SHAREHOLDER’S RIGHT TO LITIGATE IN THE US, GERMANY AND KAZAKHSTAN: COMPARATIVE ANALYSIS

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Abstract

The most important principles of corporate governance under modern conditions include the principle of ensuring the protection of shareholders' rights and the principle of equal treatment of all groups of shareholders, including minority and foreign shareholders, guaranteeing equally effective protection to each of them in case of violation of their rights. In the US, protection of shareholders’ rights to litigate is ensured by direct and derivative actions allowing the shareholders not only to sue the director of the company but also a third party on behalf of the corporation. Protection of shareholders’ rights through derivative instrument also exists in most European countries, however with some differences, such as ‘lawsuit admission procedure’ in Germany.

Nowadays, there is a rapid development of corporate governance in Kazakhstan which requires, as a priority, the activation of the responsibility mechanism of directors and, subsequently, the protection of shareholders' rights from the unfair activities of directors. Existing law of the Republic of Kazakhstan on Join Stock Companies does not allow us to speak about any effective exercise of shareholders’ rights to litigate.

The main purpose of this thesis is to find out whether shareholders of Kazakhstan are able to litigate and if there is any limitation in exercising of these rights. Furthermore, this paper is also going to investigate the existing mechanisms used in foreign countries in particular through comparative legal analysis in three jurisdictions: the US, Germany and Kazakhstan. Advantages and disadvantages of instruments exercised in protecting shareholders’ rights in the US and Germany will be investigated with the possibility of implementing these instruments into the corporate governance system of Kazakhstan. Conducting of this research should contribute to the development and ultimately stabilization of the entire system of corporate relations of companies in Kazakhstan.
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Introduction

Managers of big corporations have a huge power on managing and disposing of these corporations. Abuses of this power are not uncommon even in the countries with developed economies. The carrying out of effective control over the activities of the managers of the company is one of the main goals of corporate governance discussions. The peculiarity of the legal status of the company’s managers is that they own and dispose of property that does not belong to them, but to the company itself. Shareholders of these companies are not owners of this property. As for the company, in legal relations they participate through their bodies, i.e. managers of the company. Thus, a vicious circle has been created: the possibilities of protecting the rights and interests of the company belong to the persons from whose invasions the rights and interests of the company should be protected.

Despite the fact that the laws of many countries have rules governing the responsibility of companies’ managers, in practice, it is associated with certain difficulties. First of all, this is explained by the narrow circle of persons who have the right to sue managers, and by the complicated procedure of appealing decisions of the managing bodies of the company. Therefore, one of the elements of modern discussions on corporate governance is the strengthening of the role of the shareholders ’claim against the managers of companies.

This thesis will consider a derivative claim by shareholders. This claim differs from the direct claim when shareholders sue directors or managers of the company on damage caused to them directly. In derivative suit, violated rights of the shareholders derive from the violated rights of the company. This means that managers of the company cause damages to the company, and when the company failed to protect itself through litigation against its managers, shareholders can bring derivative action to the benefit of the company.

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1 As an evidence, the bankruptcy of the large American companies “Enron” and “WorldCom”. As a result of balance manipulations by the managers of the WorldCom, damage in the amount of 11 billion US dollars was caused.
2 Hopf/Kanda/Roe/Wymeerssh/Prigge (Hrsg), Comparative Corporate Governance (1998), at 89.
3 Id. at 92.
In recent decades, a derivative lawsuit, also known as an indirect lawsuit, has become a global phenomenon. Originating in the Anglo-Saxon legal system, as an institution for bringing to responsibility of managers and directors of companies, a derivative lawsuit was consolidated at the legislative level in the jurisdictions of many countries (Singapore (1993), New Zealand (1994), Italy (1998), Australia (2000), Hong Kong (2005), Germany (2005), China (2006)).

Intensive introduction of a derivative claim in the laws of different countries indicates a clear interest in this legal phenomenon. In the legal systems of different countries, a derivative lawsuit is used either as a corporate governance tool, allowing to control the fulfillment of obligations by the management bodies of companies, or as a procedural tool of protecting the rights and interests of shareholders. In both cases, as a legal method, the derivative lawsuit is aimed at ensuring the interests of the participants of corporate law.

In Kazakhstan, a derivative lawsuit, as a form of control over the executive bodies of joint stock companies and a mechanism for bringing them to responsibility, is enshrined exclusively in substantive law. The Law of the Republic of Kazakhstan dated May 13, 2003 “On Joint Stock Companies” establishes the right of shareholders to sue officials of the company (Article 14, clause 7), and describes a procedure that must be followed by shareholders before going to the court with the claim. But this procedure is specified only in one paragraph of the article on the responsibility of company officials. Insufficient regulation of this institution creates certain problems in protecting the rights of shareholders, as well as a conflict of interests between minority and major shareholders, as well as between shareholders and officials.

\(^4\)Id. at 95.
This thesis is devoted to a comparative analysis of the substantive and procedural legal nature of the derivative claim in three jurisdictions: the US, Germany and Kazakhstan. To achieve this goal the following tasks were set:

i. to describe and analyze the history of development and legislative regulation of the derivative claim in the Anglo-Saxon legal system, where it was originated (on the example of the US), as well as to analyze the achievements of the legislation of an European country (on the example of Germany);

ii. to consider the historical development of the norms on a derivative lawsuit in Kazakh law, to conduct a systematic analysis of the norms of Kazakh substantive and procedural legislation regarding the regulation of a derivative lawsuit;

iii. to develop theoretical and practical recommendations for improving the norms of Kazakh legislation in the framework of the problem under study.

The choice of countries such as the US and Germany is not accidental, and is due to their belonging to the different legal systems as Anglo-Saxon and Romano-Germanic, as well as the fact that within these systems the derivative lawsuit received its greatest development. Although, Kazakhstan belongs to the Romano-Germanic legal family, Kazakhstan will be considered as a separate country during the analysis of the development of a derivative lawsuit.

This thesis will proceed in two parts. The first part of this thesis is concerned with the historical development and description of derivative claims of the US, Germany and Kazakhstan on the basis of the statutes and legislation. It also gives an overview of the procedural provisions in order to figure out the probable prerequisites of the derivative claims.

The second part is dedicated to a comparative analysis of derivative claims in three jurisdictions. The main aim of this part is to find out the advantages and disadvantages of the
Kazakh model of derivative claims in compare to American and German models of derivative claims.
CHAPTER 1. AN OVERVIEW OF DERIVATIVE CLAIMS IN THE US, GERMANY AND KAZAKHSTAN

Legal publications indicate that historically derivative lawsuit has arisen in the countries of the Anglo-Saxon legal system. At the same time, in the context of globalization of law, the legal phenomenon in question, as a mechanism for protecting the rights of shareholders, appeared in the legal systems of various states, in particular in Chile (1981), Hong Kong (2005), Ireland (2006), as well as in countries like Singapore (1993), New Zealand (1994), Italy (1998), Australia (2000), Germany (2005), United Kingdom (2006), China (2006).  

Considering the various geopolitical and cultural conditions of the origin and functioning of derivative lawsuits, it is interesting to study the specifics of this legal phenomenon in such countries as the US, Germany and Kazakhstan from the point of view of the historical approach, as well as through the systematic analysis of the substantial and procedural legislation of these countries.

1.1 American model of derivative claims

1.1.1 The development of the derivative lawsuit in the US

The origins of derivative claims are observed in common law countries, and the institution of derivative claims is most developed in the United States. Considering the American model of a derivative lawsuit in a historical aspect, it is worth noting that until the 19th century, shareholders did not have the right to file a claim for damages caused to corporations. This circumstance is due to the presence of the principle of separation of the rights of a corporation from the rights of shareholders in corporate law of the US. Subsequently, the lack of an appropriate mechanism to control the management decisions of governing bodies led to an increase in the number of abuses by these bodies. In order to prevent violations of the rights of corporations and shareholders, US courts provided shareholders, as owners of capital, with the opportunity to file claims against directors in the

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form of derivative claims. Thus, a derivative lawsuit was the achievement of case law in the US. From this moment, derivative claims became a hallmark of US law.

One of the first court decisions taken by American courts in a derivative lawsuit was in the first half of the 19th century. In *Robinson v. Smith* the New York Chancery Court upheld the right of shareholders to sue for the interests of the corporation, arguing that the offense against the corporation should be eliminated and this was not possible without granting the shareholders with the right to sue. In 1855, the derivative lawsuit again became the subject of proceedings in *Dodge v. Woolsl y*. In this case, US Supreme Court noted the dual nature of the derivative lawsuit, which combines two lawsuits. The first lawsuit is directed against the company in order to force the company to enforce its obligations to protect the rights of the shareholder. The second lawsuit is a lawsuit protecting the rights of the company against those who caused damage to the company itself.

After the famous decision in *Foss v. Harbottle* in the UK in 1880, the US Supreme Court in *Hawes v. Oakland* tightened the procedural requirements for derivative claims that became Federal Equity Rule 94, Federal Equity Rule 27, and later Federal Rule of Civil Procedure 23(b), and currently Federal Rule of Civil Procedure 23.1. Despite this, state courts were more patronizing about the possibility of shareholders to file a derivative claim, which allowed the lawsuit to become popular at the beginning of the 20th century. The increase in the number of derivative lawsuits in the first half of the last century had negative consequences. Lawyers generally started to initiate a derivative lawsuit with the aim of obtaining inappropriately exaggerated fees for participating in such lawsuits.

