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insights

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The Business Judgment Rule: Perfection Not Required

The "business judgment rule" is a presumption that the directors of a corporation make business decisions on an informed basis, in good faith, and in the honest belief that the action taken was in the company's best interests. Generally, there is a conflict of interest exception where a corporate director cannot rely on the business judgment rule if their personal interests significantly conflict with the company's interests. However, this exception only applies if the interests of a company's individual decisionmakers diverge from the interests of the enterprise as a whole. In other words, if the corporate directors' actions remain in the best interests of the company as a whole, regardless of the individual's interest, the business judgment rule can still apply.

In the recent California appellate decision of *Randhir Tuli v. Specialty Surgical Center of Thousand Oaks, LLC*, the Court of Appeal held that where the corporate members acted in the company's best interests, the business judgment rule applied even in the presence of potential conflicts of interest or hostility among corporate members.

In this case, plaintiff Randhir Tuli ("Tuli") was a member of defendant Specialty Surgical Center of Thousand Oaks, LLC ("Specialty"). Specialty's operating agreement, which Tuli and his colleague Dr. Andrew Brooks negotiated, contained a "terminating event" provision. Under the agreement, a "terminating event" would occur when "[a] Member has disrupted the affairs of the Company or has acted adversely to the best interests of the Company, as determined in the reasonable discretion of the Governing Board."

Once Specialty opened for business, it was immediately and impressively profitable. However, disputes arose between Tuli and the other members of Specialty. Tuli's colleagues sought to buy him out, but Tuli refused. Instead, he circulated a cease and desist letter to Specialty's members and potential investors claiming Specialty was engaging in criminal activity. Specialty used the cease and desist letter as a basis to oust Tuli from the company, claiming it constituted a "terminating event" under the operating agreement.

Tuli filed a claim for breach of fiduciary duty against his colleagues for ousting him from Specialty. The trial court held that the business judgment rule barred Tuli's claims against Specialty, finding that "[t]he evidence supported Specialty's rational fear that Tuli's letter would scare off potential investors, that it was rational to notify Tuli his letter was a terminating event, and that it was rational to oust him when he refused to cure within 30 days of Specialty's notice."

On appeal, Tuli argued that the business judgment rule did not apply because there was (1) a conflict of interest, (2) bad faith, and (3) no proper investigation.

First, Tuli argued there was a conflict of interest, as each person who owned shares in Specialty would benefit from ousting Tuli because Tuli's shares would be redeemed for $0. However, the Court of Appeal rejected this argument, finding that "Specialty's decisionmakers worked in the best interest of the company as a whole."

Second, Tuli argued the business judgment rule did not apply because bad faith and improper motives drove the governing board to oust him, as Tuli's colleagues had been extremely upset with him at the time. The Court of Appeal also rejected this argument because it found that Specialty acted in the best interests of the company. Indeed, the Court noted that it is not bad faith "where a company decisionmaker, while working in the company's best interests, privately disparage[s] a colleague."

Lastly, Tuli argued that Specialty did not properly investigate the charges in his letter that Specialty was engaged in illegal conduct. However, the Court found that Specialty had already investigated the legal issues in Tuli's letter prior to the letter being sent. Tuli also did not offer any evidence that indicated additional investigation would have changed anything. Therefore, the Court rejected Tuli's argument.

The key takeaway is this: If a member of a corporation acts in their own individual interest, their actions may still be protected under the business judgment rule if made in the best interest of the company as a whole.

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- Property and transfer tax issues;
- Litigation issues;
- and more.

For any questions regarding commercial real estate or the blog content, please contact Jeff Brown.

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