SHAREHOLDER DERIVATIVE LITIGATION AND THEORIES OF THE CORPORATION

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ABSTRACT

Shareholder derivative litigation occupies a unique and uncomfortable position within the American legal system, as it upends the separation of ownership and control that is one of the hallmarks of the modern business corporation. Yet for all the attention paid to this phenomenon, virtually no commentators have critiqued it theoretically. This Article helps fill that gap by assessing shareholder derivative litigation from the various theoretical conceptualizations of the business corporation. In so doing, this Article demonstrates that certain significant divergences exist between the practice of shareholder derivative litigation and particular theories of the corporation. It is largely up to the reader to decide whether these divergences more properly call into question the practices of derivative litigation or the corporate theories found to be incongruent with them.

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TABLE OF CONTENTS

ABSTRACT 371
INTRODUCTION 372
I. SHAREHOLDER DERIVATIVE LITIGATION 376
A. *The English Legal System* 376
B. *The Derivative Action* 378
1. *England* 380
2. *United States* 393
C. *The Demand Requirement* 406
1. *Demand upon the board* 409
2. *Demand on shareholders* 416
II. SHAREHOLDER DERIVATIVE LITIGATION CRITIQUED BY CORPORATION THEORY 420
A. *Brief History of the Corporation* 420
B. *Theories of the Corporation* 422
1. *Artificial Personhood* 422
2. *Concessionary Theory* 425
3. *Aggregation Theory* 429
4. *Real Entity Theory* 438
5. *Contractarian Model* 444
6. *Stakeholder Model* 448
CONCLUSION 450

INTRODUCTION

Shareholder derivative litigation sits uneasily within the world of corporate law, and, for that matter, within the world of Anglo-American jurisprudence more generally. Such litigation violates foundational principles of both worlds. With regard to the former, it infringes upon "separation of ownership and control," a distinguishing feature of the modern business corporation.[1] With regard to the latter, it permits a party with very little direct interest in a matter to bring a lawsuit putatively on behalf of a party with an interest that is both direct and superior.[2] Not surprisingly, shareholder derivative litigation

1. *See* Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247, 1247 (2010).

2. *See* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L., ECON. & ORG. 55, 60–61 (1991).

remains a phenomenon subject to controversy, confusion, and criticism.[3] Indeed, as far back as the 1940s it was roundly criticized by some as a "remedy [that] has become maladjusted to the disease"[4] but applauded by others as a "'wholesome' if inadequate remedy to expose corruption in the directing of corporate activities."[5] In our own times, Delaware Vice Chancellor Sam Glasscock III has referred to the derivative action as a "necessary evil."[6]

Somewhat surprisingly, despite all of the controversy it has engendered, shareholder derivative litigation remains largely undertheorized. Perhaps the reason for this can be traced to its origins. Shareholder derivative litigation arose nearly two centuries ago as a particular response to a particular problem (albeit a problem that reaches back to ancient times): *quis custodiet ipsos custodes*, or *who is to guard the guards themselves*?[7] It serves

3. *See* Quinn Curtis & Minor Myers, *Do the Merits Matter? Empirical Evidence on Shareholder Suits from Options Backdating Litigation*, 164 U. PA. L. REV. 291, 293 (2016) ("Since suits are initiated by plaintiffs' attorneys and settled by corporate managers using firm or insurance company dollars, the risk of strike suits and collusive settlements is high.").

4. FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS 96 (1944).

5. George D. Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COLUM. L. REV. 1, 31 (1947).

6. Park Emp.'s & Ret. Bd. Emp.'s Annuity & Benefit Fund of Chi. v. Smith, C.A. No. 11000-VCG, 2016 WL 3223395, at *1 (Del. Ch. May 31, 2016).

7. OXFORD DICTIONARY OF QUOTATIONS 51 (Elizabeth Knowles ed., 7th ed., Oxford Univ. Press 2009). Organized collectives invariably suffer from intraorganizational disputes. Problems with such disputes, and how best to resolve them, must have plagued humanity for much of its history. Indeed, we can find examples of this throughout the ages. In the Anglo-American tradition, we see in 1307, for the protection of a house of monks, King Edward I "required the abbot to keep the [abbey's] corporate seal in a particular place to prevent its continued misuse to the detriment of the house." Bert S. Prunty, Jr., *The Shareholders' Derivative Suit: Notes on Its Derivation,* 32 N.Y.U. L. REV. 980, 981 (1957) (citing 1 FREDERICK POLLOCK & FREDERIC WILLIAM MAITLAND, HISTORY OF ENGLISH LAW 509 (2d ed. 1923)). This statute was declared void in 1449. In 1601, for the protection of donors and beneficiaries of charitable funds, the "Charitable Uses Act" was passed, authorizing investigation into "Fraudes and breaches of Truste and Negligence" with regard to such funds upon "complainte by any partie grieved." Charitable Uses Act 1601, 43 Eliz. 1 c.4 (Eng. & Wales); *see also* Prunty, *supra*, at 981 (citing Charitable Uses Act 1601, 3 Eliz. 1, c.4 (Eng. & Wales)) (bestowing upon the Chancellor the power to "inquire into certain corporate affairs 'on the complaint of any party grieved.'"). Shareholder derivative litigation, therefore, is simply a relatively modern solution to this age-old problem within the particular context of the business corporation.

as a somewhat desperate, practical mechanism by which directors can be held accountable for harms they inflict upon the corporations they manage.[8]

Since its origins, shareholder derivative litigation has evolved—and continues to evolve in our own day—along significantly different paths depending upon the jurisdiction.[9] As one commentator aptly observed, "[d]erivative litigation, albeit a uniquely complex form of civil litigation, has never existed in a social or legal vacuum."[10] Which particular path is or has been the wisest is a matter of considerable debate.[11]

Our understanding of the corporation has also evolved—and continues to evolve.[12] Indeed, the corporation itself has evolved quite dramatically over the centuries.[13] Consequently, a critical reappraisal of shareholder derivative litigation, taking into account society's evolving understanding of the corporation, is long overdue. Such a reappraisal will enable commentators and policymakers (including, particularly in this area of the law, judges) to weigh and potentially adjust the various implementations of shareholder derivative litigation to fashion a more logical, coherent approach that better harmonizes practice and theory. This reappraisal comes at a time when the longstanding predominance of Delaware as the jurisdiction of

8. Such is the case with much of the common law, especially in the field of corporation law. As Delaware Vice Chancellor Strine observed, "[i]n building the common law, judges" are "forced to balance" multiple concerns, and "cannot escape making normative choices[] based on imperfect information about the world." In re Pure Res., Inc., S'holders Litig., 808 A.2d 421, 434 (Del. Ch. 2002).

9. To its credit, the Supreme Court of Delaware has explicitly underscored the importance of such evolution. *See* United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1058 (Del. 2021) ("[I]t is both appropriate and necessary that the common law evolve in an orderly fashion to incorporate . . . developments.").

10. DEBORAH A. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 1:3 (2025–2026 ed.), Westlaw SDALP § 1:3 (database updated Oct. 2025).

11. *See, e.g.*, Hornstein, *supra* note 5, at 2 (decrying New York legislation regarding shareholder derivative lawsuits as "largely influenced by 'special interests'").

12. *See* SUSANNA KIM RIPKEN, *Legal Theories of the Corporate Person*, *in* CORPORATE PERSONHOOD 21–57 (Cambridge Univ. Press 2019).

13. *See* Hornstein, *supra* note 5, at 1; *see also infra*, Section II.A (summarizing a brief history of corporations).

preferred incorporation (and, concomitantly, the choice of corporate law) is coming under attack with a seriousness not seen in generations,[14] creating a particularly ripe opportunity for change in American corporate law.

This Article will proceed as follows. Part I will expound upon shareholder derivative litigation, covering its origins, its historical evolution, and its current manifestations. Critical to the modern American approach to shareholder derivative litigation is the demand requirement, and substantial attention will be devoted to that subject. Part II will provide an overview of the business corporation, covering the interrelated matters of its history and its various theoretical conceptualizations. This overview will then be drawn upon to critique shareholder derivative litigation. This critique will, in turn, help inform the debate over which approaches to shareholder derivative litigation are most fitting and sensible, and which are, conversely, incongruous and difficult to justify given our current understanding of the corporation.

One important qualification must be set forth up front: certain key features of shareholder derivative litigation, including, primarily, the role of special litigation committees, merit individualized assessment. However, the issues raised by such an assessment are numerous and complicated and cannot be adequately examined within the length typically accorded an article such as this. I hope to employ the analysis developed here to examine these key features, and in particular the unique role and history of the special litigation committee, in a subsequent article.

14. *See* Amy Simmerman, William B. Chandler III & David Berger, *Delaware's Status as the Favored Corporate Home: Reflections and Considerations*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 8, 2024), https://corpgov.law.harvard.edu/2024/05/08/delawares-status-as-the-favored-corporate-home-reflections-and-considerations/ [https://perma.cc/UG3J-2KEH].

I. SHAREHOLDER DERIVATIVE LITIGATION

The English legal system provided the context in which shareholder derivative litigation initially developed,[15] and as such this Part will commence with a very brief overview of that system. A discussion of the development of shareholder derivative litigation will follow, with particular attention paid to the "demand requirement,"[16] arguably the most critical feature of derivative litigation in the United States today.

A. The English Legal System

Formal courts of law have existed on the British Isles for approximately 2,000 years.[17] In 43 A.D., under Emperor Claudius, Rome commenced its conquest of the Isles, and by the end of the First Century, Britannia was established as a Roman province.[18] With that came the trappings of the Roman administrative state, including a formal legal system complete with courts, trials, and a process for appeals.[19]

But these courts disappeared following the Roman retreat from Britannia in the Fifth Century, precipitating the period commonly known as the Dark Ages.[20] This was an era of Anglo-Saxon rule, during which time justice was characterized by decentralization and local, communal courts (derived from ancient tribal courts).[21] As per one commentator, it would be "anachronistic to regard" these tribunals as genuine courts of

15. *See* Ann M. Scarlett, *Shareholder Derivative Litigation's Historical and Normative Foundations*, 61 BUFF. L. REV. 837, 842 (2013).

16. *See infra* Section I.C.

17. Łukasz Jan Korporowicz, *Roman Law in Roman Britain: An Introductory Survey*, 33 J. LEGAL HIST. 133, 137 (2012).

18. *Id.* at 136.

19. *See id.* at 137.

20. *See* HENRIETTA LEYSER, A SHORT HISTORY OF THE ANGLO-SAXONS 1 (I.B. Tauris & Co. 2017); J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 4 (5th ed. 2019).

21. George Jarvis Thompson, *Development of the Anglo-American Judicial System*, 17 CORN. L.Q. 9, 10 (1931).

law.[22] There "were no lawyers," "no official records were kept," and reasoned decision-making was avoided.[23]

Historians generally trace the origins of the modern English legal system to approximately 1,000 years ago—the time of the Norman conquest in 1066.[24] Although shortly before this time England had already become a "unified nation with a central government,"[25] the Normans brought "a taste for strong government and a flair for administration."[26] Within a century of the Norman conquest, the "rudimentary" justice system of the Anglo-Saxons "had grown so far as to beget . . . a judicial system whereby the king's justice" was dispensed regularly by members of the king's *curia*.[27]

At that time, the king was the "fountain of justice and supreme administrator of the laws," and he "decided each case before him according to his royal will."[28] The burdens this placed upon the king were naturally quite great, and eventually led to the king's decision to delegate the administration of justice to itinerant justices endowed with jurisdiction.[29] Concomitantly, access to justice became more of a right and less an exercise of the king's grace.[30] This development was ultimately enshrined in the Magna Carta,[31] and gave rise to "the supremacy of the law" in England.[32]

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22. BAKER, *supra* note 20, at 6.

23. *Id.* at 3.

24. *Overview of the Judiciary*, CTS & TRIBUNALS JUDICIARY, https://www.judiciary.uk/about-the-judiciary/history-of-the-judiciary-in-england-and-wales/history-of-the-judiciary/ [https://perma.cc/FM6G-JZNK] (last visited Nov. 19, 2025). Concomitant with the development of England's secular courts was the proliferation of sophisticated ecclesiastical tribunals. *See* BAKER, *supra* note 20, at 135. This development is beyond the scope of our inquiry.

25. BAKER, *supra* note 20, at 16.

26. *Id*.

27. *Id.*

28. George Jarvis Thompson, *Development of the Anglo-American Judicial System*, 17 CORN. L.Q. 203, 203 (1932).

29. *Id.* at 204.

30. *Id.*

31. *Id.*

32. *Id.* at 205.

This concession on the part of the king, however, was not complete.[33] So, in addition to the creation of "common law" courts (which handled controversies pertaining to matters in which the king ceded his authority), there were created "prerogative courts" to handle matters pertaining to the king's "residuary prerogative of justice."[34] From these prerogative courts came the High Court of Chancery.[35] Chancery became "the great court of equity by succeeding to the prerogative jurisdiction . . . to grant specific relief in extraordinary cases."[36] For centuries thereafter, both in the United States and Great Britain, the traditional rule was that courts of equity would not have jurisdiction over an issue for which there existed a remedy in a court of law.[37] Particularly relevant to our inquiry is that the law of trust originated in the chancery courts.[38] For "[t]he trust . . . which began as a mere trusting of someone, with no prospect of legal protection, came first to be upheld by the Chancery in individual cases . . . then treated as a regular species of property . . . ."[39] And it is from these courts of equity that the derivative action came into being.[40]

B. The Derivative Action

As a leading commentator has aptly explained, "[t]he derivative proceeding developed as an equitable device to enable shareholders to enforce a corporate right against faithless

33. *See id.*

34. Thompson, *supra* note 28, at 205.

35. *Id.* at 206.

36. *Id.*

37. *E.g.*, Tuttle v. Walton, 1 Ga. 43, 58 (1846) (Nisbet, J., dissenting); Adley v. The Whitstable Co. (1810) 34 Eng. Rep. 122, 125–26; 17 Ves. Jun. 315, 325–27 (Ch.). In the United States, jurisdiction over cases in law and cases in equity was famously merged in federal courts in 1938. Leandra Lederman, *Equity and the Article I Court: Is the Tax Court's Exercise of Equitable Powers Constitutional?*, 5 FLA. TAX REV. 357, 375 (2001).

38. BAKER, *supra* note 20, at 215.

39. *Id.*

40. *See* Henry duPont Ridgely, *The Emerging Role of Bylaws in Corporate Governance*, 68 SMU L. REV. 317, 329 (2015).

officers and directors, or abusive majority shareholders, that the corporation had either failed or refused to assert on its own behalf."[41] Its forerunner was the recognition of the representative suit brought by one or more shareholders on behalf of all of a company's aggrieved shareholders.[42] Over time, it evolved into a unique cause of action by which a shareholder could bring suit to assert a right of the corporation itself.[43]

In his Commentaries on American Law published in 1827, Chancellor Kent makes no mention of "[i]ntracorporate abuse."[44] And the first case in which a law of equity was "asked to intervene in corporate management at the suit of a minority stockholder" was not presented until 1828.[45] Perhaps this is to be expected, given the novelty of the corporate form *per se* at that time.[46]

Shareholder derivative litigation is generally traced back to a pair of cases (one in the United States and one in England) decided within eleven years of each other: *Robinson v. Smith* (1832) and *Foss v. Harbottle* (1843).[47] Each of these cases generated a separate and parallel line of development for the shareholder derivative action that, with one major exception, concluded similarly.[48] A review of this history enables us to better and more deeply understand the phenomenon that is the shareholder derivative action. This, in turn, will allow us to more profitably critique the action from various perspectives of corporate theory in Part II.

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41. 13 FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5940, Westlaw FLETCHERCYC § 5940 (database updated Sept. 2025) [hereinafter FLETCHER CYCLOPEDIA].

42. DEMOTT, *supra* note 10, § 1:3.

43. *Id.*

44. *See* Hornstein, *supra* note 5, at 1.

45. *See id.*; *see also infra* text accompanying notes 73–79 (discussing Hichens v. Congreve (1828) 38 Eng. Rep. 917, 4 Russ. 562 (Ch.)).

46. *See* Hornstein, *supra* note 5, at 1 ("More corporations are now chartered daily in the United States than were in existence in 1800.").

47. Robinson v. Smith, 3 Paige Ch. 222 (N.Y. Ch. 1832); Foss v. Harbottle (1843) 67 Eng. Rep. 189; 2 Hare. 461 (Ch.), *see* Prunty, *supra* note 7, at 980, 986.

48. The exception being the demand requirement. *See infra* Section I.C.

1. England

To most properly set the stage for our discussion of shareholder derivative litigation we ought to hearken back to the 1742 English case of *The Charitable Corporation v. Sutton*.[49] *Sutton* concerned "prodigious" losses occasioned by the "mismanagement" of a charitable organization by its "committee-men" (directors, essentially).[50] As per the court, this amounted to a breach of "trust."[51]

The defendants in *Sutton* (as defendants are wont to do) proffered multiple, serious arguments as to why the case against them could not proceed.[52] In response to these arguments, Chancellor Hardwicke declared: "I will never determine that frauds of this kind are out of the reach of courts of law or equity, for an intolerable grievance would follow from such a determination."[53]

Charitable Corporation v. Sutton contributed to the evolution of the shareholder derivative action by (1) subscribing to the concept of directors as "trustees" (or analogous thereto)[54] and (2) setting forth the veritable principle, for one of the first times within the field of corporate law, that for every wrong, equity must supply a remedy.[55] These contributions emboldened courts in both England and the United States to eventually forge

49. Charitable Corp. v. Sutton (1742) 26 Eng. Rep. 642, 2 Atk. Rep. 400 (Ch.). *Charitable Corporation v. Sutton*, as with most if not all early cases appearing in the timeline of the shareholder derivative lawsuit, was brought in the court of chancery. This should come as no surprise, as chancery courts "long had a monopoly of the jurisdiction in partnership matters," permitted "the representative suit," and afforded "equitable remedies." L. S. Sealy, *The Director as Trustee*, 25 CAMBRIDGE L.J. 83, 86 (1967).

50. *Charitable Corporation*, 26 Eng. Rep. at 642–43, 2 Atk. Reps. at 400–02.

51. *Charitable Corporation*, 26 Eng. Rep. at 643, 2 Atk. Rep. at 402; *see also* DEMOTT, *supra* note 10, § 1:3.

52. *Charitable Corporation*, 26 Eng. Rep. at 644–45, 2 Atk. Rep. at 405–06.

53. *Charitable Corporation*, 26 Eng. Rep. at 645, 2 Atk. Rep. at 406.

54. *See* Sealy, *supra* note 49, at 84. Or, perhaps more accurately, actors who, while not technically trustees, are held accountable via fiduciary duties as if they were trustees. *See id.* at 86.