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6 W. Puchniak, Harald Baum and Michael Ewing-Chow, Id. at 65; Robinson v. Smith. 3 Paige 222 (1832).
7 W. Puchniak, Harald Baum and Michael Ewing-Chow. Id. at 65; Dodge v. Woolsl y. 18 Howard 331, 1 US 284 (1855).
8 W. Puchniak, Harald Baum and Michael Ewing-Chow. Id. P. 65; Hawes v. Oakland. 104 US 450 (1881).
10 Fed.R.Civ.P. 23.1. see sections 362 [hereinafter FRCP].
In 1944, the State of New York passed a law on securing the legal costs of derivative claims, which is supported in sixteen US states. Moreover, it established contemporaneous-share-ownership requirement; provisions for indemnifying corporate personnel for their litigation expenses; and a special six-year statute of limitations for certain actions brought by or in behalf of a corporation against its directors, officers or shareholders.\textsuperscript{11}

Despite of measures specified above, at the end of the 1960s, the number of cases on derivative claims in American courts reached its maximum. In response to the next increase in the number of derivative claims in the 1970s, special committees appeared in the structure of the board of directors of corporations whose activities are aimed at resolving situations involving violations of rights of corporations and shareholders. The decisions of these committees could further terminate the proceeding of derivative claims in courts. Moreover, mostly, the judges recognized the decisions of the committees as the legal basis for terminating the lawsuit on a derivative action. With the advent of special committees, the number of derivative lawsuits has decreased and this trend in the United States has persisted for the past three decades. However, a derivative lawsuit is still perceived by many American scholars as an extremely important mechanism that is necessary in corporate governance.

The case and statutory regulation of the derivative claim in the US is carried out both at the federal and state levels. In the framework of statutory regulation, the rules on derivative lawsuit are contained in corporate and procedural law (rules of civil procedure) of the US. The procedure for applying to US courts with derivative claims in every State differs from each other. The rules of civil procedure are determined by both States and the federation, that is, the procedural law of the US refers to the joint jurisdiction of the States and the federation. Considering that more than half of the corporations registered at New York Stock Exchange

and about 60% of the corporations listed at Fortune 500 are located in the state of Delaware, the corporate law of this State on a derivative claim is of the greatest interest.\textsuperscript{12}

The Rules of Court of Chancery of the State of Delaware\textsuperscript{13} reveal some procedural aspects of derivative claims and are an important source of procedural law of the US. The corporate and procedural law of other states of the US also contains rules on a derivative lawsuit, which have some peculiarities; therefore, in terms of analyzing the characteristics of the derivative claim, there is a need to refer to the statutes of the US states. For example, the Minnesota Statutes and the Minnesota Rules of Civil Procedure\textsuperscript{14} govern the use and filing of derivative lawsuits at State of Minnesota.

At the federal level, a number of statutes and regulations have been adopted that are important for the unification of corporate law on derivative claims. These rules are borrowed in whole or in part by the statutory law of most US states. Currently, the Model Business Corporation Act of 1969 and 1984 (revised 2008)\textsuperscript{15} (hereinafter – “MBCA”) and the Federal Rules of Civil Procedure\textsuperscript{16} (hereinafter – “FRCP”) establish a common model of derivative claims and procedural requirements for the procedure for filing and reviewing derivative claims. The American Law Institute (hereinafter – “ALI”) developed the Principles of Corporate Governance (1994)\textsuperscript{17}, which are not mandatory in nature, however, an important source of development of corporate law of US states and ensure consistency of legislation of States on derivative claims. These acts are the main sources regarding a derivative claim in the US. An analysis of them will make it possible to characterize the derivative claims from the position of substantive law.

\textsuperscript{12} W. Puchniak, Harald Baum and Michael Ewing-Chow. Id. at 75.
\textsuperscript{13} Rules of Court of Chancery of the State of Delaware (Dec. 24, 2018), \url{http://delcode.delaware.gov}.
\textsuperscript{14} Minnesota Rules of Civil Procedure (Dec. 24, 2018), \url{https://www.revisor.mn.gov/statutes}.
\textsuperscript{16} FRCP, supra note 10.
In the FRCP, the rules governing the procedure for filing and adjudicating derivative claims were structurally included in the Rule 23 “Group actions” as subsection “b” until 1966. Thus, derivative claims were considered a type of class action. Subsequently, the US Congress introduced an appropriate amendment to the FRCP, and the rules on derivative claims were singled out in a separate Rule 23.1. Therefore, the derivative claim acquired an independent status.

At present, FRCP (paragraph (a) of section 23.1 “Parties”) establishes the necessary prerequisites (pleading requirements) for submission of the derivative claim:

“one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.” (p. 33)\(^\text{18}\)

This rule allows to reveal the following characteristics of the derivative claim: derivative claim is a type of corporate claim, as it results from the violation of the subjective rights of the corporation. Such claim can be both an individual and a class action. When filing the derivative claim, it is necessary to respect the interests of all plaintiffs - the shareholders and the corporation itself. The need for the derivative remedy is best illustrated when those who control the corporation are the alleged wrongdoers.\(^\text{19}\)

There is no generally accepted legally defined definition of the term “derivative action” in the US statutes. Both the FRCP and state laws provide a list of conditions under which a derivative action or main action should be filed. The only definition of a derivative claim is given in the MBCA (paragraph 7.40 of chapter 7 “D”). According to which, a derivative

\(^{18}\)FRCP, supra note 10, 23(1).
lawsuit, as a civil lawsuit, which is filed in the right of the domestic corporation, or in cases provided for in §7.47, in the right of a foreign corporation.\textsuperscript{20}

According to the Article 7.01 of the ALI Corporate Governance Principles, a derivative action may be filed on behalf of and in defense of the rights of the corporation by the security holder ..., in order to compensate for the harm caused to the corporation, or to ensure the fulfillment of obligations to the corporation. A lawsuit in which the holder of shares can act only as one who proves damage to a corporation or a violation of its obligations to a corporation should be considered a derivative lawsuit.\textsuperscript{21} This provision suggests that a derivative claim is not always a claim for recovery of damages. The subject of the claim may include different requirements aimed at eliminating the violation of obligations towards the corporation. According to Marjorie F. Knowles,

“A direct action may be filed on behalf of and in defense of the rights of the security holder, in order to compensate for the harm suffered by security holder, or to ensure the performance of duties in relation to the security holder. A lawsuit in which the security holder can act without proving the harm injured by the corporation, or without proving a breach of obligations towards the corporation, should be considered as a direct lawsuit that can be filed on behalf of the security holder itself.”\textsuperscript{22} (p. 3)

An explanation of the above definitions can be found in Tooley v. Donaldson, Lufkin & Jenrette, Inc., which states that, in a direct action, “the shareholder must prove that the obligation was violated towards the shareholder and that he could win the case without demonstrating the harm to the corporation”.\textsuperscript{23} So, the main difference between a direct and derivative lawsuit, in accordance with the ALI Corporate Governance Principles, is that who was primarily affected by the wrong. Consequently, another important feature that should be

\footnotesize{\textsuperscript{20}MBCA, supra note 15.  
\textsuperscript{22}Id.  
\textsuperscript{23} Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004).}
taken into account in the derivative claim is the “subject component” of the derivative claim, in particular, to whom exactly and how was caused the damage.

General Law on Corporations of the State of Delaware (subsection XIII § 327) establishes the rule that a plaintiff in derivative suit has to be a stockholder at the time of the transaction or to be a stockholder as a result of their transfer to the plaintiff by operation of law.\(^{24}\) So, the law only enshrines the requirement of “contemporaneous ownership”, which will be discussed in more detail later.

An analysis of Articles 300-319B “Corporations” and Articles 321-323A “Partnerships” of the Laws of the Minnesota shows that the provisions of these articles only duplicate some rules of procedural sources.\(^{25}\)

The section 607.07401 (1) of the Florida Business Corporation Act provides that “A person may not commence a proceeding in the right of a domestic or foreign corporation unless the person was a shareholder of the corporation when the transaction complained of occurred or unless the person became a shareholder through transfer by operation of law from one who was a shareholder at that time”.\(^{26}\)

So, the statutory law of US states regulating corporate legal relations does not include rules on a derivative action. At the same time, the provisions on derivative lawsuit are either scattered according to chapters and articles of laws, or duplicate the norms of procedural law. In addition, the substantive law of the US states does not contain a definition of the term “derivative action”.

Thus, Rules of the Delaware Chancellor (23.1) provides that:

“in a derivative action brought by one or more shareholders or members to enforce a right of a corporation or an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint

shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff’s share or membership thereafter devolved on the plaintiff by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff’s failure to obtain the action or for not making the effort.”

