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On the Double (Derivative): North Carolina Could Single-Handedly Recognize Double Derivative Suits

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ABSTRACT

When a corporation suffers a harm caused by its own directors or officers, most often resulting from a breach of fiduciary duty, and the board does not initiate litigation to remedy the alleged wrong, shareholders may file suit on behalf of the corporation to redress the harm. Courts recognize this cause of action—a single derivative suit—in the name of equity, meaning equitable principles drive a court's recognition of the action. Consulting the same equitable principles, courts have extended the single derivative suit to shareholders owning shares in a corporation that owns a subsidiary, allowing these shareholders to bring "double derivative" suits on behalf of the corporation's subsidiary when the subsidiary suffers a similar harm. North Carolina's courts have not explicitly addressed whether a plaintiff may bring a double derivative claim under North Carolina law. This Comment argues that North Carolina, if given the opportunity, should recognize the double derivative suit because of the suit's equitable nature, North Carolina's receptiveness to justifying other business-related causes of action in the name of equity, and the ease at which North Carolina could statutorily recognize the cause of action.

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INTRODUCTION

When a corporation suffers an alleged wrong, and its board of directors declines to initiate litigation to remedy the wrong, shareholders may file a lawsuit against the alleged wrongdoers—most often members of the board itself. These actions are called single derivative suits.[1] These suits are brought on the corporation's behalf and for the corporation's benefit, and the corporation's officers and directors are most often the defendants.[2] The basis of the alleged wrong is typically "fraud, breach of fiduciary duties, waste, mismanagement of corporate assets, or failure to pursue claims against a third party."[3] A single derivative suit has been characterized as "two-fold" because it is: (1) "the equivalent of a suit by the shareholders to compel the corporation to sue"; and (2) "a suit by the corporation, asserted by the shareholder[s] on its behalf, against those liable to it."[4]

Double derivative suits are filed when there exists a parent-subsidiary relationship between two entities. A parent company is an entity "that has a controlling interest in [a subsidiary]," meaning the parent company controls more than half of a subsidiary's stock.[5] A controlling interest in

1. This comment uses "single derivative suit" to refer to what is otherwise known as a "derivative suit," which involves a corporation and its shareholders, to avoid confusion with a "double derivative suit," which involves a parent corporation, a subsidiary, and parent-level shareholders, discussed *infra* Part I.B.

2. *See* 18 C.J.S. *Corporations* § 477 (2024); 19 AM. JUR. 2D *Corporations* § 1932 (2024).

3. *Derivative Actions for Corporations or LLCs*, PATTERSON L. FIRM, https://www.pattersonlawfirm.com/practice-areas/derivative-actions-for-corporations-or-llcs/ [https://perma.cc/3T8L-AH7D].

4. 13 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5941.10 (perm. ed., rev. vol. 2021).

5. Adam Hayes, *Parent Company: Definition, Types, and Examples*, INVESTOPEDIA (Mar. 26, 2022), https://www.investopedia.com/terms/p/parentcompany.asp [https://perma.cc/G46E-YPQA]; James Chen, *Subsidiary Company: Definition, Examples,*

the subsidiary means that "parent companies often have considerable influence over their subsidiaries,"[6] including when to initiate litigation. If a subsidiary's stock is owned entirely by another company, the subsidiary is referred to as a wholly-owned subsidiary.[7] Subsidiaries are legally distinct from their parent companies, although "[parent companies]—along with other subsidiary shareholders, if any—vote to elect a subsidiary company's board of directors."[8] Furthermore, it is not uncommon for the parent and subsidiary companies' boards to have overlapping personnel.[9]

When there is an alleged wrong that both parent and subsidiary boards refuse to remedy through litigation, parent-level shareholders (those who own shares in the parent company) may bring a double derivative suit on behalf of the subsidiary and for the subsidiary's benefit.[10] The alleged wrong may "include[] not only wrongs done directly to the parent corporation . . . but also the wrong[s] done to the corporation's subsidiaries that indirectly . . . affect[] the parent corporation and its shareholders."[11] The parent-level shareholders have standing to bring suit because of their ownership in the parent corporation.[12] When parent-level shareholders bring a double derivative suit, they are essentially maintaining a single derivative suit on behalf of the subsidiary.

One justification for derivative suits is that "a corporation's board has been so faithless to investors' interests that investors must be allowed to pursue a claim in the corporation's name."[13] Derivative suits, whether single or double in nature, are suits in equity. They are designed "to place in the hands of the individual shareholder a means to protect the interests of the corporation"[14] from "faithless officers and directors . . . who had damaged or threatened the corporat[ion] . . . and whom the corporation through its managers refused to pursue."[15]

Pros & Cons, INVESTOPEDIA (Oct. 30, 2023), https://www.investopedia.com/terms/s/subsidiary.asp [https://perma.cc/GY2Y-7D9H].

