

DIRECT VERSUS DERIVATIVE CLAIMS: PERMITTING DIRECT SHAREHOLDER ACTIONS FOR CLOSELY HELD CORPORATIONS



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INTRODUCTION

It is a fundamental maxim of corporate law that a corporation is an entity separate and distinct from its owners. It is, as Justice Marshall observed, “an artificial being, invisible, intangible, and existing only in [a] contemplation of law.”¹ The conceptual underpinnings of the doctrine of corporate personhood—one of which is that in giving substance to corporations, we give individuals the opportunity to assert their legal rights against corporations—are clearly articulated in existing jurisprudence.² Conversely, such a system provides the corporation the opportunity to assert its own interests in litigation as an entity which can be harmed by the action or inaction of its principals.

However, corporations are not atomic. They are made up of the people who hold some kind of interest in the entity. Employees have an employment interest, executives and boards of directors have management interests, and stockholders (or

shareholders³) have some form of ownership interest based on the number of shares owned in a corporate entity.⁴ As these interests make clear, the management of a corporate entity is generally separate from its ownership.⁵ As such, decision-making for a corporation is often separated from the people who own its shares.

At a fundamental level, this means that the people who stand to gain or lose from a corporation's decisions and management are often not the same people who make those decisions. This often results in circumstances where the management decisions of a company result in a loss of stock value for the investors in a corporation.⁶ Thus, shareholder derivative litigation is “one of the most interesting and ingenious of accountability mechanisms for large formal organizations”⁷ where the shareholder brings suit on behalf of an injured corporation. As the Delaware Supreme Court observed in *Kramer v. Western Pacific Industries*:⁸

In such a suit, the shareholder sues on behalf of the corporation for harm done to it. Ordinarily, therefore, any damages recovered in the suit are paid to the corporation. Historically, the derivative suit was conceived of as a double suit, or two suits in one: The plaintiff (1) brought a suit in equity against the corporation seeking an order compelling it (2) to bring a suit for damages or other relief against some third person who had caused legal injury to the corporation. Shareholders may also bring direct actions, both as individuals and as a class, for injuries done to them in their individual capacities by corporate fiduciaries. Recovery, in these individual or class actions goes to the suing shareholders, not their corporation.

As one commentator notes, this type of representative litigation is an attempt to strike a “balance of power between the board and the shareholders. The board of directors could be held accountable by shareholders other than through elections, and the board was not the sole power controlling the corporation.”⁹

As a result of this paradigm, distinguishing between claims properly belonging to a corporation, as opposed to claims belonging to an individual, becomes a paramount consideration in shareholder derivative litigation. However, “the line of distinction between derivative suits and those brought for the enforcement of personal rights asserted on behalf of a class of stockholders is often a narrow one” and not readily apparent.¹⁰ In this respect, Delaware jurisprudence on the distinction between direct and derivative claims is particularly instructive, with seminal cases like *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*¹¹ and its progeny developing, and refining, the analytical factors used to distinguish such claims over the course of the last century.¹²

Accordingly, this article will first elucidate and clarify the legal tests utilized by courts to distinguish direct and derivative claims, with a focus on Delaware and Virginia law, including the legal and policy justifications for the complex procedural requirements attendant to shareholder derivative litigation. Next, this article will apply the controlling legal test

enunciated under *Tooley* and its progeny to small businesses to argue that, at least in that context, it makes more legal and practical sense for courts to allow otherwise derivative claims to be asserted directly by shareholders.

A PRIMER ON DIRECT VERSUS DERIVATIVE CLAIMS

In its 2004 decision in *Tooley*, the Delaware Supreme Court overruled the traditional “special injury” analysis in favor of a new test: “The analysis must be based solely on the following questions: Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?” Stated differently, a shareholder has no legal standing to maintain a direct action for claims that are derivative in nature, that is, where the injury is suffered by the corporation.

