NGIRABRENGES OMELAU,
Plaintiff,

v.

REPUBLIC OF PALAU DIVISION OF FISH AND WILDLIFE PROTECTION, and KAMMEN CHIN, CHIEF OF FISH AND WILDLIFE PROTECTION, in his official capacity,
Defendants.

CIVIL ACTION NO. 09-032

Supreme Court, Trial Division
Republic of Palau

Decided: December 23, 2009

[1] **Constitutional Law:** Due Process

When property seized by the government is no longer needed for evidentiary purposes, either because trial is complete, the defendant has pleaded guilty, or the government has abandoned its investigation, the person from whom the property is seized is presumed to have a right to its return. Where the government fails to bring criminal proceedings of civil forfeiture proceedings against the property owner, it bears the burden of showing that it has a legitimate reason to retain the property.

ALEXANDRA F. FOSTER, Associate Justice:

On February 16, 2009, Plaintiff Ngirabrenges Omelau filed a complaint seeking the return of 28 kesokes nets with attached floaters and sinkers and a net bag in its pre-seizure condition, or compensation for

unconstitutional deprivation, or damages for an intentional conversion of Plaintiff's property. In response, Defendants filed a motion to dismiss on March 9, 2009, and Plaintiff filed his response to that motion on March 20, 2009. On May 22, 2009, the Court denied in part and granted in part Defendants' motion to dismiss. Plaintiff's claim for the return of property survived, but his claims for compensation for unconstitutional deprivation and damages for intentional conversion were dismissed as claims barred by sovereign immunity. On June 2, 2009, Defendants filed an answer and counterclaimed for: (1) 29 separate violations of 27 PNC § 1204 (m) and (n), which each carry a fine of $200,000; (2) forfeiture of the nets under 27 PNC § 1208(b)(3), because they were unlawful under 27 PNC § 1204 (m) and (n); and (3) an injunction for any future use of the nets under 27 PNC § 1209 (b)(5).[1] Defendants also sought costs and attorney fees, but set forth no basis for such an award. On June 25, Plaintiff answered the counterclaims with the affirmative defenses of laches, estoppel, statute of limitations, waiver and failure to state a claim upon which relief can be granted. The parties were unable to resolve their differences and this matter went to trial on December 14, 2009, with written closings filed on December 18, 2009. By the time of written closings, Plaintiff still sought return of the nets (including sinkers and floaters) or compensation, but the Republic had downgraded its demand to civil forfeiture of the illegal nets.

The Court hereby issues its findings of the relevant facts and conclusions of law pursuant to ROP R.Civ.P. 52.

FINDINGS OF FACT

The Court finds that upon the advice of a local fisherman named Rechirei Bausoch and a manager from the Palau Fisherman's Association,[2] Plaintiff flew to the Philippines in 2000 to buy fishing gear from a specific vendor. He bought twelve sacks of floaters, 90 rolls of string and 89 rolls of mesh/fishing net. He bought the weights ("sinkers") in Palau. Plaintiff knew that the legal minimum mesh size was three inches,[3] and so he had the Filipino vendor measure the net before he was bought it. He saw that the mesh of the net measured three inches.[4] The vendor also pushed a pencil-like object with a diameter of three inches through the net. The nets cost about $2,000 in the Philippines, but Plaintiff also had to shoulder the cost of transporting these items back to Palau—the only specific cost Plaintiff mentioned was $85 bill for excess baggage. The weights cost $2,500.

[1] 27 PNC § 1209(b)(5) does not exist. The Court assumes counsel means 27 PNC § 1208(b)(5).

[2] Plaintiff's witness, Abby Rdialul, referred to the organization as the "Palau Federation of Fishing Association." Either way, it is an entity that sold fishing equipment in Palau.

[3] In fact, Plaintiff testified that he had to retire his father's fishing nets because they were not in compliance with the three-inch requirement. Somewhat confusingly, Plaintiff testified that his father threw the nets out before he died in 1981. The law concerning mesh size was not passed until 1994, however.

[4] Plaintiff measured the mesh of the net at trial. Measuring diagonally from one knot to the other, the net is barely three inches.

Finally, Plaintiff hired four Filipino workers to come to Palau and help him assemble the nets. He paid each worker $250/month, and the four men were here for two months, all of which adds up to $2,000 for the four workers. Although the workers had told him that they knew how to assemble nets, once they arrived here it became clear that they did not know how to make these nets, so he paid Rechirei $2,000 to show the workers how to make kesokes nets.[5] The nets varied from 150 to 250 feet in length. After they were assembled, Plaintiff fished with the nets for about three years until they were confiscated.

On September 10, 2004, the Division of Fish and Wildlife Protection ("DFW") confiscated all 28 of Plaintiff's kesokes nets, along with a bag. The DFW alleged that the nets' mesh size was too small as it did not measure three inches diagonally. The DFW told that Plaintiff that his nets were the same size as Rdialul's nets. The DFW has not returned the nets to Plaintiff, nor have they filed criminal charges or commenced civil forfeiture proceedings against Plaintiff.

Everyone appears to agree that Plaintiff's nets were the same size as Rdialul's nets. Rdialul's nets were confiscated around the same time as Plaintiff's nets. Rdialul had purchased his nets in Palau from Palau Fishing Authority, which ran a fishing gear store called Palau Federation of Fishing Association. (These are the same individuals who sent Plaintiff to their vendor in the Philippines, because the store had run out of kesokes nets.) Rdialul paid about $3,000 for his nets and $75 for the net bag. Rdialul believed the mesh size of his nets met the legal requirement of three inches. He testified that although the mesh may expand or contract when wet, it returned to its original size when it dried. On September 12, 2003,[6] DFW confiscated "twenty some" nets from Rdialul, because DFW alleged that the mesh size of Rdialul's nets was less than three inches. Over four years later, on January 14, 2008, Rdialul filed a civil complaint against the Republic, the DFW, and DFW Chief Kammen Chin. On May 28, 2008, Justice Salii dismissed Plaintiff's civil case because the Republic was prosecuting Rdialul for possession of unlawful kesokes nets in Criminal Action No. 08-073.[7] On December 22, 2008, in a one page verdict in Criminal Action No. 08-073, Justice Materne found Rdialul not guilty of retaining possession of kesokes nets in violation of 17 PNC §§ 1204 and 1209 (a) "[f]or reasons stated in open court."[8] At trial in this case, Rdialul testified, that someone measured the nets in front of the judge and "found out that my nets were bigger then they originally thought." Rdialul was not fined or imprisoned.[9] Rdialul added that

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[5] Plaintiff has no receipts for his purchases in Palau, his purchases in the Philippines, or his payments to the workers or Rechirei.

