Failure to Consider Human Rights Suits as a Potential Basis for Derivative Actions

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FAILURE TO CONSIDER HUMAN RIGHTS SUITS AS A POTENTIAL BASIS FOR DERIVATIVE ACTIONS

I. Introduction

With the spread of globalization, multinational corporations have seen their power and influence grow. Countries in the developing world clamoring to get a piece of the pie are increasingly making concessions to corporations in order to attract investments. ¹ This regulatory race to the bottom has given multinational corporations the upper hand when dealing with developing nations and many of these corporations have abused this power. Corporations have been accused of aiding and abetting governments in human rights abuses ² and even in perpetrating human rights abuses themselves.³

This troubling growth in corporate human rights abuses has inspired efforts aimed at holding corporations accountable in United States domestic courts for wrongs perpetrated abroad. One of the major avenues pursued by those seeking to hold corporations accountable for their actions abroad is the Alien Torts Statute (ATS).⁴ The ATS allows aliens to bring claims in U.S. courts for torts in violation of the law of nations.⁵ While these claims have seen limited success in actually collecting damages from defendant corporations, they have done a great deal

¹ See e.g., Kenny, Dr. Tom, “Zambia, Deregulation and the Denial of Human Rights; Submission to the UN Committee on Economic, Social and Cultural Rights,” available online at http://www.rsc.ox.ac.uk/PDFs/rrzambia00.pdf. Last accessed on March 24, 2009.
² See e.g., Doe v. Unocal Corporation, 395 F.3d 932, 947 (9th Cir. 2002) (concerning corporation aiding and abetting in forced labor, forced relocations and physical abuse); Blanding, Michael, “Coke: the New Nike,” The Nation, March 24, 2005, available online at www.thenation.com/doc/20050411/blanding. Last accessed on March 24, 2009 (concerning alleged complicity of Coke in the killing of union members by paramilitaries.)
⁵ Id.
to publicize corporate participation in human rights abuses. Given the high cost of litigating ATS claims to corporations, the potential of adverse judgments or settlements, and the ‘spotlighting’ effect of being subject to an ATS suit there may be an alternate path to holding those in the corporations responsible for allowing human rights abuses to occur liable.

One example of this alternate path are derivative suits. Derivative suits provide a means by which shareholders can hold corporate boards accountable for failing to exercise their fiduciary duties to the corporation through a breach of the duty of care, the duty of loyalty and the associated duty of good faith or through fraud, illegality, conflict of interest or other extreme malfeasance. The Supreme Court opined on the underlying purposes behind allowing derivative actions and problems associated with derivative actions in *Cohen v. Beneficial Industrial Loan Corp.* Derivative actions arose out of concerns regarding “vast aggregate of funds committed to corporate control” which “was not subject to an effective accountability.” This pooling of funds without effective oversight “created strong temptation for managers to profit personally at expense of their trust,” while the corporate law before the rise of the derivative action left stockholders facing this situation “singularly impotent in obtaining redress of abuses of trust.”

To address this growing problem courts began to use their power in equity to allow those shareholders harmed by the self-dealing of corporate boards “to step into the corporation's shoes and to seek in its right the restitution he could not demand in his own.” Courts demanded that plaintiff shareholders first “demand that the corporation vindicate its own rights.” When those

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7 337 U.S. 541 (1949).
8 *Id.* at 549.
9 *Id.*
10 *Id.*
11 *Id.*
who were perpetrating the fraud predictably refuse to seek the vindication demanded by the
shareholder, courts “would hear and adjudge the corporation's cause through its stockholder”
with the corporation as a “nominal” defendant.\(^\text{12}\) The derivative action as so described, “afforded
no small incentive to avoid at least grosser forms of betrayal of stockholders' interests.”\(^\text{13}\)

Unfortunately just as derivative actions were designed to combat abuses of trust by
corporate boards, derivative actions themselves became subject to abuse. There arose a breed of
suits “brought not to address real wrongs” but rather purely for their nuisance value or solely
intended to induce settlement.\(^\text{14}\) As a result of the misuse of the derivative action, complicated
and restrictive rules have arisen to limit the ability of shareholders to sustain an action.\(^\text{15}\)

Despite the difficulties encountered in bringing a derivative action they remain an
effective check on the ability of corporate boards to abuse their roles to their own benefit or to
ignore their duties to the corporation. This note proposes that in instances where corporate
boards have knowingly or through their gross negligence allowed potentially costly human rights
abuses to occur or where boards have failed to utilize appropriate monitoring standards to ensure
compliance with human rights laws, they may be held to account for resulting losses to their
shareholders in derivative actions.

