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[California Court Of Appeal Affirms Dismissal Of Shareholder Derivative Action Where Company Refused Demand](#)

In *Bezirdjian v. O'Reilly*, Case No. A124859, 183 Cal. App. 4th 316, 2010 WL 1212437 (Cal. App. Mar. 30, 2010), the [California Court of Appeal for the First Appellate District](#) affirmed the dismissal of a shareholder derivative action against current and former board members of Chevron Corporation. The Court held that the plaintiff failed to allege facts with sufficient particularity to rebut the presumption that the company's refusal to pursue the case in response to the shareholder demand was protected by the business judgment rule. This decision joins the growing body of California cases that follow or apply Delaware law in protecting the integrity of corporate decision-making.

In *Bezirdjian*, plaintiff alleged breach of fiduciary duties, gross mismanagement, constructive fraud and waste of corporate assets in connection with illicit payments Chevron allegedly made to Saddam Hussein in exchange for Iraqi oil from 2000 to 2003. Under Delaware law (Chevron is a Delaware corporation), a shareholder seeking to institute an action against board members on behalf of a corporation must exhaust intracorporate remedies by making a pre-suit demand on the directors or, alternatively, plead with particularity why demand is excused. Here, the parties stipulated to treating the initial complaint as a demand on the board of directors to pursue an action against current and former board members. The parties further stipulated that the shareholder plaintiff could file an amended complaint after this "demand" had been considered.

In response to the "demand," Chevron's board authorized a special committee of three independent directors, appointed to the board after the alleged wrongdoing, to "investigate, analyze, deliberate upon, and respond to the demand" and make a binding decision on the board without further review. On June 11, 2008, the committee issued a determination that, after interviewing 34 individuals and reviewing over 150,000 pages of documents, it was not in the best interests of the corporation or its shareholders to pursue the claims alleged in the complaint. Thereafter, the plaintiff shareholder amended his complaint to indicate that his demand had been refused, and challenged the refusal of demand as wrongful and itself a breach of fiduciary duty.

Chevron responded by filing a motion for judgment on the pleadings to dismiss the action. In its motion, Chevron was able to show from the face of the pleadings, facts stipulated by the parties and those matters properly subject to judicial notice (here, its 2008 proxy statement) that the special committee was

comprised of independent directors who had acted reasonably and in good faith in declining to pursue the underlying lawsuit. The trial court granted Chevron's motion, holding that, under *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984), "unless the business judgment rule does not protect the refusal to sue, the shareholder lacks the legal managerial power to continue the derivative action, since the power is terminated by the refusal."

In affirming judgment for Chevron, the Court of Appeal noted that the decision to bring a lawsuit or refrain from litigating a claim on behalf of a corporation is a decision concerning the management of the corporation and is therefore soundly subject to the protections of the business judgment rule. Significantly, the burden is on a challenging shareholder to establish facts rebutting the presumption that in making a business decision, not involving self-interest, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the company.

Unable to meet this burden, the plaintiff shareholder argued that Chevron's motion was actually a disguised motion for summary judgment because it sought to introduce the truth of the committee's findings. The Court disagreed, noting that the fact that the disinterested committee had refused the demand was discernable from the allegations in the amended complaint. Thus, the Court held that the trial court's reliance on the facts incorporated in the complaint to establish the independence and diligence of the committee was proper. In doing so, the Court also held that Chevron was not required to prove conclusively by a preponderance of the evidence that the committee was independent or that it acted diligently and in good faith, but rather "Chevron's burden was simply to allege facts sufficient to raise the presumption" of good faith, after which the burden shifted to the challenging shareholder to rebut the presumption. The Court specifically noted that it was "significant" that the shareholder failed to challenge the actual propriety of the committee's decision to reject his demand when he was required to allege that the refusal was wrongful.

Plaintiff's inability to allege facts regarding the wrongful refusal may have been the result of its inability to obtain discovery of committee reports and materials. Plaintiff argued that Delaware law allows for the discovery of such materials; however, the Court noted that discovery of evidence pertaining to the corporations' decision to refuse to pursue a lawsuit is generally not available, citing *Scattered Corp. v. Chicago Stock Exchange*, 701 A.2d 70, 77 (Del. 1997). In *Scattered*, the Delaware Supreme Court held that shareholder plaintiffs are not entitled to discovery in order to assist in pleading facts with particularity in cases of demand refusal, rather a prospective shareholder plaintiff must use the "tools at hand" to acquire the relevant corporate records, such as reports or minutes, in order to allege that the demand was wrongfully refused. In so holding, the Court noted that it was determinative that the instant action concerned *refusal* of a demand, since limited discovery regarding the independence and good faith of a special committee is sometimes allowable when a plaintiff pleads that demand was *excused* because it would have been futile.

Much of Chevron's ability to prevail on its motion and appeal can be attributed to its strategic decision to refrain from challenging the underlying allegations in the complaint. By doing so, Chevron was not only able to evade plaintiff's argument that Chevron was actually arguing for summary adjudication of an issue of fact, but Chevron was also able to insure that plaintiff had no viable argument for obtaining discovery. As the Court noted, "absent a specific allegation as to why the Committee was not disinterested, or why the refusal was improper, and absent a specific argument from plaintiff as to what more discovery would yield," it was inappropriate to allow plaintiff access to discovery to cure the deficiencies in his own complaint.

Bezirdjian is yet another decision in the growing body of California case law protecting corporate managerial decision-making. Specifically, *Bezirdjian* confirms that when faced with a shareholder demand and the possibility of a derivative suit, the business judgment rule offers strong protections against judicial second-guessing of an independent special committee's conclusions. The decision provides invaluable guidance for disposing of shareholder derivative actions before the corporation is forced to suffer time consuming and costly discovery. Notably, Chevron's decision to focus on the shareholder plaintiff's inability to show wrongful refusal with the requisite particularity allowed it to successfully challenge the suit at the pleading stage without ever having to address the underlying factual basis of the claim.

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