[6] The Court found this date in Chief Kammen Chin's February 18, 2008, affidavit attached to the Republic's motion to dismiss.

[7] Justice Salii's order dismissing the civil case is attached to Plaintiff's complaint.

[8] Justice Materne's verdict is attached to Plaintiff's complaint.

[9] Confusion surrounds whether the civil or criminal case was filed first and which case actually went to trial. Rdialul thought that his civil case was pending, and that the criminal case preceded the civil case. Chin thought that no

others fish with nets the same size as his, and those nets have not been seized.[10]

After his nets were seized, Plaintiff heard a rumor that Eisenhower "Eisen" Meresbong was using some of his confiscated nets. Plaintiff went to visit Eisen. He saw Eisen's nets and recognized them as his own. He recognized his nets by their telltale yellow string through the black net, along with Plaintiff's sinkers and floaters. Plaintiff told Eisen those were his nets that had been confiscated by DFW. Eisen told Plaintiff that he measured the mesh size, found it to be three inches, and was fishing with the nets.[11] Plaintiff had his son take photographs of Eisen and Plaintiff with the nets.[12]

Eisenhower Meresbong agreed that he owned kesokes nets, but he testified that he bought his nets from the Philippines. After some prodding, he conceded that he had received nets from the DFW. He did not recognize the nets in the photographs (Plaintiff's Ex. 2), but admitted that the nets he received from the DFW looked like the nets in the courtroom (Plaintiff's Ex. 3 – two of Plaintiff's nets which remain in the possession of the DFW). He testified that although the DFW nets have a three-inch mesh size, he could not use them for fishing because the nets were damaged; they were missing weights and floaters. DFW instructed him that he should only use the nets for agriculture, and he testified that he has followed those instructions.[13]

The DFW also gave some of Plaintiff's nets to John "Aro" Remengesau for agricultural purposes. Remengesau requested and received some of Plaintiff's nets, weights and floaters from the Subelek Farms, which the DFW ran. Remengesau did not know who originally owned the nets. He knew the nets were illegal mesh size because the mesh looked smaller than his legal gill nets, but he thought that they would work as a fence to keep the pigs out of his farm.[14] He burned down the weights into smaller and longer sinkers for his gill nets. Originally, he testified that he did nothing with the floaters but then, when asked whether he could return the floaters, he testified that six of his gill nets

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criminal case had ever been filed against Rdialul, and that he testified in the Rdialul's civil case. The Court takes this confusion as a reflection of the complexities of the law, and not as a reflection of the witnesses' intelligence or memory.

[10] He stated, however, that he had never seen Eisen or Aro fishing with similarly-sized kesokes nets. As will be discussed more thoroughly later in the decision, the DFW gave these individuals Plaintiff's nets for agricultural purposes.

[11] Plaintiff's statements to Eisen and Eisen's responses were admitted not for the truth of the matter asserted, but as impeachment of Eisen.

[12] Black and white copies of five of those photographs were introduced as Plaintiff's Exhibit 2. The nets are hanging like fishing nets. Floaters are visible in at least two of the photographs.

[13] It seems fairly clear from Plaintiff's photographs, and Mersebong's demeanor and testimony at trial (e.g., he repaired the damaged nets by replacing the sinkers and floaters) that he is using these nets for fishing. Meresbong is not a party to this case, however, so the Court need not reach a decision as to whether he violated any laws.

[14] Apparently, he ultimately did not use the nets for that purpose.

had been stolen and Plaintiff's floaters were with those nets. Aro paid nothing for the nets, weights and floaters.

Chief Kammen Chin testified that he had Plaintiff's nets seized because the mesh of the nets was too small. Chin has been measuring kesokes nets in the same manner ever since DFW started confiscating nets. He measures nets from the inside knot of the mesh hole to the other inside knot of the mesh hole. Chin testified that dictionaries define "mesh" as the open space between wires, chords or threads. Using the method of measuring the open space—and not the entire hole to include the netting itself—Chin showed the Court at trial that the mesh hole of Plaintiff's net measured about 2 3/4 inches. Chin used a demonstrative wooden fish, which measured three inches at its widest and tried to fit it through Plaintiff's nets. His attempts were unsuccessful. Plaintiff points out that the demonstrative wooden fish is about 1/4-inch in thickness and that thickness should be taken into account in setting the size of the fish. In other words, if one considers the thickness, the wooden fish was actually 3 1/2 inches.

Chin did not know how many nets were seized from Plaintiff, although he conceded that it could have been as many as 28. Apparently, there is no record of the number of nets seized. Plaintiff's Exhibit 1, the Receipt of Confiscated Property, which DFW gave Plaintiff when they confiscated his nets, reads: "1) 250 ft. each kesokes" and "2) Bkuro."[15]

The preamble to the Receipt reads: "The following items have been seized by authority of the Division of Fish and Wildlife Protection because . . . such items are unlawful to possess. These items may be transferred to the custody of another agency for storage or as part of the investigation process."[16] Chin testified that the seized nets were bulky and took up too much space in the office, so they were transferred from the Division of Fish and Wildlife to Subelek Farm, where there was more storage space. Chin headed up Subelek Farms until last year.

Chin conceded that only two of Plaintiff's nets remain in the DFW's custody today (Plaintiff's Ex. 3). When asked what happened to the other nets and the bag, Chin answered that they had been given to farmers such as Eisen and Aro and others whose names he did not remember. After receiving the green light from the Attorney General's office, Chin agreed to release the nets to these men, and presumably others, on the condition that the nets be used for farming and not fishing. Again, there is no record of who received nets, and how many were given to each recipient. Chin testified that he just told each recipient to "get what he needed." Chin contends that because the nets had been properly seized, the DFW could dispose of the nets as they wished.

Although the testimony is conflicting on whether Aro and Eisen, or workers at Subelek Farm, or both, removed the floaters

[15] Plaintiff testified that "Bkuro" is the net bag.