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\(^\text{12}\) Id.
\(^\text{13}\) Id.
\(^\text{14}\) Id.
\(^\text{15}\) Briefly stated, the necessary procedural steps for filing an effective derivative action in Delaware are as follows. Plaintiffs will generally first make a demand upon the board, usually in the form of a letter, that is reasonably specific so as to inform the board of the nature of the cause of the action. Once having received this demand the board may either accept the demand and seek to vindicate the corporation’s claims or deny it. If the board rejects the claim the prospective plaintiff must show that the board acted with gross negligence in not pursuing the action. The demand process can be averted if the plaintiff can demonstrate its futility, generally through showing the board is so invested in the contested plan of action (i.e., engaged in self-dealing) that they will be unable to use their best business judgment in considering the demand. Once the demand process is completed, or the demand process has been shown to be futile, there are additional requirements placed on the plaintiff. Plaintiffs will generally have to pay security to the corporation to indemnify the corporation from bearing the costs of the action if it is ultimately unsuccessful. Plaintiffs must then verify their claims by way of some sort of affidavit. Finally, it is incumbent upon the plaintiff to demonstrate that they are a representative shareholder who fairly adequately represents the similarly situated shareholders and whose claim is not specific to themselves.
Part II will look at the fiduciary duties owed by directors to Delaware corporations. Part III will look at the development of relevant ATS case law. Part IV will explore the question of whether or not the potential of ATS suits and their associated consequences is sufficient to hold corporate boards responsible for ignoring that risk. This note will apply Delaware law with regards to the legal standards and procedures governing derivative suits.

II. Duties of Corporate Directors

Corporate directors owe a number of fiduciary duties to their employer corporation. These duties are the duty of care and the duty of loyalty (including the subsidiary duty of good faith and the duty to monitor). This section sets forth and defines the major duties of directors under Delaware law and explores the ways in which these duties may be violated. It is in the violation of these duties that one hoping to hold corporate directors liable for failing to account for the risk of ATS suits must look for a cause of action.

A. Duty of Care.

The duty of care requires the board of directors to make informed decisions with regards to corporate undertakings. Courts have held that the duty of care requires directors to “use that amount of care which ordinarily careful and prudent men would use in similar circumstances.” Breaches of the duty of care are analyzed using the business judgment rule. The business judgment rule is an outgrowth from the fundamental principle in Delaware law, codified by 8 Del.C. § 141(a), that the board of directors manages the business and affairs of a corporation. The rule acts as “a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the

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17 In re Walt Disney Co. Derivative Litig. (Disney V), 907 A.2d 693, 749 (Del. Ch. 2005)
best interests of the company.”19 A party attacking a decision made by the board must then rebut the presumption that the business judgment made by the board was an informed one.20

Whether or not a business judgment is considered to have been an informed one hinges on “whether the directors have informed themselves prior to making a business decision, of all material information reasonably available to them.”21 This duty however does not require directors “to read in haec verba every contract or legal document,”22 or to “know all particulars of the legal documents [they] authorize[ ] for execution.”23 Directors who have made “an unintelligent or unadvised judgment” receive no protection from the business judgment rule.24 Delaware courts apply a gross negligence standard when determining whether a board’s decision was an informed one.25 Gross negligence in this context has been defined as “reckless indifference to or a deliberate disregard of the whole body of stockholders’ or actions which are ‘without the bounds of reason.’”26

In their analysis of whether or not a corporate board has exercised its duty of care Delaware courts look only for procedural due care.27 This focus on procedural due care means that courts will only assess the quality of the process through which a particular decision was made rather than actual merits of the decision.28

**B. Duty of Loyalty**

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19 Id (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).
20 Id.
21 Id. (citing Aronson, 473 A.2d at 812)(internal quotations omitted).
22 Id at 883 n. 25.
24 488 A.2d at 872 (citing Mitchell v. Highland-Western Glass, 167. A 831, 833 (Del. Ch. 1933)).
25 Id.
27 488 A.2d at 874-88.
The traditional duty of loyalty under Delaware law derives from the fundamental precept of corporate law that there should be no conflict between the duty of directors to act in the interest of the corporation and their own self-interest. The duty of loyalty requires that the interest of the corporation and its stockholders take precedence over any personal interest of the director or board. A director is deemed to have self-interest in the outcome of a decision where the director “will receive a personal financial benefit from [the] transaction that is not equally shared by the stockholders.” Self-interest may also arise where the “corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders.” The self-interest pursued by the director need not be financial to constitute breach of the duty of loyalty, but rather can be in the form of any “substantial benefit from supporting a transaction.”

The duty of good faith is a subset of the duty of loyalty. Directors are said to have acted in bad faith if they “consciously and intentionally disregarded their responsibilities, adopting a ‘we don’t care about the risks’ attitude concerning a material corporate decision.” The Delaware Supreme Court has identified two types of behavior that constitute bad faith. The first is “so-called ‘subjective bad faith,’ that is, fiduciary conduct motivated by an actual intent to do harm.” The second bad faith behavior involves “intentional dereliction of duty, a conscious disregard for one’s responsibilities.” A failure to act in good faith can be shown “where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the

30 *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).
32 *Id.*
33 *Id.* at 362 (Del. 1993)
34 *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 289 (Del. Ch. 2003).
35 *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.*) 906 A.2d 27, 63 (Del. 2006).
36 *Id.* at 64.
37 *Id.* at 66.
corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."  

38 It was left open that there may be other situations where there is a breach of the duty of good faith as well. 39 Because the duty to act in good faith is a subsidiary of/element of the duty of loyalty its breach violates the duty of loyalty and therefore can result in the “direct imposition of fiduciary liability.”

The court identified two ‘doctrinal consequences’ stemming from the court’s views on the failure to act in good faith. First, the duty to act in good faith is not an additional fiduciary duty on the same footing as the duties of care and loyalty. 41 Only the duties of loyalty and care where violated can result directly in liability whereas the failure to act in good faith may do so but only indirectly. 42 Secondly, there is an expansion of the duty of loyalty to include not only “cases involving a financial or other cognizable fiduciary conflict of interest” but also those “cases where the fiduciary fails to act in good faith.” 43 Put simply, “[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation’s best interest.” 44 A breach of the duty of good faith as a basis for a derivative action resulting from an ATS claim is most likely to occur in the context of a Caremark claim, discussed below.