55. *See, e.g.*, LARRY RIBSTEIN, ROBERT R. KEATINGE & THOMAS E. RUTLEDGE, 2 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 13:3 (2025), Westlaw RKLLC § 13:3 (database updated Dec. 2025).

a path to relief in similar situations, beyond the context of charitable organizations to instances involving aggrieved corporate shareholders who, for reasons both procedural and substantive, were not otherwise entitled to relief.[56]

The early nineteenth century saw other significant milestones along the evolution of the shareholder derivative action before blossoming in the aforementioned cases of *Robinson v. Smith* and *Foss v. Harbottle*.[57] The 1810 case of *Adley v. The Whitstable Co*.[58] concerned a member of an incorporated fishery who sued for profits denied to him pursuant to a bylaw of the fishery.[59] The plaintiff based his claim on the alleged invalidity of the bylaw in question.[60] As business organizations were matters of private ordering, courts "usually abdicated their jurisdiction [over intracorporate disputes] in favour of the obvious alternative authority—the majority of the members," or to the organization's designated decisionmakers (the directors).[61] This bias survives to our very day in the form of the "business judgment rule."[62] In *Adley*, however, the chancery court nevertheless exhibited a willingness to exercise its jurisdiction over the dispute in question—one that was *intra*corporate in nature.[63]

In 1828, shareholders of a mining company were permitted to bring suit in chancery court against directors alleged to have

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56. DEMOTT, *supra* note 10, § 1:3.

57. *See* Prunty, *supra* note 7, at 980, 986; Robinson v. Smith, 3 Paige Ch. 222, 231–33 (N.Y. Ch. 1832); Foss v. Harbottle (1843) 67 Eng. Rep. 189, 190, 207–08, 2 Hare. 461 (Ch.).

58. Adley v. The Whitstable Co. (1810) 34 Eng. Rep. 122, 17 Ves. Jun. 315 (Ch.) (cited in Prunty, *supra* note 7, at 981).

59. Prunty, *supra* note 7, at 981–82.

60. *Adley*, 34 Eng. Rep. at 122 (Ch. 1810).

61. K.W. Wedderburn, *Shareholders' Rights and the Rule in* Foss v. Harbottle, 15 CAMBRIDGE L.J. 194, 194 (1957) [hereinafter Wedderburn 1957]; *see also* Victoria Barnes, *Judicial Intervention in Early Corporate Governance Disputes*, 58 AM. J. LEGAL HIST. 394, 394 (2018) (explaining that those with the majority of shares or voting rights are the company's decision-makers).

62. *See* RONALD J. COLOMBO, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES, AND LIABILITIES § 2:16 (2025–2026 ed.), Westlaw LCODR § 2:16 (database updated Oct. 2025) [hereinafter LAW OF CORPORATE OFFICERS AND DIRECTORS].

63. *See* Prunty, *supra* note 7, at 981–82.

misappropriated corporate funds.[64] Not only was this another example of an intracorporate dispute entertained by the chancery court but, additionally, the relief sought was restoration of the misappropriated funds to the company's treasury.[65] We thus see the assertion of remedies that do not flow directly to the plaintiffs, but rather to the corporate entity itself—another hallmark of modern shareholder derivative litigation.

Whereas representative suits had been permitted for actions brought in connection with charitable organizations (since at least the sixteenth century, if not earlier),[66] it was not until the early nineteenth century that "the representative suit had been sanctioned where the business was in corporate form."[67] This advance was an important one, as it permitted plaintiffs to evade the "necessary parties rule," adopted out of appreciation of the fact that joining anything less than all interested parties to a suit runs the risk of "a multiplicity of suits" arising from the same set of facts.[68] Precedent had been split on the requirement to join all necessary parties in cases throughout the eighteenth century.[69] This advance can be found in at least three cases: *Hichens v. Congreve*,[70] *Preston v. The Grand Collier Dock Co.*,[71] and *Wallworth v. Holt*.[72]

The earliest of these, *Hichens*, was decided in 1828.[73] As per George Hornstein, *Hichens* is notable for being "the first [c]ase

64. *See id.* at 982.

65. *See id.*

66. *See* David V. Patton, *The Queen, the Attorney General, and the Modern Charitable Fiduciary: A Historical Perspective on Charitable Enforcement Reform*, 11 U. FLA. J.L. & PUB. POL'Y 131, 137 (2000); *see also* Scarlett, *supra* note 15, at 843 ("Examples of representative litigation are found in the 'earliest days of English law.'").

67. Prunty, *supra* note 7, at 982.

68. Robinson v. Smith, 3 Paige Ch. 222, 231 (N.Y. Ch. 1832). The necessary parties rule developed over the course of the Eighteenth Century, and "required the joinder of all parties interested in a matter so that a final resolution could be made." Scarlett, *supra* note 15, at 845.

69. Scarlett, *supra* note 15, at 848–56.

70. (1828) 38 Eng. Rep. 917, 4 Russ. 562 (Ch.).

71. (1840) 59 Eng. Rep. 900 (Vice-Ch.).

72. (1841) 41 Eng. Rep. 238, 244, 4 My. & Cr. 619, 635 (Ch.).

73. 38 Eng. Rep. at 917, 4 Russ. at 562 (Ch.).

to be found in which a court of equity was asked to intervene in corporate management at the suit of a minority stockholder."[74] *Hichens* featured shareholders of a joint stock company bringing suit, on behalf of themselves and other shareholders, against the company's directors on account of alleged fraud.[75] The company featured "upwards of two hundred shareholders" and joining them all to the lawsuit "would be inconveniently great."[76] Consequently, the court observed that "justice would be unattainable, if all the shareholders were required to be parties to the suit."[77] The defendants objected that the suit could not proceed without "making all the shareholders parties."[78] Without much comment, the court overruled the defendants' objections in the interests of convenience and justice.[79]

Preston, decided in 1840, concerned a suit brought by a shareholder, "on behalf of himself and all the other members [shareholders]," alleging fraudulent misconduct on the part of the directors of the Grand Collier Dock Company.[80] Among other reasons, the defendants objected on account of "want of parties," as there were "upwards of 100 members of the company" and not all had been joined to the lawsuit.[81] Again, without much explanation, the court overruled this objection, noting that "it would be impossible to make all of [the shareholders] parties," and that, "according to the decisions which have been made on the point," the defendants' objection "cannot prevail."[82]

In the *Wallworth* case, Lord Chancellor Cottenham more thoroughly articulated a justification for reaching the same

74. *See* Hornstein, *supra* note 5, at 1.
75. *See Hichens*, 38 Eng. Rep. at 917, 4 Russ. at 562.
76. *Id*. at 922, 4 Russ. at 576.
77. *Id.*
78. *Id*. at 921, 4 Russ. at 573.
79. *See id*. at 922–23, 4 Russ. at 576–77.
80. Preston v. Grand Collier Dock Co. (1840) 59 Eng. Rep. 900, 11 Sim. 327 (Vice-Ch.).
81. *Id*. at 907, 11 Sim. at 347.
82. *Id*. at 907, 11 Sim. at 347–48.

result.[83] As with *Preston*, defendants in *Wallworth* moved to dismiss a representative suit brought by shareholders against directors of a joint-stock bank for "want of equity" and "want of parties."[84] The court noted that "the number of the shareholders of the company was so great . . . that it was not possible, without the greatest inconvenience, to make them parties to the suit."[85] To overcome this, the court invoked precedent in which it "dispensed with the presence of parties who would, according to the general practice, have been necessary parties."[86] Echoing the remarks of Chancellor Harwicke in *The Charitable Corporation v. Sutton*, Lord Chancellor Cottenham explained:

> I think it the duty of this Court to adapt its practice and course of proceeding to the existing state of society and not by too strict an adherence to forms and rules, established under different circumstances, to decline to administer justice, and to enforce rights for which there is no other remedy.[87]

As referenced previously, the English case traditionally identified as the first to recognize a shareholder derivative action is *Foss v. Harbottle*,[88] decided in 1843.[89] This is somewhat paradoxical, as *Foss* is a *Marbury v. Madison*-esque opinion, in which the court recognized its power to provide the relief requested in theory but prescinded from exercising that power

83. *See* Wallworth v. Holt (1841) 41 Eng. Rep. 238, 4 My. & Cr. 619 (Ch.).

84. *Id.* at 244, 4 My. & Cr. at 634; *see also* Prunty, *supra* note 7, at 982 (finding that both the *Wallworth* and *Preston* defendants' objection over "want of parties" was overruled).

85. *Wallworth*, 41 Eng. Rep. at 241, 4 My. & Cr. at 627–28.

86. *Id.* at 244, 4 My. & Cr. at 635–36.

87. Prunty, *supra* note 7, at 982 (quoting *Wallworth*, 41 Eng. Rep. at 244, 4 My. & Cr. at 635).

88. *See* (1843) 67 Eng. Rep. 189, 2 Hare. 461. That said, precursors to the derivative action can be traced back to 1307. Prunty, *supra* note 7, at 981.

89. Scarlett, *supra* note 15, at 856 ("The 1843 case of *Foss v. Harbottle* is the seminal case cited regarding the shareholder derivative action in English law."); *see also* FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS 96 (1944) (finding that derivative actions derive from the dictum in *Foss*).

under the facts presented.[90] Indeed, as one astute commentator has noted, *Foss* more properly represents "a restriction, not an expansion, of shareholders' rights to judicial intervention."[91]

Foss concerned "The Victoria Park Company," and allegations that the directors thereof engaged in "various fraudulent and illegal transactions, whereby the property of the company was misapplied, aliened and wasted."[92] Plaintiffs Richard Foss and Edward Starkie Turton were shareholders of the company, and they brought suit against the directors "on behalf of themselves and all other . . . shareholders or proprietors of shares in the company."[93]

A difficulty immediately confronting the plaintiffs was the traditional judicial reticence "to interfere in the internal affairs of companies and similar associations,"[94] as discussed previously.[95] Additionally, since the suit was "complaining of injuries to the corporation," defendants argued that plaintiff shareholders "were not entitled to represent the corporate body."[96] Such was the prerogative of the board of directors.[97] Further still, had plaintiff shareholders presumed to sue in the "name of the corporation," it would have been "open to the Defendants, or to the body of directors or proprietors assuming the government of the company, to have applied to the Court for the stay of proceedings, or to prevent the use of the corporate name."[98] Thus, *Foss* not only identifies the core issue in derivative litigation of who may bring suit in the name of the

90. *See generally* Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803) (declaring that the judiciary "say[s] what the law is" but declining to award Marbury his commission).

91. Prunty, *supra* note 7, at 983.

92. *Foss*, 67 Eng. Rep. at 190, 2 Hare. at 461.

93. *Id*. at 190–91, 2 Hare. at 461.

94. Wedderburn 1957, *supra* note 61, at 194.

95. *See supra* text accompanying note 61.

96. *Foss*, 67 Eng. Rep. at 200, 2 Hare. at 485.

97. *See id.* at 203, 2 Hare. at 492–93. For those who would decry such "formalism," the court aptly notes that such rules "though in a sense technical, are founded on general principles of justice and convenience." *Id.*

98. *Id.* at 200, 2 Hare. at 485.

corporation, but also arguably presages the use of special litigation committees to quash ongoing derivative litigation.

The court in *Foss* acknowledged that it could not be argued that "any individual members of a corporation . . . [could] assume to themselves the right of suing in the name of the corporation."[99] For "[i]n law the corporation and the aggregate members of the corporation are not the same thing for purposes like this . . . ."[100] This reflects one of the major distinctions between a partnership and a corporation: whereas a partnership is merely the aggregation of its members,[101] a corporation was a legal "person,"—a "metaphysical body"—"separate from the members of which it is composed."[102] The court observed that "the only question can be whether the facts alleged in this case justify a departure from the rule which, *prima facie*, would require that the corporation should sue in its own name and in its corporate character . . . ."[103] Echoing the principle enunciated in *Sutton*,[104] the court proclaimed "the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue."[105]

The court continued: since "directors are made the governing body" of a corporation, "it must not be without reasons of a very urgent character that established rules of law and practice are to be departed from."[106] Two situations in which a shareholder could conceivably bring suit in the corporation's name were then identified by the court: (1) where, for some reason,

99. *Id.* at 202, 2 Hare. at 490.

100. *Id.*

101. *See* Gary S. Rosin, *The Entity-Aggregate Dispute: Conceptualism and Functionalism in Partnership Law*, 42 ARK. L. REV. 395, 396, 400–01 (1989); René Reich-Graefe, *Socio-Philosophical Ontology: Supraorganic Emergence of Social Reality*, 26 U. PA. J.L. & SOC. CHANGE 121, 160 (2023).

102. Wedderburn 1957, *supra* note 61, at 196.

103. *Foss*, 67 Eng. Rep. at 202, 2 Hare. at 490–91.

104. *See supra* text accompanying note 55.

105. *Foss*, 67 Eng. Rep. at 203, 2 Hare. at 492. The court did not cite *Sutton* for this proposition but did acknowledge it as a case cited in argument. *Id.* at 201, 2 Hare at 487.

106. *Id.* at 203, 2 Hare. at 492.

the proper governing body (the board of directors or the shareholders acting in concert) of the corporation is disabled from acting,[107] and (2) with respect to transactions that are void ("and not merely voidable").[108] In all other situations, the court reasoned that the shareholders could ratify the acts of the board, should they decide to do so.[109] As such, in all other situations, the court should not interfere with an internal corporate dispute.[110] Put differently, the court limited derivative litigation to acts of directors that could not be ratified by the shareholders;[111] situations in which "there is no chance of confirmation by the majority."[112]

With regard to the question of ratification, the court approached the issue with reference to the law of trusts.[113] As the court explained, the proceeding before it "purports to be a suit by *cestui que trusts* complaining of a fraud committed . . . by persons in a fiduciary character."[114] A "*cestui que trust*" is "[h]e who has a right to a beneficial interest in and out of an estate the legal title to which is vested in another."[115] Or, put more simply, "[t]he beneficiary of a trust."[116] Critically, a *cestui qui trust* holds

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107. *See id.* at 204–05, 2 Hare. at 496–97; *see also* Anthony O. Nwafor, *Enforcement of Corporate Rights—The Rule in Foss v Harbottle: Dead or Alive*, 12 CORP. BD.: ROLE, DUTIES & COMPOSITION 6, 7 (2016) (finding that "directors as the governing body are the only ones vested with power to sue in the name of the company" unless the directors are incapacitated, then shareholders may interfere in directors' managerial powers).

108. *Foss*, 67 Eng. Rep. at 208, 2 Hare. at 504.

109. *See id.* at 203–04, 2 Hare. at 494–95; *see also* Nwafor, *supra* note 107, at 9, 11–12 (finding that shareholders can prevent a derivative action through ratification).

110. *Foss*, 67 Eng. Rep. at 203–04, 2 Hare. at 494; *see* Wedderburn 1957, *supra* note 61, at 198 ("Whatever the ordinary majority of members could ratify was a matter outside the purview of the court.").

111. DEMOTT, *supra* note 10, § 1:3.

112. Wedderburn 1957, *supra* note 61, at 203.

113. *Foss*, 67 Eng. Rep. at 200, 2 Hare. at 486. The fact that the company had taken on the corporate form, and was not established as a trust *per se*, "would not be allowed to deprive the *cestui que trusts* of a remedy against their trustees for the abuse of their powers." *Id.* For purposes of the suit at hand, the "directors were trustees for the Plaintiffs to the extent of their shares in the company." *Id.*

114. *Id.* at 203, 2 Hare. at 494.

115. *Cestui Que Trust*, BLACK'S LAW DICTIONARY (6th ed. 1990).

116. *Id.*

the power to confirm an action allegedly detrimental to its interests.[117] Acknowledgment of this power helped the court identify who, exactly, was the *cestui qui trust* in the case before it.

In answer to the question: "who are the *cestui que trusts* in this case?,"[118] the court, after recognizing that "[t]he corporation, in a sense, is undoubtedly the *cestui que trust*,"[119] hastened to add that *so were the shareholders*.[120] This followed from the fact a "majority of the proprietors at a special general meeting assembled, independently of any general rules of law upon the subject, by the very terms of the incorporation in the present case, has power to bind the whole body. . . ."[121] Accordingly, the court concluded that "this suit cannot be sustained whilst that body retains its functions."[122] In other words, the actions of the directors upon which the suit had been predicated were indeed ratifiable. Or, as one nearly contemporaneous commentator explained: "This case was decided against the complaining stockholders on the ground that the complainant had not proved that the corporation itself was under the control of the guilty parties, and . . . that it was unable to institute the suit."[123]

Who exactly is the *cestui qui trust vis-à-vis* a corporation's directors has remained a disputed question. Some contend that the corporation itself is the *cestui que trust*; others contend, like *Foss*, that it is the shareholders as a group.[124]

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117. *Foss*, 67 Eng. Rep. at 203, 2 Hare. at 494. This rule prevails today. *E.g.*, Nalley v. Langdale, 734 S.E.2d 908, 918 (Ga. Ct. App. 2012) ("a beneficiary may . . . ratify a breach of trust.").

118. *Foss*, 67 Eng. Rep. at 203, 2 Hare. at 494.

119. *Id.*

120. *See id.*

121. *Id.*

122. *Id.* at 204, 2 Hare. at 494.

123. WILLIAM W. COOK, 3 A TREATISE ON THE LAW OF CORPORATIONS: HAVING A CAPITAL STOCK § 645 (7th ed. 1913).

124. *See id.* § 648; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 297 (1999).

Edwards v. Halliwell,[125] decided in 1950, compiled a list of situations in which, as per decisions rendered in subsequent cases established, ratification would not be possible (thereby permitting the shareholder suit to proceed).[126] As recapitulated by K. W. Wedderburn, this consists of the following:

- Ultra Vires and Illegality ("[w]here the act complained of is wholly *ultra vire*s . . ." or "illegal")[127]
- Special Majorities ("[w]here the matter is one 'which could validly be done or sanctioned not be a simple majority of the members . . . but only by some special majority")[128]
- Personal Rights ("[w]here the personal and individual rights of [plaintiff's] membership . . . have been invaded")[129]
- Fraud by those in control ("[w]here what has been done amounts to . . . a fraud on the minority and the wrongdoers are themselves in control of the company")[130]

The plaintiffs' suit in *Foss* appears to have rested upon the fourth ground listed above: fraud by those in control. For in *Foss* it was alleged that the "wrongdoers control the company."[131] However, under the particular circumstances of *Foss*, ultimate

125. Wedderburn 1957, *supra* note 61, at 196, 203 (citing Edwards v. Halliwell, 2 ALL E.R. 1066 (1950)).

126. Wedderburn 1957, *supra* note 61, at 203.

127. *Id.*

128. *Id.* As per the reasoning of the courts, this is necessary to prevent directors from violating the company's own regulations and subsequently asserting that the company "alone was the proper plaintiff" via passage of an "ordinary resolution." *Id.* at 207.