Therefore, paragraph (a) of the Regulation 23.1 contains similar FRCP rules on the possibility of shareholders of a corporation (members of an association) to file a derivative action. The rule states that a lawsuit is filed in case of violation of the corporative (association) rights. This provision does not determine which substantive claim is the subject of a derivative claim. It is assumed that the subject of the derivative claim may be any requirements aimed at protecting the subjective corporate rights (associations). Also, the rule does not specify who exactly the defendant is in the derivative claim. Thus, the traditional notion that a derivative claim is a claim for damages, which is filed against the governing bodies of a legal entity, is not a legally established norm in US procedural law. The rules of this subclause also establish the requirements for claimants in a derivative lawsuit: “the contemporaneous ownership requirement” and “the demand requirement” (the requirement to send a pre-trial claim):

“each person seeking to serve as a representative plaintiff on behalf of a corporation or unincorporated association pursuant to this Rule shall file with the Register in Chancery an affidavit stating that the person has not received, been promised or offered and will not accept any form of compensation, directly or indirectly, for prosecuting or serving as a representative party in the derivative action in which the person or entity is a named party except (i) such fees, costs or other payments as the Court expressly approves to be paid to or on behalf of such person, or (ii) reimbursement, paid by such person’s

28 Id.
attorneys, of actual and reasonable out-of-pocket expenditures incurred directly in connection with the prosecution of the action. The affidavit required by this subpart shall be filed within 10 days after the earliest of the affiant filing the complaint, filing a motion to intervene in the action or filing a motion seeking appointment as a representative party in the action. An affidavit provided pursuant to this subpart shall not be construed to be a waiver of the attorney-client privilege.” (R. 23.1 ((b))

In legal practice of the US, a derivative lawsuit was often used by claimants-shareholders in improper way as an instrument of obtaining funds from corporate directors, and by lawyers as a way of earning unreasonably high fees. As a result, the main purpose of the derivative claim, as a mechanism for protecting the rights of corporations, implemented by its shareholders, lost its meaning. The provisions enshrined in the considered subparagraph are aimed at preventing abuse by both plaintiff-shareholders and attorneys handling cases on derivative claims:

“A derivative action may be rejected by the court if it is seen that the claimant does not represent objectively and properly the interests of all the shareholders of the corporation (members of the association). The waiver of a derivative claim and the conclusion of a settlement agreement must be approved by the court, and a notice of the renunciation of a suit or conclusion of a settlement agreement must be sent to the shareholders of the corporation (members of the association) in such manner as the Court directs.”29 (R. 23.1 (c))

This subclause of the Rules of the Delaware Chancellor establishes a requirement known as ‘adequate representation’ (requirement to represent the interests of all participants of the process impartially), and also stipulates the need for judicial approval of the claimant-shareholder’s renunciation of the suit and conclusion of a settlement agreement. Indicated

29 Id.
norms are aimed at protecting the rights of both the corporation and other shareholders from
the improper representation of their interests by the plaintiff-shareholder.

It is permissible to state that the main issue for US lawmakers is not the problem of
differentiation between the direct claims and derivative claims, and not the legislative
definition of the ‘derivative claim’, but the prerequisites and procedural conditions for filing
derivative claims. The absence of a legally fixed definition of a derivative lawsuit, as well as
practical difficulties associated with the qualification of lawsuits as ‘derivatives’ or ‘direct’,
led to the adoption of a significant number of judicial decisions in various US states.

This fact indicates a high degree of judicial interpretation and judicial discretion in
determining the claim as a derivative, which, in principle, is characteristic of the Anglo-Saxon
legal system. In most cases, American judges try to determine derivative claims through
defining direct claims itself. Speaking of direct claims, the court decisions use terms such as
‘right personal to the shareholder’; ‘direct injury’, ‘right belong directly to each
shareholder’30; ‘direct right’31. So, Court of Appeals of Minnesota in Whartan v. Midwest
Consol. Ins. Agencies, Inc. found that “in a situation where the shareholder’s right to vote is
violated, the personal right of a shareholder is violated, since this right is granted on the basis
of shareholder’s status. In this case, there is a direct ground for filing a claim, since the
damage was caused directly to the shareholder”32.

In Chabot v. Industrial Relations Council, Inc., US District Court for the District of
Minnesota indicated that “shareholders have the direct right to inspect the company’s business
papers and a direct lawsuit is aimed at eliminating the harm”.33

In some decisions of US courts, it is established that legal protection in a derivative
lawsuit is granted to the corporation, despite the fact that the lawsuit is filed by the plaintiff-

shareholder. On this issue, the Minnesota Supreme Court explained that “a derivative lawsuit is a lawsuit on violation of a duty with respect to a corporation; therefore, funds withdrawn from the corporate budget must be returned to the corporation”.

In *Warner v. E.C. Warner Co.* the Minnesota Supreme Court also clarified that “in derivative lawsuits, a legal dispute actually exists between the corporation and the employees who caused the damage to the corporation. A corporation is a beneficiary in a lawsuit, even though it acts as a defendant in the process, since plaintiff-shareholders only represent the interests of the corporation. ... Derivative plaintiffs represent the interests of the corporation in a derivative lawsuit”.

A review of US judicial practice allows us to state that despite the fact that claims on a derivative action are made in favor of the corporation, the purpose of the derivative claim is not only to protect the rights and interests of the corporation, but also to protect the rights of shareholders themselves. Thus, the subject of protection in a derivative lawsuit is the rights and interests of both the corporation and the shareholders, whose rights are indirectly violated as a result of the violation of the rights of the corporation itself.

However, a derivative action may also be brought against third parties who have caused damage to the corporation. There are cases in a judicial practice of the United States where a derivative action was filed against the lawyers of the corporation, who by their wrongdoings actions caused harm to the corporation. So, there are all grounds to believe that a derivative lawsuit is not always used as an instrument of protecting the rights and interests of subjects of corporate relations exclusively. This conclusion confirms the analysis of the American legal literature, which also indicates the possibility of using such claims in other branches of law.

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34 Seitz v. Michel, 148 Minn. 80, 87, 181 N.W. 102, 105 (1921).
36 Westgor v. Grimm, 318 N.W.2d 56, 59 (Minn. 1982).
One of the most authoritative dictionaries of legal terms in the United States the Black's Law Dictionary gives several definitions of the term derivative action and it is not always considered as a type of corporate action:

- “a suit by a beneficiary of a fiduciary to enforce a right belonging to the fiduciary; esp., a suit asserted by a shareholder on the corporation's behalf against a third party (usu. a corporate officer) because of the corporation's failure to take some action against the third party;

- a lawsuit arising from an injury to another person, such as a husband's action for loss of consortium arising from an injury to his wife caused by a third person. In other words, it is the claim of one spouse to a third party about the loss of those benefits that this spouse received from the marriage union and which were lost as a result of causing harm to the other spouse”.37

Based on the above, practically, it is difficult to distinguish derivative claims from direct claims. Because, in some cases, the claim qualifies as a derivative and direct at the same time. So, the question of the legal nature of a derivative claim is not as trivial as it may seem at first glance, and even in the US, where the practice of applying the derivative suit has more than one decade, this question remains one of the most difficult for both lawmakers and American judges.

1.1.2 Procedural aspects of the derivative claim in the US

In the US, the question of qualifying the claims as direct or derivative matters from the standpoint of legal proceedings and the procedural requirements that are imposed on plaintiffs on derivative claims. Violation of these requirements, as a rule, has the consequence the derivative claim of being rejected by the court. In the American doctrine, there are three basic procedural requirements that are based on statutory law and are enshrined in the rules of civil

litigation of states and federation: (1) contemporaneous ownership requirement; (2) adequate representation requirement; (3) demand requirement.

Requirement 1: contemporaneous ownership requirement - the requirement to be a shareholder at the time of the transaction or to be the owner of the shares as a result of their transfer to the plaintiff-shareholder by virtue of legislation. Paragraph 7.40 (2) of the MBCA defines the term “shareholder”, which is applicable only for the purposes of subsection “D - Derivative claim” of the MBCA: “shareholder includes a record shareholder, a beneficial shareholder and an unrestricted voting trust beneficial owner”. Some American authors who investigate this issue note that the “contemporaneous ownership requirement” prevents from acquiring corporate shares solely for the purpose of filing a derivative action.

At the same time, a number of authors criticize this requirement, believing that “the time of purchasing shares by a plaintiff-shareholder should not interfere with the filing of a claim on behalf of a corporation, since it does not matter who filed the claim and when the shareholder bought the shares. In any case, the corporation benefits from filing a lawsuit”.

It should be noted that this requirement has some exceptions and compromises in some states of the US. Thus, Article 801 (b) (1) of the California Code of Corporations, apart from the general contemporaneous ownership requirement, provides for a special provision that allows judicial discretion to support the claim of any shareholder, if proven by the shareholder and determined by the court ... that: a) there is a sufficient amount of evidence to support a claim filed on behalf of a corporation; b) the identical derivative lawsuit was not filed; c) the plaintiff acquired the shares before being aware of the damage caused to the corporation; d) the claim will not lead to unjust enrichment of the corporation or shareholders.”.