*In Re Caremark International Inc. Derivative Litigation*, a memorandum opinion issued by a Delaware Chancery Court in 1996 has proven to be highly influential in terms of the duties

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38 Id.
39 Id.
40 Id. at 369-370.
41 Id. at 370.
42 Id.
43 Id.
44 Id. (internal citations omitted).
ascribed to corporate boards for the oversight of the corporation.\textsuperscript{45} In Caremark plaintiff shareholders claimed that Caremark’s board of directors breached their fiduciary duties to the corporation due to the board’s failure to properly oversee the conduct of Caremark employees.\textsuperscript{46} Various Caremark employees were charged with breaking federal and state laws regulating the practice of health care providers, such as Caremark paying remunerations to induce physicians to recommend services or products that Caremark provided to Medicare and other patients.\textsuperscript{47} As a result of these illegal actions Caremark was charged with multiple felonies and assessed fines totaling approximately $250 million.\textsuperscript{48}

The court discussed two models of director liability. The first is liability following “\textit{from a board decision} that results in a loss because that decision was ill advised or “negligent”.”\textsuperscript{49} This first model of liability calls for application of the classic business judgment test discussed above. The second form of director liability discussed in Caremark involves situations where “liability to the corporation for a loss may be said to arise from an \textit{unconsidered failure of the board to act} in circumstances in which due attention would, arguably, have prevented the loss.”\textsuperscript{50} The court termed this sort of liability “liability for failure to monitor.”\textsuperscript{51}

Citing the increasing tendency under federal criminal law to hold corporate boards accountable for assuring “corporate compliance with external legal requirements, including environmental, financial, employee and product safety as well as assorted other health and safety regulations,” the court decided that corporations ought to feel a strong incentive to have

\textsuperscript{45} 698 A.2d 959 (Del.Ch. 1996).
\textsuperscript{46} \textit{Id}. at 960.
\textsuperscript{47} \textit{Id}. at 961.
\textsuperscript{48} \textit{Id}. at 960-961.
\textsuperscript{49} \textit{Id}. at 967 (emphasis and quotations in original).
\textsuperscript{50} \textit{Id}. (emphasis in original, citations omitted).
\textsuperscript{51} \textit{Id}. at 968.
appropriate compliance programs to detect illegalities. The court continued to on to find that a
director’s fiduciary duty to the company includes a duty to “attempt in good faith to assure that a
corporate information and reporting system, which the board concludes is adequate, exists.”
Failure to assure that an adequate corporate information system exists “under some
circumstances may … render a director liable for losses caused by non-compliance with
applicable legal standards.” The court developed a four-part test to determine when directors
have breached their duty of care with regards to monitoring employee conduct, plaintiffs must show either: “(1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of.” The court felt that this standard ought to be narrowly applied to cases where there is “a sustained or systematic failure of the board to exercise oversight.”

The Delaware Supreme Court has embraced the standard of assessing director oversight
liability articulated under Caremark. The Caremark standard has been understood to be
applicable when a board has failed to act in good faith. The prerequisites to director liability
stemming from Caremark, as understood and defined by the Delaware Supreme Court are: “(a)
the directors utterly failed to implement any reporting or information system or controls; or (b)
having implemented such a system or controls, consciously failed to monitor or oversee its
operations thus disabling themselves from being informed of risks or problems requiring their

52 Id. at 969.
53 Id. at 970.
54 Id.
55 Id. at 971.
56 Id.
57 In re Walt Disney Co. Deriv. Litig., 906 A.2d 27 (Del. 2006).
attention.” In either case the “imposition of liability requires a showing that the directors knew they were not discharging their fiduciary duties.”

Two recent Chancery court decisions have further refined the Caremark standard. In In Re Citigroup Inc Shareholder Derivative Action, shareholders brought a Caremark claim against the directors of Citigroup for their alleged failure to properly monitor Citigroup’s business risks related to Citigroup’s investments which ultimately fell victim to the subprime mortgage crisis. In assessing the plaintiffs’ claims the court first expressed uneasiness with applying the Caremark oversight standards to the failure to monitor business risks as opposed to illegalities as was the case in Caremark and Stone. Such allegations could put the court in the improper role of second guessing business decisions, thus placing such allegations more comfortably as duty of care claims subject to the business judgment rule. This uneasiness aside the court did acknowledge that under the right facts a failure to monitor business risks could conceivably be sufficient to state a claim under Caremark.

The Citigroup plaintiffs essentially alleged that the board failed to notice multiple ‘red flags’ (public documents reflecting the worsening condition of the mortgages market and the economy generally) and this failure to notice ‘red flags’ resulted in losses to the company. Plaintiffs further allege that proper monitoring would have prevented the losses. The court found these allegation inadequate to state a Caremark claim, stating “that the director defendants knew of signs of a deterioration in the subprime mortgage market, or even signs suggesting that

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59 Id. (emphasis in original).
60 Id.
62 Id.
63 Id.
64 Id.
65 Id.
66 Id.
conditions could decline further, is not sufficient to show that the directors were or should have been aware of any wrongdoing at the Company or were consciously disregarding a duty somehow to prevent Citigroup from suffering losses.”67 Such allegations, the court continued, “do not even specify how the board’s oversight mechanisms were inadequate or how the director defendants knew of these inadequacies and consciously ignored them.” This decision makes clear that in pleading a Caremark case plaintiffs must make specific allegations as to what the failures of the monitoring system were and must actually demonstrate that directors consciously disregarded known risks or remained willfully ignorant by way of having inadequate monitoring systems.