129. *Id.* at 203 (internal quotations omitted). These may be rights personal to an individual director (as asserted against fellow directors) or personal to an individual shareholder, as per the articles of incorporation. *Id.* at 210. Such actions would not be properly deemed derivative in nature today, but were properly brought (and would still be properly brought) as representative in nature. *Id.* at 212.

130. *Id.* at 203.

131. K.W. Wedderburn, *Shareholders' Rights and the Rule in* Foss v. Harbottle *(Continued)*, 16 CAMBRIDGE L.J. 93, 93 (1958) [hereinafter Wedderburn 1958].

control remained in the hands of the shareholders, thereby obviating recourse to the extraordinary form of derivative relief.[132] This does not comport with modern corporate practices, however, pursuant to which "the articles of association . . . delegate to the directors the management of many, or all, of the company's affairs."[133] This difference is what justifies prosecution of an action in the corporate name by shareholders against directors accused of wrongdoing in practically all modern corporations.[134]

Foss's advertence to shareholder ratification left open the apparent ability of directors to defraud a corporation if their doing so was permitted by a compliant majority of the shareholders.[135] The subsequent case of *Atwool v. Merryweather*[136] closed that door by holding that "the majority [of shareholders] could not bind the minority" with respect to an act that was fraudulent.[137] *Atwool* concerned a contract between a company and the defendant directors that, in the words of the court, was "a complete fraud."[138] Declaring that such a contract "cannot stand," the court appeared to reject defendants' contention that the contract was "not void, but merely voidable."[139] This was an important distinction as a "merely voidable" contract would not permit the shareholders to bring a derivative lawsuit as per *Foss*.[140] Supporting this interpretation of *Atwool* is the court's

132. Whereas ownership and control are more strictly separated in corporations today, the Act of Incorporation for the Victoria Park Company appears to have reserved for the shareholders considerable rights in management when acting collectively, to the extent that "it was argued that the company was not to be treated as an ordinary corporation; that it was in fact a mere partnership." *See* Foss v. Harbottle (1843) 67 Eng. Rep. 189, 200, 2 Hare. 461, 486 (Ch.). This fact contributed to the court's conclusion.

133. Wedderburn 1957, *supra* note 61, at 201.

134. *But see id.* at 202.

135. *See* Prunty, *supra* note 7, at 984.

136. (1868) L.R. 5 Eq. 464.

137. Prunty, *supra* note 7, at 985.

138. *Atwool*, L.R. 5 Eq. at 467.

139. *Id.*

140. Foss v. Harbottle (1843) 67 Eng. Rep. 189, 2 Hare. 461, 504 (Ch.); *see supra* text accompanying note 108–09.

language stating that "[i]t appears . . . that it would not be competent for a majority of the shareholders against a minority to say that they insist upon a matter of that kind."[141] In this context, "competent" would most likely mean (as it has since at least the eighteenth century) "[w]ithin one's rights, legally or formally open or permissible."[142] Corroborating this would be the court's additional statement that "the persons who may possibly form a majority of the shareholders, could not in any way sanction a transaction of that kind."[143] This is sensible, as it could not be maintained that one or a minority number of shareholders should be able to thwart the will of the corporation's shareholder majority in undertaking a course of action the majority could legitimately undertake.[144]

The interplay of this concept with the duty of loyalty is noteworthy. At the turn of the twentieth century, the law was well settled "that a director cannot, as against the dissent of a single stockholder, become a contractor with the corporation, nor can he have any personal and pecuniary interest in a contract between a third person and the company of which he is a director."[145]

Potentially more important, jurisprudentially, was the court's discussion absolving the shareholders of the need to sue in the name of the corporation *per se*, versus on behalf of themselves and all other similarly situated shareholders.[146] The defendants in *Atwool* made a point of the fact that the corporation itself, acting through its directors (three of six which were named defendants[147]) and, subsequently, at a general meeting

141. *Atwool*, L.R. 5 Eq. at 468.

142. *Competent*, OXFORD ENG. DICTIONARY, https://www.oed.com/dictionary/competent_adj?tab=meaning_and_use [https://perma.cc/VMT3-YGCW] (last visited Dec. 24, 2025).

143. *Atwool*, L.R. 5 Eq. at 468.

144. *See* WM. L. CLARK, JR., HANDBOOK ON THE LAW OF PRIVATE CORPORATIONS 495 (St. Paul Publ'g Co., 3d ed. 1916).

145. COOK, *supra* note 123, § 649.

146. *See Atwool*, L.R. 5 Eq. at 468.

147. *See id.* at 465.

of the shareholders, explicitly decided against pursuing the lawsuit in question.[148] The shareholder vote rendering that decision was 344 (against proceeding with the lawsuit) to 324 (in favor of proceeding with the lawsuit).[149]

But the court took into account the fact that of the 344 votes against proceeding with the lawsuit, *106 belonged to two of the defendant directors*.[150] The court recognized that crediting defendants' argument would make it "simply impossible to set aside a fraud committed by a director under such circumstances, as the director . . . would always be able to outvote everybody else."[151] Consequently, the court rebuffed the suggestion that the plaintiff, who had sued "on behalf of himself and the other shareholders," seek leave to "use the name of the company" in order to proceed.[152] Such a "circuitous course" was criticized as "idle" and "not necessary."[153] Significantly, the court observed that "I have a majority of the shareholders, *independent of those implicated in the fraud*, supporting the [lawsuit]."[154] This stands for, if not establishes, the proposition that in assessing corporate action decided upon by shareholder vote, votes of conflicted shareholders ought not be considered.[155]

Tellingly, as one commentator observed with regard to the evolution of the shareholder derivative action in England, "[t]he metaphysical separation of corporate rights and individual rights is not a premise from which the derivative feature is

148. *See id.* at 465–66.

149. *See id.* at 468. Since the court previously seemed to hold that the transaction in question was void, this discussion regarding the shareholder vote would seem to be superfluous. For *Foss*'s rule, that suits to enjoin corporate transactions must be brought by the whole company and cannot proceed in representative fashion, only applies to corporate decisions that are "merely voidable" and not void *per se*. *See supra* text accompanying notes 139–40.

150. *See Atwool*, L.R. 5 Eg. at 468.

151. *Id.* The court's math doesn't exactly add up here.

152. *Id.*

153. *Id.*

154. *Id.* (emphasis added).

155. I cannot find an earlier case for that proposition, but am far from certain that none exists.

deduced. Rather the right of action as it matured . . . appears as a frank recognition of the limitations of the principle of [corporate] self-government . . . ."[156] Such evolution was stunted, however, by Parliamentary action during the mid-nineteenth century that largely obviated the need to utilize the bourgeoning derivative action; it was not until adoption of the Companies Act of 2006, "which statutorily permitted shareholder derivative lawsuits for the first time," that such actions have reappeared.[157]

2. United States

The case traditionally credited with giving rise to the shareholder derivative lawsuit in the United States is *Robinson v. Smith*,[158] decided in 1832 and hailing from New York.[159] The *Robinson* case was brought "by certain stockholders of [an incorporated company] against the directors of that corporation," for fraud and mismanagement in the execution of their trust, by which the property of the corporation was dissipated and lost.[160]

Defendants moved for dismissal on multiple grounds. The first was that "[t]he bill should have been filed in the name of the corporation as complainant."[161] Or at least the bill should have been filed by "all the stockholders" and, if not, it should have set forth "the excuse for not making all the stockholders parties."[162] This was based upon the necessary parties rule,

156. Prunty, *supra* note 7, at 985.

157. Scarlett, *supra* note 15, at 859–60.

158. 3 Paige Ch. 222 (N.Y. Chan. 1832).

159. *See* Prunty, *supra* note 7, at 986. *But see* Scarlett, *supra* note 15, at 871 (contending that the first shareholder action in the United States was *Percy v. Millaudon*, 8 Mart. (n.s.) 68 (La. 1829)).

160. *Robinson*, 3 Paige Ch. at 222.

161. *Id.* at 224.

162. *Id.* at 225. In *Robinson*, the shareholders filing suit held 160 out of 4,000 shares outstanding. *Id.* at 230.

discussed above[163]—a rule that American courts inherited from their English forebearers.[164]

The defendants also pointed out that the court of chancery, in England (at that time), assumed jurisdiction "only over charitable corporations," and pressed for a similar approach in New York.[165]

With regard to the first point of contention, the court acknowledged that

> The corporation should be before the court, either as complainant or as a defendant. Generally, where there has been a waste or misapplication of the corporate funds by the officers or agents of the company, a suit to compel them to account for such waste or misapplication, should be in the name of the corporation.[166]

However, the court was quick to add that it "never permits a wrong to go unredressed merely for the sake of form."[167] As such:

> [I]f it appeared that the directors of the corporation refused to prosecute by collusion with those who had made themselves answerable by their negligence or fraud, or if the corporation was still under the control of those who must be made the defendants in the suit, the stockholders, who are the real parties in interest, would be permitted to file a bill in their own names, making the corporation a party defendant.[168]

If "the stockholders were so numerous as to render" such a suit "impossible" or "very inconvenient," then a representative

163. *See supra* notes 68–69 and accompanying text.

164. Scarlett, *supra* note 15, at 860.

165. *Robinson* was filed in the Chancery Court of New York. *Robinson*, 3 Paige Ch. at 226.

166. *Id.*

167. *Id.*

168. *Id.*

suit would be permitted, in which the shareholders could sue on "behalf of themselves and all others standing in the same situation."[169] Thus, as with *Foss*, the court in *Robinson* permitted the lawsuit to proceed as representative in nature "to protect and further the shareholders' interests." [170]

With regard to the exercise of jurisdiction by the chancery court over a noncharitable institution, the court in *Robinson* resolved this difficulty by conceptualizing the case before it as one arising from principles of trust:

> If the allegations in this bill are true, there is no doubt that the directors of this company were guilty of a most palpable violation of their duty. . . . [D]irectors of a moneyed or other joint-stock corporation, who willfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable, as trustees, to make good that loss. And they are equally liable if they suffer the corporate funds or property to be lost or wasted by gross negligence and inattention to the duties of their trust.[171]

The court proceeded to refer explicitly to the directors as "trustees" and the stockholders as the "*cestui qui trusts*."[172] This comports with a practice that remains appropriate to this day: employment of the "familiar principle of the law of trusts"[173] to allow derivative suits "by beneficiaries against trustees and third-party defendants. . . ."[174]

According to Bert Prunty, Jr., this conceptualization was made possible by the previous opinion in *Attorney General v.*

169. *Id.*

170. DEMOTT, *supra* note 10, § 1:3.

171. *Robinson*, 3 Paige Ch. at 231.

172. *Id.* at 232.

173. DEMOTT, *supra* note 10, § 1:3 (quoting N.Y. State Workers' Comp. Bd. v. Comp. Risk Managers, LLC, 59 Misc. 3d 254, 265 (N.Y. Sup. Ct. 2017)).

174. DEMOTT, *supra* note 10, § 1:3.

Utica Ins. Co., authored by the illustrious Chancellor Kent.[175] In that opinion, Chancellor Kent opined (albeit in dicta) that "persons who . . . exercise the corporate powers, may, in their character of trustees, be accountable to this court for a fraudulent breach of trust, and to this plain and ordinary head of equity the jurisdiction of this court over corporations ought to be confined," even in the case of a "civil corporation" established for "private pecuniary purposes."[176] Chancellor Kent added that any recovery would be "for the use and benefit of the company at large."[177] Whether by force of logic or force of reputation, or perhaps a bit of both, Chancellor Kent's additional observation was prophetic: "[i]n most of these early actions bills which sought monetary recoveries prayed for restoration to the corporate treasury."[178]

Relevant to our inquiry, these early American decisions, as did the early English decisions, rested on concepts of trust, and a "judicially recognized relationship between [the] shareholders."[179] They did not rest upon "abstractions concerning the 'corporate entity'."[180] Indeed, American courts analogized the shareholder's situation to that of a creditor in order to justify the shareholder suits as "a matter of individual right."[181] A good example of this is provided by the case of *Hodges v. New England Screw Co.*,[182] decided in 1850 by the Supreme Court of Rhode Island.[183] *Hodges* concerned directors who exceeded their chartered powers by engaging in business beyond that for which the

175. Prunty, *supra* note 7, at 986–87.

176. Att'y Gen. v. Utica Ins. Co., 2 Johns. Ch. 371, 388–89 (N.Y. Ch. 1817) (quoted in Prunty, *supra* note 7, at 987).

177. *Utica Ins. Co.*, 2 Johns. Ch. at 390 (quoted in Prunty, *supra* note 7, at 989).

178. Prunty, *supra* note 7, at 989.

179. *Id.*

180. *Id.*

181. FRANKLIN S. WOOD, SURVEY AND REPORT REGARDING STOCKHOLDERS' DERIVATIVE SUITS 100 (1944).

182. 1 R.I. 312, 340 (1850).

183. *Id.* at 312.

company was authorized to conduct.[184] The court commenced its decision by announcing that "[w]e think the directors of the Screw Company are liable in equity, as trustees, for fraudulent breach of trust."[185] The court next refers back to *Sutton* in support of the proposition that, as a court of equity, it had jurisdiction "over such a case."[186]The trust conceptualization was important because it furnished the means upon which equity could exercise its jurisdiction to render relief.[187]

In its analysis of the merits, the court was not so much concerned with whether the corporate charter had been violated, but rather with whether such violation was "from want of proper care."[188] In an articulation, essentially, of the business judgment rule (but without using that appellation), the court explains that if the directors acted "in good faith and for the benefit of the Screw Company, they ought not to be liable."[189]

Or put more expansively, and framed more in terms of the duty of care: "Directors are not personally responsible for a violation of the charter, where such violation resulted from mistake as to their powers, provided such mistake did not proceed from a want of ordinary care and prudence."[190]

Finding no justification to infer otherwise, the court would not hold the defendant directors personally liable.[191]

The plaintiffs in *Hodges* also requested that the transaction in question be set aside as violative of the corporate charter.[192] In analyzing this request, the court turned its framing from one of whether the directors had engaged in wrongdoing, to

184. *Id.* at 319.
185. *Id.* at 340.
186. *Id.*
187. COOK, *supra* note 123, § 648.
188. *Hodges*, 1 R.I. at 346.
189. *Id.*
190. *Id.* at 312.
191. *Id.* at 349.
192. *Id.*

whether "the *corporation*" had violated its charter.[193] And in so doing, the court held that the corporate entity is not, itself, a trustee of the shareholders: "the relation of the corporation and stockholders does not imply a trust in the corporation."[194] And in the absence of this trust relationship, the court concluded that it lacked jurisdiction over plaintiff's claim for relief.[195]

Eventually, the derivative action transformed from one that was viewed as essentially representative (of the shareholders) in nature into an action brought genuinely on behalf of the corporation itself.[196] Propelling this transformation were actions brought by shareholders to enforce corporate rights against outsiders—against non-director, non-officer defendants.[197] For corporate insiders owe fiduciary duties to both the corporation and its shareholders; attempting to discern which of these two should more properly be deemed the victim of an insider's breach of duty can oftentimes be both pointless and downright impossible.[198] Hence, in an action brought against the defendants in such a case, courts were not required to carefully distinguish between characterizing the action as one best brought by a shareholder in a representative capacity on behalf of all shareholders (or all similarly situated shareholders) versus one best brought by the corporation itself. However, corporate outsiders do not owe duties to the shareholders of a corporation victimized by their wrongdoing.[199] Rather, the basis of any cause of

193. *Id.* at 350 (emphasis added).

194. *Hodges*, 1 R.I. at 350.

195. *Id.* at 356.

196. DEMOTT, *supra* note 10, § 1:3.

197. Prunty, *supra* note 7, at 990.

198. *See* Dohmen v. Goodman, 234 A.3d 1161, 1168 (Del. 2020) ("Directors of Delaware corporations owe duties of care and loyalty to the corporation and its stockholders."). *But see* Zachary J. Gubler, *The Neoclassical View of Corporate Fiduciary Duty Law*, 91 U. CHI. L. REV. 165, 170 (2024) ("Thus, when the classical formulation says that fiduciary duties are owed to the corporation, it means that it's owed to the equity capital. But that isn't the same thing as fiduciary duties being owed to the individual shareholders who, in a publicly traded corporation, might come and go over time.").

199. *See* Kenneth Geisler II, *Hacking Wall Street: Reconceptualizing Insider Trading Law for Computer Hacking and Trading Schemes*, 48 TEX. J. BUS. L. 1, 3, 27 (2019).

action against such outsiders would be a breach of their duty owed to the corporation itself (whether arising from contract law, tort law, or some other source).[200]

An early example of this latter situation is the 1841 case of *Forbes v. Whitlock*.[201] *Forbes* was brought by stockholders of the Flax and Hemp Manufacturing Company against Sidney B. Whitlock, who, stockholders claimed, defrauded the company with regard to a contract for sale of machinery thereto.[202] The claim could not proceed because it fell solely to the corporation, and not to the stockholders.[203] As the court explained:

> [T]he whole agreement must[] . . . be considered as inuring to the benefit of the corporation. . . . [W]hatever breach of the covenant may have been committed or of fraud perpetrated by falsehood and misrepresentation, by means of which an injury has resulted or a loss has been sustained, that loss or damage has fallen upon the corporate body and that body having a legal capacity to sue, the remedy should be pursued by or in the name of the corporation . . . .[204]

The court acknowledged that the stockholders would, "of course, participate in the benefit of what would be recovered."[205] Without employing the term, the court nevertheless articulates the "derivative" nature of the lawsuit.[206] And this development should not be overlooked, as it further distinguishes the shareholder derivative action from its trust-law

200. *See In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 238 F. Supp. 3d 799, 891 n.91 (S.D. Tex. 2017), *aff'd sub nom.*, Lampkin v. UBS Fin. Servs., Inc., 925 F.3d 727 (5th Cir. 2019).

201. 3 Edw. Ch. 446 (N.Y. Ch. 1841).

202. *Id.* at 446–47.

203. *See id.* at 447–48.

204. *Id.* at 447. In its opinion, the court essentially overlooked the complicated fact that in connection with the contract, the defendant had also assumed the role of corporate treasurer. *See id.* at 446; Prunty, *supra* note 7, at 990.

205. *Forbes*, 3 Edw. Ch. at 447.

