

51 Cal.App.5th 943

Court of Appeal, Third District, California.

Ronald F. COLEY, Plaintiff and Appellant,

v.

ESKATON et al., Defendants and Appellants.

C084328

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Certified for Partial Publication.*

Synopsis

Background: Homeowner brought action against homeowners association (HOA), two directors on HOA's board, and housing community operators that employed majority of HOA directors for breach of fiduciary duty and other claims, alleging directors approved actions of HOA for benefit of operators rather than HOA itself and homeowners. Following trial, the Superior Court, Sacramento County, No. 34-2014-00171851-CU-MC-GDS, [David W. Abbott, J.](#), found directors breached fiduciary duty to HOA and its members but declined to find directors liable in their personal capacities and awarded homeowner damages and attorney fees. Operators and directors appealed and homeowner cross-appealed.

Holdings: The Court of Appeal, [Raye, J.](#), held that:

[1] directors failed to establish HOA transactions were fair and reasonable;


[2] directors had personal financial interest in transactions they approved that was distinct from interest of HOA members generally; and

[3] directors breached fiduciary duty to HOA members by approving transactions in which they had material financial interest and which were not inherently fair to HOA and its members.

Affirmed in part, reversed in part, and remanded with instructions.


Procedural Posture(s): On Appeal; Judgment.

West Headnotes (20)

[1] **Corporations and Business Organizations**  Business judgment rule in general

The “business judgment rule” is a policy of deference to a corporate board's decisionmaking.


1 Case that cites this headnote

[2] **Corporations and Business Organizations**  Business judgment rule in general

Corporations and Business Organizations  Management of corporate affairs in general

The common law business judgment rule is similar to the statutory business judgment rule for nonprofit mutual benefit corporations in that it immunizes directors for their corporate decisions that are made in good faith to further the purposes of the corporation, are consistent with the corporation's governing documents, and comply with public policy. [Cal. Corp. Code § 7231](#).

1 Case that cites this headnote

[3] **Corporations and Business Organizations**  Business judgment rule in general

Corporations and Business Organizations  Management of corporate affairs in general

The common law business judgment rule is broader than the statutory business judgment rule for nonprofit mutual benefit corporations in that it insulates from court intervention those management decisions that meet the rule's requirements. [Cal. Corp. Code § 7231](#).

2 Cases that cite this headnote

[4] Corporations and Business**Organizations** 🔑 Conflicts of Interest and Self-Dealing in General

A director cannot obtain the benefit of the business judgment rule when acting under a material conflict of interest.

1 Case that cites this headnote

[5] Corporations and Business**Organizations** 🔑 Business judgment rule in general**Corporations and Business****Organizations** 🔑 Conflicts of Interest and Self-Dealing in General

Deference under the business judgment rule is premised on the notion that corporate directors are best able to judge whether a particular transaction will further the company's best interests, but that premise is undermined when directors approve corporate transactions in which they have a material personal interest unrelated to the business's own interest or, particularly, when a majority of directors approve transactions while having a material conflict of interest.

1 Case that cites this headnote

[6] Corporations and Business**Organizations** 🔑 Conflicts of Interest and Self-Dealing in General

Although the business judgment rule is inapplicable to a director's decision to approve a corporate transaction while having a material conflict of interest, that is not to say that corporate decisions affected by these types of conflicts are improper as a matter of law.

[7] Corporations and Business**Organizations** 🔑 Entire fairness in general

The common law business judgment rule requires interested directors to prove that the business arrangement they approved was fair and reasonable, a rigorous standard that requires them not only to prove the good faith of the

transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

1 Case that cites this headnote

[8] Corporations and Business**Organizations** 🔑 Conflicts of Interest and Self-Dealing in General**Corporations and Business****Organizations** 🔑 Conflicts of interest and dealing with corporation, shareholders, or members

Unlike the statutory business judgment rule for nonprofit mutual benefit corporations, the common law business judgment rule is not concerned only with transactions between a corporation and either its directors or a business in which its directors have a material financial interest; rather, recognizing the potential for self-dealing may also exist outside this particular context, the common law business judgment rule requires directors to also satisfy its requirements when they approve other transactions in which they have a material financial interest distinct from the corporation's own interest. *Cal. Corp. Code* § 7233.

1 Case that cites this headnote

[9] Corporations and Business**Organizations** 🔑 Evidence

Under the common law business judgment rule, although a director's conflict of interest with respect to a corporate transaction does not necessarily establish actionable impropriety, it shifts the burden to the director to show the transaction was just and reasonable.

