Common Law Derivative Action and Challenges in Seeking Multiple Derivative Actions in Hong Kong SAR.

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Introduction

Corporate governance is fundamental in safeguarding the interest of various stake holders of a body corporate. Effective corporate governance has the potential to not only protect the private interest in an incorporated company but also the interest of the public in general. The increasing emphasis on effective corporate governance by listing rules and stock exchanges, aimed at protecting the interest of prospective investors in a public offering, is a clear example of protection of public interest. However, effective corporate governance could be subjected to threats in various scenarios, where innovative legal or regulatory mechanisms are warranted to protect the private and public interests. For example, cross border public offering or listing of stocks may threaten the interest of prospective investors that could be attributed to the diverse standards of corporate governance between the place of incorporation and place of listing.

Similarly, public policies and regulations aimed at preventing corruption or money laundering by companies incorporated in a jurisdiction will be difficult to implement in the context of their cross border operations or against their subsidiaries abroad. Some countries like the United States (US) seek to enforce such policies through extraterritorial application of laws like the Foreign Corrupt Practices Act (FCPA), but such examples are not common in other jurisdictions. The interests of the shareholders or minority shareholders of a companymay be comprehensively protected under the company laws of theplace of incorporation and shareholders may resort to class action suits to effectively enforce their rights in that jurisdiction. However, such protection or effective enforcement may not be available to the shareholders with regard to the operations of a subsidiary of their company incorporated abroad, where the protection of the interest of the company or the shareholders

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could be relatively weak. Although protection of specific interests is generally considered to be more challenging in a cross border context, studies have revealed that protection could sometimes be enhanced in such circumstances. For example, the protection of the right of minority shareholders that is often weak in some jurisdictionswas found to have been enhanced during cross listing of shares in foreign stock exchanges[2]. However, such enhanced protection could mainly be perceived between jurisdictions, where there are disparities in legal regime warranting better corporate governance. But among jurisdictions with developed corporate law regimes, such differences with regard to the protection of rights of the minority shareholders may hardly exist.Concerns about the vulnerability of minority shareholders' rights and introduction of sound protection measures are commonly found in most developed legal regimes. This does not mean that jurisdictions with developed corporate law and standards will be homogeneous in various respects of corporate governance or related remedies. For example, jurisdictions with developed corporate law regimes could differ with each other to a great deal with regard to the recognition and admittance of derivate actions or multiple derivative actions. Such diversity may in turn create private international law implications for shareholder derivative or multiple derivate actions initiated in a cross border context, which is highlighted in the later part of this paper that examines multiple derivative actions initiated in Hong Kong with regard to companies incorporated under Macau law.

Other than the public interest and shareholders interest, the interest of the company as a legal person itself needs protection and is generally the responsibility of the directors and top management of the company to secure the same. But if the interest of the company is threatened by the fraud or failure of the duties of the directors or the top management, how to secure the interest of the company becomes a challenging task. It is under these circumstances the shareholders could step into the shoes of the company and seek to protect its interest through shareholder derivative actions. However, this method of protecting the interest of the company could becomequite complex, depending on the nature of the derivative action undertaken. The present paper is aimed at specifically examining key legal issues arising in the context of multiple and cross-border derivative actions in Hong Kong SAR and implications for companies incorporate abroad including those in Macau SAR. A

[2]For example, companies incorporated in countries with a weak legal protection for minority shareholders were found to have opted for cross listing in New York Stock Exchange or Nasdaq and subject themselves to more stringent provision of US Securities Laws and higher accounting standards in order to increase the chances of raising capital. As a result of such cross listing, the protection of minority shareholders in those companies was found to have increased albeit it was not the primary motivation. See William A. Reese Jr. and Michael S. Weisbach, "Protection of minority shareholder interests, cross-listings in the United States, and subsequent equity offerings" *Journal of Financial Economics* Vol. 66 (2002) 65–104.

basic reference is made to some related issues arising in the context of Macau. As the paper is mainly focused on the common law jurisprudence, a case law method is adopted in the paper whereby a specific set of cases from USA, Hong Kong and UK are closely examined in order to identify the challenges with regard to both derivative and multiple derivative actions involving the top management and subsidiaries respectively.