6. Chen, *supra* note 5.

7. *Id.*

8. *Id.*

9. *Id.*

10. *See* 13 FLETCHER ET AL., *supra* note 4, § 5977; 18 C.J.S. *Corporations*, *supra* note 2, § 478; 3 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 15:10 (3d ed. 2023).

11. 13 FLETCHER ET AL., *supra* note 4, § 5977 (footnote omitted).

12. *See id.*

13. Robert F. Booth Tr. v. Crowley, 687 F.3d 314, 316–17 (7th Cir. 2012).

14. Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 95 (1991).

15. Ross v. Bernhard, 396 U.S. 531, 534 (1970).

Most of the case law on double derivative suits comes from Delaware.[16] This is not unexpected, as Delaware "has been the premier state of formation for business entities since the early 1900s."[17] In 2022, Delaware saw more than 313,000 business entities formed under its laws, and it was the state of registration for approximately seventy-nine percent of initial public offerings in the United States.[18] Moreover, as of 2022, Delaware is the "domicile of choice for members of the Fortune 500 at nearly 68.2 percent."[19] Delaware's robust corporate statute, the Delaware General Corporation Law (DGCL), is regarded as the "most advanced and flexible business formation statute in the nation."[20] The Delaware Court of Chancery, a court of equity, and the Delaware Supreme Court are traditionally among the leading corporate law authorities.[21] Unsurprisingly, Delaware courts recognize double derivative suits because absent "a right to proceed double derivatively," shareholders would have "no procedural vehicle to remedy the claimed wrongdoing."[22]

Part I of this Comment discusses the procedural background for both single and double derivative suits. Part II argues that North Carolina should recognize double derivative suits. More specifically, Part II discusses the equitable nature of double derivative suits, and it notes that North Carolina courts already recognize the equitable nature of single derivative suits and generally consult equity principles in other business-related causes of action. Finally, Part III outlines single derivative standing requirements for North Carolina business entities, which can be readily applied to double derivative suits.

16. Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074, 1079 (Del. 2011) ("Delaware law has long recognized that a shareholder of a parent corporation may bring suit derivatively to enforce the claim of a wholly owned corporate subsidiary, [when] the subsidiary and its controller parent wrongfully refuse to enforce the subsidiary's claim directly.").

17. *Why Businesses Choose Delaware*, DELAWARE.GOV, https://corplaw.delaware.gov/why-businesses-choose-delaware/ [https://perma.cc/UK4J-5FG8].

18. *Delaware Division of Corporations: 2022 Annual Report*, DELAWARE.GOV, https://corp.delaware.gov/stats/ [https://perma.cc/T22D-AS2E].

19. *Id.*

20. *Id.*

21. *See id.*

22. Lambrecht v. O'Neal, 3 A.3d 277, 283 (Del. 2010).

I. PROCEDURAL BACKGROUND

A. Single Derivative Suits

Rule 23.1 of the Federal Rules of Civil Procedure provides the prerequisites and pleading requirements for a single derivative action in federal court.[23] Rule 23.1's provisions stem from the Supreme Court's ruling in *Hawes v. City of Oakland*,[24] where the Court first endorsed single derivative suits.[25]

Rule 23.1 applies when "one or more shareholders . . . bring a derivative action to enforce a right that the corporation . . . may properly assert but has failed to enforce."[26] Rule 23.1's pleading requirements state that the complaint must allege: (1) the plaintiff was a shareholder at the time of the alleged wrong;[27] (2) the suit is not one borne out of collusion to obtain jurisdiction in an otherwise incompetent jurisdiction;[28] and (3) state with particularity that the shareholders made a demand to the corporation's directors or other equivalent authority that the action be taken, and "the reasons for not obtaining the action or not making the effort."[29]

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23. FED. R. CIV. P. 23.1. Many states have adopted similar provisions in their versions of Rule 23.1 or otherwise similar statutes. 13 FLETCHER ET AL., *supra* note 4, § 5963; *see also* discussion *infra* Part II.B.

24. 104 U.S. 450 (1881).

25. *See* Daily Income Fund, Inc. v. Fox, 464 U.S. 523, 529–32 (1984) ("With some additions and changes in wording, the conditions set out in *Hawes* have been carried forward in successive revisions of the federal rules.").

26. FED. R. CIV. P. 23.1(a).

27. FED. R. CIV. P. 23.1(b)(1).

28. FED. R. CIV. P. 23.1(b)(2). The United States Supreme Court expressed concern in *Hawes v. City of Oakland* that corporations would collude with out-of-state shareholders to create diversity jurisdiction, thus invoking federal court jurisdiction. *See* Hawes v. City of Oakland, 104 U.S. 450, 461 (1881).