[16] Despite many other entries, such as "Location of items at time of seizure," "Owners of items, if known" and a signature line for the "person from whom items were confiscated," nothing else has been filled out or signed.

and sinkers from the nets before Aro and Eisen could take the nets, what is clear is that Chin intended for the floaters and sinkers to be removed so that the nets would not be used for fishing. Chin relied exclusively on the recipient's word that the recipient would not replace the floaters and sinkers and continue fishing with these nets.

CONCLUSIONS OF LAW

According to Defendants the nets were seized as violations of 27 PNC § 1204 (m) and (n). Under the statute, "it shall be unlawful for any person to: . . . (m) fish . . . with a kesokes net with no bag portion or with the bag portion having a mesh size of less than three (3) inches measured diagonally; (n) retain possession of . . . a kesokes net having a mesh size of less than three (3) inches measured diagonally . . . ."

In its May 22, 2009, addressing Defendants' motion to dismiss, this Court held that the statute at issue in this case contemplated trial and conviction prior to forfeiture. 27 PNC § 1208(b)(3) (nets are "subject to forfeiture . . . upon conviction of a criminal violation pursuant to subsection 1209 (a)"). At the very least, the Republic should have sought civil forfeiture under 27 PNC § 1210. *Cf.* 27 PNC § 184 (civil forfeiture proceeding presumed in the context of seizure of foreign fishing vessel and fishing gear). Otherwise, how can a citizen contest the forfeiture of his nets if the Republic never files criminal charges or initiates a forfeiture proceeding? To keep the statute within constitutional bounds, the Court must read in a right to due process after a seizure of property. If there is no criminal trial or forfeiture proceeding, the Court must, at least, hold a hearing for the return of the property, akin to a civil forfeiture hearing. *Cf.* ROP R. Crim. P. 41(e). At the hearing, the Court considered whether the Republic had the right to continued retention of the property, and, if not, whether the Republic should return the property to Plaintiff.

[1] When the movant seeks the return of property before the indictment or information, the movant bears the burden of showing that the seizure was illegal and that he is entitled to lawful possession of the property. *United States v. Martinson*, 809 F.2d 1364, 1369 (9th Cir. 1987). However, "when the property in question is no longer needed for evidentiary purposes, either because trial is complete, the defendant has pleaded guilty, or, as here, the government has abandoned its investigation, the burden of proof changes. The person from whom the property is seized is presumed to have a right to its return, and the government has the burden of demonstrating that it has a legitimate reason to retain the property." *Id*. In a case such as this one, where the delay is several years, the delay shifts the burden of proof to the Republic. *See Martinson*, 809 F.2d at 1369 n.5. Finally, "even if it is alleged that the property the movant seeks to have returned is no longer within the Government's possession, the district court has jurisdiction to determine whether such property has been in [the Government's] possession and whether [the Government] wrongfully disposed of such property." *United States v. Bein*, 214 F.3d 408, 411 (3d Cir. 2000).

Here, it has been over five years since the nets were seized. The statute of limitations have almost elapsed, *see* 14 PNC § 405 (six-year statute of limitations for civil cases), 17 PNC § 107 (six-year statute of

limitations for criminal cases), and Defendants had no intention of instituting criminal or civil proceedings of Plaintiff, except as counter-claims to Plaintiff's claims. The burden of proof therefore shifts to Defendants to show that "it has a legitimate reason to retain the property." Defendants' sole "legitimate reason" is their contention that the property is illegal. Defendants may be right, but it should not take Plaintiff hauling them into Court to prove that fact. Instead, Defendants have seen fit to parse out 26 of these purportedly illegal fishing nets,[17] along with one bag, to others, based on an oral promise that the nets, and presumably the bag, would be used for agricultural purposes with absolutely no means of oversight to ensure that the nets are being put to legal use.

Since Defendants have produced no bag, the Court has no means of determining whether the bag mesh is less than three inches, as required by 27 PNC § 1204 (m). The Court finds, however, that the mesh size of Plaintiff's nets did not measure three inches according to DFW's measuring standards, and therefore Plaintiff was in violation of 27 PNC § 1204 (n). The DFW measures the nets diagonally from the interior of the knot to the interior of the knot. Measuring Plaintiff's net (Plaintiff's Ex. 3) in that manner, Plaintiff's net is less than three inches diagonally.[18]

In his written closing, Plaintiff asks the Court to return all nets, floaters and sinkers in Defendants' possession, and reimburse Plaintiff for all missing nets, sinkers and floaters. Defendants, in closing, ask this Court to order forfeiture of the nets as "below legal mesh size," and "lay this matter finally to rest."

The Court has found that Plaintiff's nets were in violation of 27 PNC § 1204 (n), and therefore the DFW properly seized the nets. Since the Republic, through the DFW, has shown a willingness to release these nets to the public, however, the Court sees no reason why they should not be returned to Plaintiff. The nets in Exhibit 3 should be returned to Plaintiff, with floaters and sinkers removed so that the nets do not violate 27 PNC § 1204 (n). Further, Defendants are ordered to search Subelek Farm and all of the other depositories of seized property, and determine if any more of Plaintiff's nets,

[17] Defendants hint that the Court should find fewer than 28 nets, because Plaintiff have not proven that 28 nets were seized. The Defendants did nothing to itemize the exact number of nets seized. It should not be on the Plaintiff to prove the number of nets seized. Plaintiff submitted the only scrap of paper to reflect the seizure of his nets, and the only thing written on that piece of paper is "250 ft. each kesokes" and one "Bkuro." Defendants' failure to itemize the seized items should inure to the benefit of Plaintiff, not Defendants.