The paper concerns the question of constraints in shareholder derivate action as an effective remedy against lapses of corporate governance. Therefore, the paper first examines how such lapses are espoused in the US courts, where derivative actions are debated at length, which provides a good opportunity to identify a range of claims that could be raised by the shareholders against the top management. Moreover, the specific case examined in the paper also sheds light on how the US courts address legal questions in a derivative action challenging transactions involving different states and consequentially the need to applythe laws of more than one state. After identifying some typical claims that may be raised in a shareholder derivative action, the paper highlights its complexities and argues that they are bound to increase in circumstances,where the claims take the form of multiple derivate actions, especially when the underlying dispute involves more than one jurisdiction.

The next part of the paper takes a closer examination of approach of the Hong Kong common law courts in dealing with multiple-derivative actions involving companies incorporated in Macau SAR. In this context, the paper highlights how the English common law jurisprudence continued to influence the outcome of the case in various respects. The paper identifies the ardent following by Hong Kong courts of specific English common law standards like the rule of exclusion of reflective loss and the *Konamaneni* principle.Potential critique of the Hong Kong common law courts' interpretation of the governing law of Macau SAR, which belongs to a civil law legal tradition, is highlighted.The concluding part of the paper identifies the challenges revealed out of the single and multiple derivative actions examined in this paper and calls for the need to initiate international harmonization measures to bring more uniformity with regard to principles governing derivative actions among various jurisdictions. The desirability for an increased exchange between the Hong Kong and Macau SARs in various frontiers of corporate law and governance is expressedtowards the end.

Shareholder derivate action as an effective remedy against lapses of corporate governance or malfeasance

Shareholder derivative actions are legal actions by a shareholder or a group of shareholders of a company against others (third parties) or its own directors or officers involved in its management (the "top management") in order to enforce or defend a legal right or claim on behalf of a company. Firstly, derivative actions by shareholders are warranted because of the conundrum that the very directors or officers who should otherwise be safeguarding the interest of the company fail to take appropriate action to protect such interests. This may trigger the shareholders to seek action against the third parties on behalf of the company. Secondly, the shareholders could initiate derivative actions against their own directors or the top management, whenthey themselves indulge in acts that are against the interest of the company. Such inappropriate actions become the subject matter of the cause of action, which is espoused by the shareholders through derivative actions. In such derivative actions, shareholders typically complain that the top management had breached their fiduciary duty or had acted against the interest of the company. The range of acts complained against may include inaction on the part of the management, mismanagement, fraud or other types of misfeasance. The remedy sought against such acts could not only involve demand for better corporate governance but also substantial monetary claims from individuals responsible for such impugned acts. In either case, it is the right of the company, which the shareholders are seeking to protect on behalf of the company and therefore the outcome of the derivative actions will belong to the company and not the shareholders who are pursuing the action.

The nature of the acts that could trigger a shareholder derivative action and the scope and extent of remedies sought could differ among jurisdictions and may vary based on the domestic corporate law governing the matter. For example, in US, the range of acts triggering a shareholder derivative action and the remedies sought are influenced by the applicable federal law and the relevant state law governing the matter. US courts have not only admitted shareholder derivative actions in a wide range of impugned acts but also have granted drastic remedies including staggering amounts of monetary claims. *Wade Tucker, et.al. v Richard M. Scrushy, et.al.*[3] ("the *Tucker* case") is a leading shareholder derivate actioncase, where the court granted a mammoth monetary judgment of over 2.876 billion US dollars in favour of

[3] Decision dated 18 June, 2009 by Justice Allwin E.Horn, Circuit Judge, Circuit Court of Jefferson County, Alabama, HealthSouth Corporation 2002 Derivative litigation, CV 02-5212 AEH and all consolidated cases. ("Circuit Court Decision in Tucker Case")

the shareholders' of HealthSouth against itsCEO Scrushy. A closer examination of this sample derivative action in the US reveals the range of claims and remediesthat have been admitted and granted by the US court against the actions of the CEO and top management of a company.