As the Virginia Supreme Court noted in *Simmons v. Miller*, “the overwhelming majority rule is that an action for injuries to a corporation cannot be maintained by a shareholder on an individual basis and must be brought derivatively.”¹³ In other words, the “[w]rongs committed against the corporation by the officers and directors in the management of corporate affairs are derivative rights,” where any recovery belongs to the corporation, not the individual shareholder.¹⁴

The consequence of classifying a claim as direct as opposed to derivative carries enormous significance with respect to the procedural aspects of how such claims are litigated, and the eventual recovery to be obtained. As observed by the *Tooley* Court:

Determining whether an action is derivative or direct is sometimes difficult and has many legal consequences, some of which may have an expensive impact on the parties to the action. For example, if an action is derivative, the plaintiffs are then required to comply with the requirements of Court of Chancery Rule 23.1, that the stockholder: (a) retain ownership of the shares throughout the litigation; (b) make pre-suit demand on the board; and (c) obtain court

approval of any settlement. Further, the recovery, if any, flows only to the corporation.¹⁵

In addition, the recovery in a derivative suit is subject to claims by a corporation's creditors as well as corporate tax consequences.¹⁶ Conversely, recovery in a direct suit goes directly to the shareholder and is not subject to claims by corporate creditors or corporate taxation.¹⁷

The policy considerations underlying this framework are clearly articulated in existing case law. As the Virginia Supreme Court noted in *Simmons*:

The reasons underlying the general rule are that 1) it prevents a multiplicity of lawsuits by shareholders; 2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; 3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not a party to the suit; and 4) it adequately compensates the injured shareholder by increasing the value of his shares.¹⁸

Two years after the *Tooley* decision, the Delaware Supreme Court recognized an exception to the prior direct versus derivative paradigm for claims that were “dual-natured,” that is, both direct and derivative.¹⁹ However, in a recent unanimous en banc opinion in *Brookfield Asset Management, Inc., et al. v. Rossion, et al.*, the Delaware Supreme Court overturned its oft-criticized decision in *Gentile v. Rosette*²⁰ and reaffirmed *Tooley* as the dominant and exclusive test in this regard.²¹

In fact, *Brookfield* serves as both a ruling on how to classify corporate claims and a commentary on the state of distinguishing between those claims properly brought on behalf of a corporation and those properly brought on behalf of an individual. The real power of *Brookfield* is that it makes Delaware's stance on the direct/derivative distinction extraordinarily clear in the face of previous case law, mainly *Tooley* and *Gentile*.

The special injury analysis: the predecessor to Tooley

The consideration for originally allowing a special injury analysis is that, ultimately, there will be instances when an individual suffers a claim that is special or distinct from other shareholders or the corporation. Thus, the “special injury” test distinguished between derivative and direct claims by inquiring whether the plaintiff suffered a harm independent of any harm done to the corporation or other shareholders.²²

While the term “special injury” was not defined by the Delaware courts, later decisions interpreted this requirement to mean a wrong perpetrated solely on the shareholder or a wrong that affects a particular shareholder right.²³ For example, the Delaware Supreme Court's decision in *Bokat v. Getty Oil Co.* interpreted the “special injury” test for direct claims to require that the injury did not fall proportionately across all shareholders.²⁴

This analysis was later discarded under *Tooley* as “confusing and inaccurate” in part because “a direct, individual claim of stockholders that does not depend on harm to the corporation can also fall on all stockholders equally, without the claim thereby becoming a derivative claim.”²⁵ For example, a direct claim for false disclosures by a shareholder could also injure other shareholders proportionately. Yet, under the erstwhile special injury analysis, the sole redress for an injured shareholder was to sue derivatively and comply with its procedural requirements.

Tooley analysis: the controlling legal test

As elucidated under *Tooley*, the basic two-part test for distinguishing direct versus derivative claims is as follows: “Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?”²⁶ In this analysis, for a shareholder to assert a direct claim, he must demonstrate: (i) an injury to the shareholder independent of any injury to the corporation; and (ii) the duty breached was owed to the shareholder, and that he can prevail without showing an injury to the corporation.²⁷

This test benefits from being easy to understand, easy to apply, and reasonably workable. Notably, this test appears to indicate that any claim in which the action shows a breach or injury to the corporation will necessarily result in the corporation being the appropriate party to bring that action, thus disallowing direct claims thereon.