206. *Id.*

progenitors.[207] For when the wrongdoing in question is on the part of the corporate insiders (the corporate trustees), a somewhat conventional cause of action is presented: that of a defendant being sued for breaching a duty owed to the plaintiff.[208] The lack of any duty whatsoever owed to the plaintiff shareholders in this case helps underscore the truly derivative nature of the litigation.[209]

Derivative harm, or participation in the benefits of a successful suit derivatively, does not permit the stockholders to "prosecute on their individual account."[210] In a case such as this one, "the corporation itself is to seek the remedy."[211] This, arguably, reveals an embrace of the corporation as a separate entity as clearly as any among the early shareholder derivative lawsuits or their forerunners.[212]

The court distinguished from the case before it those in which "directors, officers, or managers, having the control of the corporation and its affairs, are guilty of misconduct that amounts to a breach of duty as trustees."[213] Citing *Robinson v. Smith*, the court acknowledged that in cases concerning insider-defendants, stockholders may properly call the insiders "to an account by a bill in their own names."[214] Even then, however, "it may be necessary to make the corporation a party either as complainant or defendant."[215]

The distinction, however, may not be as profound as it initially appears. For in asserting a claim against corporate

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207. *See* Prunty, *supra* note 7, at 994.

208. *See, e.g.*, KDW Restructuring & Liquidation Servs. LLC v. Greenfield, 874 F. Supp. 2d 213, 221 (S.D.N.Y. 2012).

209. *See id.* at 224.

210. *Forbes*, 3 Edw. Ch. at 447–48.

211. *Id.* at 448.

212. *See* Prunty, *supra* note 7, at 990.

213. *Forbes*, 3 Edw. Ch. at 448. To this day commentators have argued that the "law ought to distinguish claims alleging breaches of the duty of loyalty by corporate fiduciaries from other claims raised derivatively on the corporation's behalf." DEMOTT, *supra* note 10, § 5:18.

214. *Forbes*, 3 Edw. Ch. at 448.

215. *Id.*

outsiders, shareholders are still condemning corporate insiders—even though this time it is for their failure to assert a claim against someone else. In *Forbes*, this condemnation was implicit.[216] In *Dodge v. Woolsey*,[217] however, the condemnation was explicit, forcing the court to confront the issue that *Forbes* sidestepped.[218] As per Daniel Fischel, when directors have "unjustifiably refused to assert a clear cause of action," shareholders should be permitted to bring suit. [219] "If shareholders are permitted to sue when the directors breach their fiduciary duty of loyalty by being interested in the transaction attacked, it is anomalous to prohibit suit when the directors breach their fiduciary duty of care."[220]

In *Dodge*, plaintiff Woolsey, a shareholder of the Commercial Branch Bank of Cleveland, brought suit in chancery court seeking to enjoin Ohio's efforts to collect a tax on the bank.[221] His claim was that the tax was unconstitutional.[222] Prior to the commencement of his suit, Woolsey had petitioned the bank to bring suit.[223] Although the bank agreed with Woolsey that the tax was unconstitutional, it explained that it nonetheless "cannot consent to take the action which we are called upon to take" in light of "the many obstacles in the way of testing the law in the courts of the State."[224]

As an initial matter, it is interesting to note that, writing in 1855, the U.S. Supreme Court could claim that "[i]t is now no

216. *Id.*

217. 59 U.S. 331 (1856).

218. *Compare id.* at 331 (indicating that shareholders should be permitted to bring suit against corporate directors who breach duty trust), *with Forbes*, 3 Edw. Ch. at 448 (indicating that stockholders who want to bring action against controllers of a corporation must make the corporation a party).

219. Daniel R. Fischel, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168, 195 (1976).

220. *Id.* at 196.

221. *Dodge*, 59 U.S. at 336. "Dodge" in the case name is George C. Dodge, the tax collector for Ohio. *Id.*

222. *Id.* at 339.

223. *Id.* at 340.

224. *Id.*

longer doubted, either in England or the United States, that courts of equity . . . have a jurisdiction over corporations, at the instance of one or more of their members" to provide redress for certain intracorporate wrongdoing.[225] However, the Court was quick to add that "there is an important distinction" between cases involving a breach of trust and cases "in which there is no breach of trust, but only error and misapprehension, or simple negligence on the part of directors."[226] The critical question before the Court was how to categorize the decision of the bank's directors not to bring suit against Ohio for levying an allegedly unconstitutional tax.[227] The Court concluded that the decision "was not 'an error of judgment merely' but a breach of duty," thereby justifying the plaintiff's prosecution of the case.[228]

The distinction is an important one, for as one somewhat contemporaneous commentator explained:

> Even when it is clear that a corporation has a right to sue to redress or enjoin certain wrongs committed or threatened, the fact that it refuses to do so does not necessarily entitle a stockholder to sue. . . . As a rule, the courts will not interfere with the suit of a stockholder to obtain redress for an injury to the corporation, because of failure or refusal of the directors, or a majority of the stockholders, to sue. It is only when the action of the corporation in refusing to proceed at the request of a stockholder is fraudulent, or ultra vires, or in disregard of his vested rights, that he can maintain a suit in his own name in the corporate right.[229]

225. *Id.* at 341–43.
226. *Id.* at 343–44.
227. *Dodge*, 59 U.S. at 344.
228. *Id.* at 345.
229. CLARK, *supra* note 144, at 497.

The Court's reasoning would explain why Woolsey would have been able to sue the bank's officers and directors for breach of duty—under the "familiar" principles of "breach of trust" previously discussed.[230] And it advances the ball, so to speak, by recognizing that a breach of trust, upon which a representative/derivative action can be based, can extend to matters beyond conflict of interest/personal aggrandizement.[231] Put simply, it can extend to any unjustifiable refusal on the part of the board to pursue the corporation's legitimate interests when pressed to do so.[232]

A little more than twenty-five years later, the U.S Supreme Court revisited the issue of shareholder derivative lawsuits in its 1881 decision in *Hawes v. Oakland*.[233] After surveying the situation in both America and England, the U.S. Supreme Court wrote that the precedent in *Dodge* "does not establish, nor was it intended to establish, a doctrine on this subject [the shareholder derivative suit] different in any material respect from that found in the cases in the English and in other American courts."[234] It thereafter proceeded to identify the apparent consensus regarding the situations that "enable a stockholder in a corporation to sustain in a court of equity in his own name, a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff."[235] These situations implicate actions that can generally be described as *ultra vires*, fraudulent, a breach of the duty of loyalty, or illegal:

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230. *See* Prunty, *supra* note 7, at 991.

231. *See id.* at 992.

232. *See* Scarlett, *supra* note 15, at 893–94 (quoting Meyer v. Fleming, 327 U.S. 161, 167 (1946)) ("The U.S. Supreme Court in 1946 described shareholder derivative suits as a remedy 'for those situations where the management through fraud, neglect of duty or other cause declines to take the proper and necessary steps to assert the rights which the corporation has.'").

233. 104 U.S. 450 (1881).

234. *Id.* at 460.

235. *Id.*

- Where "[s]ome action or threatened action of the managing board of directors or trustees of the corporation which is beyond the authority conferred on them by their charter or other source of organization."[236]
- Where "a fraudulent transaction" was either "completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with other shareholders" which "will result in serious injury to the corporation, or to the interests of the other shareholders."[237]
- "[W]here the board of directors, or a majority of them, are acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the other shareholders."[238]
- "[W]here the majority of the shareholders themselves are oppressive and illegally pursuing a course in the name of the corporation, which is in the violation of the rights of other shareholders, and which can only be restrained by the aid of a court of equity."[239]

In short, derivative lawsuits permit shareholders to redress "misconduct by the corporation's directors or officers"[240]—misconduct that, in principle, ought to be redressed by the corporation entity itself but, owing to the realities and practicalities of the situation, would not be.[241] Recognition of the fact that this misconduct ultimately harms the corporation's shareholders

236. *Id.*
237. *Id.*
238. *Id.*
239. *Hawes*, 104 U.S. at 460.
240. Scarlett, *supra* note 15, at 892.
241. *See id.*

justified placing the right to seek redress into their hands.[242] Commentators at the time were explicit about this:

> A stockholder's action, in such cases, is brought for and on behalf of the corporation, and a stockholder is permitted to sue in the right of the corporation merely to set the judicial machinery of the court of equity in motion when the corporation refuses to enforce its own rights to the detriment of its stockholders. In these cases, the stockholder is not enforcing any personal right of his own. The real plaintiff is the corporation. The position of the stockholder who institutes [the] suit is, after all, the same as that of directors when they institute an action in the name of the corporation. . . . The relief asked is on behalf of the corporation, not the individual shareholder, and, if it be granted, the complaining shareholder derives only an incidental benefit from it.[243]

A turn-of-the-century (1898) American treatise summarized the law regarding derivative actions as follows:

> "A stockholder cannot bring suit to enforce the ordinary claims of the corporation. . . . Sometimes . . . there are certain cases involving fraud on the part of the directors or *ultra vires* acts where the stockholder may sue on behalf of the corporation."[244]

Thus can be seen the evolution of the derivative lawsuit into an action "prosecuting a claim on behalf of the corporation

242. *See id.*

243. CLARK, *supra* note 144, at 488. Query whether the position of the stockholder is genuinely "the same" as that of a director, the latter of which may have no ownership stake in the corporation. *Id.*

244. COOK, *supra* note 123, § 12.

rather than its individual shareholders as a group . . . ."[245] Indeed, if one posits that certain actions must be in the name of the company, and if the company is under the exclusive control of directors engaged in wrongdoing, it would seem necessary to permit shareholders to sue in the name of the corporation against said directors.[246]

Notwithstanding the *Hawes* court's declaration of harmony on both sides of the Atlantic regarding the derivative suit,[247] one development in America clearly distinguished (and continues to distinguish) the American approach from the English approach: the demand requirement.[248]

C. The Demand Requirement

The demand requirement arises from the desire that a shareholder first exhaust intracorporate remedies before involving the courts.[249] Moreover, it serves to further the most basic principle of corporate organization: "that the management of the corporation be entrusted to its board of directors."[250] It does this by reserving the extraordinary vehicle of the derivative action "for those situations where the management through fraud, neglect of duty or other cause declines to take the proper and necessary steps to assert the rights which the corporation has."[251] It is the "principle means by which the Court" seeks to

245. DEMOTT, *supra* note 10, §1:3.

246. *See* Wedderburn 1958, *supra* note 131, at 93–94.

247. *See supra* text accompanying notes 234–34.

248. *See* Scarlett, *supra* note 15, at 871 n.223. By "demand requirement" we mean demand upon the board; demand upon one's fellow shareholders was long a feature of derivative litigation in England. *See generally Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit*, 73 HARV. L. REV. 746, 247 (1960); Kurt A. Goehre, *Is the Demand Requirement Obsolete? How the United Kingdom Modernized Its Shareholder Derivative Procedure and What the United States Can Learn from It*, 28 WIS. INT'L L.J. 140, 150 (2010).

249. *See* Fischel, *supra* note 219, at 171; CLARK, *supra* note 144, at 490.

250. Fischel, *supra* note 219, at 171; *see also* United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1049 (Del. 2021) ("[T]he demand-futility analysis provides an important doctrinal check that ensures the board is not improperly deprived of its decision-making authority[.]").

251. Scarlett, *supra* note 15, at 893 (quoting Meyer v. Fleming, 327 U.S. 161, 167 (1946)).

"vindicate" the policy that "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors . . . ."[252]

Dodge, discussed previously, underscored the importance of a plaintiff's decision to make a demand upon the board (although that terminology was not employed by the Court).[253] For this served, in large part, to furnish the predicate upon which a breach of duty, on the part of the board, could be found.[254] Recall how the board in that case condemned itself, in the eyes of the Court, by acknowledging the merits of Woolsey's proposed lawsuit, but nevertheless prescinding from pursuing the action when asked to do so.[255] Viewed from another angle, the shareholder plaintiffs were able to "account for the fact that the company has not seen fit to bring action on its own behalf." [256]

In 1881, the U.S. Supreme Court commented favorably upon the development of the demand requirement.[257] For the derivative suit had already, by that time, been subject to significant abuse, and indeed its very existence was an affront to the role of the board of directors as *the* governing body of the corporation.[258] After decades of experience with the phenomenon of derivative litigation, the precondition of demand was conjoined to the limited circumstances upon which such a suit could historically be brought.[259] The Supreme Court's 1881 decision in

252. Daily Income Fund v. Fox, 464 U.S. 523, 532 (1984) (quoting United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263 (1917)) (cleaned up).

253. *See* Prunty, *supra* note 7, at 992 (discussing Dodge v. Woolsey, 59 U.S. 331 (1855)).

254. *See id.* According to Prunty, the Court's "emphasis . . . upon the shareholder's demand for corporate action . . . was not unique" by the time *Dodge* was decided. *Id. See also* Wedderburn 1958, *supra* note 131, at 95 (discussing the demand requirement principle).

255. *See* Dodge v. Woolsey, 59 U.S. 331, 340 (1855); *supra* notes 221–24 and accompanying text.

256. Wedderburn 1958, *supra* note 131, at 95.

257. *See* Hawes v. Oakland, 104 U.S. 450, 460 (1881).

258. FLETCHER CYCLOPEDIA, *supra* note 41, § 5940; *see also* Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 529–30 (1984) (discussing examples of derivative suit abuse).

259. *See* FLETCHER CYCLOPEDIA, *supra* note 41, § 5940.

Hawes v. Oakland articulated the demand requirement in words that a modern corporate lawyer would find familiar:

> [I]n addition to the existence of grievances which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it.[260]

Over time, the demand requirement outlined in *Hawes* made its way into the Federal Rules of Civil Procedure (more specifically, Rule 23.1).[261]

In its 1984 decision in *Daily Income Fund v. Fox*,[262] the United States Supreme Court recounted the history of the shareholder derivative action in America.[263] The Court explained that the action exists to enable a shareholder to "enforce a right of a corporation [when] the corporation [has] *failed to enforce a right*

260. *Hawes*, 104 U.S. at 460–61.

261. Daily Income Fund v. Fox, 464 U.S. 523, 530 n.5 (1984); FED. R. CIV. P. 23.1; *see also* Aronson v. Lewis, 473 A.2d 805, 813–14 (1983) (emphasizing the importance of the demand requirement). Not long following the development of the demand requirement came the development of the demand-futility exception, which is today part and parcel with the requirement. *See* Scarlett, *supra* note 15, at 879.

262. 464 U.S. 523 (1984).

263. *See id.* at 528–30.

which may properly be asserted by it."[264] Or, put differently, to enable a shareholder to "step into the corporation's shoes and to seek in its right the restitution he could not demand [on] his own."[265] The Court recounted approvingly the observation of one commentator that a derivative action "may be viewed as the consolidation" of an equitable action by the shareholder against corporate directors, and a lawsuit by the corporation against these same wrongdoers.[266]

1. Demand upon the board

Demand upon the board of directors involves nothing talismanic. The requirement can be satisfied by a simple articulation of the alleged wrongdoing and identification of the alleged wrongdoers, coupled with specification of the harm wrought thereby and a request (the "demand") that the directors take remedial action.[267]

Most commentators have lauded the practice of making demand upon the board, as it offers "several practical advantages"[268] while "impos[ing] little hardship on the complaining shareholders."[269] These advantages include the possibility of alternative remedies, thereby avoiding the cost of litigation, by those best situated (the board) to assess the costs and benefits of all available options.[270] The Model Business Corporation Act (MBCA) embraces the demand requirement rule, along with the

264. *Id.* at 528 (alterations and italics in original).

265. *Id.* (quoting Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548 (1949)).

266. *Daily Income Fund*, 464 U.S. at 529 n.4.

267. *See* GREGORY A. MARKEL, 4E NEW YORK PRACTICE SERIES-COMMERCIAL LITIGATION IN NEW YORK STATE COURTS § 115:10 (5th ed. 2020).

268. Fischel, *supra* note 219, at 171.

269. *Id.* at 172.

270. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:9 ("The directors are presumably in the best position to assess whether or not proposed litigation would be in the best corporate interests as well as to measure the potential impact on the corporation.").

laws of many states.[271] Commonly referred to as the "universal demand requirement," shareholders in these jurisdictions are not permitted to bring a derivative suit without first making demand upon the board.[272]

Should the board acquiesce to the shareholder's demand, the derivative suit is averted and the board takes the action requested of it.[273] Should the board reject the shareholder's request, the derivative suit can proceed only if the shareholder is able to demonstrate that said rejection was "wrongful."[274] Generally, a court will employ the business judgment standard of review in assessing the board's rejection for wrongfulness.[275] Thus, a board's rejection will be deemed wrongful only if plaintiff brings forth evidence showing a conflict of interest tainting a majority of the directors,[276] or if "the directors are either controlled by the alleged wrongdoer or interested in the transaction attacked to a degree which impairs the exercise of their business judgment . . . ."[277] This is most readily established by demonstrating that "a majority of the directors have participated in [the] injurious or illegal transaction" upon which the

271. Scarlett, *supra* note 15, at 896. The American Law Institute's Principles of Corporate Governance also endorses this "universal demand" rule. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:10.

272. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:10. Narrow exceptions are recognized when the prospect of irreparable injury due to delay can be demonstrated. Model Bus. Corp. Act. § 7.42 (2002).

273. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:9.

274. Scarlett, *supra* note 15, at 894. Should the board fail to respond to the demand within a reasonable amount of time, the demand requirement will be deemed satisfied, thereby permitting a plaintiff to proceed with the lawsuit. *See* JAMES D. COX & THOMAS LEE HAZEN, 3 TREATISE ON THE LAW OF CORPORATIONS § 15:7 (4th ed. 2024), Westlaw LAWOFCORP § 15:7 (database updated Nov. 2025).

275. *See* COX & HAZEN, *supra* note 274, § 15:7; *see also* Scarlett, *supra* note 15, at 894 ("To establish either that a demand was wrongfully rejected by the board or that demand should be excused, the plaintiff essentially must show that the business judgment rule does not apply to the board's decision.").

276. *See* Scarlett, *supra* note 15, at 895.

277. Fischel, *supra* note 219, at 193 (citation omitted). *See also* Aronson v. Lewis, 473 A.2d 805, 813–14 (Del. 1984) ("[T]he business judgment rule operates only in the context of director action . . . [and] it has no role where directors have either abdicated their functions [or] are under an influence which sterilizes their discretion.").

shareholder's complaint is predicated,[278] or if a majority of the directors are under the control of someone else who has.[279] Some courts have found refusal wrongful if directors had "unjustifiably refused to assert a clear cause of action"[280] or a "constitutional claim."[281] Finally, "[i]n the rare cases where the directors' decision not to sue is itself illegal," at least one court has held that "the shareholders should be allowed to maintain a derivative action."[282]

Some commentators have argued that demand refusal should not be afforded the deference of the business judgment rule.[283] For starters, the business judgment rule exists in large part to protect directors from the liability that might result if all their decisions were subjected to post-hoc, second-guessing.[284] Whereas evaluation of a business decision as improperly decided quite directly exposes a director to potential liability, the same cannot be said for a board's refusal of a shareholder demand; deciding that the refusal was wrongful merely permits the shareholder to proceed with his or her derivative lawsuit.[285] Further, although less convincing in my opinion, is the argument that evaluation of a shareholder demand is not something within the "business expertise" of the directors compared to the "managerial, financial, manufacturing, and planning"

278. Fischel, *supra* note 219, at 194 (citation omitted).

279. *See id.* at 193–94 (outlining circumstances that give shareholders standing to sue a corporation's board of directors).