The Shareholders of HealthSouth initiated a number of derivative actions against Scrushy and other senior management officials of the company in different courts, when theydiscovered that the financial integrity in the management of the company had been compromised over a long period of time from 1994 to 2002[4]. It became evident that many of the higher management officials of the HealthSouth had been engaged in fraudulent accounting practices including falsely inflating various reported earnings and the financial position of the company, often to meet the related predictions made by the Wall Street ratings. This misled various stakeholders including investors, who purchased the overvalued shares of HealthSouth that ultimately plummeted when the fraud came to the limelight. Although, HealthSouth was a Delaware Corporation, the shareholders derivative actions were initiated in different forums. While some shareholders filed derivative actions in the native Delaware, Wade Tucker and others initiated derivative actions in the courts of Alabama. Subsequently, most of those derivative actions were coordinated or consolidated with *Tucker* case conducted in Alabama.The derivative action filed in Tucker case made various claims including those arising out of "(1) improper "interested transactions," waste and "misappropriation of corporate assets"; (2) unjust enrichment; (3) breach of contract; (4) conspiracy; (5) "intentional, reckless, and innocent misrepresentation and suppression"; (6) breach of fiduciary duty of loyalty, related to fraud, false accounting, and "insider trading"; and (7) seeking to impose a constructive trust."[5]

Firstly, the shareholders argued that Scrushy was unjustly enriched with a bonus of 10.4 million in 1996 even though no bonus were properly payable to him that year because the actual net income of the company did not exceed the budgeted net income. Secondly, the shareholders argued that Scrushy was involved in insider trading and claimed the profit of more than 147 million USD, which he made through the sales of HealthSouth shares in 1997. They argued thatthe Alabama court should apply the Delaware law and order the return of

[4] Criminal charges were also framed against the involved management officials of the HealthSouth, to which many of those charged pleaded guilty and were convicted.
[5] See *Richard Scrushy v. Wade C. Tucker and the Wendell J. Cook, Sr., Testamentary Trust, John P. Cook, trustee, derivatively, for and on behalf of HealthSouth Corporation*. Case no. 1081424. Supreme Court of Alabama, January 28, 2011 at p.5. This is the appellate decision in the appeal made by Scrushy against the judgement of the lower court in *Tucker* Case. ("Appellate Decision in Tucker case")

profit to the company because under the Delaware law an insider or a fiduciary, who uses inside information to profit from a sale of shares at the expenses of innocent buyers, holds it in constructive trust for the company. Thirdly, the shareholders sought to rescind Scrushy's employment contract and related retirement benefits accruing under the contract. As both Delaware and Alabama laws recognized rescission in cases of material breach as well as fraud or concealment of fraud, the shareholders claimed that Scrushy has forfeited all rights under the employment contracts due to knowledge and participation in the fraud and breach of duty of loyalty to the company.

The shareholders also challenged several transactions approved by Scrushy on the grounds that he appeared on both sides of those transactions. Those transactions were concluded between HealthSouth on one side, represented by Scrushy as the CEO of the company and Scrushy himself or his family or trusts on the other side. The shareholders argued that the burden of proof was on Scrushy to establish that all those transactions were entered by Scrushy with entire fairness to HealthSouth, demonstrating fair price (economics) and fair dealing (process) and the approval of those transactions by the Board standing alone wasinsufficient to discharge such a burden. The shareholders also sought to hold Scrushy liable for an incomplete hospital project initiated under the aegis of the companyon the grounds that it did not have any economic basis and Scrushy had knowledge that the company did not have the money to complete it.

Finally, the shareholders made several fraud damage claims against Scrushy for his role in reconstruction and remediation of financial statements, incurring excess debt costs and repurchasing its own stock (at a price inflated by fraudulent financial reports) for the company from the open market, payment of excess salaries and bonuses to disloyal employees perpetrating fraud and payment of taxes on fictitious assets or earnings.The Alabama court agreed with most of the claims by the shareholders and granted a final judgement for and on behalf of HealthSouth Corporation towards a sum of 2,876,103,000.00 against Scrushy. The Court also declared that all the employment contracts between the company and Scrushy as void and denied him all the related retirement benefits. The subsequent appeal of this decision by Scrushy in the Alabama Supreme Court was dismissed and the outcome was affirmed without any changes[6].