The second recent case involving the Caremark standard is American International Group, Inc., Consolidated Derivative Action (AIG).68 AIG offers an example of a factual footing sufficient to sustain a Caremark claim, at least for the purposes of surviving summary judgment. The plaintiff shareholders allege a more traditional Caremark claim concerning failing to properly oversee and prevent illegal conduct rather than the failure to monitor business risks alleged in Citigroup. The AIG plaintiffs allege that an ‘Inner Circle’ of AIG, Inc. executives and officers engaged in massive financial malfeasance that when discovered cost the AIG, Inc. and its shareholders billions of dollars.69 The defendants moved for dismissal of the Caremark claim on the grounds that the plaintiffs had failed to plead sufficient facts specific to the defendants to create a reasonable inference that they knew AIG, Inc.’s internal controls were broken.70 The court rejected this argument. Noting the extraordinary “diversity, pervasiveness, and materiality of the alleged financial wrongdoing at AIG,” the court felt it was inferable that defendants “were

67 Id.
69 Id.
70 Id.
aware of misconduct that should have been brought to the attention of AIG’s independent
directors … but chose to conceal their knowledge, despite having a fiduciary duty to speak.”

III. The Development of Case Law under the ATS

In order to assess the potential for finding that a director violated one of her fiduciary
duties to the corporation by ignoring the risk of ATS suits, it is first necessary to define what that
risk is. The first step in coming up with a definition of that risk is to analyze case law under the
ATS to see what amounts to a cause of action under the statute and to see what sort of standards
courts apply in assessing liability under the statute. This section charts the development of case
law under the ATS in order to define what available causes of action are under the ATS and to
identify standards of liability that a director should take account of in their corporate decision
making.

A. The ATS before Sosa

The ATS was originally passed as part of the Judiciary Act of 1789 and provides that “the
district courts shall have original jurisdiction of any civil action by an alien for a tort only,
committed in violation of the law of nations or of a treaty of the United States.” The law was
largely forgotten and unused until 1980 when it was raised in the case of Filartiga v. Pena-Irala
wherein the plaintiffs, residents of Paraguay, brought a wrongful death claim against fellow
Paraguayan Americo Norberto Pena-Irala in connection with the kidnapping and murder of the
plaintiff’s son as a means of political suppression. The Second Circuit found that “official
torture” is “prohibited by the law of nations” and thus held for the plaintiff.

71 Id.
73 630 F.2d 876 (2d Cir. 1980).
74 Id at …
After *Filartiga* an increasing number of ATS claims began to be raised, including some for corporate abuses of human rights. The next major case arising under the ATS was *Kadic v. Karadzic* wherein the door was opened for a finding of liability in the absence of state action. In *Kadic* Plaintiffs alleged that the defendant Radovan Karadzic and persons under his control committed a number of atrocities including genocide, rape, forced prostitution and impregnation and torture among others during the Bosnian civil war. Defendant Karadzic argued, among other things, that he could not be held individually liable because international law only binds states and those acting under the color of state law. The court disagreed, holding that genocide and war crimes are proscribed under international law regardless of whether there is state action.

This holding created an important precedent for those seeking to hold corporations liable for their conduct in derogation of international human rights standards, as it cracks the door open for liability for non-state actors. The Court opened the door only to genocide and war crimes, refusing to open the door to individual liability for other serious crimes such as torture. Thus, under the *Kadic* standard, one could only assert liability against a private actor for human rights abuses to the extent that those abuses were perpetrated “in pursuit of genocide or war crimes.”

A more promising standard for holding corporations liable for human rights abuses arose in *Doe v. Unocal Corporation*. In *Unocal* residents of Myanmar brought suit against the government of Myanmar, the state run oil company and a private U.S.-based oil company, Unocal, for human rights abuses committed by the Myanmar military which occurred in

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75 70 F.3d 232 (2d Cir. 1995).
76 Id. at 237.
77 Id. at 239.
78 Id. at 241, 242.
79 Id. at 243.
80 Id. at 244.
81 395 F.3d 932 (9th Cir. 2002).
connection with construction of an oil pipeline.\textsuperscript{82} The evidence in \textit{Unocal} would reveal that the Unocal Corporation “knew that forced labor was being utilized and that the Joint Venturers (sic) benefited from the practice.”\textsuperscript{83} To formulate a standard of liability for a corporation that knowingly benefits from the criminal actions of a state actor the court looked to aiding and abetting standards utilized by international tribunals including the International Tribunal for the Former Yugoslavia and the International Tribunal for Rwanda.\textsuperscript{84} Borrowing from the international criminal aiding and abetting standard the court created a standard for aiding and abetting under the ATS. This standard is defined as “knowing practical assistance or encouragement that has a substantial effect on the perpetration of the crime.”\textsuperscript{85}

\textit{Unocal} was ultimately settled out of court and the aiding and abetting test was never reviewed on appeal. The standard however has proven to be influential and the settlement has informed corporations that they may ultimately be held to pay for wrongs committed in conjunction or participation with states. This standard of liability meshes well with the \textit{Caremark} standard discussed above and may prove to be an effective way to synthesize the knowledge requirements under the ATS in \textit{Unocal} and for the failure to have effective monitoring systems in place under \textit{Caremark}.