38 MBCA, supra note 15.
41 California Code of Corporations §800.
The Florida State Code contains a rule that provides an opportunity to file a derivative claim to any shareholder who purchased shares from another shareholder who was at the time of the transaction, which caused damage to the corporation.\textsuperscript{42} Regardless of the attitude of the researchers to the requirement of contemporaneous ownership, the existence of the considered requirement in the US procedural rules indicates the fact that the derivative lawsuit is applied as a means of protecting the rights and interests of the plaintiff-shareholder as well.

Requirement 2: adequate representation requirement - the requirement to represent the interests of all shareholders objectively and impartially, as well as the interests of the corporation itself. This requirement is closely related to the principle of legal certainty (\textit{res judicata}), which excludes the possibility of re-filing a lawsuit with identical requirements. Due to the specifics of the derivative claim, the observance of the \textit{res judicata} principle implies, firstly, preventing from filing a claim with similar requirements from other shareholders, and secondly, excluding the claim on a similar issue by the corporation. In view of this, a plaintiff in a derivative claim must objectively and fairly represent the interests of other shareholders and the corporation. Moreover, the ‘adequate and impartial’ plaintiff may be a shareholder who owns the minimum number of shares.\textsuperscript{43} If during the review of a derivative claim it turns out that the plaintiff does not represent the interests of other shareholders or the corporation properly, then the court may reject the claim.

Requirement 3: demand requirement - requirement to send a claim to the board of directors so that the board of directors considers the facts stated in the appeal and can take the appropriate procedural actions on behalf of the corporation. The implementation of this requirement can be both mandatory and optional, depending on the norms set forth in the statute of each state.

\textsuperscript{42}Fla. Stat. § 607 - 607.07401.

More questions arise when the need to send a claim to the board of directors is mandatory. When the claim is dismissed by the board of directors (or a special committee) due to the contradiction of the facts to the interests of the corporation, the court in most cases rejects a derivative action. On the other hand, if the claimant does not submit a claim to the board of directors, and the court considers that the submission of the claim was necessary, claim will also be rejected by the court. There is a situation when a shareholder has to make a choice between the presenting claim to the board of directors and proving the futility of such claim in a court due to the bad faith of directors. In fact, the plaintiff-shareholder must disprove the presumption of good faith of the directors of the corporation (business judgment rule) and prove that the board of directors did not act properly.

The practice of creating special committees (special litigation committee) has been used in the United States since 1970s, which consider claims sent by shareholders. ‘Special litigation committee’ is a committee that is created in the structure of the board of directors of a corporation, consisting of independent directors. The committee examines the alleged offenses and identifies cases for further litigation in the court. Thus, ‘the demand requirement’ enshrined preliminary settlement of a dispute procedure (mandatory) in a derivative lawsuit in procedural law of the US.

Researchers of a derivative claim treat these requirements differently. According to some experts, the procedural requirements put the plaintiffs in a derivative lawsuit in a less advantageous position compared to the plaintiffs in direct claims. Others believe that the purpose of this requirement is to prevent the abuse of a derivative lawsuit, which can lead the most successful corporation to financial collapse and bankruptcy.

45 See for ex.: Chugunova E.I. Proizvodnyeiski v Rossii za rubezhom// Arbitrazhnyi I grazhdanskiyprotsess. Yurist (2003), at 44.
So, the analysis of the American model of derivative lawsuit makes it possible to conclude the following.

1. The American derivative lawsuit was formed as a dual requirement and was a synthesis of two independent lawsuits – a lawsuit against the corporation on protection of shareholders' rights and a lawsuit against the management board in defense of the rights of the corporation. This circumstance, as well as a number of other provisions of the statutory and case law of the United States, makes it possible to assert that the subject of protection in a derivative lawsuit are rights and interests of the corporation and the rights and interests of shareholders whose rights are violated indirectly as a result of violation of the rights of the corporation.

2. The traditional notion that a derivative lawsuit is a claim for damages, which is filed against the management bodies of a legal entity, is not confirmed in the statutory law of the United States. The subject of a derivative claim may be various requirements aimed at protecting the subjective rights of the corporation, and the defendant – any person who violated the subjective rights of the corporation.

3. US procedural law focuses on the procedural requirements for plaintiff-sharholders and the procedural procedure for filing, reviewing and resolving derivative claims (the need to be a shareholder at the time of the transaction; the need to send a pre-trial claim to a special committee of the corporation; to represent all shareholders and corporations impartially and fairly; the need for judicial control over the withdrawal of the claim and the conclusion of a settlement agreement; awarding the recovery in favor of corporations, etc.).

1.2 German model of derivative claims

1.2.1 The development of the derivative lawsuit in German law

The first mention of a derivative lawsuit in Germany dates back to the mid-nineteenth century. As early as 1847, an article was published proposing to give shareholders the right to
file lawsuits against directors of joint stock companies in a situation where the general meeting of shareholders left without proper attention the directors' participation in illegal actions against the company.\textsuperscript{46} However, the German courts, like German lawyers, did not support such an idea. Thus, in a court decision in 1877, the Supreme Imperial Court on Settlement of Trade Disputes (Reichsoberhandelsgericht) denied the right of the plaintiff-shareholder to bring an action on the basis of “contradiction to the nature of the joint stock company”.\textsuperscript{47}

At the same time, in 1880, the main topic for discussion at the XV German Lawyers Congress was the need for derivative and/or direct claims of shareholders against company’s directors who found guilty of intentional violation of their duties or violation of obligations due to gross negligence. The speakers of the congress recommended granting shareholders the right to file direct and/or derivative claims in such cases. According to the results of the congress, appropriate amendments were proposed to the legislation of Germany. Despite the existence of significant restrictive conditions for shareholders to sue according to these recommendations, the German legislature refused to take into account the proposals of German lawyers. The main reason for such refusal was the political situation in the country, namely, skepticism about the rights of minority shareholders and the rights of the individual in general. Moreover, the granting of such rights was perceived by German society as a way to anarchy or as a way of extorting money from the directors of companies, and therefore such claims were considered to be clearly illegal. Nevertheless, a norm was proposed as a compromise and it was a functional alternative to a derivative lawsuit. According to this norm, a group of shareholders whose share in the company’s capital was 20\% of the total number of shareholders could file such a claim.

\textsuperscript{46} W. Puchniak, supra note 5, at 73, with reference to J. Jolly. Das Recht der Actiengesellschaften (1847) Zeitschrift für deutsches Recht und deutsche Rechtswissenschaft 11: 317-449.

\textsuperscript{47} Id.
shares in circulation (and 10% starting from 1897) had the right to force the company to sue directors who were responsible for committing offenses against the company.\footnote{W. Puchniak, \textit{supra} note 5, at 73.}

Thus, it became permissible for shareholders to sue the company to file a lawsuit against the company’s directors. It is not possible to call such claim a derivative in full. However, the requirement of coercion to file a claim is included in the structure of the “dual” American derivative lawsuit, which contains two independent requirements: 1) requirement on forcing the company to file a claim; 2) claim for recovery of damages.

Proceeding from this, it can be argued that the German derivative lawsuit went through a similar historical path of development as the American one - from the ‘single’ requirement on forcing to file a lawsuit against the company's directors to the “dual” requirement: 1) the requirement on forcing the company to file a suit; and 2) the requirement on recovery of damages.

A strong negative factor preventing shareholders from filing the lawsuits on forcing the corporation to file a lawsuit against the directors of companies was that, if the lawsuit was lost, the shareholders who filed such claim to the company bore the burden of court costs. Due to this circumstance, claims did not receive active support from the shareholders. During the period from 1965 to 1999, only two claims were the subject of German courts.\footnote{W. Puchniak, \textit{supra} note 5 with reference to Peter Ulmer. \textit{Die Aktionärsklage auch Instrument zur Kontrolle des Vorstands– und Aufsichtsratshandelns}. 163 Zeitschrift für das Gesamte Handels- und Wirtschaftsrecht [ZHR] 290, 295 n. 19 (1999) (Ger).}

This situation existed in Germany until 2005. In 2005, some changes were made to German law to stimulate the development of derivative lawsuits. Changes in Germany’s legislation on derivative claims in 2005 occurred after 121 years since the reform of the law on joint stock companies in 1884, when the legislature refused to introduce a rule on a derivative lawsuit into the German legal system.
The modernization of German law, which occurred after such a long period of time, is due to some external factors. At the end of the 1990s, Germany began to develop foreign economic activity more actively. At the same time, German joint-stock companies began to attract capital from various sources, including foreign ones, such as foreign bank loans, foreign stock exchanges in order to expand financial resources. It became obvious that in order to create favorable conditions for the inflow of foreign investments, it is necessary to create effective means of judicial protection of participants in corporate relations. The previous regime of protection of the rights of society and shareholders did not satisfy the current economic needs. Thus, the reform of 2005 was intended to make German joint stock companies more attractive to foreign investors by expanding the rights of shareholders.

However, unlike an American model, a derivative lawsuit in Germany is not considered as a corporate control mechanism or as an instrument of corporate governance. The supervisory function of the management decisions of directors in German joint stock companies is exercised by other bodies, namely the supervisory board of the joint-stock company. The only and most important application of derivative lawsuit in Germany is to protect the rights of joint stock relations’ participants.