29. FED. R. CIV. P. 23.1(b)(3). This portion of the rule is referred to "demand futility" and addresses the issue that arises when a corporation's board refuses to initiate derivative litigation against its own members. The Delaware Supreme Court adopted a three-part test to determine when demand will be deemed futile and thus allow shareholders to meet the third pleading requirement:

> [A] demand on the board will be futile where at least half of the corporation's directors (i) received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand; or (iii) lacks independence from someone who "received a material personal benefit from the alleged misconduct that is the subject of the litigation demand or who would

Prior to *Hawes*, federal courts "entertained suits by minority stockholders to enforce corporate rights in circumstances where the corporation had failed to sue on its own behalf."[30] The United States Supreme Court recognized that such actions by minority shareholders could fall victim to abuse. For instance, one concern was that a corporation facing a "controversy, which it is foreseen must end in litigation, and preferring . . . that this litigation shall take place in a [f]ederal court" could conspire with out-of-state shareholders to obtain diversity jurisdiction and thus litigate in a forum where "the real parties to the controversy" would otherwise lack standing.[31]

The Court also expressed concerns that actions by minority shareholders, if not properly constrained, could "undermine the basic principle of corporate governance that the decisions of a corporation—including the decision to initiate litigation—should be made by the board of directors or the majority of shareholders."[32] With these concerns in mind, the Court sought to limit the number of instances in which "it was appropriate to permit a shareholder 'to institute and conduct a litigation which usually belongs to the corporation.'"[33]

B. Double Derivative Suits

The standing requirements for a double derivative suit are largely the same as those for a single derivative suit. As one court stated, "[a]lthough the terminology used to describe . . . multi-tier derivative actions may change, . . . the applicable principles of derivative standing remain constant."[34]

Shareholders bringing a double derivative suit must satisfy the Rule 23.1 pleading requirements at both the parent and subsidiary levels, but need

face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

13 FLETCHER ET AL., *supra* note 4, § 5965 (quoting United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1058 (Del. 2021)).

30. *Daily Income Fund, Inc.*, 464 U.S. at 529 (citing *Hawes*, 104 U.S. at 452).

31. *Hawes*, 104 U.S. at 452–53.

32. *Daily Income Fund, Inc.*, 464 U.S. at 530 (citing *Hawes*, 104 U.S. at 454–57).

33. *Id.* (quoting *Hawes*, 104 U.S. at 460).

34. Sagarra Inversiones, S.L. v. Cementos Portland Valderrivas, S.A., 34 A.3d 1074, 1079 (Del. 2011); *see also* Blasband v. Rales, 971 F.2d 1034, 1042–43 (3d Cir. 1992) ("A double derivative action is identical in form to a traditional derivative action.").

only plead demand futility at the parent level.[35] This means that demand futility, pled pursuant to Rule 23.1(b)(3), must be made to the parent company's board. In the event that the parent company's state of incorporation has a different Rule 23.1 than the subsidiary's state of incorporation, the shareholder must comply with the parent company's jurisdiction's Rule 23.1.[36]

The Delaware Court of Chancery reasoned:

> "[T]here is no basis in law or logic" to require [demand futility analysis at both parent and subsidiary levels, as doing so] . . . would treat the parent corporation as "if it were a minority shareholder" that only could proceed on behalf of its subsidiary by establishing demand futility, when in reality the parent corporation simply directs its subsidiary to file suit.[37]

As long as the complaint satisfies the applicable standing requirements, parent-level shareholders may "'stand in the shoes' of the parent" and bring claims belonging to the subsidiary.[38]

II. NORTH CAROLINA SHOULD RECOGNIZE DOUBLE DERIVATIVE SUITS

Like single derivative suits, double derivative suits are equitable in nature because they provide parent-level shareholders and subsidiaries a vehicle for recovering against alleged wrongs when they otherwise may not have been able to recover.[39] North Carolina already recognizes single derivative suits and piercing the corporate veil in the name of equity. Additionally, North Carolina has enacted a statutory scheme for single derivative suits that can be easily applied or adopted in response to a recognition of the double derivative cause of action.

35. Hamilton Partners, L.P. v. Englard, 11 A.3d 1180, 1207 (Del. Ch. 2010); 13 FLETCHER ET AL., *supra* note 4, § 5963.

36. *See Sagarra Inversiones, S.L.*, 34 A.3d at 1080–82 (stating that "the law of the jurisdiction of incorporation of the entity on whose board a presuit 'demand' is required'" governs).

37. *Hamilton Partners, L.P.*, 11 A.3d at 1206–07 (quoting Lambrecht v. O'Neal, 3 A.3d 277, 288–89 (Del. 2010)).

38. *Sagarra Inversiones, S.L.*, 34 A.3d at 1079.

39. *See Lambrecht*, 3 A.3d at 282–83.