[6] See the Appellate Decision in Tucker case 2011, *ibid.*

The *Tucker* case is a clear example of judicial recognition and support for shareholder derivative action against the top management of a company. The courts have been highly critical of the acts perpetuated by Scrushy against the interest of the company over a long period of time and even termed him as the "CEO of the Fraud"[7]. The *Tucker*case also resulted inone of the highest financial judgments, which evidences the willingness of the judiciary to secure the interest of the company to a greater length. At the same time, it is important to take note that some claims against Scrushy were not admitted by the Circuit Court in *Tucker* case. The grounds of dismissal of these derivative action claims are mixed and not all of them are entirely convincing. For example, the dismissal of claims against some of the dealings entered by Scrushy, even when they were far more expensive and involved an obvious conflict of interest, could be subjected to criticism. The plaintiffs claim to recover the dealings made by HealthSouth with the computer reselling company owned by Scrushy's parents was not admitted by the Court,in spite of the evidence that the price paid was substantially higher than what HealthSouth would have paid to buy the same equipment elsewhere[8].

At the same time, the grounds of dismissal of some other claims are less objectionable. For example, the court found that the transactions made by HealthSouth with a real estate investment trust organized by Scrushy and others were fair because they primarily benefitted the HealthSouth[9]. A final point regarding the recognition of the right of a Shareholder to initiate a derivate claim against certain acts of the management occurring even before the shareholder acquired the shares of the company is worth noting. Scrushy's objection that the Tucker did not have standing to seek claims accruing before he acquired his shares in HealthSouth was categorically dismissed by the Alabama courts[10]. Although, the *Tucker* case evidences a range of issues and concerns that may arise in the context of a shareholder derivative action, it is a straight forward and direct claim by the shareholders of company against the top management. However, the complexity of derivative actions could increase when it involves claims against others, especially when the action is sought against parties

[7] See the Circuit Court Decision in *Tucker* Case, 2009 at p.25

[8] The evidence revealed that over five million dollars in excess were paid for the equipment. The Court rejected the plaintiffs claim because of the lack of evidence that Scrushy's brother who negotiated that deal was involved in a fraud.

[9] Under such circumstances, the Court did not attach any significance to the fact that Scrushy made millions of dollars out of such transactions. At the same time it should be noted that there was no evidence of fraud in these transactions and they were found to be not detrimental to the interest of the company. Moreover, the Court pointed out that these transactions were accurately reported in the right time through the public documents filed by HealthSouth and there were no objections made or litigation initiated in a timely manner (thereby resulting in the bar of claims against the transactions under the statutes of limitation).

[10] See Para 27, Page 41 of the Circuit Court Decision in *Tucker* Case, 2009.

from other jurisdictions.The complexity will further exacerbatewhen the derivative action sought by the shareholders of a company involves actions of its subsidiary incorporated in a different jurisdiction.

Multiple and Cross-Border Derivative Actions

Derivative action recognizes the right of the shareholders to initiate claims on behalf of their company However, whether the shareholders of a company can pursue a derivative action on behalf of its subsidiary of that company is an intriguing question, especially when the lapses in the management of the subsidiary has the potential to affect the interest of the parent company. Jurisdictions like Hong Kong have permitted such actions, which are referred as multiple-derivative actions. Multiple-derivative actions may often warrant cross border litigation, as parent and subsidiary of a company could typically be incorporated in two different jurisdictions.

Given the involvement of two distinct legal persons and two different jurisdictions, the complexity of the legal issues in cases of multiple-derivative actions in a cross-border contexttends to increase. One of the major challenges in this regard pertains to the diversity in different jurisdictions as to the recognition of multiple-derivative actions. Some jurisdictions do not recognize the right of the shareholders of a company to initiate multiple-derivative actions.Other jurisdictions, where such actions are recognized, may still permit them more restrictively in comparison with a derivative action. Therefore, the shareholders whoseek to initiate multiple-derivative action have to first verify whether the courts in the jurisdiction where they seek to initiate the action (the forum) recognizes a multiple-derivative action and is willing to admit the shareholders of a parent company to initiate such an action.However, the recognition of a multiple-derivative action in the forum does not mean that all multiple derivate actions will be admitted. The successful admittance of a multiple derivative action could still be challenged by other factors. For example, if thecase warrants the application of law of a foreign jurisdiction and if multiple derivative actions are not recognized under that applicable law, the forum may still dismiss the action. Multiple derivative actions initiated in a cross border context would typically face such conflict of law challenges.

