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.