A. Double Derivative Suits Are Equitable and North Carolina Likes Equity

One reason courts permit double derivative suits[40] is that derivative suits, whether single or double in nature, are products of equity jurisprudence.[41] Equity principles have compelled courts to recognize double derivative suits largely because not doing so would leave indirectly harmed parent-level shareholders without a remedy for alleged wrongs.[42]

Perhaps the best explanation for permitting double derivative suits comes from *Brown v. Tenney*.[43] There, the Illinois Court of Appeals recognized double derivative suits by allowing plaintiff Brown to bring suit on behalf of a subsidiary, and the Illinois Supreme Court affirmed, officially recognized double derivative suits.[44] In *Brown*, the parties formed Pioneer Commodities Incorporation ("Pioneer") together in 1975.[45] In 1982, Pioneer shareholders "formed T/B to act as a holding company for Pioneer," which would in turn become T/B's subsidiary.[46] In 1983, Brown filed a derivative action "alleging that Tenney had engaged in, and was continuing to engage in, a course of conduct that was wasting, diverting[,] and damaging" both Pioneer's and T/B's assets in a series of self-dealing transactions.[47]

Before *Brown*'s appeal to the Illinois Supreme Court, the Illinois Appellate Court first considered six theoretical bases other jurisdictions had used to justify permitting double derivative suits:

40. Some legal scholars argue that two rationales for permitting single derivative suits—compensation and deterrence—also support permitting double derivative suits. *See, e.g.*, David W. Locascio, *The Dilemma of the Double Derivative Suit*, 83 NW. U. L. REV. 729, 753–57 (1989).

41. *See* Brown v. Tenney, 532 N.E.2d 230, 234 (Ill. 1988); *see also* Brown v. Tenney, 508 N.E.2d 347, 350 (Ill. App. Ct. 1987), *aff'd*, 532 N.E.2d 230 (Ill. 1988) ("[N]or has our research led us to, any sufficient contrary legal or equitable theory which sets forth a persuasive argument for denying a shareholder . . . the right to maintain a double derivative action."); Hirshhorn v. Mine Safety Appliances Co., 54 F. Supp. 588, 592 (W.D. Pa. 1944) (supporting other courts' findings of equitable reasons for permitting double derivative suits); Blasband v. Rales, 971 F.2d 1034, 1044 (3d Cir. 1992) (recognizing that Delaware courts, in shareholder actions, rule in equity).

42. *See Lambrecht*, 3 A.3d at 283.

43. 532 N.E.2d 230 (Ill. 1988).

44. *Brown*, 508 N.E.2d at 351 (Ill. App. Ct. 1987), *aff'd*, 532 N.E.2d 230 (Ill. 1988).

45. *Id.* at 348.

46. *Id.*

47. *Id.*; *Brown*, 532 N.E.2d at 232 (Ill. 1988). The self-dealing transactions included converting Pioneer's corporate funds for personal use. *Brown*, 532 N.E.2d at 232 (Ill. 1988).

(1) a double derivative action is equivalent to a single derivative suit after the court has pierced the corporate veil and treated parent and subsidiary as one corporation;

(2) a double derivative suit is justified because both the parent and the subsidiary are controlled by the same persons. Therefore, the shareholders of the parent are the only parties who might realistically bring a suit to redress a wrong to a subsidiary;

(3) a double derivative suit is in essence a suit by the beneficiary of a fiduciary (the parent), which is in turn the beneficiary of a second fiduciary (the subsidiary);

(4) a double derivative action is justified by agency principles;

(5) a parent corporation "owes a duty [to shareholders] to use its control of the subsidiary to right any wrong to it, and the shareholders may . . . seek specific performance of that duty";

(6) a double derivative action is justified because harm to the subsidiary will inevitably fall on the shareholders of the parent corporation.[48]

The Illinois Appellate Court allowed the double derivative suit to proceed, but not because it adopted any of the six theories. Instead, the court concluded that it was not shown any "sufficient contrary legal or equitable theory which sets forth a persuasive argument for denying a shareholder . . . the right to maintain a double derivative action."[49] What is more, the court reasoned that double derivative suits would "comport with the realities of corporate structure" in "modern society."[50]

The Illinois Supreme Court eventually recognized double derivative actions after *Brown* was appealed, and it rejected the defendants' argument that public policy disfavors recognizing double derivative causes of action.[51]

In affirming the Illinois Appellate Court, the Illinois Supreme Court recognized that in the parent-subsidiary structure, a parent-level shareholder would ordinarily lack standing to bring a single derivative suit against the subsidiary because the parent-level shareholder would not hold shares in the subsidiary itself. The parent-level shareholder would therefore lack a

48. Locascio, *supra* note 40, at 734–35 (alterations in original) (citing *Brown*, 508 N.E.2d at 350 (Ill. App. Ct. 1987)).

49. *Brown*, 508 N.E.2d at 350 (Ill. App. Ct. 1987).