\textbf{B. The Impact of \textit{Sosa}}

While the holding in \textit{Filartiga} opened the door for ATS claims, and many followed, it was not until 2004 when the Supreme Court set forth the guidelines for ATS claims in \textit{Sosa v. Alvarez-Machain}.\textsuperscript{86} \textit{Sosa} involved a claim made by a Mexican national Mr. Alvarez-Machain (Alvarez) against another Mexican national Sosa, amongst others, for false arrest. Sosa had been

\begin{footnotesize}
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  \item \textsuperscript{82} \textit{Id}.
  \item \textsuperscript{83} \textit{Id}. at 947 (internal citations omitted).
  \item \textsuperscript{84} \textit{Id}. at 950-951.
  \item \textsuperscript{85} \textit{Id}. at 947.
  \item \textsuperscript{86} 542 U.S. 692 (2004).
\end{itemize}
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enlisted by the Drug Enforcement Agency (DEA) to apprehend Alvarez while Alvarez was in Mexico. Alvarez initially moved to dismiss the indictment against him, alleging that the apprehension violated the extradition treaty between the U.S. and Mexico. While the Court agreed that the conduct was illegal, it decided that this illegality did not deprive the federal courts of jurisdiction over him. Alvarez was eventually acquitted on the charges underlying his detention in the U.S., he then brought suit under the ATS alleging that his detention was a tort against the law of nations.

The Court held that his detention did not rise to a level sufficient to qualify as a tort against the law of nations as they conceived it. The Court in Sosa held that in order to have a cause of action under the ATS one must plead a tort in violation of the law of nations or in violation of a treaty of the United States. Sosa sets a high bar for the sorts of international legal norms that the violation of is sufficient to create standing under the ATS. The Court held that only violations of international legal norms on par with the 18th-century paradigms that Congress considered when enacting the ATS—offenses against ambassadors, violations of safe conduct and actions arising out of prize captures/piracy—are actionable.

In addition, the Court held that the statute in of itself is only jurisdictional, and does not create a cause of action. It is for this reason that the Court felt that the statute should only apply in certain narrow situations, those in which a jurisdictional grant would have provided some cause of action at the time the statute was enacted – “a very limited category defined by the law of nations and recognized at common law.” The law of nations consists of two parts. The first

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88 542 U.S. 692 at 724.
89 Id.
90 Id. at 712.
91 Id.
part covers “the general norms governing the behavior of national states with each other.” 92 The Court held that “this aspect of the law of nations thus occupied the executive and legislative domains, not the judicial.” 93 The second part is “a body of judge-made law regulating the conduct of individuals situated outside domestic boundaries and consequently carrying an international savor.” 94 It is the in narrow space where “these rules binding individuals for the benefit of other individuals overlapped with the norms of state relationships” that one can find a cause of action under the ATS. 95

In its decision the Court expressed wariness with the ATS and advises federal courts to exercise “great caution” in the process of applying the law of nations to create private rights. 96 The Court warned about the potential for “collateral consequences” to U.S. foreign policy if its courts were over eager to entertain private allegations of violations of international law by foreign nations. 97 Emblematic of this concern the Court advised that there should be a “policy of case-specific deference to the political branches” and that in such cases “courts should give serious weight to the Executive Branch’s view of the case’s impact on foreign policy.” 98 Furthermore, the Court noted the lack of a “congressional mandate to seek out and define new violations of the law of nations.” 99 What is clear from Sosa is that courts are to take a conservative view as to what constitutes a violation of the law of nations and that they must be wary of expanding the law.

With the above in mind it must be noted that the Court did not entirely shut the door on the emergence of new causes of action under the ATS. The Court instructed federal courts to

92 Id. at 714.
93 Id.
94 Id. at 715.
95 Id.
96 Id. at 728.
97 Id.
98 Id. at 733, fn. 21.
99 Id. at 728.
require “any claim based on the present-day law of nations to rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms we have recognized.” When considering new claims under the present day law of nations, courts are to exercise their power under the ATS “on the understanding that the door is still ajar subject to vigilant doorkeeping, and thus open to a narrow class of international norms today.”

The following three criteria are generally emblematic of what courts require to find a customary international legal norm: “(1) no state condones the activity in question and there is a recognizable “universal” consensus prohibiting this act; (2) sufficient criteria exist so as to determine when a specific act violates this consensus; and (3) the prohibition against the act in question is non-derogable and therefore binding at all times against all actors.” This ‘universal, specific, obligatory’ standard to determine whether there is a sufficient norm in international law was embraced in *Sosa*. In order to inform the court as to whether the above requirements have been achieved, *Filartiga* suggests looking at the “usage of nations, judicial opinions and the works of jurists” as “the sources from which customary international law is derived.” A violation of a rule does not “logically foreclose the existence of that rule as international law.”