[18] The Court uses DFW's standard, since they are the Division empowered to enforce the Marine Protection Act of 1994, *see* Chief Chin's testimony and 27 PNC § 1208(b) ("the Bureau of Public Safety shall have primary enforcement responsibility"). Accordingly, the DFW's reasonable interpretation of the law must prevail. Here, DFW has reasonably—and repeatedly—measured mesh size from the inside of the net. Plaintiff, no doubt, believed that his nets were lawful, but his subjective belief is irrelevant in a strict liability case such as this one. *See Sugiyama v. Republic of Palau*, 9 ROP 5, 6 (2001) (noting that violation of 27 PNC § 1204 is a "regulatory offense" where subjective proof of intent is not required).

floaters and sinkers remain in the possession of DFW or any other law enforcement body by March 1, 2010. If any of Plaintiff's nets or portions of his nets (to include floaters and weights) remain in the possession of DFW or any other law enforcement body, Defendants will return those items to Plaintiff by March 16, 2010. The nets are returned with the understanding that Plaintiff cannot use them for fishing. He can, however, use the returned floaters and sinkers for fishing with legally-sized nets.[19]

CONCLUSION

Plaintiff's nets violate 27 PNC § 1204 (n), and therefore the DFW properly seized the nets. However, the Court finds that the Republic wrongfully seized the nets without then instituting criminal or civil proceedings.[20] Further, the Court finds that the Republic wrongfully disposed of the property without first effecting a valid seizure. Because the DFW violated Plaintiff's right to a hearing and has released Plaintiff's nets to others in the community, the DFW is hereby ordered to return any nets or portions of nets in the Bureau of Public Safety's possession to Plaintiff in a manner which no longer violates 27 PNC § 1204 (n). (In other words, the DFW should remove all floaters and sinkers to ensure that the nets cannot be possessed and used for fishing purposes.) In return, Plaintiff is ordered not to fish with the nets, although he may use the legal floaters and sinkers for fishing.

The DFW and Attorney General's office are now on notice that, in the future, if the DFW seizes allegedly illegal property, DFW and the Attorney General's office must follow the law—they can either initiate civil forfeiture proceedings and/or institute criminal proceedings against those whose property was seized. They cannot, however, just seize the property and do nothing. Even more egregious is the seizure of property, and then parceling it out to others.

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[19] As detailed in the Court's May 2009 Order, even if the Court found that the nets were not in violation of the statute, the only remedy which the Court could order is the return of the nets still in Defendants' possession.

[20] At trial, Chin agreed that no one ever asked the courts if the nets were in violation of any laws, but he asserted that no one approached the courts because the DFW chose not to prosecute first-time offenders. Instead, the DFW just seized the nets as a warning. The Court understands that law enforcement officers must have some flexibility in their application of the laws. However, if they do opt to seize property, instead of just issuing a warning, they must follow through and either seek civil forfeiture or criminal prosecution.

ROSALINDA ONGALIBANG, ELLENA TELLEI, PETER NAPOLEON, ANGELES TAKASHI, CLARINDA ALEXANDER, OLYMPIA E. REMENGESAU, and LAURINDA F. MARIUR,
Plaintiffs,

v.

PALAU ADMINISTRATION CREDIT UNION, LEO RULUKED, JOHN KEBOU, ROSEMARY MERSAI, YORANG MINER, EMIL RAMARUI, KOKICH INGAS, and ALONZO TELLEI,
Defendants.

CIVIL ACTION NO. 07-064

Supreme Court, Trial Division
Republic of Palau

Decided: April 9, 2010

[1] **Corporations and Partnerships:** Derivative Actions

Because the directors and officers owe fiduciary duties to the corporation, any wrongdoing or mismanagement that results in a breach of those duties constitutes direct harm to the corporate entity, not the individual shareholders. Therefore, the general rule is that a corporation is the proper party to sue for wrongs to itself through mismanagement of its affairs, official misconduct, or waste of its assets by its directors or officers.

[2] **Civil Procedure:** Real Party in Interest; **Corporations and Partnerships:** Derivative Actions

If the directors or officers of the corporation decline to file suit to redress harm to the corporation, a shareholder may initiate a derivative action on behalf of the corporation. The corporation, however, remains the real party in interest and any recovery obtained by the shareholder(s) goes to the corporation, not the individual shareholders.

[3] **Corporations and Partnerships:** Derivative Actions

Key factors to the distinction between direct and derivative suits are (1) the party who suffered the alleged harm, i.e., the party to whom the wrongdoer owed the duty breached; and (2) the party who would receive the benefit of any recovery or other remedy.

[4] **Corporations and Partnerships:** Derivative Actions

Rule 23.1 of the ROP Rules of Civil Procedure requires a shareholder-plaintiff to plead certain allegations when filing a derivative action. The plaintiff must allege that he or she was a shareholder or member at the time of the transaction of which the plaintiff complains. The plaintiff must also allege, with particularity, any efforts made to demand that the directors or officers take action on behalf of the corporation, as well as any such demand or request on other shareholders or members. If the directors refused to take action or if the plaintiff made no such demand, he or she must also allege with particularity the reasons for the directors' refusal or for the failure to make the demand. Rule 23.1 then states that the plaintiff must "fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the

corporation or association." Finally, a complaint alleging a derivative cause of action must be verified.

[5] **Corporations and Partnerships:** Derivative Actions

The purpose of the heightened pleading requirements in Rule 23.1 of the ROP Rules of Civil Procedure is to ensure that the shareholder-plaintiff properly represents the best interests of the corporation. Consequently, courts typically apply Rule 23.1 strictly and take the "particularity" requirement of the pleadings seriously.

[6] **Constitutional Law:** Standing

The "shareholder-standing" or "prudential standing" rule is not a doctrine of a constitutional dimension. If there is no constitutional standing, a court must dismiss the suit, but nonconstitutional standing belongs to an intermediate class of cases in which a court may choose to raise the issue on its own and dismiss, but it is not obliged to do so.

ALEXANDRA F. FOSTER, Associate Justice:

Pursuant to the Court's Order of March 31, 2010, the Court held a hearing on April 7, 2010, on whether this matter should have been brought as a derivative action under ROP R. Civ. P. 23.1 and, if so, what is the effect of Plaintiffs' failure to bring this case under ROP R. Civ. P. 23.1.