280. *Id.* at 195.

281. *Id.* at 196–97.

282. *Id.* at 198 (discussing Miller v. American Telephone & Telegraph Co., 507 F.2d 759 (3d Cir. 1974)). Some of these grounds would appear to overlap. *Id.*

283. *See* COX & HAZEN, *supra* note 274, § 15:7.

284. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 2:16.

285. *See* COX & HAZEN, *supra* note 274, § 15:7. Admittedly, "merely" is arguably not the optimal modifier here, as the derivative suit to follow typically concerns itself with director misconduct.

decisions more typically afforded protection by the business judgment rule.[286]

Delaware leads the majority of American jurisdictions in following a different path.[287] Pursuant to Delaware law, there is no universal demand requirement.[288] Rather, demand will be excused when "futile."[289] To establish demand futility, shareholder plaintiffs must call into question the ability of the board to exercise proper, unbiased judgment with regard to the issue at hand (the issue that would be the subject matter of any putative demand). [290] This can be done in multiple ways, which differ somewhat from state to state[291]:

> (1) By demonstrating that a majority of the directors are under the control of the alleged wrongdoers (frequently, a controlling shareholder);[292]
>
> (2) By demonstrating that a majority of the directors suffer from a conflict of interest with regard to the subject matter of the derivative lawsuit (if,

286. *See id*. This argument is less convincing because directors must routinely evaluate the risks and merits of potential litigation, and have recourse to legal counsel to assist them as necessary.

287. *See id.* The Federal Rules of Civil Procedure mirror this approach: plaintiffs wishing to bring a derivative lawsuit in federal court must "allege with 'particularity' the efforts made to obtain the action they desire from directors or the reasons for not making an effort." *See* Fischel, *supra* note 219, at 169. The former aspect of this (the "efforts made to obtain the action they desire from the directors") is the "demand" per se; the latter aspect of this ("the reasons for not making an effort") constitutes the "demand futility" exception to the demand requirement. *Id.*; COX & HAZEN, *supra* note 274, § 15:7.

288. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:10.

289. *See id*. §§ 9:10–11 ("In [] states, such as Delaware, that recognize the 'demand futility exception,' demand will be excused when the plaintiff has plead particularized facts sufficient to establish the 'futility' of demand.").

290. *See id.* § 9:11. More specifically, plaintiff shareholders must plead particularized facts creating reasonable doubt as to the independence or disinterestedness of the board of directors. *See id.*; Scarlett, *supra* note 15, at 895.

291. *See* COX & HAZEN, *supra* note 274, § 15:7.

292. *See* Fischel, *supra* note 219, at 173. "Demonstrating" control will not typically be satisfied via "unsupported allegations that the directors are controlled by the alleged wrongdoers." *Id.* at 174. Nor is control of the company (via proof of majority voting power) deemed equivalent to control of the *directors*, individually. *See* COX & HAZEN, *supra* note 274, § 15:7.

for example, the directors have a direct financial interest in the subject);[293]

(3) By demonstrating that a majority of the directors themselves participated in the transaction at issue in the derivative lawsuit.[294] With regard to this third ground of futility, merely naming a majority of the directors as defendants will not suffice, as this would encourage "sham pleading."[295] Rather, this demonstration "requires an extended inquiry into the merits of the shareholders' complaint."[296] This, in turn, requires inquiry into the actual potential of director liability.[297] Pursuant to this, the Delaware Supreme Court has definitively held that "exculpated [duty of] care violations do not excuse demand."[298] This is because an exculpated breach of care claim does not "pose a threat that neutralizes director discretion."[299] Moreover, courts have reasoned that "[i]t does not follow . . . that a director who merely made an erroneous business judgment in connection with what was plainly a corporate act will refuse to do [his] duty in behalf of the corporation if [he] were asked to do so."[300]

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293. *See* Fischel, *supra* note 219, at 174–75.

294. *Id.* at 175. There is certainly a fair degree of overlap in the second and third bases of demand futility. *See id.* at 175–76.

295. *Id.* at 179.

296. *Id.*

297. *See* COX & HAZEN, *supra* note 274, § 15:7.

298. United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1052 (Del. 2021). "Exculpated" violations are those upon which directors cannot be sued for monetary damages; directors are protected against liability in a derivative lawsuit brought against them. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2025).

299. *United Food & Com. Workers Union*, 262 A.3d at 1054.

300. COX & HAZEN, *supra* note 274, § 15:7 (quoting In re Kauffman Mut. Fund Actions, 479 F.2d 257 (1st Cir. 1973)) (alterations in original).

> (4) By demonstrating that the board of directors has already made clear that it is opposed to the lawsuit.[301] This fourth basis has only limited support and, *contra* the opinions of at least one other commentator,[302] appears ill-advised. The "timing" of a board's rejection of demand (that is, whether the board waits for demand to be made before rejecting it or, alternatively, "rejects" demand preemptively by announcing its opposition to any derivative lawsuit under the circumstances) should not, I suggest, bear upon a determination of whether the board is sufficiently disinterested to weigh upon the wisdom of bringing the lawsuit in question.

The purpose of the demand-futility analysis is

> [T]o assess whether the board should be deprived of its decision-making authority because there is reason to doubt that the directors would be able to bring their impartial business judgment to bear on a litigation demand. That is a different consideration than whether the derivative claim is strong or weak because the challenged transaction is likely to pass or fail the applicable standard of review. It is helpful to keep those inquiries separate.[303]

The terminology used in this context is noteworthy, as it broadcasts the controlling principle. The conflict of interest on the part of a majority of the board is said to "deprive[]" the board of its authority as per the quote above.[304] As expressed in a different case, such a conflict creates a situation where the

301. *See* Fischel, *supra* note 219, at 180; COX & HAZEN, *supra* note 274, § 15:7.

302. *See* Fischel, *supra* note 219, at 181.

303. *United Food & Com. Workers Union*, 262 A.3d at 1059.

304. *See also supra* text accompanying note 293.

board is "unable to act in the corporation's best interest."[305] Or, as framed by the venerable case of *Aronson v. Lewis*, a conflict of interest "sterilizes" board discretion, such that the board "cannot be considered proper persons" to handle the proposed litigation.[306] The demand-futility analysis is

> complicated by the fact that a wrong done by directors potentially justifying derivative litigation is a fact fixed in time, while board composition is fluid over time. The question thus arises, when evaluating whether directors can employ their business judgment to evaluate potential litigation, *which* directors must be so evaluated?[307]

The answer to this question has been most recently addressed by the Delaware Supreme Court in *United Food and Commercial Workers Union v. Zuckerberg*.[308] *Zuckerberg* held that in assessing whether demand ought to be excused, the focus must be on the board of directors as constituted at the time of the demand.[309] Put differently, the inquiry must focus upon "the decision regarding the litigation demand, rather than the decision being challenged."[310]

This approach, however, is vulnerable to exploitation. "[G]reat mischief could be done if change in board composition could be used by defendants as a tool to raise the cost of appropriate derivative litigation and to deprive the litigant of the benefits of his effort, and mischief could result even if innocent changes to board composition have that result."[311] "For example, a board—anticipating that a stockholder is on the eve of filing a derivative suit—might, in Plaintiff's view, quickly change

305. Park Emp. & Ret. Bd. Emp. Annuity & Benefit Fund of Chi. v. Smith, C.A. No. 11000-VCG, 2016 WL 3223395, at *8 (Del. Ch. May 31, 2016).

306. Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984).

307. *Park Emp. & Ret. Bd. Emp. Annuity & Benefit Fund*, 2016 WL 3223395, at *2.

308. *United Food & Com. Workers Union*, 262 A.3d at 1034.

309. *Id.* at 1058.

310. *Id.* at 1058–59.

311. *Park Emp. and Retirement Bd. Emp. Annuity and Benefit Fund*, 2016 WL 3223395, at *2.

its membership by removing conflicted directors, so as to preclude the plaintiff from filing a derivative suit . . . ."[312] In part due to this concern, changes "to a board's composition *after* filing of the complaint are generally disregarded."[313] However, this too can be gamed on the part of the plaintiff —by making a demand upon a board on the eve of a change in composition.[314] Hence, Delaware's courts have exercised discretion in determining which directors should be assessed in adjudicating demand futility.[315]

As can be seen, the grounds upon which demand can be excused as "futile" under the Delaware approach largely mirror the grounds upon which the refusal of demand would be deemed "wrongful" under the approach of a jurisdiction that adopted the universal demand requirement.[316] As per one commentator: "the inquiry into whether the board lacks the capacity to make the decision not to sue is much like the inquiry into whether the demand should be excused because it would be futile."[317]

2. Demand on shareholders

Far less common than demand upon the board is demand upon a corporation's shareholders.[318] As per one commentator, "[t]oday the necessity that a demand be made on the

312. *Id.* at *10.

313. *Id.* at *9.

314. *See* Natasha Hussain, *A Twist on the Shareholder Demand-or-Futility Requirement in a Derivative Suit*, 35 CORP. COUNS. REV. 287, 288 (2016).

315. *Park Emp. & Ret. Bd. Emp. Annuity & Benefit Fund*, 2016 WL 3223395, at *9. Should the court determine that demand futility should be assessed against directors who are not those against whom plaintiff pled demand futility, plaintiff would be inviting to replead demand futility against the appropriate group of directors. *See id.* at *10.

316. *Compare supra* text accompanying notes 289–94 (highlighting obligations of plaintiffs in Delaware's futility jurisdiction), *with supra* text accompanying notes 274–82 (highlighting the standard plaintiffs must uphold in universal approach jurisdictions).

317. COX & HAZEN, *supra* note 274, § 15:7.

318. *See* FLETCHER CYCLOPEDIA, *supra* note 41, § 5964; COX & HAZEN, *supra* note 274, § 15:6.

shareholder is largely of historical significance."[319] This is because, even in those few jurisdictions that maintain the requirement, "rarely do the courts fail to excuse the demand."[320]

Nomenclature notwithstanding, "[s]ignificant differences exist" between demand made upon a board versus demand made upon a corporation's shareholders.[321] Shareholders ordinarily do not manage the corporation, and thus demand upon shareholders cannot be justified on the basis of putting any potential litigation into the hands of those with managerial authority or superior expertise.[322] Further, whereas demand upon the directors is a relatively simple and straightforward process,[323] demand upon a corporation's shareholders can "impose significant expense and delay."[324]

As per the Federal Rules of Civil Procedure, demand on shareholders is only required "if necessary" under state corporate law.[325] States requiring shareholder demand generally deem it necessary under either one of two theories: "ratification theory" or "business judgment theory."[326]

Most jurisdictions follow ratification theory, in which "demand is required only when the alleged wrong can be ratified by a majority vote of the shareholders."[327] Conduct "that is fraudulent, illegal, or ultra vires" is not included, as it cannot be

319. COX & HAZEN, *supra* note 274, § 15:6.

320. *Id.*

321. Fischel, *supra* note 219, at 182.

322. *See id*. In those rare situations where shareholders do control the corporation, some courts have held that demand upon the shareholders is necessary. *See* FLETCHER CYCLOPEDIA, *supra* note 41, § 5964.

323. *See supra* text accompanying note 267.

324. *See* Fischel, *supra* note 219, at 182; COX & HAZEN, *supra* note 274, § 15:6.

325. Fischel, *supra* note 219, at 182, 182 n.91 (discussing FED. R. CIV. P. 23.1).

326. *Id.* at 183.

327. *Id.*

ratified.[328] When this type of conduct is alleged, then demand on shareholders is unnecessary.[329]

The concept of ratification flows from recognition of "majority rule as a fundamental principle concerning corporations," along with a hands-off approach to the internal affairs of the corporation.[330] It merges principles of partnership law into corporate law.[331]

Nonratifiability should be straightforward, except for the fact that some courts "have found merit in the possibility that shareholders might take remedial actions other than ratification and have therefore required demand even when the alleged wrong was nonratifiable."[332] This presents a "major conceptual problem."[333] It implicates the exercise of business judgment on the part of the shareholders, and "as a general rule, shareholder exercise business judgment only by electing directors; thereafter, shareholders are excluded from participating in managing the corporation." [334] This is a bit of an overstatement, as shareholders do vote upon other important decisions, such as the approval of a merger or sale of assets, which certainly represent an exercise of business judgment.[335]

Under the business judgment theory, "demand on shareholders is required in all derivative actions where there is a disinterested majority of shareholders."[336] The assumption under this theory is that "the shareholders are entitled to exercise their judgment whether the best interests of the corporation will be served by bringing the action, even though the power to run the

328. *Id.*

329. *Id.* at 183 & n.101 (citing 13 FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5795, at 96 (rev. perm. ed. 1970)).

330. Wedderburn 1957, *supra* note 61, at 198.

331. *Id.* (internal citations omitted).

332. Fischel, *supra* note 219, at 186.

333. *Id.*

334. *Id.*

335. DEL. CODE ANN. tit. 8, § 251 (2024).

336. Fischel, *supra* note 219, at 184.

corporation's affairs is normally vested in the directors."[337] Courts have not been strict in finding that a disinterested "majority" of shareholders is lacking.[338] Courts have permitted demand to be excused when only a small number of interested shareholders hold a large percentage of stock (even if not crossing the threshold into a majority stake).[339] In other words, some courts have applied a test of control in assessing this ground for excusing demand.[340]

Even if there is a disinterested majority of shareholders, demand upon them should probably not be required. Most shareholders are "rationally apathetic"[341] when it comes to following corporate affairs, and "[a]llowing shareholders the opportunity to exercise business judgement assumes that they can do so intelligently, based on adequate knowledge of the facts and legal theories underlying the alleged cause of action."[342]

Finally, notwithstanding the above, demand has generally been excused when it would give rise to "undue expense or delay."[343] For example, the delay of demand might foreseeably present statute of limitations difficulties.[344] And where there are a large number of dispersed shareholders, as in the typical public corporation, the financial hardship of demand would seem excusable as imposing undue expense upon the derivative plaintiff.[345] As per one commentator: "Requiring demand when it involves staggering expense can be explained only by judicial hostility to the derivative suit." [346]

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337. *Id.*

338. *Id.* at 185.

339. *Id.*

340. *Id.* Courts are split on whether an otherwise meritorious derivative lawsuit should be precluded if a majority of disinterested shareholders vote against bringing it. *See id.* at 201.

341. Christopher Gulinello, *The Retail-Investor Vote: Mobilizing Rationally Apathetic Shareholders to Preserve or Challenge the Board's Presumption of Authority*, 2010 UTAH L. REV. 547, 573 (2010).

342. Fischel, *supra* note 219, at 187.

343. *Id.* at 184–85.

344. *Id.* at 190.

345. Courts have split on this issue. *See id.* at 190.

346. *See id.* at 191.

II. SHAREHOLDER DERIVATIVE LITIGATION CRITIQUED BY CORPORATION THEORY

Having explored shareholder derivative action and its history, let us now evaluate that phenomenon through the lens of corporate theory. To do so, let us first briefly review the history of the corporation itself, as the evolution of the corporation is linked to the evolution of corporate theory. Thereafter, we shall review the various theoretical conceptualizations of the corporation and apply each of their insights to shareholder derivative litigation.

A. Brief History of the Corporation

By way of background, organized commercial and investment activity can be traced to the very beginning of recorded human history (the third and fourth centuries B.C.).[347] That said, the modern for-profit business corporation is of much more recent vintage, best considered to have made its debut around the nineteenth century.[348]

To properly understand this timeline, we must first define what we mean by the "modern, for-profit business corporation." Stephen Bainbridge has ably identified six attributes that characterize this entity which, especially when taken together, distinguish it from other forms of business organization: "[I] formal creation as prescribed by state law; [II] legal personality; [III] separation of ownership and control; [IV] freely alienable ownership interests; [V] indefinite duration; and [VI] limited

347. *See* RONALD J. COLOMBO, THE FIRST AMENDMENT AND THE BUSINESS CORPORATION 30 (2015) (tracing organized investment activity to Assyria, 2,000 B.C) [hereinafter THE FIRST AMENDMENT AND THE BUSINESS CORPORATION]; G. A. Walker, *Money and Financial Technology (Fintech) History*, 56 INT'L LAW. 227, 229–30 (2023) ("Recorded history only covers about 5,000 years from the introduction of writing in Mesopotamia around 3200 BC, with numeric notation having been introduced 300 years previously around 3500 BC. History is distinct from historiography, which examines historical methodology." (footnote omitted)).

348. *See* Charles R.T. O'Kelley, *The Evolution of the Modern Corporation: Corporate Governance Reform in Context*, 2013 U. ILL. L. REV. 1001, 1017 (2013).

liability."[349] These attributes were picked up over the course of history in different times and places.[350] For example, legal recognition of groups, the predicate to the "legal personality" of the corporation, can be traced back to Rome in the seventh century B.C.[351] Limited liability, and some degree of separation of ownership and control within an organization, can be traced back to the *societates publicanorum* of Rome in the third century B.C.[352]

By the seventeenth century, most of the critical attributes of the modern business corporation had coalesced in an English entity known as the "joint-stock business corporation," sometimes even referred to as "business corporations."[353] Most of these entities did not actually possess a corporate charter—the instrument granting limited liability—and as such did not generally feature the *sine qua non* of the modern business corporation.[354] Corporate charters were "reserved for special cases and

349. Stephen M. Bainbridge, *Competing Concepts of the Corporation (A.K.A. Criteria? Just Say No)*, 2 BERKELEY BUS. L.J. 77, 88 (2005) (positing six marks of the corporation). Sometimes these are framed differently; *see, e.g.*, John Armour, Henry Hansmann, Reinier Kraakman & Mariana Pargendler, *Foundations of Corporate Law* (Eur. Corp. Governance Inst., Working Paper No. 336, 2017) (substituting "centralized management" for "separation of ownership and control" and listing only four key attributes in total).

350. *See, e.g.*, RONALD E. SEAVOY, THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION (1982); Taisu Zhang & John D. Morley, *The Modern State and the Rise of the Business Corporation*, 132 YALE L.J. 1970, 1977 (2023); RON HARRIS, GOING THE DISTANCE: EURASIAN TRADE AND THE RISE OF THE BUSINESS CORPORATION 255–58 (2020).

