the officials' duty to act in good faith since this category is rather judgement-based and deprived of its own sense beyond the duty of loyalty and duty of care.

To our mind, the establishment of the list of fiduciary duties will positively influence the legal regulation of the derivative action. In fact, according to Art. 86 of the Draft Law of Ukraine 'On JSCs', officials shall only be liable for the actions (omission) taken contrary to the company's interests.[137] However, if officials have acted in the company's interests, but have taken the decision in breach of the duty to act reasonably (duty of care), i.e., have violated any of the fiduciary duties, the business judgement rule shall also not be used, and the official must be held liable. Therefore, it will be logical to amend the rule and prescribe that officials are liable for the actions (omission) taken contrary to the company's interests and in breach of the duty to act reasonably (duty of care).

131 Draft Law of Ukraine 'On Joint-Stock Companies' (n 8).

132 Ibid.

133 *Aronson v Lewis,* 473 A. 2d 805 (Del. 1984).

134 Civil Code of Ukraine (n 23); Act of Ukraine 'On Limited Liability and Additional Liability Companies' (n 61); Draft Law of Ukraine 'On Joint-Stock Companies' (n 8).

135 Act of Ukraine 'On Limited Liability and Additional Liability Companies' (n 61).

136 Draft Law of Ukraine 'On Joint-Stock Companies' (n 8).

137 Ibid.

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

7 CONCLUSIONS

The institute of a derivative lawsuit is a complex legal concept only recently implemented in Ukrainian legislation. Nevertheless, a derivative action is an important guarantee of protection of the rights and interests of the corporation and minority participants (minority participants) from abuse and wrongful acts by those who control the corporation. At the same time, the current model of legal regulation of the derivative lawsuit contains many shortcomings, the analysis and solution of which is carried out in this scientific work.

The formation of the will (decision-making) to exercise the procedural rights and obligations of the corporation is an incorrect and internally contradictory approach, as the latter are subject to further approval by the applicants (members of the corporation). The corporation must be allowed to acquire and exercise its procedural rights and obligations (make decisions) on its own behalf through its members, who filed a lawsuit.

The right to file a derivative lawsuit must be granted to members of all corporations – entrepreneurial and non-entrepreneurial alike. To that end, property qualification must be substituted with a representation quota for members of non-entrepreneurial corporations. Continuing the topic of persons, who can file a derivative lawsuit, such a right must be granted to holders of preferred stock since there is no reason to deprive them of such right, as it was shown in this scientific work. The right to file a derivative lawsuit must also be granted regardless of whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.

The prevention mechanism regarding any abuse of the right to file a derivative lawsuit should amount to the extended *locus standi* procedure. The latter has to consist of the following requirements: 1) property qualification or representation quota; 2) mandatory application of a demand to the corporation for taking actions; 3) the legal entity, contrary to its interests, has failed to take any action to defend its rights and interests for one month or has rejected the person's demand (is unable to defend its rights and interests on its own); 4) there are no other grounds that would prevent a derivative action from being brought.

The cause for a derivative lawsuit is the inability of the legal entity to protect their rights and interests in cases where the persons controlling it do not take any measures, and the damage was caused by the majority of members or even third parties. Considering this, it is necessary to extend the circle of defendants by including members of the corporation and third parties as those against whom the lawsuit may be filed. Such a suggestion confirms with foreign practices.

It is quite common for a corporation's official to be employed. In that case, the necessity for distinguishing civil (financial) and employment (material) liability. The cause to file a derivative lawsuit and to bring officials to financial liability rises when the damages were caused by officials' acts (omission) in violation of the duties associated with management of the legal entity. Otherwise – the liability must be material. One other issue to consider is the possibility to hold liable an official who abstained from voting regarding the resolution of the governing body that caused the damage. To our mind, such conduct must be deemed a violation of the official's fiduciary duties by omitting to take the actions that would prevent the adoption of a resolution that will inflict damages upon the corporation.

To prevent any detrimental effect to the management of the corporation caused by officials' constant questioning of their decisions, the 'business judgement rule' must be implemented into Ukrainian legislation. This refutable presumption must include two duties – 'duty of care' (person acted reasonably and was informed) and 'duty of loyalty' (person acted in the interest of the corporation). The 'duty to act in good faith' is too broad in its meaning and can be effectively substituted with other duties – 'duty of care' and 'duty of loyalty'. For

the implementation of the business judgement rule to be effective in national legislation, the latter must provide its application in cases where officials acting reasonably and in the interest of the corporation decided not to take any actions. The latter cannot be considered an omission because officials do not fail to discharge their duties.