Plaintiffs argued that this matter was properly brought as a direct action or, in the alternative, Plaintiffs should be granted leave to file an amended complaint to comply with the pleading requirements of ROP R. Civ. P. 23.1. Counsel for Defendants Ruluked, Mersai and Kebou responded that it was clear Palau Administration Credit Union ("PACU") should be treated as a corporation; it was clear that this matter should have been brought as a derivative action; and therefore the Court's options were to dismiss this case without prejudice or allow Plaintiffs to amend their complaint and Defendants to amend their answer. Counsel for Defendants Remarui, Ingas, Miner and Tellei argued that this matter should be dismissed, because it would be unfair to Defendants to allow Plaintiffs to amend their complaint at this late juncture. Further, Defendants pointed to the inherent unfairness of drastically changing the posture of the litigation at this late stage in the proceedings. Defendants would have made different discovery requests, and filed different motions if they had known this was a derivative action.[1]

Plaintiffs responded that it would be unfair to Plaintiffs to have this matter dismissed, since the Court—and not Defendants—raised the issue. Further, ROP R. Civ. P. 17 requires that Plaintiffs be granted an opportunity to amend their pleading before a matter is dismissed. Finally, Plaintiffs could face statute of limitations hurdles to litigation if this matter were dismissed at this time.

I. PACU Should Be Treated as a Corporation.

[1] Although not mentioned, any amendment to the complaint would likely include an exponential increase in damages sought which, in turn, would likely affect settlement discussions.

First, the Court must address whether PACU, as a duly incorporated credit union under the laws of Palau, is subject to the laws generally applicable to corporate entities, unless stated otherwise by the Palau National Code. Plaintiffs and Defendants assert that this is so, and the Court agrees.

According to the Corporate Regulations, promulgated by the Registrar of Corporations under 12 PNC § 122, a "credit union" is "a cooperative, non-profit association, incorporated in accordance with the provisions of Title 12 of the Palau National Code . . . . A credit union is authorized to issue shares of stock to its members and perform certain other services for them, in accordance with its charter and the laws of the Republic." ROP Corporate Regulations, Chapter 7, pt. 1, § 1.4d. According to the authorizing legislation, the provisions of Title 12, Chapter 1 (governing corporations) apply to nonprofit as well as for-profit corporations. 12 PNC § 102. Furthermore, the Regulations consistently refer to a credit unions as a "corporation" and expressly state that a credit union incorporated under Chapter 7 "shall hereafter be subject to the provisions of these regulations except as otherwise herein provided." *Id.* pt. 2, § 2.1.

Credit unions are subject to supervision by the Registrar of Corporations, *id.* § 2.8, are governed by a board of directors and must have an audit and credit committee, *id.* pt. 3, § 3.2, must hold regular shareholder (or member) meetings, *id.* § 3.3, and are subject to similar dissolution requirements to corporations, *id.* pt. 4, § 4.1.

PACU, as a non-profit credit union authorized, governed by, and chartered according to Palauan law, should be treated as a corporate entity for purposes of this case. No specific provision of the Palau National Code, or the Corporate Regulations passed thereunder, specifies otherwise. Finally, the parties themselves acknowledge that PACU should be treated as a corporation.

II. This Matter Should Have Been Brought as a Derivative Action.

A corporation is a business association that permits individuals to conduct business as a separate entity, with each shareholder's liability limited to the amount of their investment in the corporation. *See* 18 Am. Jur. 2d *Corporations* §§ 1, 6; *see also* ROP Corporate Regulations, Chapter 1, pt. 5, § 5.3. A corporation typically is managed by a board of directors, which appoints officers to conduct the day-to-day business operations. A corporation is a distinct legal entity which comes into existence by charter from the Republic, with the authority to conduct business, make contracts, own property and land, and sue or be sued. 18 Am. Jur. 2d *Corporations* §§ 1, 2, 26, 44; *see also* ROP Corporate Regulations, Chapter 7, pt. 1, § 2.6 (including among the powers of a credit union the authority to make contracts, to sue and be sued, to purchase and hold property, to issue shares to its members, and to undertake other activities not inconsistent with the regulations). Consequently, any income or revenue belongs to the corporation, as does any loss or liability.

A natural corollary of a corporation's status as a separate legal entity is that any harm or injury suffered by the corporation is

properly redressed by the corporation itself, not its individual shareholders. The corporation's power to sue on its own behalf provides the proper mechanism for recovering for wrongs against it, and any recovery returns to the corporate balance sheet. *See Massey v. Merrill Lynch & Co., Inc.*, 464 F.3d 642, 646 (7th Cir. 2006) (stating that a corporate injury means the claim "belongs to" the corporation, and "any resulting recovery flows to the corporate coffers").

This principle becomes a bit trickier when actions or omissions by the corporation's own directors or officers inflict the corporation's alleged injury. Directors and officers are fiduciaries who owe certain duties to the corporation, such as duties of care/prudence, to act with the "utmost good faith," *see* 10 Am. Jur. 2d *Banks and Financial Institutions* § 408, to use skill and diligence in managing the corporation's affairs, *id.* § 402, or to remain loyal in managing the corporation, 18B Am. Jur. 2d. *Corporations* § 1460. It is settled that the directors and officers owe their fiduciary duties to the corporation, not to the shareholders individually. *Id.* § 1462.

[1] Because the directors and officers owe fiduciary duties to the corporation, any wrongdoing or mismanagement that results in a breach of those duties constitutes direct harm to the corporate entity, not the individual shareholders. No doubt, the shareholders may suffer harm—most commonly through a diminution in the value of their shares—but this injury is an indirect injury that derives from the harm to the corporation. Therefore, the general rule is that a corporation is "the proper party to sue for wrongs to itself through mismanagement of its affairs, official misconduct, or waste of its assets by its directors or officers." *Id.*

[2] Of course, a corporation cannot simply head to the courthouse with a complaint in hand; someone must file a suit on its behalf. Like most business decisions, this authority resides first with the corporation's directors and officers. But if the directors or officers decline to file suit to redress harm to the corporation, shareholders have a recourse—a derivative action. In such a lawsuit, a shareholder may sue on behalf of the corporation rather than in an individual capacity. *See Tamakong v. Nakamura*, 1 ROP Intrm. 608, 610-11 (1989). The corporation, however, remains the real party in interest, and any recovery obtained by the shareholders goes to the corporation, not the individual shareholders. *Id.*; 19 Am. Jur. 2d *Corporations* § 1944; *see also Rawoof v. Texor Petroleum Comp., Inc.*, 521 F.3d 750, 757 (7th Cir. 2008); *Massey*, 464 F.3d at 645; *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004).