The simple reason that Delaware has chosen to rely primarily on the *Tooley* test and has removed all of the carve-outs and specialized requirements is that applying a simple two-factor test makes it dramatically easier for the courts to articulate the limits of the doctrine when determining the direct or derivative nature of a claim. Commentators and attorneys who have examined this change have supported the simplification, arguing that the more predictable outcomes in the determination of such claims are better, in a general sense, for structuring complex commercial transactions.²⁸

Virginia considerations

While Virginia has not expressly adopted the *Tooley* test in this respect, existing case law decisions appear to be based on the same underlying considerations.²⁹ An important difference between Delaware and Virginia law in this regard is that Virginia does not recognize, as Delaware does, any fiduciary duties stemming from the corporation's entities to the individual shareholders.³⁰ Thus, absent anything to the contrary in the governing documents of the corporation, Virginia's fiduciary duties can only be alleged between the directors of the corporation and the corporation itself.³¹ In light of this consideration, it appears that with respect to claims arising from a fiduciary's misconduct in Virginia, the claims are only ever properly brought as derivative. Virginia has, in essence, refused to wrestle with the issue of dual character claims by simply saying that a claim is direct or it is derivative, never both.

AN ARGUMENT FOR DIRECT SHAREHOLDER ACTION IN CLOSELY HELD BUSINESS DISPUTES

According to the US Small Business Administration's (SBA) Office of Advocacy, there were approximately 32.5 million small businesses in the United States in 2021.³² These small businesses constitute 99.9

percent of all US businesses.³³ In other words, the overwhelming majority of businesses in the United States are classified as small businesses. According to the SBA, moreover, approximately 80 percent of these small businesses have no employees.³⁴

While the structure for distinguishing direct from derivative suits may work well in the context of larger, complex, specialized organizations with hundreds, if not thousands, of shareholders, some commentators have criticized the application of these principles in the context of small closely held corporations.³⁵ Such closely held corporations tend to function more like partnerships than as corporations, and imposing the stringent considerations of derivative suits upon such relatively simple organizations can hamper, rather than promote, the fair and just resolution of disputes.³⁶ Notably in this regard, partnership law does not subscribe to the derivative suit requirements, and partners are free to assert direct claims to resolve partnership disputes.

Consider the case of a corporation with two shareholders, A and B. Under the traditional analysis, any corporate malfeasance by A would likely force B to first comply with the presuit demand before initiating a derivative action. In such cases, it would be nonsensical to assume that a demand upon the wrongdoer, A, would yield any meaningful results. Further, any recovery in such an instance will go to the corporation, which will eventually end up benefiting the wrongdoer, A, in this case.

In recognizing this problem, the American Law Institute (ALI) enacted certain standards in its Principles of Corporate Governance: Analysis and Recommendations, based on which courts would have discretion to allow certain direct actions by shareholders if the policy considerations informing derivative claims were otherwise absent.³⁷ However, this ALI approach remains the minority view and gained little to no traction in national jurisprudence.

The concerns traditionally associated with disregarding the corporate form, generally, do not seem to apply as readily in the context of close corporations. Those who adhere to the derivative requirement still argue that the reason to maintain the

corporate form in this manner is because of a number of principled reasons.³⁸ Broadly, these reasons can be summed up in the following way:

- The rules that govern corporations were established for a reason;
- Everyone who gets involved in a corporation understands those rules (at least theoretically) when they choose to incorporate;
- There is no reason to cater to an individual who just happens to have buyer's remorse; and
- Predictability is an important consideration for the corporate entity in all respects. As stated by the Seventh Circuit in *Bagdon v. Bridgestone/Firestone, Inc.*, "[W]hether to incorporate entails a choice of many formalities. Commercial rules should be predictable; this objective is best served by treating corporations as what they are, allowing the investors and other participants to vary the rules by contract if they think deviations are warranted."³⁹

The point remains, however, that such considerations tend not to be present in the closely held entity context. Indeed, the fact that the closely held corporation is often referred to as an "incorporated partnership" reinforces that concept. The recognition that there is something about the closely held entity that is distinct from the generally understood notion of a "corporation" suggests that the rules that bind those corporations may also not be applicable.⁴⁰ Regardless, the reason for limiting the use of direct suits to closely held small entities of two persons flows from the exact concerns present in the larger corporate context.