50. *Id.*

51. *See Brown*, 532 N.E.2d at 234–36 (Ill. 1988).

remedy because it could not commence an action.[52] Emphasizing that a double derivative suit is part of "a long-standing doctrine of equity jurisprudence," the court noted that without a right to sue double derivatively, no one would represent the parent-level shareholders' interests in rectifying harms suffered directly by the subsidiary corporation and indirectly by the parent-level shareholders.[53]

In fact, the court reasoned that a "lack of representation [would] be even more pronounced when the directors of a holding company are also the directors of a subsidiary."[54] Absent a right to pursue a double derivative action, the parent-subsidiary structure would "prevent the righting of many wrongs and would insulate the [parent corporation] wrongdoer from judicial intervention."[55] Indeed, to provide a remedy for parent-level shareholders, the subsidiary company would effectively function "as a shield [for the alleged wrongdoers], when actually it is transparent to the dispute."[56]

Despite the defendant asserting "a loss of corporate franchise tax revenue, a dearth of directors' indemnity insurance, corporations besieged by requests for information from all sources, and a flood of shareholder actions" as policy reasons in favor of rejecting double derivative suits, the court quickly dismissed them.[57] The court determined that those consequences were not likely to happen and were not sufficiently compelling to the extent that they would outweigh the benefits of permitting an otherwise remedy-less shareholder to "redress wrongs committed against a subsidiary by defalcating, abusive[,] and manipulative directors and officers."[58]

1. North Carolina Recognizes Single Derivative Suits in the Name of Equity

North Carolina has long recognized single derivative suits—first in its courts, and later in its general statutes.[59] North Carolina courts have already accepted the United States Supreme Court's justification for single derivative suits in that they are "one of the remedies which equity designed for those situations where the management through fraud, neglect of duty[,]

52. *Id.*
53. *Id.*
54. *Id.* at 235.
55. *Id.* at 233 (citation omitted).
56. *Id.* at 235.
57. *Id.* at 236.
58. *Id.*
59. *See* Moore v. Silver Valley Mining Co., 10 S.E. 679, 682 (N.C. 1890); N.C. GEN. STAT. § 55-7-40 (2023).

or other cause declines to take proper and necessary steps to assert the rights which the corporation has."[60] As such, and because double derivative suits are likewise justified in equity, North Carolina is, in theory, already receptive to recognizing equitable bases in shareholders' rights to hold corporate wrongdoers accountable for their wrongs.

The North Carolina Supreme Court first discussed single derivative suits in *Moore v. Silver Valley Mining Company*,[61] "approach[ing] the . . . action with caution."[62] Although it may be "impracticable and absurd" to allow shareholders to bring a single derivative suit, the *Moore* court explained, equity principles would necessitate allowing shareholders the right to bring suit.[63] The court stated:

> The right to bring, and the occasion for bringing, such actions arise only when and because the proper corporate officers will not, for some improper consideration, discharge their duties as they should do. . . . [S]tockholders . . . may not bring such actions at their pleasure . . . . Such actions are allowed because of necessity, and for the benefit of the corporation and its stockholders.[64]

Subsequent North Carolina Supreme Court cases have "entertained" single derivative suits, allowing them to proceed "subject to the requirements of exhaustion of intra-corporate remedies, including demand on directors, and contemporaneous ownership."[65]

North Carolina courts also allow plaintiffs in a single derivative suit to plead demand futility, another principle rooted in equity. Demand futility is an "equitable exception" to the requirement that shareholders make a demand on the corporation's board to pursue litigation.[66] When a

60. Anderson v. SeaScape at Holden Plantation, 773 S.E.2d 78, 87 (N.C. Ct. App. 2015) (emphasis omitted) (quoting Meyer v. Fleming, 327 U.S. 161, 167 (1946)).

61. 10 S.E. 679 (N.C. 1890).

62. Alford v. Shaw, 349 S.E.2d 41, 46 (N.C. 1986), *withdrawn*, 358 S.E.2d 323 (N.C. 1987) (citing *Moore*, 10 S.E. at 682).

63. *Moore*, 10 S.E. at 682.

64. *Id.*

65. *Alford*, 349 S.E.2d at 46 (citing Goodwin v. Whitener, 138 S.E.2d 232 (N.C. 1964) (mismanagement)); Johns-Manville Sales Corp. v. Townsend, 104 S.E.2d 826 (N.C. 1958) (fraudulent withdrawal and appropriation of corporate assets); Caldlaw, Inc. v. Caldwell, 102 S.E.2d 829 (N.C. 1958) (preempting profit on sale of corporate property); Jordan v. Hartness, 55 S.E.2d 484 (N.C. 1949) (fraudulently dissipating assets)).