351. THE FIRST AMENDMENT AND THE BUSINESS CORPORATION, *supra* note 347, at 30; HARRIS, *supra* note 350, at 255.

352. *See* WILLIAM MAGNUSON, FOR PROFIT: A HISTORY OF CORPORATIONS 15–38 (2022); Sergio Alberto Gramitto Ricci, *Archeology, Language, and Nature of Business Corporations*, 89 MISS. L.J. 43, 74–79 (2019); Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1360–61 (2006); *see generally* Claude Nicolet, *Polybius VI, 17, 4 and the Composition of the* Societates Publicanorum, 6 IRISH JURIST 163, 174–76 (1971) (discussing how *societates publicanorum* extended credit to the state during wartime). *But see* Geoffrey Poitras & Frederick Willeboordse, *The* Societas Publicanorum *and Corporate Personality in Roman Private Law*, BUS. HIST. 2–3, 11 (2019) (asserting that the evidentiary record does not justify the common claim that the *societas publicanorum* was a forerunner of the modern business corporation). If it seems hyperbolic to compare today's corporation to those of antiquity, consider the following from a prominent Nineteenth Century corporate scholar: "The Roman corporation was much the same as the corporation of modern times." COOK, *supra* note 123, § 1.

353. *See* HARRIS, *supra* note 350, at 253–54.

354. *See* Barnes, *supra* note 61, at 396–99 (2018); HARRIS, *supra* note 350, at 253–54.

tightly controlled by parliament."[355] The eighteenth century saw the first real proliferation of such charters.[356]

B. Theories of the Corporation

As explained in the Introduction, central to our analysis of shareholder derivative litigation is our theoretical understanding of the corporation.[357] Indeed, corporate theory is the lens by which we plan to ultimately examine the phenomenon of derivative litigation. This Section will set forth the leading theoretical conceptualizations of the business corporation. It should be noted at the outset that these conceptualizations are not necessarily hermetically sealed off from one another—there is and can be significant overlap among them. Moreover, they are not necessarily mutually exclusive nor even theoretically inconsistent—sometimes multiple conceptualizations can operate together, simultaneously, in explaining the corporation.[358] Immediately following each explanation of a particular theory of the corporation will be an analysis of shareholder derivative litigation through the lens of that theory.

1. Artificial Personhood

In 1819, Chief Justice Marshall famously defined the corporation as "an artificial being, invisible, intangible, and existing only in [the] contemplation of [the] law."[359] This summarizes quite nicely the "artificial person," or *persona ficta*, understanding of the corporation.[360] Although this understanding arguably

355. Barnes, *supra* note 61, at 398.

356. *See* Hansmann et al., *supra* note 352, at 1378.

357. *See supra* Part I.

358. Indeed, as the corporate theory evolved over time, "[n]o theory totally replaced its predecessor." John A. MacKerron, *Shareholder Derivative Litigation and the Nexus of Contracts Corporation*, 40 KAN. L. REV. 679, 681 (1992).

359. Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819).

360. Melissa Vise, *The Matter of Personae in Medieval Italy*, 63 AM. J. LEGAL HIST. 131, 144 (2023).

supports other particular understandings of the corporation (particularly concessionary[361] and contractarian theory[362]), the implications of "artificial personhood" can be both overstated and understated. For jurisprudentially, "personhood" is a legal concept, not a metaphysical one.[363]

On the one hand, legal (or juridical) personhood certainly encompasses very real things—such as walking, talking human beings,[364] which corporations most certainly are not.[365] On the other hand, there are also some very real things to which legal personhood does not attach, such as unborn human beings.[366] Black's Law Dictionary captures the concept well in defining an "artificial person" under the law as an entity "given certain legal rights and duties of a human being; a being, *real or imaginary*, who for the purpose of legal reasoning is treated more or less as a human being."[367] Hence although the practice of referring to the business corporation as an "artificial person" is inescapable, it should not drive us into the arms of any particular theory of the corporation. Indeed, the appellation of the corporation as an artificial person is not a theory or conceptualization of the corporation *per se*, but rather simply recognition of an indisputable legal reality. Confusion, if any, only arises because of the somewhat pejorative employment of the adjective "artificial." Far better, more accurately, and less rhetorically charged, would be

361. *See infra* Section II.B.2; *see, e.g.*, Eric C. Chaffee, *A Theory of the Business Trust*, 88 U. CIN. L. REV. 797, 798 (2020) (equating "artificial entity theory" to "concession theory").

362. *See infra* Section II.B.5.

363. *See, e.g.*, *Trs. of Dartmouth Coll.*, 17 U.S. at 636.

364. *See* Alexis Dyschkant, *Legal Personhood: How We Are Getting It Wrong*, 2015 U. ILL. L. REV. 2075, 2077 (2015).

365. *See* Robert E. Wagner, *Corporate Criminal Prosecutions and the Exclusionary Rule*, 68 FLA. L. REV. 1119, 1131 (2016).

366. *See* RIPKEN, *supra* note 12, at 21; *see generally* Kayhan Parsi, *Metaphorical Imagination: The Moral and Legal Status of Fetuses and Embryos*, 2 DEPAUL J. HEALTH CARE L. 703 (1999) (noting the complex moral and legal status of the unborn); ROBERT P. GEORGE, EMBRYO: A DEFENSE OF HUMAN LIFE (2008).

367. *Artificial Person*, BLACK'S LAW DICTIONARY 1258 (9th ed. 2009) (emphasis added).

to instead refer to the corporation as a "legal person"[368] or a "constitutional person" or a "juridical person," a practice which many commentators have adopted.[369]

This concept of imbuing an entity with a legal personality separate from the individual human beings who comprise it is "a uniquely Western" development.[370] This concept originated in Roman law, saw refinement throughout the Middle Ages (in both canon and civil law), and ultimately found its way into the Anglo-American common-law tradition.[371]

* * *

Artificial personhood would seem to be the *sine qua non* of shareholder derivative litigation. Although in its gestational stages, derivative litigation was conceived of as having been brought on behalf of the shareholders collectively (including those who were similarly situated, akin to a class action),[372] today it is undeniable that a shareholder derivative lawsuit is brought by the shareholders on behalf of the corporation itself and not on behalf of shareholders *per se*.[373] For prior to the 1940s, the derivative suit was frequently articulated in class action terms: a vehicle for allowing shareholders to bring lawsuits "on behalf of themselves and the other shareholders when the shareholders were so numerous as to make it inconvenient to bring them all before the court."[374] Although the corporation was named as a party, this was only "to prevent it from later bringing a duplicative action."[375] But by the mid-twentieth

368. Tara Helfman, *Transatlantic Influences on American Corporate Jurisprudence: Theorizing the Corporation in the United States*, 23 IND. J. GLOB. LEGAL STUD. 383, 407 (2016).

369. *See* Charles I. Lugosi, *If I Were a Corporation, I'd Be a Constitutional Person, Too*, 10 TEX. REV. L. & POL. 427, 447 (2006).

370. *See* Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 772 (2005). Although this practice has now spread beyond the West. *See id.*

371. *Id.*

372. *See supra* note 169–70 and accompanying text.

373. *See supra* text accompanying note 243.

374. Scarlett, *supra* note 15, at 888–89.

375. *Id.* at 890.

century, "U.S. courts routinely began to describe shareholder derivative lawsuits as 'being brought on behalf of the corporation.'"[376]

Although this descriptive shift occurred "without any explanation," Ann Scarlett suggests that it indeed holds meaning.[377] Yesteryear's reference to the derivative suit as representative in nature, "brought on behalf of all the shareholders," reflects a "shareholder primacy" model of the corporation.[378] It reflects a belief that the real party in interest with respect to mismanagement of the corporation is, ultimately, the shareholder.[379] Reframing the derivative suit as not a representative one, but rather as one brought on behalf of the corporation itself, suggests a move away from this belief. It underscores the distinctiveness of the corporate entity as separate and apart from its shareholders.[380]

As for the particulars of shareholder derivative litigation, especially the demand requirement, conceptualizing the corporation as an artificial person does not appear to favor one approach versus another. For, as discussed, artificial personhood, as properly understood, does little more than recognize the independent legal status of the corporation—it does not provide a basis for normatively assessing how a corporation's internal affairs ought to be structured.[381]

2. Concessionary Theory

Under concession theory, the government "creates the corporation to achieve public goals that it does not have the time,

376. *Id.* at 888–89.

377. *See id.*

378. *Id.* at 890–91.

379. *Id.*; *see also* Maximilian Koessler, *The Stockholder's Suit: A Comparative View*, 46 COLUM. L. REV. 238, 242 (1946) ("The derivative stockholder-plaintiff is not only a nominal plaintiff, but at the same time a real party in interest. He sues not solely upon a corporate cause of action but also upon his own cause of action.").

380. *See* Scarlett, *supra* note 15, at 890–91.

381. *See supra* text accompanying notes 363–65.

money, or other resources to achieve."[382] As a corollary to this understanding, "by using its power to create the corporation, the government defines the rights and obligations of that entity."[383]

Concessionary theory was at its height, and its most sensible, when the corporation served, essentially, as an arm of the state by undertaking responsibilities that were not typically profit-oriented.[384] This would characterize the Roman ancestors of the corporation, which oversaw "religious societies, trade guilds, political clubs, burial societies . . . and . . . municipalities."[385] This would also characterize the medieval English predecessors of the corporation, created for "municipal, religious, and charitable purposes."[386] On the eve of the modern corporation's manifestation, the bond between incorporation and public purpose was as strong as ever: charters were granted to companies "to develop newly conquered lands," for example.[387] Throughout this period, the sovereign granted corporate charters on a case-by-case basis through specific exercises of its discretion.[388]

Concessionary theory predominated the American understanding of the corporation at the Founding of the United States

382. Chaffee, *supra* note 361, at 813–14.

383. *Id.* at 814. To this is frequently conjoined characterization of the corporation as an "artificial entity." *See id.* Although such a characterization in some ways naturally follows, I submit it need not invariably do so: a very real entity could still owe its legal recognition, and power to act, to government approbation. *See also* Jonathan A. Marcantel, *A Unified Framework to Adjudicate Corporate Constitutional Rights*, 39 U. HAW. L. REV. 115, 147 (2016) (arguing that concessionary theory could be harmonized with real entity theory).

384. I suggest that Brian McCall's framing of the corporation as an "imperfect society" is closely related to concessionary thinking and can be categorized as a subspecies thereof. *See* Brian McCall, *The Corporation as Imperfect Society*, 36 DEL. J. CORP. L. 509, 558 (2011).

385. Chaffee, *supra* note 361, at 803; *see* MAGNUSON, *supra* note 352, at 9–11. *But see* Avi-Yonah, *supra* note 370, at 772–76 (suggesting that Roman law did not necessarily consistently embrace a concessionary view of the corporation).

386. Chaffee, *supra* note 361, at 803.

387. *Id.* at 803–04.

388. *See id.* at 803; Helfman, *supra* note 368, at 392 ("During the early decades of the [American] Republic, incorporation occurred on an ad hoc basis by special legislation only.").

and well into the eighteenth century.[389] It was during this time period that Chief Justice Marshall famously defined the corporation as "an artificial being, invisible, intangible, and existing only in the contemplation of the law."[390] This did not make the United States an outlier; in characterizing the corporation this way, as Chief Justice Marshall "drew richly from the existing body of English law."[391]

Charters granted to for-profit undertakings were rare in the eighteenth century but increasingly common in the nineteenth (especially in the United States).[392] The nineteenth century also saw the move toward acts of general incorporation, pursuant to which a corporate charter could be obtained as a matter of course by simply filing the requisite paperwork with the appropriate organ of government.[393] Taken together, these developments spelled the death knell for concession theory.[394] When one considers that modern corporate law statutes are overwhelmingly enabling in nature, largely providing an off-the-rack set of rules for the convenience of entities wishing to conduct business in the corporate form, entertainment of concessionary theory appears even more anachronistic today.[395]

Nevertheless, the attractiveness of concessionary theory would never dissipate completely because, ultimately, incorporation still requires operation of law. As one early twentieth-century American commentator explained:

> Individuals, under their right to make contracts and acquire property, have an absolute right to form partnerships, including joint-stock

389. *See* Marcantel, *supra* note 383, at 116; RIPKEN, *supra* note 12, at 23–26.

390. Trs. of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819).

391. Helfman, *supra* note 368, at 396.

392. *See* Avi-Yonah, *supra* note 370, at 783–85.

393. *See* Chaffee, *supra* note 361, at 804–05.

394. *See* Daniel P. Sullivan & Donald E. Conlon, *Crisis and Transition in Corporate Governance Paradigms: The Role of the Chancery Court of Delaware*, 31 L. & SOC'Y REV. 713, 727–28 (1997).

395. *See* William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 263 (1992).

> companies, for the purpose of carrying on any lawful business, and no authority from the state is necessary. But they have no such right to form a corporation, and conduct their business in that privileged mode, by mere agreement between themselves. A corporation can be created only by the state—with us, by or under legislative authority.[396]

* * *

It would seem as though a concessionary view of the corporation generally supports the existence of shareholder derivative litigation. For concessionary theory, especially considering its historical underpinnings, views the corporation as a concession of the state permitted to exist because of some service it renders to the common good.[397] Should the corporation fail to serve its intended purposes, it follows that there ought to be some means by which to correct this failure. What form that means ought to take is not suggested by concessionary theory. An obvious approach would be to permit the state to exercise its power over the corporation to address corporate wrongdoing. Indeed, in centuries past, the crown did involve itself directly in the affairs of corporate entities to protect against wrongdoing.[398] And in our own time, some other jurisdictions have taken this approach, such as Australia. [399] The United States has not gone down this road, however.[400]

Whether government regulation of corporate fiduciary duties is a meritorious idea or not is beside the question;[401] what is

396. CLARK, *supra* note 144, at 35.

397. *See* Scarlett, *supra* note 15, at 890–91.

398. *See supra* note 7.

399. *See* Renee M. Jones & Michelle Welsh, *Toward A Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 375 (2012).

400. That said, there have been efforts to address breach of fiduciary duties via creative application of federal law. *See* Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 44 (2010).

401. For a discussion in favor of such regulation see Jones & Welsh, *supra* note 399, at 375–79.

fairly clear is that a concessionary view of the corporation would seem to support such an idea. Also fairly clear, however, is that a concessionary view of the corporation is largely anachronistic,[402] undercutting the persuasiveness of basing arguments thereupon.

A frequent corollary to government enforcement is private enforcement, as the availability of private rights of action unleashes an army of "private attorney generals" to supplement government law enforcement efforts.[403] Insofar as public policy favors the enforcement of corporate fiduciary duties, the shareholder derivative action would well fit within this tradition of empowering "private attorney generals."[404] What's lacking here would be the aforesaid *government* enforcement mechanism (as private enforcement is, as mentioned, *supplementary*). Nevertheless, concessionary theory would seem to support this lesser means of regulating the corporation, even in the absence of the more robust means of government enforcement.

Regarding the demand requirement and other particulars of derivative litigation, concessionary theory would seem to support whatever means most effectively furthers the common good. This would be in contrast to approaches more deferential to private ordering, as suggested by other theoretical conceptualizations of the corporation to follow.[405]

3. Aggregation Theory

The movement away from concessionary theory led to a somewhat temporary embrace of aggregation-based views of the corporation.[406] Under such views, "[t]he emphasis was on the individuals—the shareholders who had been constituted a

402. *See supra* text accompanying notes 392–393.

403. *See* Dee Pridgen, *Wrecking Ball Disguised as Law Reform: Alec's Model Act on Private Enforcement of Consumer Protection Statutes*, 39 N.Y.U. REV. L. & SOC. CHANGE 279, 281 (2015).

404. *Id.* at 281–83.

405. *See infra* Sections II.B.3–6.

406. *See* Allen, *supra* note 395, at 266; RIPKEN, *supra* note 12, 29–32.

corporation."[407] The corporation was analogized to a limited partnership,[408] if not a general partnership,[409] and the corporate name simply "represents persons who are members of the corporation."[410] This theory was articulated quite well by Justice Field in this passage from *Santa Clara Cnty. v. S. Pac. R. Co.*, which is worth quoting at length:

> [P]rivate corporations consist of an association of individuals united for some lawful purpose, and permitted to use a common name in their business and have succession of membership without dissolution. . . . In this state they are formed under general laws. By complying with certain prescribed forms any five persons may thus associate themselves. In that sense corporations are creatures of the state; they could not exist independently of the law, and the law may, of course, prescribe any conditions, not prohibited by the constitution of the United States, upon which they may be formed and continued. But the members do not, because of such association, lose their rights to protection, and equality of protection. They continue, notwithstanding, to possess the same right to life and liberty as before, and also to their property, except as they may have stipulated otherwise. As members of the association— of the artificial body, the intangible thing, called by a name given by themselves—their interests, it is true, are undivided, and constitute only a right during the continuance of the corporation to participate in its dividends, and, on its dissolution, to a proportionate share of its assets; but it is property, nevertheless, and the courts will protect it, as

407. Allen, *supra* note 395, at 266.

408. *See id.*

409. *See* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 202 (1990).

410. Avi-Yonah, *supra* note 370, at 786–87.

> they will any other property, from injury or spoliation.
>
> Whatever affects the property of the corporation—that is, of all the members united by the common name—necessarily affects their interests. If all the members of the corporation die or withdraw from the association, the corporation is dead; it lives and can live only through its members. When they disappear the corporation disappears. Whatever confiscates or imposes burdens on its property, confiscates or imposes burdens on their property, otherwise nobody would be injured by the proceeding. Whatever advances the prosperity or wealth of the corporation, advances proportionately the prosperity and business of the corporators, otherwise no one would be benefited. It is impossible to conceive of a corporation suffering an injury or reaping a benefit except through its members. The legal entity, the metaphysical being, that is called a corporation, cannot feel either. So, therefore, whenever a provision of the constitution or of a law guaranties to persons protection in their property, or affords to them the means for its protection, or prohibits injurious legislation affecting it, the benefits of the provision or law are extended to corporations; not to the name under which different persons are united, but to the individuals composing the union. The courts will always look through the name to see and protect those whom the name represents.[411]

As will be seen, aggregation theory gave way to a "real entity" conceptualization of the corporation within a few

411. Santa Clara Cnty. v. S. Pac. R. Co., 18 F. 385, 402–03 (Cal. Ct. App. 1883), *aff'd*, 118 U.S. 394 (1886), *and aff'd sub nom*. California v. N. R.R. Co., 118 U.S. 417, 6 S. Ct. 1144, 30 L. Ed. 125 (1886), *and aff'd sub nom*. San Bernardino Cnty. v. S. Pac. R. Co., 118 U.S. 417 (1886).

decades.[412] Despite its short-lived duration, however, aggregation theory arguably bequeathed to modern corporate law a powerful norm that remains in place to this day: shareholder primacy.[413]

Conceptualizing the corporation as merely the aggregation of its shareholders rather ineluctably suggests that the corporation's property is that of the shareholders.[414] Indeed, as a legal person, the very corporation itself can be viewed as the property of the shareholders[415]: "The shareholders own the corporation, so directors are merely stewards of their interests."[416]

The 1919 case of *Dodge v. Ford Motor Co.* provides "as pure an example as exists of the property conception of the corporation."[417] In ordering the Ford Motor Company to pay out accumulated dividends to its shareholders, the Michigan Supreme Court opined that:

> There should be no confusion . . . of the duties which Mr. Ford . . . and his codirectors owe to protesting, minority stockholders. A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among

412. *See infra* Section II.B.4.