The key difference between the closely held corporation and larger corporations is that, as demonstrated above, many of the underlying principles that govern corporate law do not apply in the closely held context.⁴¹ Most of them apply even less in the two-person corporation context.⁴² Several states also recognize that it is often the case that closely held corporations tend not to strictly follow corporate formalities, and yet consider those corporate decisions valid and enforceable even in the absence of proper procedure.⁴³ Moreover, procedures for

disregarding the corporate entity as a separate person already exist in the context of corporate veil-piercing.⁴⁴ It belies reason to assume that it is any less predictable to create an exception from the rule for derivative claims in the closely held context than it is to allow for total disregard of the corporate entity itself in order to recover debts.

Simply put, this exercise of a closely held corporation exception to the derivative rules follows the general understanding that where corporate formalities are less concretely followed, and where the general reasons to uphold the fiction of a separate corporate entity are undermined—as in undercapitalization cases with respect to veil piercing—there is no reason to follow them exactly. Arguably, the closely held context in derivative lawsuits is similar to the undercapitalization context in veil-piercing cases. In both cases, the underlying purposes for upholding corporate personhood are undermined. Each is nevertheless reasonably predictable in that the preconditions must be met before the exception applies. For veil-piercing, that means that the corporation was (mis)managed in such a way that it is clear that the entity should not get the benefit of limited liability.⁴⁵ In the derivative claim context, the suit must not give rise to a duplicity of claims, and the corporate creditors must be protected from losing out on their interest.⁴⁶

Under such circumstances, there is no reason that direct claims cannot be pursued by the wronged shareholder in a two-person closely held corporation or other business entity. In allowing this principle, corporate law can preserve the general concerns with respect to corporate action while minimizing the limiting effects of corporate formalities on those corporations that are so small that the difference between a derivative and direct action is more a matter of the characterization of the claim than its substance.⁴⁷ The considerations since *Tooley* haven't changed. *Brookfield* simply made them dominant. If a distinction made sense then, as when the ALI initially put together its closely held derivative claim exception, it still applies now. The world may have changed, but the principles underlying corporate formalities (and the exceptions to those formalities) have not. 🍷