If one is able to establish that a treaty has been violated there is an additional hurdle before there is a cognizable ATS claim, whether or not the treaty is deemed to be self-executing and therefore creating obligations enforceable in federal court. In *Sosa*, for instance Alvarez

100 Id. at 725.
101 Id. at 729.
103 542 U.S. 692 at 732.
104 630 F.2d 876 at 884.
105 542 U.S. at 738, fn 29.
based his claim in part on the International Covenant on Civil and Political Rights (ICCPR), to
which the U.S. is a party.\textsuperscript{106} While the court acknowledged that the U.S. is bound by the ICCPR
“as a matter of international law,” the U.S. executed the treaty with the express understanding
that it was not self-executing.\textsuperscript{107} This left Alvarez with the task of demonstrating that the
“prohibition of arbitrary arrest has attained the status of binding customary international law.”\textsuperscript{108}

\textbf{IV. Failing to Account for the Risk of ATS Suits as a Basis for Derivative Liability}

This section applies the fiduciary duties of directors to the risks and costs associated with
ATS suits in order to identify the ways in which failing to account for these risks and costs may
constitute a violation of a director’s fiduciary duties. To do this the risks and costs of ATS suits
are identified then applied to theoretical board decisions deriving from a model case.

\textbf{A. The risk of liability under the ATS.}

While \textit{Sosa} significantly limited the situations in which liability may arise under the ATS
it did not close the door completely. Post-\textit{Sosa} courts have recognized that extrajudicial killings,
torture, crimes against humanity, war crimes and cruel and degrading treatment have all achieved
the level of customary international law required by \textit{Sosa}.\textsuperscript{109} Furthermore they have recognized
that corporations can be held liable for their participation in such acts.\textsuperscript{110} In \textit{Mujica v. Occidental
Petroleum Corp.} defendant Occidental Petroleum Corp. (Occidental) contracted with a private
security firm AirScan and coordinated with the Columbian military to provide security to
Occidental’s oil pipeline.\textsuperscript{111} It was alleged that the Columbian military acted for the benefit of

\textsuperscript{106} Id. at 735.
\textsuperscript{107} Id.
\textsuperscript{108} Id.
\textsuperscript{109} See e.g., \textit{Mujica v. Occidental Petroleum Corp.}, 381 F.Supp.2d 1164 (C.D. Cal. 2005); \textit{Bowoto v.
\textsuperscript{110} Id.
\textsuperscript{111} \textit{Mujica}, 381 F.Supp.2d at 1168.
Occidental rather than the Columbian government.\textsuperscript{112} On December 13, 1998 a low flying Columbian Air Force helicopter engaged in the protection of Occidental’s pipeline dropped a bomb on a group of civilians despite the civilians attempts to convey that they were not combatants by waiving white t-shirts and laying on the road.\textsuperscript{113} The bomb, a cluster bomb,\textsuperscript{114} caused the deaths of seventeen civilians, including six children.\textsuperscript{115} Civilians attempting to flee the bombing were shot upon.\textsuperscript{116} Following the bombing attack members of the Columbian military entered the town and ransacked it.\textsuperscript{117} Plaintiff brought claims for extrajudicial killings, torture, crimes against humanity, war crimes and cruel and degrading treatment under the ATS.

The court analyzed each of the ATS claims to determine if the stated cause of action had sufficient footing in international law to survive the standard set forth in \textit{Sosa}. On the claim for extrajudicial killing the court held that the U.S. “through the TVPA [Torture Victims Protection Act], has recognized that extrajudicial killing, no matter where it takes place, should be prohibited.”\textsuperscript{118} The court reasoned that a statute, such as the TVPA, “based on treaties or other forms of international law, provide a particularly useful source of international law for United States courts.”\textsuperscript{119} The court applied the same reasoning with regards to plaintiffs’ claims for torture.\textsuperscript{120}

The court also held that crimes against humanity are actionable under the ATS.\textsuperscript{121} In doing so the court recognized that \textit{Sosa} declined to give the UN Declaration of Human Rights

\begin{itemize}
\item \textsuperscript{112} \textit{Id.}
\item \textsuperscript{113} \textit{Id.}
\item \textsuperscript{114} A cluster bomb is one large bomb that releases a large number of smaller bombs. Each cluster bomb releases anywhere from several to 600+ submunitions (bomblets). International Committee of the Red Cross, \textit{Cluster Munitions Factsheet}, available at http://icrc.org/Web/Eng/siteeng0.nsf/html/cluster-munitions-factsheet-010208.
\item \textsuperscript{115} 381 F.Supp.2d at 1168.
\item \textsuperscript{116} \textit{Id.}
\item \textsuperscript{117} \textit{Id.}
\item \textsuperscript{118} \textit{Id.} at 1179.
\item \textsuperscript{119} \textit{Id.} (citations omitted).
\item \textsuperscript{120} \textit{Id.}
\item \textsuperscript{121} \textit{Id.} at 1180.
\end{itemize}
and the ICCPR standing sufficient to constitute a cause of action under the ATS for failure to create enforceable obligations. In response the court pointed to the Nuremberg trials, the International Criminal Tribunal for the former Yugoslavia, and the International Tribunal for Rwanda as creating enforceable obligations under international law to not engage in crimes against humanity. Similarly, with regards to the claims for cruel and degrading treatment the court pointed to the recognition of such claims by the Yugoslavia and Rwanda tribunals as well as by numerous federal courts as sufficient evidence that such claims are recognized under customary international law.