[3] "[M]aintaining a clear distinction between direct and derivative actions keeps everything in its right place." *Massey*, 464 F.3d at 647. Although courts frame the inquiry in different terms, the key factors to the distinction between directive and derivative suits are (1) the party who suffered the alleged harm, i.e., the party to whom the wrongdoer owed the duty breached; and (2) the party who would receive the benefit of any recovery or other remedy. *See Tooley*, 845 A.2d at 1036, 1039; *see also* 19 Am. Jur. 2d *Corporations* § 1935 (noting that if the injury is incidental to or an indirect result of a direct injury to the *corporation*, it is derivative; if the shareholder's injury is separate and

distinct from the injury suffered by the corporation or arises from a special duty from the director to the shareholder, it is direct).

A shareholder may have a direct cause of action for the breach of a duty owed directly to the individual shareholder, rather than to the corporation, causing injury that is separate and distinct from that suffered by the corporation. 19 Am. Jur. 2d *Corporations* § 1938. In such a case, the shareholder may bring a direct, personal action against the directors or officers for personal harm, and any recovery flows directly to the shareholder-plaintiff. *Id.*; *see also Massey*, 464 F.3d at 645; *Tooley*, 845 A.2d at 1036. Although the injury for an individual suit must be distinct from the corporation's harm, courts have held that it "need not be unique to the stockholder; an injury may affect a substantial number of stockholders and still support a direct action if it is not incidental to an injury to the corporation." 19 Am. Jur. 2d *Corporations* § 1939. Examples of a direct shareholder cause of action are a director's fraud upon a shareholder, *see id.* § 1955; wrongful interference with a particular shareholder's right to vote; *id.* § 1958; the directors' refusal to permit a shareholder's right to inspect the corporate records; *id.*; where "a special contractual duty exists between the wrongdoer and the shareholder," *Rawoof*, 521 F.3d at 757; or where the directors mistreat certain, particular minority shareholders differently than other shareholders, *see, e.g.*, *Virnich v. Vorwald*, 2009 WL 5173913, at *4 (W.D. Wis. Dec. 30, 2009).

On the other hand, a primary example of a wrong against the corporation, giving rise to a derivative action, is a breach of a fiduciary duty by a director or officer. Courts have held that claims for an injury to corporate property or funds, including diversion or dissipation of corporate assets, waste of corporate assets, removal of corporate property from the corporation, or directorial mismanagement or self-dealing, "may be pursued as derivative actions, not as direct actions." *Id.* §§ 1956, 1958.

Having already determined that PACU is properly treated as a corporate entity under the law, the Court must assess whether the plaintiffs' complaint seeks damages for the directors' breach of a duty to the individual shareholders or to PACU itself. This case should have been filed as a shareholder-derivative action on behalf of PACU, rather than as a collection of individual suits seeking individual damages. The plaintiffs' allegations that the directors breached their fiduciary duties of care by mismanaging the credit union; making ill-advised lending determinations; failing to carry the required amount of reserves; violating the terms of the ROP Corporate Regulations and PACU's own articles of incorporation and by-laws; neglecting to remain well informed about PACU's operations; refusing to liquidate PACU even as it was spiraling toward insolvency; failing to make adequate efforts to collect on outstanding loans; and otherwise driving the credit union to failure *all* implicate duties owed by the directors to PACU. Plaintiffs have not alleged that the directors owed them any individual duties or that they otherwise maintained a special or contractual relationship.

Further, the harm allegedly caused by the defendants' conduct consists of lost corporate assets of PACU, such that each member's share (or account) is depleted or

entirely gone. This is harm suffered by PACU as an entity through alleged mismanagement, and each individual members' harm is *derivative* of that corporate injury. No plaintiff has asserted any individual injury. The Court does not mean that the plaintiffs have not been harmed. Their accounts at the credit union are now worthless. Nonetheless, their harm is the result of their membership in PACU, and the only way for them to sue on PACU's behalf is through a derivative lawsuit. This category of harms to the corporation includes precisely the type of injury the plaintiffs have alleged in this case, and we therefore turn to the implications of the distinction between the two claims.

III. Why the Distinction between Direct and Derivative Claims Matters.

The distinction between a direct and derivative claim is not an empty one, nor is it a mere technicality. Whereas a party has a right to sue for injury caused by an officer's or director's breach of duty owed directly to them, a shareholder has no vested or property right to bring a derivative action on behalf of a corporation. 19 Am. Jur. 2d *Corporations* § 1959. To obtain the authority to sue on the corporation's behalf, a shareholder must comply with certain substantive and procedural prerequisites, and the failure to do so may preclude the shareholder's suit or justify dismissal of the complaint. *Id.*

Courts, including the United States Supreme Court, have consistently and uniformly held that a claim for harm to a corporation may not be brought by individual shareholders directly, but instead must be brought as a derivative action on behalf of the corporation. *See* 18B Am. Jur. 2d *Corporations* § 1583 ("The corporation is the proper party to sue for wrongs to itself through the mismanagement of its affairs, official misconduct, or waste of its assets by its directors or officers . . . ."); 19 Am. Jur. 2d *Corporations* § 1937 (citing many cases for the proposition that, "[g]enerally, a person cannot pursue an individual cause of action . . . for wrongs or injuries to a corporation in which he or she holds stock, even if the stockholder suffers a harm that flows from the injury . . . . Such an action must be pursued by the corporation or by the shareholder in the form of a derivative action."); *see also, e.g.*, *Franchise Tax Bd. of Cal. v. Alcan Aluminum Ltd.*, 493 U.S. 331, 336 (1990) (noting that shareholder standing rule "is a longstanding equitable restriction that generally prohibits shareholders from initiating actions to enforce the rights of the corporation unless the corporation's management has refused to pursue the same action for reasons other than good-faith business judgment"); *Rawoof*, 521 F.3d at 757; *Massey,* 464 F.3d at 648; *Lewis v. Chiles*, 719 F.2d 1044 (9th Cir. 1983); *Lewis v. Knutson*, 699 F.2d 230, 237-38 (5th Cir. 1983); *Virnich*, 2009 WL 5173913, at *3 (citing *Rose v. Schantz*, 56 Wis. 2d 222, 229-30 (1972)); *In re Veeco Instruments, Inc. Securities Litigation*, 434 F. Supp. 2d 267, 273 (S.D.N.Y. 2006); *Doltz v. Harris & Assocs.*, 280 F. Supp. 2d 377 (E.D. Pa. 2003); *Mathis v. ERA Franchise Systems, Inc.*, 25 So.3d 298 (Miss. 2009); *Tooley*, 845 A.2d at 1036.

