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COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

JEFFREY R. KRINSK, Plaintiff and Appellant, v. CHIRON CORPORATION, Defendant and Respondent.	D052915 (Super. Ct. No. GIC878087)

APPEAL from an order of the Superior Court of San Diego County, Linda B. Quinn, Judge. Affirmed.

Jeffrey R. Krinsk appeals an order of dismissal entered after the superior court sustained without leave to amend a demurrer by Chiron Corporation (Chiron) to his first amended complaint for deceit, negligent misrepresentation and fraud by the company and certain of its officers and directors. He contends that the superior court erred in concluding that he lacked standing to sue Chiron for the diminution in the value of his stock that resulted from the alleged misconduct. We disagree and affirm the order.

FACTUAL AND PROCEDURAL BACKGROUND

In accordance with the standards for reviewing a superior court decision sustaining a demurrer without leave to amend, the following factual recitation is based on the allegations of the operative pleading, Krinsk's first amended complaint (see *Zelig v. County of Los Angeles* (2002) 27 Cal.4th 1112, 1126).

Chiron is an international biotechnology company that develops vaccines and treatments for cancer and certain infectious diseases. In July 2003, Chiron was desirous of getting a foothold in the U.S. vaccines market and, toward that end, purchased PowerJect Pharmaceuticals (PowerJect), which had a vaccine manufacturing plant in Liverpool, England where the flu vaccine, Fluvirin, was produced.

Prior to Chiron's acquisition of PowerJect, the Liverpool plant had (1) a history of citations by the U.S. Food and Drug Administration (the FDA) for violations of applicable regulatory standards, including citations that required prompt corrective action under threat of potential license revocation or suspension, (2) been ordered in 2002 to recall several million doses of oral polio vaccine produced there for possible contamination, and (3) experienced production and operational problems that resulted in the Irish Medicine Board's suspension of PowerJect's license in 2002 as the supplier of a tuberculosis vaccine. A month prior to the closing of Chiron's acquisition of PowerJect, the FDA conducted another inspection of the Liverpool plant and found a number of contamination and other problems at the plant. In part as a result of its due diligence in connection with the acquisition, Chiron was aware of these and other problems at the plant.

After Chiron took over the Liverpool plant, the plant continued to experience repeated serious contamination problems. Notwithstanding its knowledge of these problems, Chiron represented to securities analysts and investors that the plant was "one of the most important" assets acquired in the PowerJect acquisition and that the plant had manufacturing "capabilities [able] to satisfy the U.S. [vaccine] market . . . ." Moreover, beginning in January 2004, Chiron embarked on a campaign of overstating its ability to produce its Fluvirin vaccine for the 2004-2005 flu season (including plans to produce approximately 50 million doses of the vaccine in its Liverpool plant) in its public statements and its filings with the Securities and Exchange Commission. (All further dates are in 2004 except as otherwise noted.)

As of that time, Krinsk owned 125,000 shares of Chiron stock, but was being encouraged by his financial advisor to sell 100,000 of those shares in a complex transaction known as prepaid forward contract, which would have allowed him to sell the stock for more than $5 million and achieve favorable tax treatment for those proceeds. Krinsk would have sold those shares in accordance with this advice but, based on Chiron's continuing rosy financial projections for the sale of Fluvirin, did not do so.

In September, the United Kingdom's Medicines and Healthcare Products Regulatory Agency conducted a "for-cause" investigation of the plant and, after finding conditions there to be unacceptable, informed Chiron that it would conduct a second inspection to determine whether to suspend the company's license to manufacture vaccines at that location and instructed Chiron not to release the Fluvirin in the interim. Notwithstanding this directive and Chiron's preparation of a draft press statement recognizing that its own

internal testing of the Fluvirin vaccine "failed to provide results necessary to permit release of the vaccine to the market," the company issued a press release indicating that it intended to ship approximately 48 million doses of flu vaccine to the U.S. Within a week, however, the Agency temporarily suspended Chiron's license to manufacture Fluvirin at the Liverpool plant.