Finally with regards to war crimes the court cited the Geneva Conventions and their incorporation into U.S. law as well as long settled federal common law recognizing war crimes as sufficient to create standing under the ATS.

A company engaging in extrajudicial killings, torture, crimes against humanity, war crimes or cruel and degrading treatment could thus find itself subjected to an actionable claim under the ATS. The facts in *Mujica* bear a strong resemblance to those in *Unocal*, discussed in section III A, suggesting that the *Unocal* aiding and abetting standard remains an available route to liability under the ATS. The continued viability of the *Unocal* standard must raise for directors the haunting specter of being compelled to pay a large settlement or worse yet a large jury verdict as a result of their complicity with human rights abuses. Each of these possibilities is discussed in further detail below.

**B. Costs associated with ATS suits.**

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122 Id.
123 Id.
124 Id. at 1181
125 Id.
Even an unsuccessful ATS claim can be costly for a corporation. ATS suits are generally sweeping litigation involving extensive discovery and numerous pretrial motions. Additionally, ATS suits tend to be drawn out over a number of years wracking up fees paid to outside counsel. Given the costs of actually litigating an ATS claim there arises some incentive to settle. This incentive to settle is best demonstrated by Unocal. In Unocal, the Ninth Circuit having found that the plaintiffs had a cognizable cause of action under the ATS, Unocal decided to settle.\textsuperscript{126} While the amount of the settlement has remained a closely guarded secret, this very secrecy has fueled speculation that it was substantial. Once a claim has been allowed to get to trial there is a strong incentive to settle given the notorious propensity of American jurors to give huge damage awards, especially to sympathetic victims such as those who have seen their human rights violated.\textsuperscript{127}

Even if an ATS case does not make into court, or if it ultimately proves unsuccessful in court, the damage to the corporation may have already been done. ATS claims tend to generate significant publicity; this publicity alone may have great costs to the corporation, costs outweighing the benefits of engaging in the illegal human rights abuses. The public has come to expect more from corporations.\textsuperscript{128} Non-governmental organizations (NGOs) have become increasingly effective in mobilizing resources to draw attention to issues of corporate


\textsuperscript{127} See e.g, Hersch, Jon, Viscusi, Kip T., “Punitive Damages: How Judges and Juries Perform,” 33 JLEGST 1 (2004) (discussing how juries tend to give higher compensatory damage awards which in turn divies up punitive damages).

\textsuperscript{128} Williams, Cynthia A., Conley, John M. “Is There an Emerging Fiduciary Duty to Consider Human Rights,” 74 Cin. Law Rev. 75, 78 (year).
responsibility.\textsuperscript{129} The costs of ignoring human rights violations is demonstrated by the recent decision by the University of Washington and several other universities to cancel their apparel licensing contracts with the Russell Corporation in light of growing student protests over a Russell subsidiary’s decision to close a factory as a means of cracking down on unionization efforts in contravention of international labor standards.\textsuperscript{130}

It has been increasingly recognized that reputation can account for a significant portion of a company’s value.\textsuperscript{131} A failure to account for the negative publicity that arises from being held subject to human rights litigation not only results in reduced “sales and damage [to] employee morale” but become the basis for derivative suits as a result of the financial losses sustained by way of the lost sales.\textsuperscript{132} Being known to be a company that engages in potential human rights abuses may also make it more difficult, or at the minimum more expensive, for corporations to obtain the necessary insurance.\textsuperscript{133}

Another potentially huge cost of failing to effectively prevent human rights abuses derives from the “growth of the socially responsible investor movement and activist pension fund investors.”\textsuperscript{134} Socially responsible investors become potential plaintiffs in derivative actions. Additionally, these socially responsible investors are increasingly being found at the helms of powerful institutional investment funds.\textsuperscript{135} Should an influential institutional investor decide to divest themselves from a particular corporation, the negative effects upon the stock price ergo the value of that corporation could be significant. It is the duty of the board to manage

\textsuperscript{129} Id.\textsuperscript{130} Rolph, Amy, “\textit{UW Cancels Contract for Apparel},” The Seattle Post-Intelligencer, February 25, 2009. Available online at \url{http://www.seattlepi.com/local/401357_uw25.html}. Last accessed on April 13, 2009.\textsuperscript{131} Brown, Brad, Perry, Susan, Wheeler, John O., “\textit{Liability Risk Management and Corporate Social Performance},” Risk Management and Insurance Review, Vol. 4, Issue 1, pp., 67-81 (2008).\textsuperscript{132} Id.\textsuperscript{133} Id.\textsuperscript{134} Id.\textsuperscript{135} Id. at 95.
the corporation in a manner reasonably designed to maximize its value. Failing to account for the
costs of potential ATS litigation could hardly be considered reasonable given the potential direct
and indirect costs of such litigation.

C. Failing to consider the risk of ATS suits as a breach of the duty of care

The duty of care requires board members to use sufficient procedural mechanisms to
assure that a particular decision is in the best interests of the company. Duty of care claims are
subject to the business judgment rule. As discussed above, application of the business judgment
rule involves determining if the board made an informed decision in deciding to undertake the
particular course of action at issue.\textsuperscript{136} The propriety of that decision is judged on a standard of
gross negligence.\textsuperscript{137} Gross negligence is generally defined as “[a] lack of slight diligence or
care”\textsuperscript{138} or “actions which are ‘without the bounds of reason.’”\textsuperscript{139} So the necessary question
becomes whether a corporate board could be said to have exhibited even slight diligence or care
in their decision to ignore or subvert international human rights law? Given the breadth of well-
publicized cases and controversies surrounding the abuse of human rights by corporations and
the potentially high costs of engaging in such behavior this question is likely to be answered in
the negative.