Notes

- 1 *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819).
- 2 See *In re Appraisal of Regal Entm't Grp., Cons. C.A. No. 2018-0266-JTL*, n.3. (Del. Ch. May 13, 2021); *Anne Arundel Cnty. v. Reeves*, 252 A.3d 921 (Md. App. 2021) (quoting *Cook Cty., Ill. v. United States ex rel. Chandler*, 538 U.S. 119, 125 (2003)); *Glob. Textile All., Inc. v. TDI Worldwide, LLC*, 847 S.E.2d 30 (N.C. 2020); *Santa Clara Cnty. v. Southern Pacific R.R.*, 118 U.S. 394 (1886) (ruling that corporations are within the definition of "person" for the purposes of section 1 of the 14th Amendment); *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519 (1839) (finding that corporations have certain rights distinct from its members); *Department of Medical Assistance Servs. v. Beverly Healthcare of Fredericksburg, et al.*, 601 S.E.2d 604 (Va. 2004) (distinguishing corporate persons from other individual natural persons for the purpose interpreting § 2.2-4030 of the Virginia Code, which allows "such persons" who substantially prevail against agency action to recover attorneys' fees); see also Robert Hesson, *In Defense of the Corporation*, xv (1979) (stating that "a corporation is in fact an association of individuals who are entitled to the same rights and legal protections which apply to all other individuals and organizations").
- 3 Some states, such as Virginia, refer to stockholders in a corporation as "shareholders." For the remainder of this article "shareholders" and "stockholders" will be used interchangeably.
- 4 See Scott Hirst, *The Case for Investor Ordering*, 8 *Harvard Bus. L. Rev.* 228, 237 (2018).
- 5 *Id.*
- 6 Cf. *Geyer v. Ingersoll*, 621 A.2d 784, 787 (Del. Ch. 1992) (expanding fiduciary duties of directors to include creditors as well as shareholders as a corporation nears insolvency to avoid circumstances in which directors will take risky decisions to protect shareholders' positions after a substantial loss of value).
- 7 *Kramer v. Western Pacific Industries, Inc.*, 546 A.2d 348, 351 (Del. 1988) (quoting R. Clark, *Corporate Law* 639-40 (1986)). See *Black's Law Dictionary* (defining a derivative action as "[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").
- 8 *Kramer*, 546 A.2d at 351 (quoting R. Clark, *Corporate Law* 639-40 (1986)); see also *Little v. Cooke*, 652 S.E.2d 129 (2007) ("tax damages" representing harm suffered by partners as individual investors were not recoverable in a derivative action").
- 9 Ann M. Scarlett, *Shareholder Derivative Litigation's Historical and Normative Foundations*, 61 *Buff. L. Rev.* 837, 891 (2013).
- 10 *Abelow v. Symonds*, 156 A.2d 416, 420 (Del.Ch. 1959).
- 11 845 A.2d 1031 (Del. 2004).
- 12 Before the 2004 decision in *Tooley*, Delaware courts utilized the "special injury" test in distinguishing derivative and direct claims, which focused on whether the plaintiff suffered a harm independent of any harm done to the company. See, e.g., *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330 (Del. 1993); *Kramer*, 546 A.2d at 351; *Moran v. Household Int'l, Inc.*, 490 A.2d 1059, 1070 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985); *Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970). The *Tooley* Court expressly overruled the "special injury" test, describing it as "not helpful to a proper analytical distinction between direct and derivative actions." *Tooley*, 845 A.2d at 1035.
- 13 544 S.E.2d 666, 674 (Va. 2001); see also *Crocker v. Fed. Deposit Ins. Corp.*, 826 F.2d 347, 349 (5th Cir.1987); *Cowin v. Bresler*, 741 F.2d 410, 414 (D.C. Cir. 1984); *Lewis v. Chiles*, 719 F.2d 1044, 1049 (9th Cir. 1983); *Lewis v. S.L. & E., Inc.*, 629 F.2d 764, 768 n. 10 (2nd Cir. 1980); *Brown v. Presbyterian Ministers Fund*, 484 F.2d 998, 1005 (3rd Cir. 1973); *Fifty States Management Corp. v. Niagara Permanent Savings & Loan Ass'n*, 396 N.Y.S.2d 925 (N.Y. App. Div. 1977); *Landstrom v. Shaver*, 561 N.W.2d 1, 12 (S.D. 1997); *Rose v. Schantz*, 201 N.W.2d 593, 598 (Wis. 1972).
- 14 *Simmons*, 544 S.E.2d at 674; see also *Mount v. Radford Trust Co.*, 25 S.E. 244, 245 (1896); 13 *William Mead Fletcher Et Al., Fletcher Cyclopedia of The Law of Private Corporations* § 6028, at 281 (perm ed., rev. vol. 2004) ("[a]ny recovery in a derivative suit proceeding belongs to the corporation and not to the plaintiff or other shareholders.").
- 15 See *Tooley*, 845 A.2d at 1036; see also Virginia Code § 13.1-672.1.
- 16 See *Liken v. Shaffer*, 64 F. Supp. 432, 441 (N.D. Iowa 1946).
- 17 See John W. Welch, *Shareholder Individual and Derivative Actions: Underlying Rationales and the Closely Held Corporation*, 9 *J. Corp. L.* 147, 149 (1984).
- 18 *Simmons*, 544 S.E. 2d at 674 (quoting *Thomas v. Dickson*, 250 Ga. 772, 301 S.E.2d 49, 51 (1983)).
- 19 See *Gentile v. Rosette*, 906 A.2d 91 (Del. 2006). The holding of this case was that although claims for overpayment are typically derivative, claims involving "a controlling stockholder and transactions that resulted in an improper transfer of both economic value and voting power from the minority stockholders to the controlling stockholder" present an exception to the *Tooley* test since they cannot be classified neatly as either direct or derivative.
- 20 *Id.*
- 21 No. 406, 2020 (Del. Sept. 20, 2021), available at <https://courts.delaware.gov/Opinions/Download.aspx?id=324500>.
- 22 See, e.g., *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319, 330 (Del. 1993); *Kramer*, 546 A.2d at 351 (Del. 1988); *Moran*, 490 A.2d 1059; *Bokat v. Getty Oil Co.*, 262 A.2d 246, 249 (Del. 1970).
- 23 See *Lipton v. News International, Plc.*, 514 A.2d 1075, 1078 (Del. 1986); *Moran*, 490 A.2d at 1069-70 (to distinguish a direct and derivative action, injury must be separate and distinct from that suffered by other stockholders or involve a contractual right independent of the corporation).
- 24 262 A.2d 246, 249 (Del. 1970).
- 25 *Tooley*, 845 A.2d at 1037.