413. *But see* Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson's Choice During a National Crisis*, 17 GEO. MASON L. REV. 661, 735 (2010) ("[T]he animating principle of corporate law is the maximization of social wealth and welfare, and not the narrow interest of shareholder profit . . . .").

414. *See* Allen, *supra* note 395, at 266–67; RIPKEN, *supra* note 12, at 32.

415. *Id.*

416. Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1005 (1992).

417. *See* Allen, *supra* note 395, at 268 (discussing Dodge v. Ford Motor Co., 170 N.W. 668 (1919)).

> stockholders in order to devote them to other purposes.[418]

Shareholder primacy is not necessarily inconsistent with concessionary theory: a corporation can owe its existence to government acquiescence, yet nevertheless operate for the primary benefit of its shareholders. Yet the difference in emphasis of these two theoretical conceptualizations on corporation purpose is hard to gainsay: concessionary theory promotes a more publicly oriented vision of the corporation; aggregation theory a more privately oriented vision of the corporation.[419]

It should be noted that the concept of shareholder prioritization cannot be considered an aggregation theory novelty. For, as we have seen,[420] the earliest cases addressing corporations and their immediate ancestors, back in the heyday of concessionary thinking, employed the language of trust law, and described corporate directors as "agents, trustees, or both."[421] But aggregation theory can be properly credited with picking up this longstanding principle of business enterprises generally (namely, that of owner prioritization) and firmly grafting it onto the jurisprudence of corporate law.[422]

As explained by Brian McCall, although the property implications of aggregation theory, which suggest fiduciary duties flowing to the shareholders alone, "may make sense for a company that is entirely . . . financed by its shareholders," it makes

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418. *Dodge*, 170 N.W. at 684.

419. *Compare supra* Section II.B.2 *with* Section II.B.3.

420. *See supra* text accompanying notes 88–124 and 158–87.

421. Marcia M. McMurray, *An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*, 40 VAND. L. REV. 605, 606 n.3 (1987).

422. That said, "although it is axiomatic that corporate directors and managers are fiduciaries, the question of to whom they owe their fiduciary duties is a matter of longstanding controversy. To many, the answer depends on one's view or theory of the corporation. Some scholars maintain that corporate directors and managers owe fiduciary duties to shareholders, while others assert that they owe fiduciary duties to the corporation itself." Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 682 (2016) (internal citations omitted); *see supra* text accompanying notes 117–124.

less sense today.[423] For today, "the capital invested in public companies does not come exclusively from shareholders and in many cases it comes many times over from debt investors."[424] Moreover, the shareholders themselves increasingly own their shares indirectly—through mutual funds and other "institutional, mediated structures."[425] Further still, modern corporate law does not empower shareholders with the typical accoutrements of ownership over the corporation, but rather with a far more limited basket of rights.[426] For this reason, many modern commentators insist that the only thing owned by a corporation's shareholders are "shares" of the corporation—not the corporation itself.[427] All that said, the legacy of the property model remains strong, such that to this day the prevailing (or at least *a* prevailing) understanding of directors' overarching duty is to manage the corporation "in response to shareholder interest alone."[428]

* * *

Aggregation theory would support the derivative lawsuit, but for a reason that differs from that of concessionary theory. Whereas concessionary theory's justification of such lawsuits would arise from the need to protect the public from director wrongdoing, aggregation theory's justification would arise from the need to protect the private parties who "own" the corporation—its shareholders.[429] As we have seen, this justification is as old as derivative litigation itself.[430] Indeed, this hearkens

423. McCall, *supra* note 384, at 513–14.

424. *Id.* at 513.

425. *Id.* at 514.

426. *See* Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1174 (2013).

427. *See id.*

428. McCall, *supra* note 384, at 518.

429. I employ quotes around "own" because of the modern controversy over this question. *See supra* text accompanying notes 383–95.

430. *See* McMurray, *supra* note 421, at 605–06 (citing Charitable Corp. v. Sutton, 26 Eng. Rep. 642, 644–45 (1742)) (discussing early English case law characterizing corporate directors as "agents and trustees").

back to characterizing the corporation's directors as the shareholders' agents, and employs principles of trust law to hold the former liable to the latter for breach of duty.[431]

However, this is arguably difficult to square with the practice of requiring the derivative plaintiff to sue on behalf of the corporation, rather than in the shareholders' own capacity. Aggregation theory suggests that the shareholders are directly harmed by director wrongdoing, the same way any principal is harmed by a faithless agent, and, as such, would not compel today's framing of the derivative lawsuit as representative in nature.[432] This goes to Ann Scarlett's argument, mentioned previously, that the terminological shift toward describing the derivative lawsuit as one brought on behalf of the corporation undercuts an aggregation theory of the firm.[433] That said, a review of relevant precedent reveals no articulated philosophical or theoretical justification for this shift, and, if anything, suggests that the framing of the derivative suit as one brought on behalf of the corporation was driven by practical considerations such as the need to comply with the "necessary parties" rule.[434] This counsels against reading too much into the apparent incongruity between aggregation theory and the requirement that derivative litigation must be brought in the name of the corporation.

Additionally, it bears recalling that the very concept of corporate artificial personhood is itself a matter of convenience as well.[435] Thus, the requirement that a shareholder derivative lawsuit be brought in the name of the corporation stacks one matter of practicality upon another matter of practicality.

The aggregation theory would, however, seem to call into question the veritable practice of requiring a derivative plaintiff to first make demand upon the board (or explaining why he or

431. *See supra* text accompanying notes 69–87.

432. *See* 3 AM. JUR. 2D *Agency* § 167, Westlaw (database updated Nov. 2025).

433. *See supra* text accompanying notes 377–80.

434. *See supra* text accompanying note 66–68.

435. *See supra* Section I.B.1.

she should be excused from doing so). Demand upon the board is justified by an understanding of the corporation in which ownership and control are distinctly separated; the prospect of permitting a shareholder to seize control of the firm's litigation decision-making constitutes an extraordinary departure from how the corporation operates.[436] Yet an aggregation theory does not erect such a wall of separation. Although the corporation's day-to-day operations have been turned over to a professional management team (the board of directors and its officers), that need not be viewed too differently from a sole proprietor's or a partnership's decision to do the same.[437] As such, the shareholder-principals should be understood to have reserved the right to pursue a claim against their faithless agents (the directors), or to compel the board to commence litigation against a third party who may have harmed the corporation.[438]

Another distinction between derivative litigation as currently recognized and derivative litigation under an aggregation theory of the corporation would be the prevailing right of any single shareholder to commence such an action (subject to certain qualifications).[439] Given how aggregation theory analogizes the corporation to a partnership,[440] we ought to consult how partnership law would handle such an issue. Reflecting the default rule in most jurisdictions, the Uniform Partnership Act states that:

> A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership

436. *See* Ryan v. Armstrong, No. CV 12717-VCG, 2017 WL 2062902, at *11 (Del. Ch. May 15, 2017), *aff'd*, 176 A.3d 1274 (Del. 2017).

437. *See* Minh Van Ngo, *Agency Costs and the Demand and Supply of Secured Debt and Asset Securitization*, 19 YALE J. ON REGUL. 413, 433–34 (2002).

438. *See* Megan Wischmeier Shaner, *Introduction to Symposium, Confronting New Market Realities: Implications for Stockholder Rights to Vote, Sell, and Sue*, 70 OKLA. L. REV. 1, 3 (2017).

439. *See* LAW OF CORPORATE OFFICERS AND DIRECTORS, *supra* note 62, § 9:4.

440. *See supra* text accompanying notes 406–10.

> and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.[441]

Regardless of whether the commencement of litigation is within the ordinary course of business, no individual holding less than a majority of a corporation's shares should be entitled to bring a shareholder derivative suit under the logic of partnership laws. As we have seen, there is precedent for this approach: the requirement for demand upon the shareholders.[442]

Many of the reasons favoring demand upon the directors remain salient—particularly those regarding efficiency and expertise.[443] As such, it may remain prudent to require such a demand as a means of expeditiously resolving the matter in question. However, should directors ultimately reject the demand, the highly deferential "business judgment" standard of review would seem inapposite;[444] as discussed, the shareholders should be able to bring the lawsuit as a matter of right given their role as principals.[445]

To obtain the benefits of demand upon the board, while preserving the rights and role of shareholders with respect to derivative lawsuits under an aggregation theory approach, perhaps demand upon the board could be a required predicate to demand upon the shareholders. In other words, before a shareholder could take the derivative lawsuit to all of the corporation's shareholders for their approval, that shareholder would first have to make demand upon the board. Should the board acquiesce to the demand, the lawsuit would immediately proceed under the board's direction. Should the board reject the

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441. JOSEPH K. LEAHY & DOUGLAS K. MOLL, THE REVISED UNIFORM PARTNERSHIP ACT § 401(j) (2025–2026 ed.), Westlaw RUPA § 401 (database updated Oct. 2025).

442. *See supra* Section I.C.2.

443. *See, e.g.*, Wedderburn 1957, *supra* note 61, at 195; Hawes v. Oakland, 104 U.S. 450, 460–61 (1881); FLETCHER CYCLOPEDIA, *supra* note 41, § 5940; Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 529–30 (1984).

444. *See supra* text accompanying notes 436–38.

445. *Id.*

demand, then this same demand would be made upon the corporation's shareholders. This would incentivize both the board and the complaining shareholder to take the demand process seriously, for should the two come to an impasse, demand upon the shareholders would ensue, the outcome of which might be unpredictable.

What becomes readily apparent is how far apart an aggregation theory view of what the shareholder derivative action *should be* from how the shareholder derivative action *is*. This suggests that one, or the other, is somewhat deficient. Empirically, this divergence suggests that aggregation theory provides a poor explanation for the modern business corporation and corporate law today (at least insofar as shareholder derivative litigation relates thereto). On the other hand, those wedded to an aggregation theory of the corporation could point to this divergence as a sign that modern corporate law has gone somewhat astray, and that the practice of derivative litigation today ought to be reformed to more closely conform to the corporation's nature as most properly understood.

4. Real Entity Theory

But other factors contributed to the decline of aggregation theory as well. As corporations expanded from closed to public (from a handful of shareholders to thousands of shareholders), the characterization of the corporation as simply an aggregation of individuals akin to a partnership became increasingly attenuated.[446] To this can be added the rise of full-time, professional managers, along with the deferential business judgment rule protecting said managers from mere errors of judgment—the culmination of separation of ownership and control.[447] By the end of the nineteenth century, real entity theory had begun to

446. *See* Avi-Yonah, *supra* note 370, at 798.

447. *See id.* at 799.

supplant the concessionary and aggregation theories of the corporation in the United States.[448] On a practical level, this was fostered by the evolution of the corporation itself.[449] For the concept of limited liability always undercut aggregation theories of the corporation, as limited liability underscores the separate nature of the corporation (whether real or artificial).[450] Indeed, a nineteenth-century commentator identified limited liability as "the primary distinction between a partnership and a corporation."[451]

Theoretically, there was a growing appreciation of the separateness and distinctiveness of groups from the individuals who composed them.[452] This thinking can be most directly traced back to Otto Gierke, a nineteenth century German political theorist whose works were translated into English by Frederick Maitland in 1900.[453] As per Gierke, the association, or any group, is "a living entity."[454] It has "a real and independent communal life, a conscious will, and an ability to act that are distinct from the lives and wills of its individual members."[455] Consistent with this thinking, the corporate whole came to be viewed as different from—if not greater than—the sum of its parts.[456]

When coupled with the observation that "human beings naturally form and function in groups,"[457] Gierke's theories about associations supported a view of the corporation as a

448. *See* Marcantel, *supra* note 383, at 119; RIPKEN, *supra* note 12, at 34. *But see* MacKerron, *supra* note 358, at 681 (positing that "[t]he theory of the American corporation evolved from the 'artificial entity' theory to the 'natural entity' theory to the 'aggregate' theory.").

449. *See* Allen, *supra* note 395, at 270.

450. *See* Avi-Yonah, *supra* note 370, at 790.

451. *See id.* at 789–90.

452. *See* Chaffee, *supra* note 361, at 815–17.

453. *See* Mark M. Hager, *Bodies Politic: The Progressive History of Organizational "Real Entity" Theory*, 50 U. PITT. L. REV. 575, 580 (1989).

454. OTTO GIERKE, ASSOCIATIONS AND LAW: THE CLASSICAL AND EARLY CHRISTIAN STAGES 7 (George Heiman ed. & trans. 1977), *quoted in* RIPKEN, *supra* note 12, at 34.

455. *Id.*

456. Chaffee, *supra* note 361, at 816–17.

457. RIPKEN, *supra* note 12, at 34; *see* Chaffee, *supra* note 361, at 816–17.

"natural, spontaneously formed, timeless entit[y] that preexist[s]] the state."[458] Consequently, in contrast to concessionary theory, under the real entity model of the corporation, "[t]he law does not create the corporate persons[,] but finding it in existence invests it with a certain legal capacity."[459] An early twentieth century treatise on the corporation, after dutifully providing the Chief Justice Marshall's famous definition of the corporation as "an artificial being, invisible, intangible, and existing only in contemplation of the law,"[460] nevertheless concluded that the corporation

> is no more of a fiction than is a class in law school, a baseball team, a regiment, or any other familiar collective unit. In so far only as the law treats this group of persons as though it were but one person is there anything of fiction involved in the conception of the corporation.[461]

As might readily be grasped, a real entity theory view of the corporation serves as a resounding rejection of the more normative versions of the artificial personhood perspective—versions which dismiss legal recognition of the business corporation as nothing more than a mere convenience.[462] Admittedly, granting juridical personhood to certain groups and organizations can be a matter of extraordinary convenience, but, for the reasons discussed, this does not necessarily mean that such personhood has been granted *only* on account of concerns over convenience; such personhood can very well be defended on deeper

458. *Id.*

459. ERNST FREUND, THE LEGAL NATURE OF CORPORATIONS 11 (Batoche Books Ltd. 2000); *see also* ERNST FREUND, THE LEGAL NATURE OF CORPORATIONS 13 (1897).

460. CLARK, *supra* note 144, at 3.

461. *Id.* at 5.

462. *See supra* text accompanying notes 359–67 (describing the origins and import of the legal personhood theory of corporate entities).

philosophical grounds arising from the nature of said group or organization.[463]

Real entity theory also departs starkly from concessionary views of the corporation. Whereas concessionary theory acknowledges very little moral justification for corporate pushback against state regulations and impositions,[464] real entity theory envisions the corporation in human associational terms and, consequently, as a subject of rights and obligations.[465]

Although Gierke provided the theoretical impetus for the modern era's embrace of real entity theory, this conceptualization of the organized entity reigned supreme centuries earlier, during the late Middle Ages.[466] The right of individuals to form a corporate entity was, essentially, viewed as something derived from natural law—permission from the state was not deemed necessary.[467]

As for the proper objectives of the management under real entity theory, most would suggest that its duties flow to the corporation itself, and not to the shareholders *per se*.[468]

Real entity theory is an attractive one that arguably avoids two erroneous extremes: the one of dehumanizing the corporate entity, reducing it to a mere legal fiction recognized via governmental grace (concession theory), [469] and the other of viewing the corporation as simply the individuals who comprise it (aggregation theory).[470] I join those scholars who suggest that the real entity theory appears to more accurately fit the

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463. *See, e.g.*, Lugosi, *supra* note 369, at 443–44 (listing the Supreme Court's justifications for granting corporations personhood under the Fourteenth Amendment).

464. *See supra* Section II.B.2.

465. *See* Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 893–94 (2012).

466. Avi-Yonah, *supra* note 370, at 780.

467. *See id.*

468. *See* Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1913 (2013).

469. *See supra* Section II.B.2.

470. *See supra* Section II.B.3.

reality of the modern corporation than competing ones.[471] And although most corporate scholars today embrace the contractarian model of the corporation,[472] American courts arguably continue to embrace a real entity theory of the corporation.[473]

* * *

It is not clear how modern shareholder derivative litigation fares under scrutiny from a real entity theory perspective of the corporation. Critical to real entity theory is respect for the integrity of the corporation, and an appreciation of its rightful place among the community of human associations.[474] This respect would counsel in favor of an approach to derivative litigation that respects the internal ordering of the corporation. Consequently, it would seem to favor an approach that respects the central role of the board of directors in controlling the corporation and recognizes the more limited role of the shareholders in the governance of the corporation.[475] This would seem to fall in line with derivative litigation as traditionally (and currently) understood: an extraordinary cause of action, justifiable only under limited circumstances—circumstances that can largely be described as presenting some kind of internal failure of the corporate organism.[476]

Real entity theory could, potentially, be enlisted to expand the universe of potential derivative plaintiffs beyond simply the corporation's shareholders. There would seem to be no reason why, under real entity theory, only the shareholders should be

471. *E.g.*, Avi-Yonah, *supra* note 370, at 812–13.

472. *See infra* Section II.B.5.

473. *See* Marcantel, *supra* note 383, at 125–26.

474. *See, e.g.*, Dale Rubin, *Corporate Personhood: How the Courts Have Employed Bogus Jurisprudence to Grant Corporations Constitutional Rights Intended for Individuals*, 28 QUINNIPIAC L. REV. 523, 539 (2010) ("[The] 'entity' theory had its roots in the writings of the great German legal theorist, Otto Gierke, who sought to describe the will of the group as opposed to the individuals who comprised the group. Gierke concluded that group will is the equivalent of individual will and should be given equal recognition.").

475. *See, e.g.*, Ho, *supra* note 465, at 894–95 (describing how the real entity view reflects the divided ownership and management structure of corporations).