Courts have applied this rule with equal force to banks and other financial institutions, a category encompassing credit unions. *See* 10 Am. Jur. 2d *Banks and Financial Institutions* § 405 ("A depositor or

creditor of a banking corporation cannot maintain at common law a personal action against the executive officers of a bank who have, by their mismanagement or negligence, committed a wrong against the bank to the consequent damage of such depositor or creditor."); *id.* § 416 (same with regard to directors of a bank). Put quite simply, "[i]n an action for the loss of the funds of a bank through the negligent or wrongful management of the directors, the proper party plaintiff is the bank or its assignee or receiver, and, unless it plainly appears that a cause of action exists and the bank or its assignee refuses to bring the action, the stockholders or creditors cannot maintain an action therefor." *Id.* § 425; *see also Save CU v. Columbia Community Credit Union*, 139 P.3d 386 (Wash. App. Div. 2006) (holding that members of a credit union do not have individual, direct causes of action against its directors or officers for injury against the credit union caused by their breach of fiduciary duties); *cf. Nat'l Temple Non-Profit Corp. v. Nat'l Temple Comm. Fed. Credit Union*, 603 F. Supp. 807 (E.D. Pa. 1985) (holding that the Federal Credit Union Act did not establish a private or direct cause of action for its members, and therefore, under general corporate common law, they did not have one).

It is clear, then, that a shareholder must meet the prerequisites for filing a derivative action before he or she may sue on the corporation's behalf. *See generally* 7C Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure: Civil* § 126 *et seq.* Although there are others,[2] the primary requirements for bringing a derivative action are (1) plaintiff must have been a shareholder at the time of the alleged wrongful conduct, as well as through the duration of the lawsuit, 19 Am. Jur. 2d *Corporations* § 2016; *see also Knutson*, 699 F.2d at 238; *Tooley*, 845 A.2d at 1036; (2) plaintiff must attempt to secure corporate action, i.e., make a demand on the directors, or aver that such a demand would have been futile; and (3) plaintiff must adequately represent other shareholders similarly situated, *see* ROP R. Civ. P. 23.1; 19 Am. Jur. 2d *Corporations* § 2034. In essence, the shareholder's problem is one of standing, i.e., he or she is not the real party in interest or the one who suffered the direct injury.[3] Some

[2] A plaintiff must also verify the complaint and demonstrate that the action is not a collusive one to confer jurisdiction on the court. *See* 7C Wright & Miller, *Federal Practice and Procedure: Civil* §§ 1827, 1830.

[3] Shareholder standing is a separate doctrine than *constitutional* standing under U.S. law. *See Rawoof*, 521 F.3d 750. Constitutional standing stems from the U.S. Constitution's case-or-controversy requirement, which mandates that a litigant establish (1) an injury in fact; (2) "a causal connection between the injury and the conduct complained of"; and (3) a likelihood that the injury will be redressed by a favorable decision. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992). As Plaintiffs pointed out at oral argument, Palau's standing requirement is broader than the U.S. "case or controversy" requirement, based on the ROP Constitution's grant of judicial power of "all matters in law and equity." *See Gibbons v. Seventh Koror State Legislature*, 11 ROP 97, 103-05 (2004); *Republic of Palau v. Koshiba*, 8 ROP Intrm. 243 (2000). In any event, Plaintiffs in this case would have *constitutional* standing as a result of the indirect harm suffered as a result of the injury to PACU. *See Rawoof*, 521 F.3d at 756 (holding that shareholder-plaintiff met the minimum

courts refer to this principle as "shareholder standing," *see, e.g.*, *Virnich*, 2009 WL 5173913, at *3; others refer to it as "prudential standing," *see, e.g.*, *Franchise Tax Bd. of Cal.*, 493 U.S. at 336; and still others begin with Rule 17(a) of the Federal Rules of Civil Procedure and hold that the shareholder is not the real party in interest to bring the suit,[4] *see, e.g.*, *Rawoof*, 521 F.3d at 756. Whatever the terminology, it is clear that a shareholder who does not meet the prerequisites of filing a derivative action on behalf of the corporation cannot proceed with a direct claim. These prerequisites are not mere procedural technicalities; they are conditions precedent to the derivative action and are important substantive rules that limit the powers of individual shareholders to control corporate litigation. 19 Am. Jur. 2d *Corporations* §§ 1961, 1963.

IV. Plaintiffs Have Not Met Certain Pleading Requirements Under ROP Rule of Civil Procedure 23.1.

[4] Rule 23.1 of the ROP Rules of Civil Procedure, which tracks Rule 23.1 of the United States Federal Rules of Civil Procedure, requires a shareholder-plaintiff to plead certain allegations when filing a derivative action. The plaintiff must allege that he or she was a shareholder or member at the time of the transaction of which the plaintiff complains. ROP R. Civ. P. 23.1(1).[5] The plaintiff must also allege, with particularity, any efforts made to demand that the directors or officers take action on behalf of the corporation, as well as any such demand or request on other shareholders or members. ROP R. Civ. P. 23.1(2). If the directors refused to take action or if the plaintiff made no such demand, he or she must also allege—again with particularity—the reasons for the directors' refusal or for the failure to make the demand. Rule 23.1 then states that the plaintiff must "fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." *Id.* Finally, a complaint alleging a derivative cause of action must be verified. *Id.*

[5] The purpose of the heightened pleading requirements in Rule 23.1 is to ensure that the shareholder-plaintiff properly represents the best interests of the corporation. Derivative suits, although important to protect the best interests of a corporation and its shareholders, are not favored, and should be a

requirements for constitutional standing). The question presented by the shareholder-standing doctrine, however, is one of prudential standing or, stated another way, the shareholder's right to sue on behalf of the corporate entity.

[4] Rule 17(a) states that "[e]very action shall be prosecuted in the name of the real party in interest." This typically requires that a complaint be brought in the name of the party to whom that claim "belongs" and who is entitled to enforce the right. *See Rawoof*, 521 F.3d at 756. This portion of Rule 17(a) of Palau's Rules of Civil Procedure is identical to Federal Rule of Civil Procedure 17.