REFERENCES

1. Bihniak OV, 'Derivative action and corporate contract as means of corporate rights protection: experience of Ukraine' (2018) 5 (3) European Political and Law Discourse 501.
2. Bogush MK, 'Protection of the rights and interests of the subjects of corporate legal relations' (PhD (Law) thesis, Taras Shevchenko National University of Kyiv 2018) 240.
3. Chaban OA, 'Institute of derivative action in England and Wales' (2020) 27 Scientific Papers of National University 'Odessa Law Academy' 94-99.
4. Chelebiy-Kravchenko YuK, 'General overview of participants of a legal proceeding brought by a derivative claim' (2018) 2 Entrepreneurship, Economy and Law 85-88.
5. Despotovic D, 'Fiduciary Duties and the Business Judgment Rule (with the Emphasis on the Citigroup Case)' (Master Thesis, University of Tilburg 2010).
6. Dotsenko OP, 'Invalidation of a transaction committed by the executive body of a business company in excess of its powers as a way to protect corporate rights' (2020) 3 Entrepreneurship, Economy and Law 69-76.
7. Gelter M, 'Why do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brooklyn Journal of International Law 844–892.
8. Gold AS, 'The New Concept of Loyalty in Corporate Law' (2009) 43 UC Davis Law Review 457-528.
9. Grechenig K, Sekyra M, 'No Derivative Shareholder Suits in Europe – A Model of Percentage Limits and Collusion' (2010) 15 Discussion Paper Series of the Max Planck Institute for Research on Collective Goods 29.
10. Hansen C, 'The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project' (1993) 48 (4) The Business Lawyer 1355-1376.
11. Kershaw D, 'The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle' (30 January 2013) LSE Legal Studies Working Paper No. 5/2013 39.
12. Kot OO, 'Implementation and protection of subjective civil rights: problems of theory and judicial practice' (*Alerta* 2017) 494.
13. Kot OO, 'Derivative lawsuit as a remedy for protection of corporate rights' (2016) 5-6 Bulletin of Economic Litigation 92-96.
14. Koltok OI, 'Derivative claims: innovations that are worth paying attention to' (2016) 16 Law and Business 21-22.
15. Koroyed SO, Makhinchuk VM, 'Derivative (indirect) lawsuits of the founders of legal entities as a form of implementation of the doctrine of piercing the corporate veil' (2020) 44 Scientific Bulletin of the International Humanities University. Series: Jurisprudence 74-77.
16. Kovalyshyn OR 'Indirect (derivative) lawsuits as a legal remedy for participants in corporate relations' (2010) 17 Bulletin of the Academy of Advocacy of Ukraine 61-67.
17. McMillan L, 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 (2) Wm. & Mary Bus. L. Rev 520-574.

Access to Justice in Eastern Europe
ISSN 2663-0575 (Print) ISSN 2663-0583 (Online)
Journal homepage http://ajee-journal.com

18. Nimmerfall P, Peissl LJ, 'The Business Judgment Rule and its Impact on Austrian Law' (2015) 4 Časopis pro právní vědu a prax 352-357.

19. Ostrovska LA, 'Indirect (derivative) lawsuits: international experience and legislation of Ukraine' (abstract of PhD (Law) Thesis, National University 'Odessa Law Academy' 2008) 20.

20. Ponta A Ponta, Catana RN, 'The business judgement rule and its reception in European countries' (2015) 4 (7) The Macrotheme Review 125-144.

21. Popov Yu, 'Derivative (indirect) lawsuits: foreign experience and Ukrainian prospects' (2012) 12 Ukrainian Commercial Law 55-65.

22. Sukhanov MO, 'Analysis of the practice of the supreme court regarding judicial protection of corporate rights of members of a limited liability company' (2020) 6 Law and Society 56-61.

23. Talykin Ye, 'Derivative lawsuit in commercial litigation of Ukraine: general principles of procedural construction' (2014) 4 Law Herald 161-168.

24. Zhang Z, 'The Shareholder Derivative Action and Good Corporate Governance in China: Why the Excitement is Actually for Nothing' (2020) 28 (2) Pacific Basin Law Journal 174-209.