In modern German law, the rules on derivative lawsuit are concentrated exclusively in substantive acts. There are no provisions on the derivative action in German procedural law. German law in general does not contain a legal definition of the term ‘derivative action’. Currently, the main regulations for the management and supervision of German joint stock companies whose shares are traded on the stock exchange are contained in the German Corporate Governance Code of 2002 (hereinafter – “the Code”), which includes standards of proper and responsible management. Clauses 4.1.1 and 4.3.3 of the Code establish that the management companies are obliged to act in the best interests of the partnership and observe
the interests of the company, as well as to strive to increase the value of the company's assets.\textsuperscript{50}

Despite the fact that as early as 1884, German law contained a provision for a specific lawsuit for shareholders, the rules granting shareholders the right to file a lawsuit were included in the Law of Germany on Integration of Joint Stock Companies and Modernization of the Rights of Shareholders to sue” (GesetzzurUnternehmensintegrität und Modernisierung des Anfechtungsrechts) (hereinafter – “UMAG”)\textsuperscript{51}, which entered into force on November 1, 2005. This act not only formalized the institute of derivative claims in Germany, but also made it possible for shareholders to submit individual derivative claims. UMAG also reduced the ‘property qualification’ for minority shareholders from 10% to 1%. Currently, the shareholders may bring derivative claims to the company's governing bodies, which have a share in the authorized capital of the company in the amount of 1% or with market (exchange) value of a share of EUR 100,000. Relevant provisions were adopted that prevented the possibility of misconduct by minority shareholders in order to restraint the abuse of derivative claims.

This law did not only change German law, but also introduced various legal institutions inherent to the Anglo-Saxon legal system. In particular, UMAG introduced so-called ‘business judgment rule’ into the German corporate law. According to which, there is a presumption when making a commercial decision, the board of directors acted in good faith, was fully informed of the consequences of the proposed decision and was sure that the consequences of this decision fully meet the interests of the company.

\textsuperscript{50} German Corporate Governance Code of 2002 (2002).
The general rules obliging to recover damages to the company are set out in § 117 of the German Stock Corporation Act (Aktiengesetz) dated September 6, 1965 (hereinafter – “the Corporation Act”). Thus, in accordance with § 117 of the Corporation Act,

“anyone who intentionally exerts his influence over the company to induce a member of the management board or the supervisory board, a procuration officer or an authorized signatory to act to the detriment of the company or its shareholders shall be liable to the company for any resulting damage. He shall also be liable to the shareholders for any resulting damage to the extent that they have suffered damage in addition to any damage caused by the damage of the company”.

The rules governing derivative claims are found in subsection 7, Special Audit. Asserting of Claims for damages of the Corporation Act. Paragraphs 147-149 of this law regulate the issues of claiming damages, procedural issues of admission of a claim for consideration, and issues of publishing information about derivative claims in mass media.

Thus, § 147 of the Corporation Act establishes the obligation of members of the management or supervisory board to file a claim for damages against founders, persons exerting an unlawful impact on the company or its directors in the event of damages to the company during its incorporation or during the company's normal course of business if the decision to file such claim is approved at the general meeting of shareholders. In order to bring a claim for damages, the general meeting of shareholders may appoint special representatives. At the request of shareholders, whose shares in the aggregate reach 1/10 of the share capital or the share value of 1 million euros, the court shall appoint representatives other than those appointed by the general meeting of shareholders. If the court satisfies such petition, the company bears legal costs.

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52German Stock Corporation Act (Aktiengesetz) (1965), English translation as at May 10, 2015 [hereinafter Corporation Act].
53Id. § 117.
54Corporation Act, supra note 52, § 147.
lawsuits in defense of the rights of society, but whether such claims should be attributed to derivative claims or not, German law does not give a clear answer.

§ 148 of the Corporation Act allows for submission of derivative claims by minority shareholders on their own behalf in defense of the company's rights only in the event that the company suffered a damage caused by dishonesty or gross violation of the law or of the articles of association. The paragraph provides that a shareholder has the right to file a petition in a German court with a request to allow the submission of a derivative claim in defense of the rights of the joint stock company against persons who caused damage to the company. At the same time, the norms of this paragraph establish the ‘ownership qualification’ for such shareholder in the amount of 1% of the share capital of the joint stock company, or the value of shares owned by the shareholder must be EUR 100,000 of the total value of registered share capital.55

The specified ownership requirement is argued as a “mean of “filtering” of unjustified claims, since the interest of shareholders with a size less than the quorum established for filing derivative claims is questionable”.56 Thus, this ‘ownership requirement’ is intended to limit the number of derivative claims.

In general, an analysis of the norms of German law allows us to conclude that neither the German Civil Code, the German Commercial Code, nor the German civil procedure contain rules stipulating the responsibility of management bodies and legal entities, as well as the right of legal entities' participants to file derivative claims. Thus, strict provisions of the UMAG and the Corporation Act are the only exception to the general rules, since there are practically no other rules that allow the filing of derivative claims in German law.

55 Id. § 148.
1.2.2 Procedural aspects of the derivative claim in Germany

Issues of submission and consideration of derivative claims in Germany are governed exclusively by substantive law. The procedural order is determined by the norms of the Corporation Act includes two stages. At the first stage - the stage of admission of an action - shareholders shall submit an application to the German Court for the admission of an action to enforce the damage claims of the company in their own name. As mentioned above, the filing of such an application requires the property qualification established in § 148 of the Corporation Act.

At this stage, the defendant is the person who caused the loss to the company, and the company acts in the process as a person who is not a party to the claim. The court shall approve the complaint if it establishes the following circumstances:

1. Shareholders prove that they have acquired the shares before they knew or should have known about the losses incurred by the company (analogous to the “contemporaneous ownership” requirement provided for in US statutory law, which is a prerequisite for a derivative claim in the US);

2. Shareholders prove that they have unsuccessfully set a reasonable time for the company to sue;

3. There is an evidence to support the suspicion that company suffered a damage as a result of dishonesty or gross violation of obligations;

4. There is an evidence that filing a claim for damages does not contradict the priority interests of the company. At first sight, it is obvious that a shareholder who has limited access to the company’s information will find it difficult to prove the existence of these circumstances.

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57 Corporation Act, supra note 52.
58 Id. § 147.
At the second stage - the stage of consideration of a derivative claim - the court, in case of admission of the claim to the process, directly considers the derivative claim on the merits. Thus, the right of a shareholder to sue a derivative action depends on the discretion of the court. Actually, the court makes a decision on admission of the action, namely to give the shareholder the right to a derivative claim or not. Both at the first and second stages, the company can independently apply to the court with a claim for damages. Once the company files the claim, the shareholders' pending admission or complaint proceedings concerning damage claim become unacceptable, and the court terminates the proceedings on such an application or claim. The company may also enter as a plaintiff in an already initiated process by shareholders on a derivative claim. In this case, the former applicant or claimant shall involve in the process as a third party.59

A derivative action may be filed with the court within 3 months after the entry into force of the judicial act satisfying the shareholders' request for admission of the claim and provided that the shareholders have reappointed a reasonable term to the company to file an independent claim. Even after receiving a court approval for considering a derivative claim, shareholders are obliged to appeal to the company with a request to file a claim on behalf of the company, setting a reasonable time, and only after the expiration of the specified period shareholders have the right to file a derivative claim on their own behalf. When filing multiple derivative claims, they are combined for simultaneous trial. Company may withdraw a derivative action only if such a decision is approved at a general meeting of shareholders in the absence of a formal objection from shareholders owning 10% of the company’s shares.60

Paragraph 149 of the Corporation Act establishes a requirement for the publication of judicial acts in the media. This rule is explained, inter alia, by the absence of the need for judicial approval of a settlement agreement or a waiver in German law. In accordance with

59Corporation Act, supra note 52.
60Id.
§149 of the Corporation Act, if a court finds a derivative claim acceptable and allows it to the trial, the judicial act of accepting a derivative claim for a proceeding must be published in the official periodical of Germany (Bundesanzeiger). The publication should also include information on the end of the proceedings, which should contain information about all agreements entered into in resolving the dispute, the parties to the process, as well as payments or services that were carried out by the company or another person on behalf of the company.61

A review of the German model of the derivative claims in terms of the historical approach, as well as an analysis of German law, makes it possible to draw the following conclusions.

1. A derivative lawsuit in German law was formed as a request of shareholders on forcing a company to sue against persons who caused a loss to the company.

2. Norms on derivative action in modern German law define the subject matter of a derivative action by shareholders as a claim for damages against persons who caused a loss to the company. The German model of a derivative claim corresponds to the traditional notion of a corporate derivative claim aimed at compensating losses to the joint stock company and does not allow for a broad interpretation of the subject of a derivative claim.

3. The procedural order of submission, proceeding and resolution of a derivative claim in German law has its own characteristics and is characterized by the presence of several stages. Shareholders first get the approval of the court for admission of the claim for proceeding, and then they can bring a derivative action. For example, German law makes the issue of a derivative claim dependent on the discretion of the court. German law also establishes the need for a pre-trial consideration of shareholders` claims by the general

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61 Corporation Act, supra note 52, § 149.
meeting of shareholders before a derivative claim is filed with the court to be reviewed on the merits.