66. Alford v. Shaw, 358 S.E.2d 323, 327 (N.C. 1987) (citing Hill v. Erwin Mills, Inc., 80 S.E.2d 358 (N.C. 1954)); *see also* Swenson v. Thibaut, 250 S.E.2d 279, 295 (N.C. Ct. App. 1978)).

corporation's directors or officers are the individuals alleged to have breached their fiduciary duties, "the demand of a shareholder upon directors to sue themselves or their principals would be futile, and as such is not required as a prerequisite for the maintenance of the action."[67] This principle was more thoroughly discussed in *Coble v. Beall*.[68] There, the court maintained:

> If the facts, as alleged, show that the defendants charged with a wrongdoing, or some of them, constituted a majority of the directors or managing body at the time of commencing the suit, or that the directors, or a majority thereof, are still under the control of the wrongdoing defendants, so that a refusal of the managing body, if requested to bring suit in the name of the corporation, may be informed with reasonable certainty, then an action by a stockholder may be maintained, without alleging or proving any notice, request, demand, or express refusal.[69]

North Carolina courts have already recognized single derivative suits and demand futility in the name of equity—the same principle that other courts have relied on to permit double derivative suits. Because North Carolina is receptive to recognizing a cause of action in the name of equity, it should recognize double derivative suits using the same principles it touted in recognizing single derivative suits.

2. North Carolina Courts Consider Equity Across Other Corporate Claims

North Carolina has also considered equity in other areas of corporate law, including when courts decide whether to permit plaintiffs to pierce the corporate veil. The equity principle permitting this theory is similar to that underlying double derivative suits—allowing a plaintiff to pierce the corporate veil provides a pathway to redress a harm that would otherwise go without remedy.

Shareholders appreciate limited liability for a corporation's wrongs. This is because "in the ordinary course of business, a corporation is treated as distinct from its shareholders," and therefore, shareholders should not be liable for the corporation's torts or crimes.[70] Piercing the corporate veil is an exception to the general rule of shareholders' limited liability that

67. *Swenson*, 250 S.E.2d at 295.

68. 41 S.E. 793 (N.C. 1902).

69. *Id.* at 794 (citation omitted).

70. Green v. Freeman, 749 S.E.2d 262, 270 (N.C. 2013) (quoting State *ex rel.* Cooper v. Ridgeway Brands Mfg., LLC, 666 S.E.2d 107, 112 (N.C. 2008)).

"allows a plaintiff to impose legal liability for a corporation's obligations . . . upon some other company or individual that controls and dominate a corporation," like a shareholder or director.[71] This enables plaintiffs to "bring claims against individuals who otherwise would have been shielded by the corporate form," holding those individuals—not the corporation—liable for harms they committed.[72] Therefore, "courts will disregard the corporate form or 'pierce the corporate veil' when 'necessary to prevent fraud or to achieve equity.'"[73]

North Carolina courts have recognized that piercing the corporate veil can be a useful tool when "applying the corporate fiction would accomplish some fraudulent purpose, operate as a constructive fraud, or defeat some strong equitable claim."[74] Part of the policy rationale for allowing plaintiffs to pierce the corporate veil is to prevent "[t]hose who are responsible for the existence of the corporation . . . from using [the corporation's] separate existence to accomplish an unconscionable result."[75] This means courts will allow plaintiffs to pierce the corporate veil because it prevents wrongdoers from sheltering behind the corporate name to avoid liability. To that end, the North Carolina Supreme Court has "held that a shareholder may not utilize the corporate form to shield criminal wrongdoing, defeat the public interest, [or] circumvent public policy."[76]

Similarly, courts permit double derivative suits in order to prevent corporate wrongdoers from interposing the corporation between themselves and liability for harm done to their shareholders and subsidiary/subsidiaries. Underlying both the principle of piercing the corporate veil and the double derivative cause of action is the recognition that shareholders should be able to hold corporate wrongdoers liable for harms committed and that corporate wrongdoers should not be able to use entities to shield themselves from liability. Therefore, North Carolina's recognition of a double derivative cause of action would continue a trend of recognizing equitable bases upon which shareholders may seek remedies.

71. *Id.* (citation omitted).

72. *Id.*

73. *Ridgeway Brands Mfg., LLC*, 666 S.E.2d at 113 (quoting Glenn v. Wagner, 329 S.E.2d 326, 330 (N.C. 1985)).

74. *Id.* at 112–13 (quoting Bd. of Transp. v. Martin, 249 S.E.2d 390, 395 (N.C. 1978)).

75. *Id.* at 113 (quoting *Martin*, 249 S.E.2d at 395).

76. *Id.* (citing State v. Louchheim, 250 S.E.2d 630, 639–40 (N.C. 1979)).

B. North Carolina Already Has Statutory Schemes to Make Recognition Easy

The North Carolina legislature has recognized single derivative suits and codified requirements for the action.[77] Because double derivative suits are extensions of single derivative suits and share many of the same procedural requirements as single derivative suits, North Carolina already possesses a framework for governing standing requirements for double derivative suits.[78] Therefore, the North Carolina legislature would have little work, if any, to provide a statutory framework for double derivative suits.