Similarly, simple derivative actions also could face more challenges when they manifest in a cross-border context. For example, the derivative actions relating to companies not registered in United Kingdom face more uncertainties because the English statute

governing companies limit the recognition of derivative actions to domestically incorporated companies[11]. Therefore, the derivative actions pertaining to companies incorporated abroad have to mainly rely on the common law recognition of such a remedy, which is based on the case laws rather than the more concrete source of a statute. As mentioned already, the set of complexities related to 'multiple-derivative actions' and 'cross border derivative actions'exacerbate further, when a claim is a multiple-derivative action and at the same time cross-border in nature. A 'multiple-derivative action in a cross-border context' is therefore bound to be the most challenging form of derivative action warranting a closer examination. These challenges could be demonstrated using the example of the common law recognition of multiple-derivative actionsin Hong Kong and England and the relevant limitations imposed by theirrespective courts.The continued influence of the English common law in Hong Kong warrants the need to take stock of the common law position in the UK. The experience of Hong Kong in dealing with multiple-derivative actions in the cross-border context particularly in an action by the shareholders of a company incorporated in Macau SAR is a leading case that demonstrates the key challenges.

Cross Border Derivative Actions in Hong Kong SAR and Challenges for Companies Incorporated in Macau SAR

Hong Kong and Macau are two Special Administrative Regions (SARs) of Peoples Republic of China (PRC), which enjoy greater autonomy in international economic relations under the unique 'one country two systems' principle, albeit not being independent sovereign states. Much has been written about their unique international legal personality and ardent participation in international economic forums like the World Trade Organization. One of the important characteristic that distinguishes the two SARs is the diverse legal systems, which is influenced by their respective colonial past. The common law legal system in Hong Kong and the continental legal system in Macau SAR with its varying jurisprudence provide a rich opportunity for comparative legal research.

In recent years, especially since the economic boom in Macau SAR, there is an increasing amount of conflict of law and cross border legal issues involving both jurisdictions that are being constantly raised in legal forums of the two SARs. This is particularly

[11]The recognition of derivative actions in England mainly evolved under the English common law, which ultimately found a more limited recognition under the English statutes especially under the UK Companies Act of 2006.

manifesting in the field of corporate law and governance as the new companies driving the economic boom in Macau are often connected to Hong Kong business or corporate links like the listing in Hong Kong stock exchange. The economic growth in Macau SAR and its nexus with Hong Kong SAR have resulted in an increasing amount of business disputes being raised in Hong Kong courts. As a consequence, Hong Kong courts are facing the need to deal with legal questions arising in context of both the common law legal system of Hong Kong and the civil law legal tradition of Macau SAR. Cross-border derivative action among such legal disputes is the relevant question of interest for the present paper.

In *East Asia Satellite Television (Holdings) Limited v New Cotai, LLCand others* (*East Asia Satellite Television* Case) the Plaintiff ('EAST'-incorporated in British Virgin Islands) initiated action in Hong Kong against the 1st Defendant New Cotai (a Delaware Company) and several other defendants regarding a dispute arising out of a joint venture project agreed between EAST and New Cotai. The project called as 'Macao Studio City (MSC)' was to develop a hotel, retail and entertainment complex in Macau SAR, the land grant of which was however held by another company called MacauCo (4th defendant and incorporated in Macau). MacauCo was owned 96% by Cyber Neighbour (3rd defendant and incorporated in British Virgin Islands) and 4 % by Cyber One (2nd defendant and incorporated in British Virgin Islands). However, Cyber Neighbour itself was a wholly owned subsidiary of Cyber One and East held a stake at Cyber One.