On October 5, Chiron publicly disclosed the suspension of its license, admitted that it did not expect to sell any Fluvirin in the 2004-2005 season and substantially reduced its expected pro forma earnings. Immediately after the disclosures, Chiron's stock price dropped from $45.42 to $37.98 per share. The FDA reinspected the plant and issued an October 15 statement that "none of the influenza vaccine manufactured by [Chiron] for the U.S. market [was] safe for use."

Krinsk filed this action in January 2007, asserting claims for deceit, negligent misrepresentation and fraud against Chiron and certain of its officers and directors. Chiron demurred to the complaint on the grounds that Krinsk lacked standing to pursue his claims against it, had failed to allege valid causes of action against it and had failed to allege his causes of action with sufficient particularity. The court sustained all of the demurrers with leave to amend and Krinsk filed his first amended complaint. Chiron again demurred on the same grounds and the court again sustained them, but without leave to amend. Krinsk appeals.

DISCUSSION

1. *Appealability*

After the superior court sustained Chiron's demurrer to the first amended complaint without leave to amend, Krinsk did not seek entry of a judgment of dismissal as to Chiron despite the fact that such a judgment would have been immediately appealable notwithstanding the continuation of his claims against the individual defendants. (*Culligan v. State Compensation Ins. Fund* (2000) 81 Cal.App.4th 429, 433.) Instead he obtained a stipulation by the individual defendants that the action against them would be dismissed without prejudice. Based on the stipulation, the superior court entered an order dismissing the action, from which Krinsk now purports to appeal. The difficulty is that such an order is not ordinarily appealable (see *S.B. Beach Properties v. Berti* (2006) 39 Cal.4th 374, 380), thus raising a question as to whether this appeal is proper.

While the law is clear that a voluntary dismissal *with prejudice* for the purpose of expediting an appeal is an appealable order (*Stewart v. Colonial Western Agency, Inc.* (2001) 87 Cal.App.4th 1006, 1012), it is not as clear that a voluntary dismissal without prejudice is likewise appealable. (See *Syufy Enterprises v. City of Oakland* (2002) 104 Cal.App.4th 869, 879 ["[b]y definition, a voluntary dismissal without prejudice is not a final judgment on the merits"]; compare *Gutkin v. University of Southern California* (2002) 101 Cal.App.4th 967, 972-975 [recognizing that a voluntary dismissal without prejudice does not generally have legal effect of a final judgment, but allowing an appeal from an order sustaining a demurrer without leave to amend as to certain causes of action

after the plaintiff voluntarily dismissed, without prejudice, his remaining causes of action].) Because, however, Krinsk would have been entitled to appeal a separate judgment of dismissal as to Chiron without dismissing the remaining defendants, we will treat the court's order as a judgment of dismissal as to Chiron, over which we have appellate jurisdiction and proceed to address the merits of his appeal.

2. *Standard of Review*

On appeal from a judgment of dismissal entered after the superior court sustains a demurrer without leave to amend, the appellant must show either that the demurrer was sustained erroneously or that the court's denial of leave to amend constituted an abuse of discretion. (*Smith v. County of Kern* (1993) 20 Cal.App.4th 1826, 1829-1830.) Where, as here, the appeal arises from a ruling on a general demurrer, the issue raised -- whether the facts set forth in the challenged pleading are sufficient to constitute a cause of action -- presents a question of law subject to our de novo review. (*Leko v. Cornerstone Building Inspection Service* (2001) 86 Cal.App.4th 1109, 1114; see Code Civ. Proc., § 430.10, subd. (e).)

In determining whether a demurrer is well taken, we must accept as true all well-pleaded allegations of material fact, "but not contentions or conclusions of fact or law." (*Berry v. City of Santa Barbara* (1995) 40 Cal.App.4th 1075, 1082.) Likewise, we need not accept the truth of allegations that are contradicted or inconsistent with matters subject to judicial notice, including allegations made in earlier pleadings or exhibits attached to such pleadings. (*Holland v. Morse Diesel Internat., Inc.* (2001) 86 Cal.App.4th 1443, 1447.)

A general demurrer tests the sufficiency of the pleading's allegations to state a cause of action. (*Wise v. Pacific Gas & Electric Co.* (2005) 132 Cal.App.4th 725, 738.) In ruling on such a motion, the superior court must assume the truth of all factual allegations set forth in the challenged pleading, as well as matters for which judicial notice is requested and appropriate. (Code Civ. Proc., § 430.30, subd. (a).) We review the court's ruling de novo. (*Lazar v. Hertz Corp.* (1999) 69 Cal.App.4th 1494, 1501.)

