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DERIVATIVE ACTION DISMISSED WITHOUT DISCOVERY BASED ON THE BUSINESS JUDGMENT OF DISINTERESTED DIRECTORS

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The California Court of Appeal affirmed dismissal of a shareholder derivative action, without affording plaintiff any discovery, based on the business judgment of three disinterested directors. The case is *Bezirdjian v. O'Reilly*, decided March 30, 2010. In so doing, the Court provides a blueprint for the successful defense of derivative actions.

The Case: Chevron's Alleged Payments to Saddam Hussein. Bezirdjian filed a shareholder derivative action against current and former members of the board of directors of Chevron Corporation, alleging breaches of fiduciary duty, 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. The allegations of the complaint were based on an article published in May 2007 in the *New York Times*. Chevron never defended the alleged payments to Saddam Hussein, essentially asked the Court to assume the truth of those allegations, and yet obtained an order dismissing the case without ever having to provide plaintiff with any documents, information or testimony regarding any of plaintiff's claims.

Chevron's Litigation Strategy. Chevron responded to the complaint by:

- forming a committee of the board composed of three directors who were not on the board when the alleged payments to Saddam Hussein were made,
- granting the committee the power to investigate the allegations of the complaint and resolving that the committee's conclusions would be binding on the board without further review,
- obtaining a stay of the litigation to permit the committee to perform its investigation, and
- moving for judgment in its favor solely on the basis of the committee's recommendation, as reported to plaintiff in a letter from Chevron's attorney.

The letter stated that the Committee and its counsel interviewed 34 individuals, reviewed over 150,000 pages of documents, and "determined it not to be in the best interests of Chevron or its stockholders to pursue the claims asserted" in Bezirdjian's complaint.

The Court's Reasoning. Applying Delaware law (Chevron is a Delaware corporation), the Court observed that directors, rather than shareholders, manage the affairs of Delaware corporations, and the decision whether to file suit is a decision concerning corporate management that is

subject to the business judgment rule. This rule creates a presumption that a board of directors, in making decisions not involving self-interest, acts on an informed basis, in good faith and in the honest belief that its decisions are in the corporation's best interests. Chevron was not required to prove conclusively by a preponderance of the evidence that the committee, acting for Chevron's board, was independent or had acted diligently or in good faith, but merely was required to allege facts to raise these presumptions. The burden then shifted to the plaintiff to allege facts sufficient to rebut these presumptions, which he failed to do. Moreover, under Delaware law, plaintiffs are not entitled to discovery into whether a board's actions are disinterested, diligent or in good faith, but instead must obtain this information by using the "tools at hand" generally available under state law for shareholders to request that their corporations provide them with certain types of corporate records.

Analysis. The key to Chevron's victory, and the lynchpin of the Court's ruling, is the board's appointment of a committee consisting of directors who were not members of the board during the time of the allegedly wrongful conduct. These facts were sufficient for Chevron to meet its initial burden of alleging facts to establish that the board, acting through the committee, had no self-interest, thereby triggering the usual presumptions of the business judgment rule. Chevron avoided having to submit to discovery by making no response to the central allegations of the complaint – its allegedly illicit payments to Saddam Hussein – and by seeking dismissal by means of a motion for judgment on the pleadings, rather than by a motion for summary judgment, which would have put the Court's focus on the existence of disputed facts. Finally, there is a suggestion in the Court's opinion that plaintiff failed to take advantage of California law providing shareholders with rights to inspect corporate records, but it is unlikely that Chevron would have produced any of the records plaintiff sought, such as the records on which the committee relied in reaching its conclusion, in response to such a demand.

As this case demonstrates, the business judgment rule, when skillfully employed, is a formidable weapon against derivative lawsuits.