In 2006, EAST sold its stake of 40% of Cyber One shares to New Cotai through a Share Purchase Agreement (SPA). As the land grant was held by MacauCo, initiating the MSC project by EAST and New Macau required a modification of the land grant. The SPA (under clause 6.22) recognized the need for the parties to cooperate and work together in good faith to seek the modification of the land grant and to prepare and develop the Master Plan and related changes. EAST argued that the very conclusion of the SPA was upon the basis that MacaoCo would seek a single modification to substantially increase the gross floor area (GFA) of the original land grant from Macau Government. However, no land grant modification was obtained and EAST argued that was because of the breach of clause 6.22 of SPA by New Cotai. EAST claimed that the alleged breach resulted in two major adverse consequences namely a non-payment of HK$689,065,200 payable by New Cotai on the grant of the land modification and a substantial diminution of the value of the MSC Project amounting to a sum of US$2.385 billion dollars.

EAST initiated an 'action' and a 'petition'[12] in Hong Kong courts in 2009 against New Cotai and several other defendants [including 6 individual directors (defendants 5-10) and two other companies[13] (defendants 11 and 12)]. Among various claims made in the action, some of them were personal claims, while others were derivative in nature. For the purpose of this paper, the derivative claims will be the main focus. In the action, EAST made derivative claims (on behalf of the 2nd to 4th defendants) for 'damages or equitable compensation' of 2.385 billion US dollars respectively against a) 'New Cotai' and b) defendants 11 and 12 for dishonest assistance and for conspiracy, and against c) 'the Directors of New Cotai' for breach of fiduciary duty and for conspiracy.

The defendants argued that some of the claims made by EAST cannot be sustained because they were in the form of multiple derivative actions and such actions (or analogous actions) were not possible under the laws of the places incorporation of the companies on behalf of which EAST was making the claim. The defendants also challenged that some of claims of EAST were claims for 'reflective loss', which are not recoverable under common law. The prohibition to recover reflective losses was recognized in the good old English common law decision of *Foss v Harbottle*[14], which has since been generally followed by various cases including in other common law jurisdictions.

The common law rule prohibiting the recovery of reflective loss is based on a fine distinction made between the loss of a company and the consequential loss upon the value of the shares held by the shareholders. The loss of the shareholder is simply considered as reflective of the loss faced by the company due to a wrong inflicted upon the company. Under such circumstances, if both the shareholders as well as the company (either by itself or through a derivative action) are allowed to claim for the loss, the resulting consequences may not be fair. For example, if both the shareholders as well as the company are allowed to claim, it will result in a double recovery from defendant(s), which will be unfair for them. Alternatively, if the shareholder is allowed to recover the reflective loss, it will be done at the cost of the company and its creditors. Therefore, the common law has widely recognized the

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[12]The petition was filed pursuant to s. 168A of the Companies Ordinance of Hong Kong seeking cumulative or alternative reliefs in relation to Cyber One like for example, an order to cancel the New Cotai's shares, an order that New Cotai transfer is shareholding in EAST, an order for New Cotai and its Directors pay damages and interest for unfair prejudice caused to EAST and its shareholding in Cyber One, injunction to restrain the continuation of some wrongful conduct, etc.

[13] Silver Point Capital, L.P. (11th Defendant) and Oaktree Capital Management, L.P. (12th Defendant).

[14](1843) 2 Hare 461

rule of prohibition of recovery of reflective losses by shareholders[15].

Hong Kong Court of First Instance mostly agreed with the arguments of the defendants with regard to the derivative actions against the alleged breach of duty by the directors of New Cotai. Firstly, the claim made by EAST on behalf of MacauCo was rejected on the ground the multiple derivative actions were not recognized under Macao law, which was the governing law of the matter. The claim on behalf of Cyber Neighbour was also rejected on similar grounds that the governing law, namely the law of British Virgin Islands did not recognize multiple derivative actions. At the same time, this claim was also rejected on the ground that it contravened the principle of no reflective loss as propounded by the *Foss v Harbottle* case.