3. *Krinsk's Standing to Sue*

A. Choice of Law

Chiron argues that Delaware law, rather than that of California, is controlling on the issue of whether Krinsk has standing to sue it arising out of the misconduct alleged in the first amended complaint. However, the company also admits that the laws of the two states are identical for the purposes of determining the standing issue. (See *Schuster v. Gardner* (2005) 127 Cal.App.4th 305, 316, & authorities cited therein.) Accordingly, we need not resolve the parties' dispute as to which state's law is controlling. (See *id*. at p. 312.)

B. Standing to Bring a Direct Action

Corporate management owes to its corporation's stockholders a duty to take proper steps to enforce all claims the corporation may have and, when it fails to do so, the stockholders have a right to bring a derivative action to enforce the corporation's rights and redress its injuries. (*Grosset v. Wenaas* (2008) 42 Cal.4th 1100, 1108; *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 107 (*Jones*).) Thus, shareholders may bring a derivative action to recover for injury to the corporation, to recover corporate assets or to

prevent dissipation of those assets if the board fails to do so. (*Jones, supra*, 1 Cal.3d at pp. 106-107; see Friedman, Cal. Practice Guide: Corporations (The Rutter Group 2008) ¶ 6:598, p. 6-127 (Friedman).) In such an action, the named shareholders are nominal plaintiffs and the corporation is the real plaintiff and the ultimate beneficiary thereof. (*Klopstock v. Superior Court* (1941) 17 Cal.2d 13, 21; *Russell v. Weyand* (1935) 5 Cal.App.2d 259, 260; see generally Friedman, *supra*, ¶ 6:604, p. 6-131.)

A corporate shareholder is also entitled to bring a direct action, on his or her own behalf or on behalf of a class of shareholders to which he or she belongs, for injuries to his or her interest as a shareholder. (*Jones, supra*, 1 Cal.3d at p. 107; Friedman, *supra*, ¶ 6:598, p. 6-127.) Suits to compel the declaration or payment of a dividend, to enjoin a threatened ultra vires act or to enforce shareholder voting rights fall within the class of actions that are direct in nature, as are suits for damages arising out of insider trading or directors' issuance of stock to shift control of the corporation to themselves. (Friedman, *supra*, ¶ 6:601, p. 6-128.)

Direct actions and derivative actions are said to be "mutually exclusive" in that a particular right of action and recovery belongs either to the shareholders (remediable only by direct action) or to the corporation (remediable only by derivative action). (*Jones, supra*, 1 Cal.3d at pp. 106-107; Friedman, *supra*, ¶ 6:598, p. 6-127.) However, a shareholder may sue as an individual where he is directly and individually injured, even if the corporation also has a cause of action for the same wrong, so long as his individual injuries are not merely incidental to the injuries suffered by the corporation. (*Avikian v. WTC Financial Corp.* (2002) 98 Cal.App.4th 1108, 1116.)

A shareholder's loss of stock value as a result of alleged corporate mismanagement is generally considered to be merely incidental to the corporate injury (i.e., a general diminution in value of the corporate assets) and will not support a direct action. (*Schuster v. Gardner*, *supra*, 127 Cal.App.4th at pp. 311-312; *Avikian v. WTC Financial Corp.*, *supra*, 98 Cal.App.4th at p. 1116.) The reason for this is that the underlying wrong is to the corporation, despite the fact that there is also injury to the shareholders (reflected in a devaluation of their stock), and that allowing individual actions "would authorize multitudinous litigation and ignore the corporate entity." (*Sutter v. General Petroleum Corp.* (1946) 28 Cal.2d 525, 530; see also *Tooley v. Donaldson, Lufkin & Jenrette, Inc.* (Del.Supr. 2004) 845 A.2d 1031, 1033, 1039 [indicating that under Delaware law, the stockholder may only assert an individual claim where his injury is "independent of any alleged injury to the corporation"].)