4. German law does not specify the governing bodies of the joint stock company as a defendant, but establishes that the defendant in a derivative claim is the person who caused the loss to the company. The exact circle of defendants in a derivative claim in German law is not defined, and accordingly, any persons who caused loss to the company can be a defendant. Such conclusion makes it possible to assume that a derivative action can be filed against subjects of non-corporate legal relations.

1.3 Kazakh model of derivative claims

1.3.1 The development of the derivative claim in Kazakhstan

The first joint stock companies appeared in Kazakhstan with the enactment of the laws of the KazSSR on Property dated December 15, 1990 and on Enterprises in Kazakh SSR dated February 13, 1991, and then the laws of Kazakh SSR on Economic Partnerships and Joint Stock Companies dated June 26, 1991 and on Denationalization and Privatization dated June 22, 1991, which officially approved the market orientation of the economy, legally defined the concepts of joint stock company and securities, the procedure and terms for transforming state enterprises into new forms of private enterprises.

An important step towards the formation of the legislation of the Republic of Kazakhstan regulating the activities of joint stock companies was the approval of the Decree of the President of the Republic of Kazakhstan on Economic Partnerships” dated May 2, 1995. But soon there was an urgent need for further reform of the corporate legislation system in Kazakhstan. Therefore, the special Law of the Republic of Kazakhstan on Joint Stock Companies (hereinafter – the “Law on JSC”) adopted on July 10, 1998 which was positively received by many experts, investors and participants of the securities market.
In order to improve the legislation, on February 10, 2011, the Law on Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on Mortgage Lending and Protection of the Rights of Consumers of Financial Services and Investors (hereinafter - the “Law”) made amendments in the sphere of regulation of responsibility of directors of a joint stock company. This Law was developed with the participation of the Association of Financiers of Kazakhstan and a number of representatives of commercial banks.

The most significant legislative innovations of the Law are the change of the principles of activity of joint stock company officials and more detailed regulation of the provisions on their responsibility regarding the entering into major transactions and interested party transactions. The law provides for the establishment of personal (fiduciary) responsibility of officials of joint stock companies for their decisions.

In addition, shareholder or several shareholders possessing independently or together with other shareholders five or more percent of the voting shares of the company were granted the right to independently to apply to the courts demanding from the officials to cover the losses, incurred to the company.\(^2\) Thus, shareholders are entitled to claim damages incurred to the company as a result of decision-making by officials to enter into major transactions and/or interested-party transactions. Before making such changes, only the company itself had the right to prosecute, at that, the decision of the general meeting of shareholders was necessary to bring an action; at present, both the shareholders and the company can file such a claim.

It should be noted that the Law does not provide for the rights of shareholders to demand compensation for losses caused to them in their favor, i.e. the shareholder does not act on his own behalf, but in the interests of all shareholders of the company. As a general

rule, the Law also does not provide holders of preferred shares with the right to take an action, referring only to holders of voting shares, which are usually holders of ordinary shares.

According to the paragraph 1(7) of the Article 14 of the Law on JSC\(^{63}\), a shareholder shall have the right: “when possessing independently or together with other shareholders five or more percent of the voting shares of the company to apply to the courts on their own name in the cases, demanding from the officials to cover the losses, incurred to the company, and return the profit (income) to the company by the officials and (or) their affiliates, received by them after taking the decisions (proposals to the conclusion) on major transactions\(^{64}\) and (or) the interested party transactions”\(^{65}\).

In particular, Article 63 of the Law on JSC - Responsibility of the officials of the company, entitles a shareholder or shareholders possessing independently or together with other shareholders five or more percent of the voting shares of the company the right to bring an action with the following claims and some conditions:

i. on holding liable of an official of the company for the losses, incurred to the company on the result of taking the decision on entering into interested party transactions and on the result of which the company acquired or alienated the property the cost of which is 10 or more percent of its book value;

ii. on compensation of the losses, inflicted to the company by an official;


\(^{64}\)A major transaction is a transaction or a range of the interrelated transactions in the result of which the company purchases or alienates (may purchase or alienate) the property worth twenty-five or more percent of the total balance sheet assets of the company; a transaction or a range of the interrelated transactions in the result of which the company may repurchase its allotted securities or sell the securities, repurchased by it in the amount of twenty-five or more percent of the total number of the allotted securities of the same type.

\(^{65}\)The persons, interested in the transaction shall be the affiliated persons of the company if they are: 1) a party of a transaction or participate in it as an agent or a representative; 2) the affiliates of the legal entity that is a party of the transaction or which participates in it as a representative or an agent.
iii. on return of profit (income) to the company by the official and (or) its affiliates, that
obtained after conclusion (proposal to conclude) of the major transactions and (or) the
interested parties transactions, that inflicted losses to the company. The rules of this article
require officials to act to the benefit of the company, to exercise their rights and fulfill their
duties in good faith and reasonably.
Paragraph 2 of Article 63 of the Law on JSC, defines two conditions under which
shareholders can bring an action, if:

   i. the official acted in bad faith, and (or)

   ii. the official failed to act.66

Law on JSC defines an official as a member of the board of directors of a joint stock
compny, its executive body or a person, solely performing the functions of the executive body
of a joint stock company.67 It should be noted that according to the legislation, the management
of the joint stock company is conducted by three bodies: the general meeting of the
shareholders, the board of directors (management body) and the executive body (a collegial
body or a person). Shareholder can sue only the member of management bodies of the joint
stock company that is different from German derivative claim. As mentioned above, German
law allows shareholders to sue every person who caused damage to the company irrespective
of is this person member of management or supervisory board. This limited definition of an
official in Kazakh legislation may be an obstacle at some point.

It is important to mention that neither Law on JSC nor Civil Procedural Code of the
Republic of Kazakhstan contains the definition and term of the derivative claim itself. It is
also impossible to find cases where courts could interpret derivative claims due to non-
availability of the civil cases on corporate issues.

66 Law on JSC, supra note 63, Art. 63.
67 Id. Art. 1.
This article also allows shareholders to sue third parties for compensation to the company for losses incurred by the company as a result of the company's transaction with this third party.\textsuperscript{68}

The Law on JSC also gives the right to major shareholders to demand the call of an extraordinary general meeting of shareholders or to bring an action with a claim to call it in the event that the board of directors refuses to call a general meeting of shareholders.\textsuperscript{69}

According to aforementioned, we can say that derivative claim in accordance with Kazakh legislation can be individual or class action and there is a requirement of property qualification in order to sue officials of the company. In this case, derivative claim has peculiarities with German model of derivative claims. Moreover, Kazakh legislation on joint stock companies defines the circle of defendants, that, on the one hand, limits the probability to sue other persons who cause damages to the company, and allows to define an exact person as a defendant, on the other hand.

\textbf{1.3.2 Procedural aspects of the derivative claim in Kazakhstan}

As we have noted above, both the company itself (acting on the basis of the decision of the general meeting of shareholders) and shareholders (group of shareholders), who own (in aggregate) 5 or more percent of the voting shares of the company, have the right to file a lawsuit against the official.

Before the moment of appeal to the court, the shareholder(s) is obliged to bring the issue of compensating loses by the official to consideration of the board of directors, whose in-person meeting should be called no later than 10 calendar days. The relevant decision of the board of directors should be disclosed to the relevant shareholder(s) within 3 days from the date of the meeting, and after receiving this decision or not receiving it within the

\textsuperscript{68}Law on JSC, \textit{supra} note 63, Art. 63.
\textsuperscript{69}\textit{Id.} Art. 14(2).
prescribed time, the shareholder(s) has the right to appeal to the court in his own name for the benefit of the company.\textsuperscript{70}

It should be noted that the said pre-trial procedure, which precedes the filing of a claim against an official of the joint stock company, in our opinion, is not sufficiently developed. First of all, the Law on JSC does not determine which decisions and on the basis of which documents/information can be taken by the Board of Directors according to the shareholders’ request. Secondly, the competence of the Board of Directors, reflected in the Law on JSC, does not imply the right of this body to decide on the compensation by any official of the company for the losses caused to them. Thirdly, when making a decision on compensation of losses by one of the members of the Board of Directors, this governing body initially cannot be objective. Law on JSC only requires “the members of the board of directors shall treat all the shareholders fairly, to exercise objective independent judgment on corporate issues”.\textsuperscript{71} This requirement does not give any explanation what does ‘fairly treatment and independent judgment’ mean. We assume that it would be difficult to define it by judges in case of corporate disputes. Because, as it well known that Kazakhstani courts are not required to follow precedents, and corporate cases are not publicly available to be used as an explanation and interpreting of this provision.

In conclusion, the Law on JSC does not regulate the procedure for compensation of losses by an official in the event that the Board of Directors makes a positive decision on their reimbursement. Moreover, Civil Procedural Code of the Republic of Kazakhstan does not contain any provision on derivative claims or separation section on corporate lawsuits.