The Court of First Instance also rejected the claim made by EAST on behalf of Cyber One albeit primarily on the ground that the claim was based on a reflective loss suffered by MacauCo. It is important to take note that this is not a rejection of the right of the plaintiff to initiate a single derivative action but the underlying claim was considered to be untenable due to the reflective nature of the loss it was seeking to recover. The claims of EAST against New Cotai and defendants 11 and 12 on the grounds of 'dishonest assistance and conspiracy' and the claim against the directors of New Cotai on the ground of 'conspiracy' were also challenged by the defendants. The defendants sought the court to strike out these claims on the grounds that they were part of discrepant pleas in the statement of claim in comparison with the latter pleas under the writ. The court accepted this argument and struck down those specific claims based on the grounds of dishonest assistance and conspiracy. The plaintiff, who also made derivative claims against New Cotai, and defendants 11 and 12 for 'inducing' the New Cotai directors to breach their fiduciary duties, subsequently abandoned those claims during the proceedings.

Subsequently, when the case went on an appeal before the Hong Kong Court of Appeal EAST contended that it is the law of the place of the forum (*lex fori*) and not the law of the place of incorporation (*lex incorporationis*) that should determine the availability of the multiple derivative actions. However, the principle enunciated by the English decision in *Konamaneni v. Rolls Royce (India) Ltd*.[16] (Konamaneni Principle) that the common law court will allow multiple derivative action "if and only if an analogous action can be brought" by a

[15] See *Prudential Assurance v Newman* [1982] 1 Ch 204 at 210. See also the more recent leading decision on the matter *Johnson v Gore Wood* [2002] 2 AC 1.
[16] See *Konamaneni v. Rolls Royce (India) Ltd* [2002] 1 WLR 1269

shareholder under *lex incorporationis* ultimately prevailed. In response, EAST sought to introduce evidence that multiple derivative action could be possible under Macau law in a form that results from the process of piercing of corporate veal.However, the Court of Appeal did not agree with such interpretation and upheld the view of the lower court that Macau law does not recognize multiple derivative actions.

It is important to note that the conclusion of the Hong Kong common law court differs from the position of the expert evidence on Macau law, which supported the conclusion that multiple derivative actions is possible under Macau law albeit through an indirect process. As Macau is a small jurisdiction, where corporate litigations are relatively low, the question of whether multiple derivative actions are recognized would not be obvious. Unlike in common law territories like UK,where courts get sufficient opportunity to delineate the scope and limitations of multiple derivative actions in detail as part of a common law remedy, the courts in civil law jurisdictions have to mainly rely on the statutory interpretations to determine the admissibility of multiple derivative actions. Moreover, when there is dearth of judicial interpretation regarding the admissibility of a multiple derivative action in a civil law territory, the decision of foreign courts called upon to determine the question is bound to face criticism. In the present case, the rationale of the Hong Kong courts reaching a conclusion contrary to the opinion that multiple derivative actions would be achievable in Macau SAR through an indirect process faces the same conundrum.

Concluding Remarks

The above analysis reveals that the derivate actions in general and multiple-derivative action in a cross border context in particular are highly complex and challenging remedies. The challenges arise because of the diversity among different jurisdictions with regard to the legal rules governing shareholder derivative actions. Such diversity exists not only between common law and civil law traditions but also among the common law jurisdictions themselves. Although, there is a fundamental influence of the English common law jurisprudence in some territories like Hong Kong, diversity would still be visible in other common law territories where such influence is less. For example, the approach of the US courts with regard to derivative actions seem to differ even among different states, where the influence of English common law would be relatively minimal. Moreover, the approach of the US court would also be influenced by the relevant federal and state laws governing the

matter, leading to an inevitable diversity Apart from such diversity; the paper reveals the underlying challenges arising out a range of claims in shareholder derivative actions.