There has been increasing recognition that corporations must consider human rights in
their business plans amongst academics,\textsuperscript{140} corporate defense lawyers,\textsuperscript{141} shareholder groups,\textsuperscript{142}

\textsuperscript{136} 488 A.2d 858, 872.
\textsuperscript{137} Id.
\textsuperscript{139} See e.g., “Bad Business: Why Companies Shouldn’t Trade with Abusive Regimes,”
Knowledge@Wharton, a publication of the Wharton School of Business at the University of Pennsylvania

\textsuperscript{140} See e.g., Gibson, Keith, Grabill, Jeremy T. (Weil, Gotshal & Manges LLP) “A Growing Danger On The
Horizon For Companies Doing Business Internationally: Corporate Liability Under The Alien Tort
and as embodied in the increasingly standard policies of major corporations themselves. A decision that either ignores or is not informed by the growing consensus of academics, corporate counsel, shareholders and industry practice can hardly be argued to have been an informed one or made with even the slightest diligence or care. To apply the facts of Mujica to a modern day, theoretical board decision illustrates this point. In deciding to employ the Columbian military to defend their pipelines the Occidental board has a duty to be informed as to the potential consequences of their decision. Even the slightest procedural diligence, such as a Google search, reveals enough evidence of human rights abuses at the hands of the Columbian military to render extremely questionable a decision to employ their services. This information, even in isolation from concerns regarding the ATS, should give any board second thoughts. Even the slightest diligence would also reveal the settlement paid by Unocal on similar facts. A decision by the


board to hire a military apparatus with known human rights abuses can hardly be argued to be
the result of a valid business judgment given the potentially devastating consequences of ATS
claims discussed above. An analysis of human rights standards potentially conflicting with or
impacting a board decision must be part the procedures undertaken by a corporate board in
performance of their fiduciary duties. A decision made with out any procedures for considering
potential liabilities arising out of human rights law ignores the realities of operating a business in
the current environment of using tort law to enforce human rights and as such cannot said to be
informed.

D. Failure to account for the risk of ATS suites as breach of the duty to monitor
under Caremark.

Derivative liability under the Caremark standard is most likely to arise in a situation
wherein the corporation has already been sued under the ATS, resulting in some sort of loss and
the board failed to take action to prevent the loss. The so-called ‘failure to monitor liability’
under Caremark can arise if the following conditions are met: “(1) that the directors knew or (2)
should have known that violations of law were occurring and, in either event, (3) that the
directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such
failure proximately resulted in the losses complained of.”\textsuperscript{145}

To apply the facts of Mujica once again one can make out claim under the Caremark
standard. If the board either knew as a result of an existing monitoring and reporting system or
should have known\textsuperscript{146} but did not for lack of a monitoring system, that human rights abuses were
being carried out by the Columbian military with “knowing practical assistance or

\textsuperscript{145} 698 A.2d at 971.
\textsuperscript{146} As discussed above, even the slightest diligence reveals the paltry track record of the Columbian
military with regards to human rights.
encouragement that has a substantial effect on the perpetration of the crime” by Occidental or its affiliates, a duty arises to prevent further illegalities. If no good faith steps were taken by the board to stop or prevent abuses from occurring, and those abuses resulted in an ATS suit, there is a cognizable claim under Caremark. To have allowed the abuses to occur certainly implies that the board either “utterly failed to implement any reporting or information system or controls” or “having implemented such a system or controls, consciously failed to monitor or oversee its operations” because no director acting with knowledge of the illegalities taking place and the associated potential liabilities could believe in good faith that allowing such conduct to continue was in the best interest of the corporation. When aware of pervasive and material wrongdoing, directors have a duty under Caremark to speak out and put an end to it.

Any corporate monitoring and information system to be objectively adequate must have tools in place to monitor the conduct of corporate employees, agents, and affiliates with regards to their compliance with human rights law. The failure to have such tools in place can subject the corporate board to derivative liability in addition to the potential liabilities arising under the ATS.

V. Conclusion

The path to derivative liability for human rights abuses proposed in this note certainly is not an easy one. But it is a possible one. The most likely scenario where a plaintiff shareholder could successfully bring such an action would be to bring an action against the board of a company already subject to an ATS suit and its associated losses. An action for the breach of the

\[\text{References}\]

\[147\] 395 F.3d at 947.
\[148\] 911 A.2d at 370
\[149\] Del. C.A. No. 769-VCS (Del. Chan. 2009).
duty of care is easier to make out. The standards for Caremark claims are still evolving so it is difficult to reliably predict how courts will rule on Caremark claims. Such an action would probably have the best likelihood for success in a California federal court sitting in diversity in a suit against a Delaware corporation. California district courts have shown the greatest willingness to allow ATS cases to go to trial in the post-Sosa era. As such they are more likely to recognize the potential for liability stemming from an ATS suit and impute the corporate board with the knowledge as a fiduciary to act in a manner so as to avoid liability stemming from ATS suits.