As part of the North Carolina Business Corporation Act, section 55-7-40 of North Carolina's General Statutes authorizes shareholders to bring a single derivative suit in North Carolina superior courts.[79] The related statutes codify the requirements for standing, demand, and procedure.[80] Because double derivative suits are merely extensions of single derivative suits, the single derivative suit standing requirements, as codified in North Carolina, can be easily applied to double derivative suits.

III. DOUBLE DERIVATIVE STANDING REQUIREMENTS IN NORTH CAROLINA

North Carolina has not yet "explicitly addressed whether a plaintiff may bring a double derivative claim under North Carolina law."[81] In 2016, the business court recognized the lack of authority for whether plaintiffs could bring what other jurisdictions, specifically Delaware, recognize as a double derivative claim.[82] In *White*, the plaintiff sought to bring a derivative action on behalf of a 75%-owned subsidiary LLC against parent-level LLC managers.[83] The plaintiff alleged breaches of fiduciary duties related to

77. *See* N.C. GEN. STAT. §§ 55-7-40 to 55-7-50 (2023).

78. Courts have applied Rule 23.1 requirements (which govern requirements for a single derivative suit) to double derivative suits. *See* Lambrecht v. O'Neal, 3 A.3d 277, 282 (Del. 2010) (stating that a demand for a double derivative suit need only be made *under Rule 23.1* at the parent, not subsidiary, level); *see also* FED. R. CIV. P. 23.1.

79. N.C. GEN. STAT. § 55-7-40.

80. *See id.* §§ 55-7-40 to 55-7-50.

81. White v. Hyde, No. 16 CVS 1330, 2016 WL 5853138, at *6, ¶ 48 (N.C. Super. Ct. Oct. 4, 2016).

82. *Id.*

83. *Id.* at *3–*6.

self-dealing transactions.[84] The business court recognized that the allegations would have been sufficient to constitute a double derivative claim in Delaware.[85] The court declined to dismiss plaintiff's claim at the pleadings stage, implicitly finding that North Carolina's existing framework could recognize double derivative suits.[86] However, that portion of the plaintiff's claim settled before trial, and the court lacked an opportunity to fully affirm double derivative relief on the merits.[87]

In the event North Carolina recognizes double derivative suits, the standing requirements plaintiffs must satisfy will differ depending on the type of business organization they are suing on behalf of and under which jurisdiction's laws they are suing. The statutory-based standing requirements for plaintiffs suing on behalf of North Carolina corporations, limited liability companies, and limited partnerships are outlined below. Notably, and in line with Delaware, the statutes follow the internal affairs doctrine—plaintiffs need only meet standing requirements at the parent level.[88]

A. Corporations

North Carolina has already recognized single derivative suits and has codified requirements for bringing such suits as part of the North Carolina Business Corporation Act.[89] North Carolina superior courts have jurisdiction over derivative proceedings.[90]

Plaintiffs must meet a demand requirement before commencing a single derivative suit.[91] In other words, before filing a single derivative suit, plaintiffs must present a demand on the corporation's board that the board take action to remedy the alleged wrong.[92] Shareholders can meet the

84. *Id.* at *6, ¶ 52, *8, ¶ 62. The self-dealing transactions related to lowered rental and purchase prices between a subsidiary and a tenant of a subsidiary, which in turn resulted in losses to the parent. *Id.* at *6, ¶ 52.

85. *Id.* at *6, ¶ 49 ("Plaintiff's Complaint . . . states claims . . . that would qualify as double derivative claims . . . under Delaware law.").

86. *Id.* ¶ 51.

87. *Id.*

88. *See, e.g.*, Hamilton Partners, L.P. v. Englard, 11 A.3d 1180, 1207 (Del. Ch. 2010); *see* N.C. GEN. STAT. §§ 55-7-47, 57D-8-06, 59-90 (2023).

89. *See* N.C. GEN. STAT. §§ 55-7-40 to 55-7-50.

90. *Id.* § 55-7-40.

91. *Id.* § 55-7-42.