The closer examination of the claims by the shareholders against the lapses of the top management in the *Tucker* case reveals some important challenges. Firstly, the facts of the case clearly demonstrate the limitations of corporate governance even in developed corporate regimes like in USA. For example, the inability of the existing corporate governance norms to prevent the top management from floating fundamental rules and standards underscores the need to enhance the monitoring and remedial mechanism against such flagrant violations. In this regard, based on the analysis of the *Tucker* case, it can be concluded that shareholders could act as watchdogs and the shareholder derivative actions could serve as a deterrent against flagrant violations. Moroever, from the closer examination of various claims arising in the *Tucker* case, it is evident that some of the impugned acts complained against could be more effectively challenged by shareholder derivative actions rather than other forms of action. For example, the practice of inflating numbers by Scrushy to meet market predictions or his insider trading practices were concerns not only limited to the shareholders, but of the whole market including prospective investors. As it involves a wider public interest, such acts could be condemned effectively by various forms of actions. However, with regard to the other acts of Scrushy that primarily affected the interest of the company (like the issues of bonus payment or retirement benefit), shareholder derivative actions can be the most effective remedy. Therefore, it is important to distinguish the claims that can be most effectively or exclusively served thorough shareholder derivative actions and address the major constraints or challenges facing shareholders in bringing such actions. Adopting the basic criteria of distinguishing different claims arising in a derivative action and facilitating the admittance of those that would be exclusively or best served using such an action are critical to make the remedy of derivative action more effective. Moreover, it would also prevent frivolous or trivial claims.

The *Tucker* judgment demonstrates the willingness of the US courts to grant huge sums in deserving cases of shareholder derivative actions, which certainly increases its potential role of deterrence against unscrupulous acts of senior management. Although, the rejection of some claims in the *Tucker* case could be subjected to criticism, the conservative approach taken by the US courts with regard to those claims can be seen as a necessary balance required to sustain the remedy of shareholder derivative action and to ensure that it does not become a vehicle of farfetched claims. As the remedy of derivative actions tend to

be increasingly governed by statues as witnessed in the UK company law, the onus of achieving such a balance could be shifted to the legislators. However, the role of the common law courts in this regard would still continue to be important in jurisdictions where derivative actions are part of a common law remedy, especially in cases involving multiple derivative actions.

As the complexity of multiple derivative actions involving more than one jurisdiction increases and the responsibility of courts to achieve the necessary balance becomes more challenging. Under such circumstances, the role of the courts in common law jurisdictions to ensure a balanced approach becomes highly significant because the remedy of multiple derivative actions involving companies incorporated abroad may exclusively fall within common law, as in the UK. However, the closer examination of the *East Asia Satellite Television* case in Hong Kong reveals a range of potential concerns in this regard. Firstly, the choice of the Hong Kong courts to strictly follow various limitations recognized in English common law including the rule in *Foss v Harbottle* and the *Konamaneni* Principle demonstrates its conservative approach in admitting multiple derivative actions. Such a conclusion is further supported by the fact that most of the claims relating to the multiple derivative actions in the case were not admitted by the Hong Kong courts. Although, often the reasoning for a cold reception to multiple derivative claims under the case was sound, they were mainly based on English common law. This method adopted by the Hong Kong courts to simply follow the English common law could be subjected criticism becauseit evidences their reluctance in evaluating the admissibility of multiple derivative claims by themselves. Furthermore, the conclusions reached by the Hong Kong common law courts with regard to the question of admissibility of multiple derivative actions under the Macau law is bound to increase the criticism. Especially, the rejection of the expert evidence as to the possibility of admittance of multiple derivative actions in Macau SAR using the process of piercing the corporate veil could be criticized as the lack of sensitivity of the common law courts towards the characteristics of the civil law tradition.

To sustain the importance of Hong Kong as a regional centre for corporate activities as well as to strengthen its emerging role as a forum for corporate dispute resolution in matters involving Macau SAR, it is necessary for the Hong Kong common law courts to be seen as an objective arbiter sensitive to the need of multiple derivative actions rather than a blind follower of English common law jurisprudence. To improve a better understanding of the legal principles governing corporate activities and multiple derivative actions in each

other's territory, the two SARs should enhance specific legal cooperation and initiate comparative law studies on various issues of corporate law and derivative actions. Moreover, international legal fraternity should also initiate specific legal harmonization measures in order to address the diversity of legal approach with regard to the question of admittance of derivative and multiple derivative actions in different national jurisdictions. The need to develop international harmonization measures in this regard is highly critical in a globalized world, where intricate forms of corporate structures and transactions would invariably result in complex forms of multiple derivative actions in a cross border context.