\textsuperscript{70} Law on JSC, supra note 63, Art. 63(2).
\textsuperscript{71} Id. Art. 62(2).
CHAPTER 2. ANALYSIS OF THE POSSIBILITIES TO IMPROVE KAZAKH MODEL OF DERIVATIVE CLAIMS

Corporate law is an essential element of any national legal system. Legal norms that constitute its content are designed to promote both freedom and development of entrepreneurship, as well as investments in commercial or industrial activities, effective protection of investors' rights and public interest. The definition of these goals by any national legislation does not depend on what philosophy the appropriate legislator has chosen itself as a base for building corporate legislation (either liberal approach that assumes a high degree of autonomy in incorporation of a company and conducting its affairs, or more imperative approach, requiring business organizations to comply with more extensive norms).\(^72\) It also does not depend on how the corporate legislation is formed, what constitutes its content and with what branches of the legislation it should be necessarily coordinated and agreed.\(^73\)

The achievement of the objectives of corporate law is ensured by the fact that the law provides for the creation of a corporate-type legal entity in the appropriate organizational and legal form, and establishes additional legal norms that regulate the management and conducting of such legal entity’s affairs. In turn, the protection of the rights of participants/shareholders and investors of the company is achieved through legislative regulation of issues related to the control of emerging conflicts of interests between participants of the relevant corporate relations.

The regulation of such conflicts is based on the recognition of the existence of so-called agency problem in these legal relationships. The literature identifies three categories of such problem: first follows from the relationship of the participants/shareholders of the company with its officials, second is created as a result of conflicts between the company and third parties (such as its creditors, customers and employees), and third is due to the existence of


opposing interests of major or controlling shareholders and company officials nominated by them, on the one hand, and minority shareholders, on the other.\footnote{Kraakman, Davies, Hansmann, Hertig, Hopt, Kanda and Rock, The Anatomy of Corporate Law: A Comparative and Functional Approach (2004), at 21-23.}

The strategies, forms and tools for controlling such conflicts of interests, regulated by law, may vary. However, their consideration is a serious topic for separate consideration and analysis. The establishment of relevant legal provisions is due to the protection of shareholders' interests, but it is not coordinated with other important institutions of civil substantial and procedural law, and their application in practice may lead to the emergence of corporate conflicts, resolution of which will not allow to achieve the above-mentioned goals of corporate law under the existing legislation of Kazakhstan.

In particular, Article 63 of the Law on JSC, which provides for the liability of officials of the JSC before the company and shareholders for the harm caused by their actions or inactions, as well as for losses incurred by the company. It secures to a shareholder (shareholders) owning (owning in aggregate) five or more percent of the company's voting shares, the right in its own name to file a lawsuit against the official of this company for compensation of losses caused by the official to the company. Moreover, Article 63 establishes a completely ineffective procedure of filing such claim, requiring the shareholder (in many cases minority shareholder) to submit request to the company's board of directors.\footnote{Law on JSC, supra note 63, Art. 65.}

In general, the content of the Article 63 of the Law on JSC is not only inappropriate to the modern principles of proper corporate governance, but it also does not meet the functional task of the joint stock legislation on prevention from corporate conflicts. This Article in its current version, on the contrary, provides the ground for the emergence and uncontrolled development of such conflicts in their diversity.
In this case, however, the focus of consideration is whether it is possible for a shareholder to file a lawsuit against officials of the company for reimbursement of damages and losses incurred to the company itself (in the opinion of such plaintiff) from the standpoint of Kazakhstani law.

Obviously, such a possibility of filing a claim provided for minority shareholder creates conditions for its inevitable conflict with the controlling or major shareholder, as well as with the board of directors, the majority of which are usually nominees of the aforementioned major/controlling shareholder. Assessment of the situation and the company's development prospects of a major shareholder may differ dramatically from the position of a minority shareholder who filed a lawsuit against major shareholders` nominees or against all members of the board of directors for joint liability.

There is no doubt that any institution of private law must comply with the principles and norms of civil law. In this case, in particular, it is possible to note the discrepancy between the content of the Article 63 of the Law on JSC and the general functional purposefulness of joint stock legislation itself, as well as the basic principles of corporate governance, according to which corporate decisions at the level of the board of directors are made only collegially and therefore the board members are jointly responsible for the results of their management of the company. In this regard, bringing a separate member of the board of directors to liability for damages caused to the company as a result of a transaction by the company based on the relevant decision of the board of directors becomes objectively impossible.

Individual countries have established different mechanisms to protect the rights of shareholders, and at the same time to prevent conflicts between shareholders and company`s directors.

The greatest interest, as an example of a successful solution, taking into account the peculiarities of the continental law, is the experience of German legislation. In §117 of the
German Stock Corporation Act (Aktiengesetz), the obligation is fixed for any person whose actions caused losses to the company to compensate the company these losses. In this case, members of the management and supervisory board of the company may be responsible if they acted in violation of their obligations on managing the company properly and conducting its affairs. According to §147, the claims of the company for damages to the members of the management board and the supervisory board should be presented if the general meeting adopts decision by simple majority vote. And §148 allows “small” shareholders (collectively owning at least one hundredth of the authorized capital) to apply to the court for permission to present the company’s claim for damages in its own name. The court shall take the relevant decision on the admission of the claim to court proceeding when it reveals the presence of the conditions provided for in §147. At the same time, the company’s right to claim damages is prevailing, and when it is filed by the company itself, the petition of the “small” shareholders becomes inadmissible. The law regulates in detail the procedure for admission to consideration of any shareholders’ claims by court decision.⁷⁶

Thus, German legislation reflected the elegant solution of the issue of providing minority shareholders with a tool to protect their rights and interests, not allowing the joint stock company’s independent legal personality to be compromised, on the one hand, as well as creating conditions on prevention from corporate conflicts, the soil for which is retained in Kazakh legislation due to the imperfection of content of the Article 63 of the Law on JSC.

In this case, in German law, the right to sue is conditioned by the position of the court, which it adopts on the basis of an application for permission to file such lawsuit. It is the court that decides whether there are legal grounds for filing a claim and, by its decision, authorizes a minority or other shareholder who owns a small number of company’s shares to file a lawsuit against the company's official for damages to the company.

⁷⁶Corporation Act, supra note 52.
However, in my opinion, German model of derivative action with the presence of mandatory two stages submission of the claim is complicated for shareholders and long-lasting procedure. First, the shareholder should gather enough evidences to meet conditions specified in the §147, then apply to the court in order to get permission to sue on behalf of the company. Taking into account that civil proceedings in Germany can last for more than 6 months, wrongdoer member of management or supervisor board can easily hide evidences or find other ways to escape the liability. Moreover, such complicated procedures can be the reason for unwillingness of the shareholder to sue members of the management or supervisory board. Taking into account that the company is a separate legal entity created on the basis of the will of shareholders and managed by its directors in the interests of the company, any dispute, from my point of view, should be solved, firstly, within the company itself. And only after unsuccessful attempts, the shareholders can bring an action in the court. Because, when shareholder applies to the court at the first stage, this claim would be known to the public. This can entail the unreasonable scandals and decrease in the price of company’s shares.

Federal Procedural Law (Federal Rules of Civil Procedures) of US contains Rule 23.1 - “Derivative Actions”, according to which “it applies when one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce.”

It is fundamentally important that “a derivative lawsuit may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association”. The same article establishes specific circumstances that must be confirmed by the plaintiff in the statement of claim.

77FRCP, supra note 10.
78Id.
Thus, American law is also not limited by simply securing the right of a minority or other shareholder or shareholders to sue the company's officials for damages incurred by the company: it establishes requirements for the content of the claim and actions of the plaintiff, based on the fact that the company’s losses indirectly violate the legitimate interests of its shareholders. At the same time, it is determined that the plaintiff must prove the absence of collusion in such claim, thereby protecting the company from raiding and preventing unreasonable corporate conflict.

In contrast to German law, in which the right to such claim in the interests of the company is granted by the court, American law establishes the right to file such a claim directly. This regulation is similar to the English Law on Companies (the Companies Act 2006), and this right is called statutory derivative claim. Such claim may be filed in connection with the violation by the directors of the company of their duties to exercise proper competence and care, and compared to the previous company law, minority shareholders are now not required to demonstrate the existence of control by those acting illegally or dishonestly (“wrongdoers control”).

If you trace the history of the institution of the derivative claim, the impact of US corporate law will be obvious. The obligation to enforce the requirements of the corporation in American law, as well as in German law, lies with the directors (members of the board). Since this duty is not often performed by the directors, the claim of shareholders in the US was widely developed. Moreover, it is believed that modern corporate governance in the US has arisen as a result of court decisions taken on the basis of claims of shareholders.

The claim of shareholders is associated with certain prerequisites. First, a shareholder who makes a claim on behalf of a corporation must remain a shareholder throughout the

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entire legal process, and he must have been a shareholder at the time when the corporation had a demand; secondly, it is imperative that the claimant shareholder represents the interests of the corporation correctly and properly.\footnote{Id., at 136.}

Shareholders are not allowed to file a claim directly to the court. According to all state laws, they must first apply to the board of directors with a request to sue directors on behalf of the company. After that, the board of directors takes one of the possible solutions: to sue on behalf of the corporation, to provide this opportunity to shareholders, or to refuse due to the inconsistency with the interests of the corporation. However, this does not mean that the shareholder is deprived of the right to sue, although depending on who is a defendant, the procedure for filing a claim is different.