476. *See* Scarlett, *supra* note 15, at 892–93; Wedderburn 1958, *supra* note 61, at 93–94.

permitted access to this extraordinary remedy under the appropriate circumstances.[477] This could be a point of commonality shared by real entity theory and a stakeholder model of the corporation.[478]

Conversely, real entity theory would seem to disfavor the approach suggested by aggregation theory, in which the shareholders could essentially run roughshod over the board of directors by virtue of their "ownership" of the company.[479] For this would be an affront to the norms of corporate governance and law, which have developed over the centuries, concerning the allocation of power among the corporation's various constituencies, and the special roles that each constituency plays within the life of the corporation.[480]

The demand requirement (upon the board versus upon the shareholders) strives to strike the proper balance between the authority of the board and shareholder protection.[481] Although not a feature in the English derivative lawsuit, this requirement evolved in the United States to serve that end.[482] Different American jurisdictions have adopted divergent approaches to the demand requirement as minds have differed on how best to achieve the aforementioned balance.[483] Real entity theory cannot serve as the basis of opinion regarding which approach to the demand requirement more effectively achieves that purpose. Real entity theory can, however, provide a basis for looking upon all reasonable implementations of the demand requirement with approbation; the demand requirement honors the important but different roles played by the shareholders

477. *See, e.g.*, Jessica M. Erickson, *The Lost Lessons of Shareholder Derivative Suits*, 77 WASH. & LEE L. REV. 1131, 1171–73 (2020) (explaining how directors, through a Special Litigation Committee, may become involved in a derivative litigation).

478. *See infra* Section II.B.6.

479. *See supra* notes 429–31 and accompanying text.

480. *See* Scarlett, *supra* note 15, at 871.

481. *See* Erickson, *supra* note 477, at 1171.

482. *See supra* text accompanying notes 249–61.

483. *See supra* text accompanying note 287.

and the directors of a corporation, and in so doing respects the integrity of the corporate entity.

5. Contractarian Model

Most modern corporate law scholars subscribe to the "contractarian" model of the corporation—which views the corporation, not as a thing, but as a metaphorical "nexus of contracts."[484] What we call "the corporation" is simply a convenient label slapped onto an assortment of related, implicit contracts between "the various parties involved with the firm: executives, directors, creditors, suppliers, customers, and employees."[485] This is an outgrowth of Ronald Coase's economic theory of the firm—which views companies as existing to reduce the transaction costs associated with pure, arms-length market transactions.[486] The content of these metaphorical contracts forms the basis of corporate law, ranging from the limited liability of shareholders to the fiduciary duties of directors.[487] Put differently, the rules that constitute "corporate law" can be thought of as the terms agreed upon by those parties whose interactions give rise to the corporation.[488]

Contracts are a quintessential example of private ordering and, consequently, the contractarian model "engenders skepticism about government interference with, or regulation of,

484. Robert Anderson IV, *A Property Theory of Corporate Law*, 2020 COLUM. BUS. L. REV. 1, 3 (2020) ("The dominant view of the corporation in legal scholarship is contractarian . . . ."); Lewis A. Kornhauser, Comment, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1449 (1989); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1426 (1989). Indeed, modern contractarians explicitly (and quite naturally) oppose the "reification" of the corporation. *See, e.g.*, Bainbridge, *supra* note 416, at 1025 n.209 (1992) (arguing that market forces, rather than legal systems, are the primary drivers or corporate accountability).

485. Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of "Nexus of Contracts" Theory*, 109 MICH. L. REV. 1127, 1129 (2011).

486. R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 390–92 (1937).

487. *See* Anderson IV, *supra* note 484, at 16–17; McCall, *supra* note 384, at 521.

488. *See, e.g.*, McCall, *supra* note 384, at 520–21 ("Some scholars offer a more complicated understanding of corporate law as contract law.").

corporate dealings and decision making."[489] Additionally, as a child of the law-and-economics movement, contractarian models of the corporation typically impute neoclassical economic motives to the various corporate participants.[490] Thus, "[t]he human parties are defined according to the economist's notion of rational self-interested actors who freely contract according to their own utility calculations."[491] Taken together, these currents are generally read to justify, quite strongly, the shareholder primacy orientation of the modern corporation.[492] Although the shareholders are not considered the "owners" of the corporation (because the corporation is not a thing capable of being owned), they are deemed to be the contractual beneficiaries of ownership-like privileges over corporate operations, and management is "obliged to serve at the behest of the shareholders."[493]

Nevertheless, there is a certain fundamental indeterminacy to contractarian theory. First of all, it can be employed descriptively, via a form of reverse engineering, to simply explain aspects of corporate law.[494] However, it can also be used normatively to critique these very same aspects of corporate law.[495] Drawing from its law-and-economics progenitors,[496] contractarian theory can be used to set forth a vision of what corporate *should* be: a reflection of those rules that the corporation's

489. *Id.* at 520; *see also* Susanna Kim Ripken, *Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 FORDHAM J. CORP. & FIN. L. 97, 162–63 (2009) (arguing that contractarian theory treats corporations as private ordering mechanisms and advises against governmental regulation of their internal dealings).

490. *See* Ripken, *supra* note 489, at 158–59.

491. *Id.*

492. *See id.*; Rhee, *supra* note 413, at 716.

493. RIPKEN, *supra* note 12, at 43.

494. *See* Hayden & Bodie, *supra* note 485, at 1130 ("But despite its dominance, there is still confusion over whether the theory is a descriptive model, a normative prescription, or some combination of both.").

495. *See id.*

496. *See supra* text accompanying notes 485–87.

various constituencies would be expected to agree to under a *homo economicus* (wealth-maximizing) view of humankind.[497]

Yet the contractarian model does not necessarily compel such conclusions. As I have explained elsewhere, by embracing different assumptions with regard to corporate actors, we can readily posit different orientations of the corporate enterprise.[498] Indeed, more progressive corporate law scholars have employed the contractarian model of the corporation to justify nontraditional corporate ends, such as those that would support a stakeholder model of the corporation (in juxtaposition to the prevailing shareholder primacy approach).[499]

Vis-à-vis the government, the contractarian model—as opposed to concessionary theory—does not deem the corporation's existence "a privilege bestowed by the state."[500] Rather, the corporation is deemed "a product of private, voluntary actions by people who are free to contract in their own self-interest."[501] Consequently, the corporation ought to be afforded the same kind of private-property protections and freedom from undue regulation enjoyed by other organizations and individuals in a modern free market society.[502]

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As an initial matter, akin to the concept of artificial personhood, contractarian theory can take on one of two flavors: descriptive or normative.[503] In its descriptive form, it would be

497. *See* Ronald J. Colombo, Book Review, *Exposing the Myth of* Homo Economicus, 32 HARV. J.L. & PUB. POL'Y 737, 739 (2009) [hereinafter *Exposing the Myth of* Homo Economicus].

498. *See* Ronald J. Colombo, *Ownership, Limited: Reconciling Traditional and Progressive Corporate Law via an Aristotelian Understanding of Ownership*, 34 J. CORP. L. 247, 266–67 (2008).

499. *See* David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW 16–17 (Lawrence E. Mitchell ed., Routledge 2019) (1995); McCall, *supra* note 384, at 522.

500. *See* RIPKEN, *supra* note 12, at 44.

501. *Id.* at 43–44.

502. *See id.* at 44–45.

503. *Compare supra* text accompanying notes 365–69 (explaining that labeling the corporation an "artificial" or "legal" person is simply a descriptive legal status, not a substantive theory), *with supra* text accompanying notes 494–95 (distinguishing the descriptive and normative strands of contractarian theory). *See also* Hayden & Bodie, *supra* note 485, at 1130 ("[T]here is

used to define the regime of shareholder derivative litigation as a set of rules and procedures established by the corporation's various constituencies to optimize their interests (subject to the compromises necessary in any situation of multi-party bargaining). This would offer little by way of critique.

As a normative theory drawn from the school of law and economics, contractarian theory would be positioned to offer a critique of modern shareholder derivative litigation. Such a critique would resemble, in significant ways, that of real entity theory:[504] There would be an emphasis on respect for the integrity of the corporation (or, more accurately in the case of contractarian thought, on the autonomy of the various corporate constituencies and on private ordering).

As with a real entity approach, contractarian theory would eschew the imposition of external (governmental) rules governing derivative litigation.[505] The emphasis on private ordering suggests that the rules of derivative litigation ought to be left up to each individual corporation. State corporate law could offer default rules as a convenience to the public, but the parties constituting a corporation ought to be permitted to bargain around these rules. This could, for example, be something laid out clearly in a corporation's by-laws if not its charter. It also could be part of the bundle of rights shareholders assume when purchasing stock in a company—delineated in the same way as preference in dividends or rights upon dissolution.

Even in its normative form, however, it is not clear whether contractarian theory would endorse or reject derivative litigation as currently constituted. Setting aside the use of non-economic assumptions regarding corporate actors,[506] a contractarian approach might very well find the current rules regarding

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still confusion over whether [the nexus of contract] theory is a descriptive model, a normative prescription, or some combination of both.").

504. *See supra* Section II.B.4.

505. *See* Anderson IV, *supra* note 484, at 3–4.

506. *See supra* text accompanying notes 498–99.

derivative litigation efficient—reflective of what the parties would have themselves bargained for.[507]

6. Stakeholder Model

The stakeholder model of the corporation posits that the corporation's board exists not to advance the interests of the shareholders *simpliciter*, but rather to advance the interests of a host of critical corporate "stakeholders" or "constituents."[508] It rejects the "shareholder primacy view" of the corporation associated with most traditional theories,[509] and posits squarely that the fiduciary duties of the directors are to the corporation as a whole, and must take into account more than simply shareholder wealth maximization.[510]

As critics, including myself, have pointed out, stakeholder proponents have "not presented a consistent justification" for their position, "nor a metaphysical answer to what aspect of the nature of the corporation requires, or at least suggests, this attention to non-shareholder concerns."[511] Most of the proponents of the stakeholder model, similar to the modern proponents of concessionary theory, defend their perspective via recourse to the genesis of corporations as creatures of the state existing for the purpose of serving the public or some other important common good.[512] However, this no longer characterizes the limitations upon corporate chartering or the nature of the modern business corporation.

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507. For an excellent and exceedingly rare analysis of shareholder derivative litigation under a contractarian approach, see MacKerron, *supra* note 358, at 715, 730–32.

508. McCall, *supra* note 384, at 521–22; THE FIRST AMENDMENT AND THE BUSINESS CORPORATION, *supra* note 347, at 11–12.

509. Especially aggregation and contractarian theories of the corporation. *See supra* Sections II.B.3–5.

510. McCall, *supra* note 384, at 521–22; *Exposing the Myth of* Homo Economicus, *supra* note 497, at 255–56.

511. McCall, *supra* note 384, at 522.

512. *See* Kent Greenfield, *New Principles for Corporate Law,* 1 HASTINGS BUS. L.J. 87, 90 (2005).

Thus, despite the excitement of progressive corporate law scholars over the stakeholder model,[513] this novel approach to the corporation has not managed to gain much traction or dislodge the modern corporation's shareholder-primacy orientation.[514]

* * *

There is no reason to believe that the concept of derivative litigation against the board of directors would be viewed askance from a stakeholder perspective. Indeed, there is nothing in stakeholder theory that causes it to depart significantly from other theories of the corporation with regard to the existence of fiduciary duties, and the need for suitable means of holding directors accountable when in breach of those duties. The critical difference is the question of to whom those duties are owed.

Stakeholder theory stands alone among theories of the corporation in explicitly positing that fiduciary duties are owed by the directors to various corporate constituencies—not simply the shareholders. This is similar to the idea that directors owe their duties to the corporation generally, as some other theories suggest.[515] It differs, however, in that the stakeholder model typically enumerates, quite specifically, the various corporate stakeholders to whom duties are owed.[516] These often include the company's employees, customers, critical counterparties (such as suppliers), and the community in which the corporation operates.[517]

Having identified the key constituencies to whom fiduciary duties are owed, it quite readily follows that these

513. *E.g.*, Millon, *supra* note 499, at 1–2.

514. *See* Usha Rodrigues, *From Loyalty to Conflict: Addressing Fiduciary Duty at the Officer Level*, 61 FLA. L. REV. 1, 8 n.13 (2009).

515. Real entity theory and contractarian theory can be used to support this proposition. *See supra* Sections II.B.4–5.

516. *See* Lance Ang, *The Start of History for Corporate Law: Shifting Paradigms of Corporate Purpose in the Common Law*, 38 WIS. INT'L L.J. 427, 429 (2021).

517. *Id.*

constituencies be granted the rights to enforce said duties—an argument that stakeholder model proponents have made.[518] How feasible it is to extend these enforcement rights is an interesting question; for prudential reasons, it might not be extendable to every conceivable stakeholder of the corporation,[519] but theoretically, *ceteris paribus*, such constituents should be treated no differently than the shareholders. Thus, the current practice of limiting standing to bring a derivative lawsuit to shareholders alone would seem inconsistent with a stakeholder perspective of the corporation.[520]

Similarly, the idea of making demand upon the shareholders in order to bring such a derivative suit, either in addition to or in conjunction with the suit, would seem equally problematic. After all, if the corporation is to be managed for the benefit of constituencies in addition the shareholders, those constituencies should participate in deciding whether or not a derivative lawsuit ought to be brought to the same degree as the shareholders.

As with certain other theoretical critiques of derivative litigation, whether the divergence between theory and practice indicts the former or the latter is an open question.[521]

CONCLUSION

Practices that are consistent with our theoretical understanding reflect well upon both. Conversely, incongruities between practice and theory call into question the former or latter, depending upon which the observer is more wedded to. By

518. *See* Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587, 621 (1997); Jason S. Oh & Andrew Verstein, *A Theory of the REIT*, 133 YALE L.J. 755, 833 (2024).

519. *See* Blair & Stout, *supra* note 124, at 297.

520. It should be noted that in certain situations (for example, insolvency), certain non-shareholder constituencies are indeed permitted to bring suit against the board (creditors in the case of insolvency). *See* Blair & Stout, *supra* note 124, at 297.

521. *See e.g.*, *supra* Section II.B.3.

subjecting shareholder derivative litigation to sustained theoretical examination under various conceptualizations of the corporation, we can either affirm both derivative litigation and a particular corporate conceptualization, or call into question one or the other.

Of primary importance would be an examination of derivative litigation under a contractarian model of the corporation, given that model's current domination among corporate theorists. Setting aside a preference for private ordering over mandatory rules (which would apply to virtually all corporate law under contractarian thinking), contractarian theory would best be read as supportive of derivative litigation in its modern form because derivative litigation respects the hypothetical bargain struck among the corporation's various constituencies. It recognizes the paramount role of the board as controller of the corporation, both via the demand requirement and by permitting a derivative lawsuit to proceed only under circumstances in which the board is fundamentally compromised. In those jurisdictions, such as Delaware, that allow demand to be excused due to futility, the grounds upon which futility can be argued are themselves limited to situations where, again, the board can be said to be fundamentally compromised. By restricting potential derivative plaintiffs to shareholders, derivative litigation recognizes the special role of this corporate constituency, affording it unique rights in keeping with the norm of shareholder primacy.

Real entity theory, too, appears to support derivative litigation as currently practiced, for reasons similar to those expressed above. By limiting itself to extraordinary situations, derivative litigation respects the unique nature of the business corporation, characterized by (among other things) the separation of ownership and control. Also not lost upon a real entity theorist would be how derivative litigation and its rules evolved naturally, drawing upon decades if not centuries of

relevant jurisprudence in the process. This suggests an organic response to an ailment plaguing the corporation. The theoretical support derivative litigation receives from a real entity understanding of the corporation is important because the real entity theory is arguably the conceptualization of the corporation embraced by most courts—and, arguably, a growing number of scholars as well.

Derivative litigation, as currently recognized, would receive its most critical reviews from concessionary and stakeholder-theory perspectives. Each theory would most likely find fault with limiting the derivative lawsuit to shareholder plaintiffs. A concessionary theorist would be apt to support a greater role for government in regulating director misconduct; a stakeholder theorist would be apt to support a greater role for corporate constituencies other than shareholders in regulating director misconduct. Alas, concessionary theorists and proponents of the stakeholder model of the corporation are already quite critical of corporate law as currently formulated, especially with its shareholder-primacy and the corporation's wealth-maximizing orientation. It comes as little surprise, therefore, that from these same quarters would come the most heavy criticism of derivative litigation, a fixture of corporate law.

Few courts or commentators appear to embrace the aggregation theory of the corporation. Nevertheless, out of an interest in completeness, a word should be written with regard to its assessment of derivative litigation.[522]

As discussed, an aggregation theorist should heartily approve of the concept of derivative litigation, but seriously fault its implementation. This would primarily be on account of two facets of derivative litigation that pull in somewhat opposite directions. The first is that derivative litigation makes it too

522. As expressed, "artificial personhood" is not a *bona fide* theory of the corporation, but rather simply an empirical observation. *See supra* Section II.B.1. For that reason the interplay between derivative litigation and artificial personhood will not be assessed again here.

difficult for the shareholders to hold directors accountable for wrongdoing (and not accountable at all for lesser forms of mismanagement). After all, the corporation under aggregation theory is little more than a chartered partnership, with shareholders as partners. To the extent that a corporation is a thing separate from the shareholders, the shareholders own it. All this suggests that the obstacles placed in the way of the shareholder derivative plaintiff are unwarranted—or at least unduly burdensome. Second, granting the right to bring a derivative action to one shareholder alone (or, more accurately, a minority shareholder), would cut against the analogization of the corporation to a partnership. No single shareholder should have such power—such a decision ought to be decided by shareholders representing a majority (if not a supermajority) of the corporation's shares.

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In sum, it appears as though today's leading conceptualizations of the corporation (contractarian and real entity theory) are consonant with the modern practice of shareholder derivative litigation. Conversely, those conceptualizations that hold less sway over courts and commentators today (aggregation theory, stakeholder theory, and concessionary theory) are less supportive of derivative litigation as currently constituted. Perhaps this should come as little surprise; despite the lack of theoretical attention given to shareholder derivative litigation, a profound disconnect between theory and practice would probably have given rise to louder cries for reform of the practice or movement away from the prevailing theories.

However, this conclusion should not be read to suggest that all is perfect with regard to theory or practice. As has been discussed, room for reform and improvement certainly exists even within the confines of those theories most supportive of shareholder derivative litigation and the modest discrepancies between those theories and derivative litigation cast some doubt

on the explanatory strength of those theories, but it does suggest that someone favorably disposed to either the contractarian or real entity theory of the corporation not embrace any radical departure from shareholder derivative litigation practice as currently practiced. It also would seem to throw another obstacle in the way of someone promoting a competing theory of the corporation. The modest discrepancies mentioned above are surpassed by even greater discrepancies between the practice of shareholder derivative litigation and competing theories of the corporation.