- 26 *Id.* at 1036.
- 27 *Id.* at 1039.
- 28 See, e.g., Alison Frankel, Del. Supreme Court ditches dicey precedent on shareholders' direct claims, Reuters (Sept. 21, 2021), available at <https://www.reuters.com/legal/transactional/del-supreme-court-ditches-dicey-precedent-shareholders-direct-claims-2021-09-21/> ("[E]liminating the Gentile standing doctrine will promote a more consistent, common-sense application of Delaware law."); Andrew D. Cordo et al., Delaware Supreme Court Eliminates Gentile Dual Natured Claims, Wilson Sosini (Sept. 23, 2021), available at <https://www.wsgr.com/en/insights/delaware-supreme-court-eliminates-gentile-dual-natured-claims.html>; Stanley Keller, Rob Evens, and Eugene W. McDermott Jr., Delaware Clarifies Its Rules Governing Stockholder Derivative Actions, Locke Lorde (Oct. 13, 2021) available at <https://www.lockelord.com/newsand-events/publications/2021/10/delaware-clarifies-its-rules-governing-stockholder>.
- 29 "We need not decide whether to adopt the analysis employed by the Delaware Supreme Court in Tooley, but observe that even under such an approach, Remora would not prevail." *Remora Invs., L.L.C. v. Orr*, 673 S.E.2d 845, 848 (2009). Also notably, while Remora declined to adopt fiduciary duties between shareholders and corporate officers, it did not suggest that under no circumstances could the corporate officers owe such duties to the shareholders. It instead indicated that the provision of such duties was properly the realm of contract, and would need to be specified in the bylaws or operating agreement or else in a statute.
- 30 *Simmons*, 544 S.E. 2d at 674 (holding that individual claims could not be brought against majority shareholder, and the trial court correctly struck Simmons' individual claims for breach of fiduciary duty and statutory conspiracy under Virginia Code 18.2-499;500, because "a derivative action is the sole means of redress for injury to the corporation"); *Cattano v. Bragg*, 727 S.E.2d 625 (Va. 2012) (suits for breach of fiduciary duty against officers and directors must be brought derivatively on behalf of the corporation and not as individual shareholder claims) ("The remedy sought—the return of funds, misappropriated by an officer, to the corporation—is highly appropriate for a derivative claim"); *Michael E. Siska Revocable Tr. ex rel. Siska v. Milestone Dev., LLC*, 715 S.E.2d 21 (Va. 2011) ("We have previously stated that a derivative action against a corporation is maintained directly for the benefit of the corporation, and the final relief, when obtained, belongs to the corporation, and not to the stockholder plaintiff.") (internal quotation marks and citation omitted); *Mission Residential, LLC v. Triple Net Props., LLC*, 654 S.E.2d 888, 890 (2008) (arbitrator ruled that plaintiff lacked standing to assert a direct claim for breach of the operating agreement, but that such claim could only proceed as a derivative claim); *Keepe v. Shell Oil Co.*, 220 Va. 587, 260 S.E.2d 722 (1979) (Stockholder has no standing in his own right for injury to corporation on ground that injury caused a depreciation in value of his stock) ("The corporation is a legal person, separate and distinct from persons who own it, and corporation, as alleged owner and operator of business, is person entitled to its profits and person injured by wrongs alleged in motion for judgment; thus stockholders are without legal standing to sue for injuries to corporation"); *DCG&T ex rel. Battaglia/Ira v. Knight*, 68 F. Supp. 3d 579, 584 (E.D. Va. 2014).
- 31 See *DCG&T*, 68 F. Supp. 3d at 585-86.
- 32 U.S. Small Bus. Admin., Office of Advocacy, 2021 Small Business Profile, available at <https://cdn.advocacy.sba.gov/wp-content/uploads/2021/08/30144808/2021-Small-Business-Profiles-For-The-States.pdf>
- 33 U.S. Small Bus. Admin., Office of Advocacy, Frequently Asked Questions, available at https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf ("The Office of Advocacy defines a small business as an independent business having fewer than 500 employees").
- 34 See *id.*
- 35 John W. Welch, Shareholder Individual and Derivative Actions: Underlying Rationales and the Closely Held Corporation, 9 J. Corp. L. 147, 149 (1984)
- 36 William Mead Fletcher, 8 Fletcher Cyclopedia of the Law of Private Corporations § 3997.20 (2001) ("The term incorporated partnership has been used in reference to close corporations and generally denotes a corporate entity in which the participants interact in a manner akin to partners."); see also Frank H. Easterbrook & Daniel R. Fischel, Close Corporations and Agency Costs, 38 Stan. L. Rev. 271, 297 (1986). ("That closely held corporations are really 'incorporated partnerships' is a common refrain").
- 37 Principles of Corporate Governance: Analysis and Recommendations, A.L.I., § 7.01(b), cmt. (c) (2008). Comment c lists the following actions as direct:
- (1) To enforce voting rights, to prevent improper voting, to protect against dilution, or to protect preemptive rights;
 - (2) To compel the payment of dividend or to protect dividend arrearages;
 - (3) To challenge the improper use of managerial power to perpetuate management or to frustrate voting by shareholders;
 - (4) To prevent ultra vires or unauthorized acts;
 - (5) To prevent oppression of, or fraud against, minority shareholders;
 - (6) To compel dissolution or the appointment of a receiver;
 - (7) To challenge the unlawful expulsion of shareholders through mergers, redemptions, or other means;
 - (8) To inspect corporate books and records;
 - (9) To require the holding of a shareholders' meeting or the sending of notice of such a meeting; and
 - (10) To hold controlling shareholders liable for actions taken in their individual capacities that reduce the value of minority shares.
- 38 Those reasons are noted throughout this paper, but the most important ones still remain: (i) avoiding multiplicity of lawsuits; (ii) protecting corporate creditors; (iii) equally benefiting all shareholders when a corporation generally suffers an injury; and (iv) stability and predictability in the