In this regard, so-called Special Litigation Committees deserve attention.\footnote{As noted in the literature, they arose in 1970s, when the case of bribes by corporate executives became frequent abroad.} They are filter before submitting shareholders' claims to the court. In particular, a special commission is created within the board of directors consisting of impartial directors who are not connected with disputed transaction. The commission must examine the validity of the shareholders' requirements, as well as the question of the suitability of submitting a claim to the benefit of the corporation. The commission may reject the shareholders’ claim and justify this by saying that filing a claim is not in the interests of the corporation.

The question arises whether the commission’s decision is binding on the court. Courts in different states respond differently to this question. For example, in the opinion of the New York State Supreme Court, if the commission is independent, i.e. consists of impartial directors, its decisions are binding on the court.\footnote{Auerbach v. Bennett, 47 N.Y. 2d 619; 393 N.E. 2d 994; N.Y.S.2d 920 (1979).} This means that the fate of the claim is entirely up to the directors.\footnote{This practice is developed by the courts of Alabama, California, etc.} According to the Supreme Court of the State of Delaware, the court must first verify the impartiality of the commission itself, and then whether the
commission’s refusal meets the interests of the corporation. This means that the legal fate of the admissibility of the claim is decided by the court. Thus, US corporate law provides shareholders with great opportunities to bring an action.

The above allows to make three conclusions that are important for the further development and improvement of Kazakhstan legislation regulating corporate relations.

The first conclusion is that the possibility for minority shareholders to sue company`s corporate officials for the harm caused to the company by their illegal is recognized in the legislation of common law countries, and moreover, judicial review of such claims are regulated by law in detail, and such regulation is improving. At the same time, such regulation fully meets the objectives of corporate law - the creation of an appropriate and balanced legal framework that allows to carry out business activities in the organizational and legal forms of companies and protect the interests of participants/shareholders of companies and their investors from abuse by controlling shareholders, minority shareholders and officials of the companies itself (depending on the circumstances of the particular case).

The second conclusion is aimed at confirming that in jurisdictions of civil law, to some extent, the concept of derivative claims is perceived in corporate relations. Each jurisdiction has its own decisions on this issue, both in content and in relation to the issue of an appropriate legal source. Such perception may indicate the effectiveness of legislative recognition of derivative claims as a tool to protect the rights of shareholders of the company, as well as the viability of adequate regulation of the relevant procedural issues.

Finally, it should be noted that the Kazakhstan law on Joint Stock Companies provides for the possibility of filing derivative claims, securing this right for any shareholder owning at least five percent of the voting shares of the joint stock company. At the same time, the fact that the right to a derivative action is the right of a minority or other non-major shareholder is ignored, because the controlling shareholder has full authority to bring the company's officials
to responsibility due to the ability to call and hold general meetings of shareholders (i.e., without any exceptions regarding the conditions and procedure for taking corporate decisions in the joint stock company). In addition, the granted right to a derivative lawsuit is not consistent with the task on preventing from corporate conflicts and abuse of the rights of shareholders or authorities of officials: lack of the necessary legislative procedures encourages the destabilization of company’s activity and impairment of the legitimate interests of all participants of corporate relations.

Taking all the foregoing into account, it seems necessary to substantially revise the content of the Article 63 of the Law of the Republic of Kazakhstan on Joint Stock Companies and include in the Law on JSC provisions on the responsibility of officials, taking into account foreign experience, and to include all necessary procedural provisions relating to the submission of such claims in the Civil Procedure Code of the Republic of Kazakhstan (hereinafter – “CPC”). It should be noted that paragraph 1 of Art. 47 of the CPC already provides for the possibility of filing a claim by one person in defense of the violated or disputed rights and freedoms, the legitimate interests of another person, which is carried out in the manner provided for in the CPC. With this in mind, it seems appropriate at the same time as improving the relevant provisions of the Law on JSC concerning the possibility and conditions for filing claims in the interests of a joint stock company by its shareholders, also regulate the relevant procedural aspects in the CPC. In this case, the experience of US law appears to be more attractive (and corresponding to the traditions of Kazakhstan law and the legal technique applied in it), where the relevant procedural issues are regulated specifically in the law governing the civil process, rather than the experience of German law, where both substantive and procedural issues are regulated in the law on joint stock companies.

Moreover, the role of Special litigation committees may also be relevant. In this case, independent director can play an important role that may help to keep balance in the corporate
conflict. Independent director can be able to evaluate the claim submitted by shareholder and take fair decision on appropriateness of such claim against officials of the company.
Conclusion

Derivative claim is a corporate tool that allows shareholders to sue directors of the company in case of abuse of their duties before the company and shareholders. It is not simple type of lawsuit. It differs from other types of corporate and civil lawsuits due to its complicated legal nature and being an important corporate tool which aimed to keep balance between the powers of shareholders and directors. Complicated legal nature is explained by the fact that this lawsuit is brought to protect rights and to the benefit of the third party and in case of winning the case, all benefits from the lawsuit or any amount of money that has been recovered go to the third party, not to the plaintiff as in usual lawsuit. However, shareholder receives indirect benefit from this lawsuit being shareholder of this company and receiving dividends. Because, returned or recovered amount of money would increase the book value of the company and amount of dividends of shareholders at the same time. The second reason of the complexity of this lawsuit is corporate conflicts between the participants of the corporate relations. Some shareholders misused the derivative claim to the own benefit in order to strengthen its condition in the company. During the development of derivative claims, there were a lot of abuses by shareholders who used this tool to threat directors or management bodies when they had corporate conflicts within the company.

Having regard to the above, it is obvious that countries tried and are trying to regulate this institution in order to build suitable atmosphere for the prospective investors, participants of corporate relations, protect the rights of shareholders, on the one hand, and prevent probable abuses by shareholders and management bodies, on the other hand.

The main of this thesis was to describe how derivative claims are carried out in different jurisdictions, define mechanisms and make appropriate recommendations on implementing into Kazakh law. It is very crucial for Kazakhstan taking into account of implications and pitfalls in the existing corporate legislation. As jurisdictions were chosen the US and
Germany and it has several reasons. First of all, derivative claim is appeared and developed in the Anglo-Saxon legal system. Secondly, the US and Germany are considered as representatives of two different legal systems with developed corporate law.

In the beginning of the research, the author noted that traditional notion that a derivative lawsuit is a claim for damages, which is filed against the governing bodies of a legal entity, is not confirmed in the statutory law of the US and is not legally enshrined provision. The subject of a derivative claim may be various requirements aimed at protecting the subjective rights of the corporation, and the defendant - any person who violated the subjective rights of the corporation. US procedural law focuses on the procedural requirements for claimants-shareholders and the procedural procedure for filing, reviewing and resolving derivative claims (the need to be a shareholder at the time of the transaction; the need to send a pre-trial claim to a special committee of the corporation; to represent all shareholders and corporations impartially and fairly; the need for judicial control over the withdrawal of the claim and the conclusion of a settlement agreement; awarding the recovery in favor of corporations, etc.).

As to the German model of derivative claim, the procedural order of filing, consideration and resolution of a derivative claim in German law has its own characteristics and is characterized by the presence of stages. Shareholders first get the approval of the court for admission of the claim for consideration, and then sue on the merits. For example, German law makes the issue of a derivative claim dependent on the discretion of the court. German law also establishes the need for pre-trial consideration of shareholder claims by the general meeting of shareholders prior to the submission of a derivative action to the court for consideration on the merits. German law does not specify the governing bodies of the joint stock company as a defendant as well, but establishes that the defendant in a derivative claim is the person who caused the loss to the company. The exact circle of defendants in a derivative claim in German law is not defined, and accordingly, any persons who caused a
loss to the company can be defendants. Such a conclusion makes it possible to assume that a derivative action can be filed against subjects of non-corporate legal relations.

Observing two derivative models, the author came to the conclusion that Kazakh derivative lawsuit was formed as a German model of a derivative lawsuit, which required the “qualification of ownership” and the approval of the general meeting of shareholders to bring such an action by the shareholder (shareholders). However, compared to the US and Germany, the Kazakh derivative lawsuit has some peculiarities:

i. the defendants for the derivative claim are specified and defined;

ii. there are no special committees for reviewing derivative claims (as in the USA) and there is no judicial discretion in matters of admitting a derivative claim for substantive consideration (Germany).

Kazakhstani legislation shows that in Kazakhstan the possibility of filing a non-corporate derivative claim is not allowed, in which the disputed claim arises from non-corporate legal relations.

The author tried to analyze existing models of the derivative claims and found out implications and disadvantages of Kazakh model of derivative claim. Taking into account experiences and statutory norms of the US and Germany, the author gave practical recommendations on improving Kazakhstani law on joint stock companies.

Summarizing all the findings of this research, the author believes that this thesis will help in further developing and improving Kazakh law on derivative claims with due consideration of foreign models of derivative claims.
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