92. *Id.*

demand requirement by making a written demand.[93] As discussed above, plaintiffs may instead plead demand futility in North Carolina and thereafter maintain their suit.[94] After ninety days have expired from the date the demand was made on the board, plaintiffs may proceed with their suit, assuming the board has not rejected the demand and the corporation would not suffer "irreparable injury" prior to ninety days' expiration.[95]

For a plaintiff to have standing, she must have been a shareholder of the corporation at the time of the alleged wrong or must have become a shareholder by receiving shares from someone who was a shareholder at the time of the alleged wrong.[96] Further, if a plaintiff brings a derivative suit for monetary damages on behalf of a public corporation, in addition to the requirements in section 55, the plaintiff must have been a shareholder for at least one year.[97] Lastly, the plaintiff must comply with the two-year statute of limitations, which requires a shareholder to bring suit within "two years of the date of the transaction of which the plaintiff complains."[98]

B. Limited Liability Companies

A limited liability company (LLC) is a business structure in which its owners, called "members," are protected from personal liability for the business's liabilities.[99] North Carolina permits member derivative actions in the context of LLCs under its Limited Liability Company Act.[100] Such actions may be brought in superior court on behalf of an LLC for the LLC's benefit.[101]

93. *Id.* Under subsection (2), ninety days must have passed since the demand was made, unless the shareholder was notified ahead of time "that the corporation rejected the demand," or, if waiting ninety days would be harmful to the corporation. *Id.*

94. *See* JAMES E. SNYDER JR., NORTH CAROLINA CORPORATION LAW AND PRACTICE §§ 25:3, :5 (4th ed. 2023) (citing Swenson v. Thibaut, 250 S.E.2d 279 (N.C. Ct. App. 1978)).

95. N.C. GEN. STAT. § 55-7-42.

96. *See id.* § 55-7-41(1); SNYDER JR., *supra* note 94, § 25:7.

97. N.C. GEN. STAT. § 55-7-48(1).

98. *Id.* § 55-7-48(2). If the court orders, plaintiffs must also submit "a written undertaking with sufficient surety, approved by the court, to indemnify the corporation against any and all expenses reasonably expected to be incurred by the corporation in connection with the proceeding, including expenses arising by way of indemnity." *Id.* § 55-7-48(3).

99. Jason Fernando, *What is an LLC? Limited Liability Company Structure and Benefits Defined*, INVESTOPEDIA (Sept. 30, 2023), https://www.investopedia.com/terms/l/llc.asp [https://perma.cc/YG5N-7EH4].

100. *See* N.C. GEN. STAT. § 57D-8-01.

101. *Id.* § 57D-8-01(b).

Like a corporate shareholder, an LLC's member must have been a member of the LLC at the time of the alleged wrong or have inherited its ownership interest from someone who was a member at the time of the alleged wrong.[102] The member must have made a written demand on the LLC.[103] Like within the corporate context, LLC members may bypass the written demand requirement if: (1) the written demand was rejected, (2) ninety days had passed since the date the demand was made, or (3) the LLC would suffer "irreparable injury" if the member had to wait ninety days to bring suit.[104]

C. Limited Partnerships

A limited partnership is a partnership of at least two partners, one as a general partner and one as a limited partner.[105] Limited partners enjoy limited liability "up to the amount of their investment" for the limited partnership's liabilities, while general partners have "unlimited liability."[106]

North Carolina circumstantially permits limited partners to bring a derivative suit on behalf of the limited partnership. Limited partners may bring suit if "general partners with authority to [bring suit] have refused to bring [suit]" or if it is unlikely that general partners will be persuaded by an effort to bring suit on behalf of the limited partnership.[107]

Similar to shareholders, plaintiffs in these derivative suits must have either been a limited partner at the time of the alleged wrong or their partner status "must have devolved upon [them] by operation of law or pursuant to the terms of the partnership agreement from a person who was a partner at the time of the [complained of] transaction."[108]

102. *Id.* § 57D-8-01(a)(1).

103. *Id.* § 57D-8-01(a)(2).

104. *Id.*

105. Evan Tarver, *Limited Partnership: What It Is, Pros and Cons, How to Form One*, INVESTOPEDIA (Dec. 12, 2023), https://www.investopedia.com/terms/l/limitedpartnership.asp [https://perma.cc/7DHK-DLAT].

106. *Id.*

107. N.C. GEN. STAT. § 59-1001. If plaintiffs either fail to compel the general partner(s) to bring suit or do not seek to compel the general partner(s) to bring suit at all, they must plead with particularity the efforts they made or their reasons for not making an effort (analogous to demand futility in the corporate context). *Id.* § 59-1003.

108. *Id.* § 59-1002.

CONCLUSION

If given the opportunity, North Carolina should recognize double derivative suits. These suits allow plaintiffs an equitable vehicle for recovery when a corporation's directors or officers use the corporate form as a shield from liability. North Carolina already justifies single derivative suits in the name of equity and provides statutory schemes for plaintiffs to follow when bringing single derivative suits. Across business law in general, North Carolina also recognizes that equity principles should and do guide courts' analysis for theories such as piercing the corporate veil that provide shareholders with remedies when corporate directors or officers would otherwise evade liability. Finally, North Carolina's statutory schemes for single derivative suits—for corporations, LLCs, and limited partnerships—provide bases that need not be substantially amended, if at all, for double derivative suit standing requirements. As such, North Carolina has all the justifications and statutory bases rendering it capable of recognizing double derivative suits.

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