[5] The plaintiff in a derivative action must also be a shareholder at the time of commencement of the action. 19 Am. Jur. 2d *Corporations* § 2016; *see also Knutson*, 699 F.2d at 238. Although Rule 23.1 does not state this requirement expressly, it is implied from the Rule's requirement that a derivative action may be "brought by one or more shareholders or members to enforce a right of a corporation." 19 Am. Jur. 2d *Corporations* § 2016 (citing *Schilling v. Belcher*, 582 F.2d 995 (5th Cir. 1978)).

"last resort" to enforce a corporation's rights. 19 Am. Jur. 2d *Corporations* § 1945. Consequently, courts typically apply Rule 23.1 strictly and take the "particularity" requirement of the pleadings seriously. *See id.* § 2104. The most important requirement in adhering to the purposes of Rule 23.1 is the demand requirement, which has been described as "more than a pleading requirement; it is a substantive right of the shareholder and the directors." *Id.* § 1963. Therefore, Rule 23.1 also demands that a litigant allege with particularity that a demand upon the directors or officers would have been futile. *Id.* § 1967 ("To excuse a demand on the directors in a derivative action, the shareholder's complaint must contain particularized allegations that support the application of the excuse."). After all, Rule 23.1 is designed to assure the Court that an individual shareholder has proper authority to sue on behalf of the entire corporation, and these matters are at the heart of the plaintiff's ability to maintain such an action. *Id.* § 1963.

[6] Despite the importance of the pleading requirements in Rule 23.1—and the substantive principles they reflect—the "shareholder-standing" or "prudential standing" rule, as this court mentioned above, is not a doctrine of a constitutional dimension.[6] Whereas a plaintiff's failure to establish *constitutional* standing to raise a claim in a court of law may be raised by the court or a party at any time during a proceeding and may not be waived, a plaintiff's failure to comply with the strict requirements in Rule 23.1 do not strip a court of jurisdiction. *See Rawoof*, 521 F.3d at 756-57. If there is no constitutional standing, a court must dismiss the suit, *see Gibbons*, 11 ROP at 105 (noting that "the Court has a separate and independent duty to assure that the plaintiff has standing to sue"), but nonconstitutional standing belongs to an "'intermediate class of cases in which a court'" may choose to raise the issue on its own and dismiss, but it is not obliged to do so. *Rawoof*, 521 F.3d at 757 (quoting *MainStreet Org. of Realtors v. Calumet City, Ill.*, 505 F.3d 742, 745 (7th Cir. 2007)).

V. Plaintiffs Will be Granted Leave to Amend Their Complaint To Meet The Pleading Requirements.

The facts and circumstances of this particular case merit a finding that Plaintiffs should be allowed to amend their complaint to meet the technical requirements of Rule 23.1. First, Plaintiffs' complaint and subsequent evidence adduced at trial likely satisfies the underlying factual prerequisites for filing a derivative action. Second, this is not a case where defendants raised the shareholder-standing issue in a motion to dismiss or even a summary judgment motion.[7] Rather, this

[6] *See supra* note 3.

[7] As a general principle, a litigant waives an issue unless it is timely raised. When a defendant has a defense to a claim for relief in a pleading, he or she may present the defense in a responsive pleading or a motion under Rule 12 of the ROP Rules of Civil Procedure. Failure to raise certain defenses, such as personal jurisdiction and improper venue, must be raised either in or before a responsive pleading, *see* ROP R. Civ. P. 12(b), but a defense that the plaintiff failed to state a claim upon which relief can be granted may be made in any subsequent pleading "or at the trial on the merits," ROP R. Civ. P. 12(h)(2). If defendants did not notice the shareholder standing issue before filing their

case went to trial, and a lengthy one at that. All parties no doubt expended substantial resources in litigating this matter. The parties proceeded as though Plaintiffs' claims were appropriate, and only through this Court's additional research was this issue uncovered. Third, Plaintiffs may be prohibited from re-filing their action by the statute of limitations if the Court were to dismiss the case, even without prejudice. Fourth, as far as this Court can tell, except for a glancing discussion in *Tamakong*, 1 ROP Intrm. at 610-11, there has been no reported decision in Palau concerning the shareholder-standing doctrine or even discussing the requirements for a shareholder-derivative action. Fifth, it appears Rule 17(a) mandates that Plaintiffs be given time to cure this problem. *See* 6A Wright, et al., *Federal Practice and Procedure: Civil* § 1555 (Rule 17A motion is liberally construed to effect justice, even when the statute of limitations has run). Specifically, the rule requires that "[n]o action . . . be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection" for Plaintiffs to amend their filing to reflect the real party in interest. Most importantly, the Court is satisfied that the purposes for requiring a shareholder to have standing to sue on behalf of a corporation (and therefore the reasons for the requirements of Rule 23.1) would not be undermined if the Court allowed Plaintiffs to amend their complaint.

The Court therefore holds that Plaintiffs should have brought a derivative action on PACU's behalf. Plaintiffs are not entitled to individual recovery for harm to PACU caused by its directors and officers. Plaintiffs did not characterize their claims in these terms, however, meaning that they did not comply with Rule 23.1. Under normal circumstances, this would merit dismissal of the case without prejudice, permitting Plaintiffs the opportunity to re-file their claims in a proper fashion. For the reasons detailed above, these are not normal circumstances, however. Accordingly, Plaintiffs' oral motion to amend their complaint is granted. Plaintiffs have 20 days, or until April 29, to amend their complaint, and Defendants will have 20 days thereafter to respond.

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responsive pleading or a Rule 12 motion to dismiss, they also could have filed a motion for summary judgment under Rule 56. *Cf. Rawoof*, 521 F.3d 750 (determining the shareholder-standing issue in a motion for summary judgment). Defendants did none of these. A party opposing a derivative action may use any of the pleading and motion provisions available under the federal rules, and "[l]ike Rule 12(b) motions in other actions, a motion to dismiss for failure to comply with the requirements of Rule 23.1 must be timely or it will be waived." 7C Wright & Miller, *Federal Practice and Procedure: Civil* § 1836, at 162. Defendants have therefore waived any right they may have to require strict enforcement of the rules.