systems used to determine which entity businesspeople should use in business formation. See generally Brookfield, 261 A.3d 1251.

39 916 F.2d 379, 384 (7th Cir. 1990); see also Brinkerhoff v. Enbridge Energy Co., Inc., 159 A.3d 242, 252 (Del. 2017) (reversing a prior Delaware Supreme Court ruling on the grounds of inconsistent application of the definition of “bad faith”).

40 See supra note 35.

41 See supra note 36.

42 Multiplicity of suits, which is a big concern for many courts, is entirely absent from a two-man corporation, for instance, as there is only one person who would even bring suit against the wrongdoer.

43 See, e.g., *Brewer v. Bank of Danville*, 202 Va. 807, 812-13 (1961).

44 See *Blair v. Infineon Technologies AG*, 702 F. Supp. 2d 462, 437 (D. Del. 2010); *Geyser v. Ingersoll Publications Co.*, 621 A.3d 784, 793 (Del. Ch. 1992).

45 See, e.g., *Soroof Trading Development Co. v. GE Fuel Cell Systems LLC*, 842 F. Supp. 2d 502, 521-22 (S.D.N.Y. 2012).

46 Which, interestingly enough, corporate veil-piercing helps to protect in these exact sorts of scenarios (meaning shifting corporate funds such that the individuals get the money while the corporate coffers are emptied).

47 See Allan B. Cooper et al., *Too Close For Comfort: Application of Shareholder’s Derivative Actions to Disputes Involving Closely Held Corporations*, 9 U.C. Davis Bus. L.J. 171, 197 (2009).