The analysis of *PacLink Communications Internat., Inc. v. Superior Court* (2001) 90 Cal.App.4th 958 is instructive here. There, the plaintiffs, who collectively owned a minority interest in the company, sued the majority interest holders for allegedly transferring company assets to another company in which the plaintiffs had no interest, without adequate consideration being paid. (*Id*. at p. 961.) The majority interest holders challenged the plaintiffs' standing to bring a direct action and the appellate court agreed that the plaintiffs' allegations established injury to the company, not the individual interest holders. (*Id*. at p. 964 ["the essence of plaintiffs' claim is that the assets of PacLink . . . were fraudulently transferred without any compensation being paid to the [company . . . which constitutes] an injury to the company itself"].)

Nelson v. Anderson (1999) 72 Cal.App.4th 111 is even more on point. In that case, the minority shareholder sued the majority shareholder for alleged misfeasance and negligence in managing the corporation that caused the corporation to fail. In concluding that the minority shareholder lacked standing to bring a direct action against the majority shareholder, the court explained:

> "[A]n individual cause of action exists only if the damages were not *incidental* to an injury to the corporation. [Citation.] The cause of action is individual, not derivative, only "'where it appears that the injury resulted from the violation of *some special duty owed the stockholder* by the wrongdoer and having its origin in circumstances independent of the plaintiff's status as a shareholder.'" [Citation.]
>
> "In other words, it is the gravamen of the wrong alleged in the pleadings, not simply the resulting injury, which determines whether an individual action lies. . . .
>
> ". . . . . .
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> "Because all of the acts alleged to have caused [the minority shareholder's] injury amount to alleged misfeasance or negligence in managing the corporation's business, causing the business to be a total failure, any obligations so violated were duties owed directly and immediately to the corporation. [Citation.] Because the gravamen of the complaint is injury to *the whole body of its stockholders*, it was for the corporation to institute and maintain a remedial action." (*Id*. at pp. 124-126, italics added.)

A similar analysis applies here. Krinsk's allegations are essentially that Chiron's management continued to represent publicly that the company would be able to successfully manufacture and sell the Fluvirin vaccine despite its knowledge of serious problems at the Liverpool plant that jeopardized such an outcome. As such, the allegations establish injury to the corporation, not to the individual shareholders who held Chiron stock during the relevant time period, all of whom suffered the same injury as

Krinsk did. (See *Schuster v. Gardner, supra*, 127 Cal.App.4th at p. 310 [shareholder action was held to be derivative rather than direct where shareholders alleged that corporate management caused the company to undertake ill-conceived acquisitions and misstate its finances, to the detriment of the corporation, so that members of management could sell their stock at inflated prices].) Although the pleading also alleges that the misconduct allowed the corporation to raise capital on more favorable terms than would otherwise have been available, any such misconduct benefitted the corporation, and in turn the shareholders, rather than created any injury.

Krinsk nonetheless argues that *Small v. Fritz Companies, Inc.* (2003) 30 Cal.4th 167 establishes his contention that his claims are direct rather than derivative. However, the sole issue decided in *Small* was whether, in addition to allowing claims for damages arising from a purchase or sale of stock that resulted from fraud, California law would also recognize a cause of action on the part of a shareholder who was induced by a corporation's fraud to *hold onto* his stock. (*Id*. at p. 171 [concluding that a "holder's action" is consistent with well-established general principles of California law allowing a cause of action based on misrepresentations or concealments that induce the plaintiff not to take action that he otherwise would have taken].) *Small* cannot, however, be read to stand for the proposition that Krinsk appears to suggest, to wit, that a holder's action is *always* a direct one if the shareholder can allege his reliance on the alleged misconduct with particularity regardless of whether his injury is merely incidental to the corporation's injury. (Compare *Small, supra*, at p. 193 (Baxter J., conc. opn.) [recognizing that such a

shareholder "*may* have a direct common law action against the company and its officials," italics added].)

Here, Krinsk's allegations assert an individual injury that is incidental to the corporate injury and thus the superior court properly sustained Chiron's demurrer to his complaint without leave to amend. Accordingly, we affirm the judgment of dismissal issued in Chiron's favor on this basis.

DISPOSITION

The order is affirmed. Chiron is awarded its costs of appeal.

McINTYRE, J.

WE CONCUR:

McCONNELL, P.J.

NARES, J.