2 Cases that cite this headnote

[10] Common Interest**Communities** 🔑 Governing board; members, directors, and officers; committees

Directors of homeowners association (HOA), a nonprofit mutual benefit corporation, failed to establish that HOA transactions they approved while operating under material conflict of

interest were fair and reasonable, as necessary to uphold transactions under common law business judgment rule, where directors made no showing that transactions, namely, assessments against common interest development and individually-owned homes within it, were inherently fair from viewpoint of HOA and those interested therein.

[More cases on this issue](#)

[11] **Corporations and Business**

Organizations 🔑 Entire fairness in general

Majority directors who approve a corporate transaction while operating under a material conflict of interest must show the approved transaction was “fair and reasonable,” meaning they must not only prove the good faith of the transaction but also show its inherent fairness from the viewpoint of the corporation and those interested therein.

[1 Case that cites this headnote](#)

[12] **Common Interest**

Communities 🔑 Governing board; members, directors, and officers; committees

Directors of homeowners association (HOA), a nonprofit mutual benefit corporation, who were employed by housing community operators that were HOA members had a personal financial interest in HOA's imposition of assessments against homeowners that was distinct from the interest enjoyed by HOA members generally, and, thus, common law business judgment rule did not shield directors' approval of assessments from judicial scrutiny; directors' incomes were tied in part to financial performance of their employers, incentivizing directors to shift costs of operating communities from employers to homeowners.

[More cases on this issue](#)

[13] **Fraud** 🔑 Fiduciary or confidential relations

The three elements of a cause of action for breach of fiduciary duty are the existence of a fiduciary relationship, a breach of fiduciary duty, and damages.

[1 Case that cites this headnote](#)

[14] **Corporations and Business**

Organizations 🔑 Fiduciary nature of relation

The directors of a nonprofit mutual benefit corporation are fiduciaries who must act for the benefit of the corporation and its members.

[15] **Common Interest**

Communities 🔑 Governing board; members, directors, and officers; committees

Directors of homeowners association (HOA), a nonprofit mutual benefit corporation, owed fiduciary duty to homeowners who were HOA members.

[1 Case that cites this headnote](#)

[More cases on this issue](#)

[16] **Common Interest**

Communities 🔑 Governing board; members, directors, and officers; committees

Directors of homeowners association (HOA), a nonprofit mutual benefit corporation, breached fiduciary duty to HOA members by approving HOA actions in which they had material financial interest, where actions, namely, HOA's assessment of security service fees against homeowners that would have otherwise been paid by housing community operators that employed HOA directors and individual director's disclosure of HOA's privileged communications with its own counsel for director's own benefit, were not inherently fair from viewpoint of HOA and its members.

[More cases on this issue](#)

[17] **Corporations and Business**

Organizations 🔑 Conflicts of Interest and Self-Dealing in General

Although the common law business judgment rule may generally provide a director with immunity for decisions made in good faith, such immunity does not apply when the director is acting under a material conflict of interest.

[18] Common Interest

Communities 🔑 Governing board; members, directors, and officers; committees

Homeowner's failure to show that actions by directors of homeowners association (HOA), a nonprofit mutual benefit corporation, were motivated by any specific self-interest or that directors benefited from their breach of fiduciary duty to HOA members, which occurred when directors approved HOA actions that benefited directors' employers while being inherently unfair to HOA and member homeowners, did not preclude homeowner from establishing claim for breach of fiduciary duty; specific self-interest and personal benefit from breach were not elements of cause of action for breach of fiduciary duty.

[1 Case that cites this headnote](#)

[More cases on this issue](#)

[19] Corporations and Business

Organizations 🔑 Conflicts of Interest and Self-Dealing in General

A corporate director may still be liable for damages resulting from his or her breach of fiduciary duties, even if the director did not personally benefit from that breach; to find otherwise would absolve directors of liability when they abuse their positions to benefit, for example, friends and family, and would inappropriately immunize directors who abuse their positions to benefit themselves but fail to succeed for reasons outside their control.

[20] Common Interest

Communities 🔑 Governing board; members, directors, and officers; committees

A director's unlawful failure to abide by a homeowners association's governing documents is mismanagement.

Witkin Library Reference: 9 Witkin, *Summary of Cal. Law* (11th ed. 2017) Corporations, § 383 [Self-Dealing by Interested Directors.]

****743** APPEAL from a judgment of the Superior Court of Sacramento County, [David W. Abbott](#), Judge. Reversed in part and affirmed in part. (Super. Ct. No. 34-2014-00171851-CU-MC-GDS)

Attorneys and Law Firms

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Opinion

[RAYE](#), P. J.

947** Eskaton, Eskaton Village-Grass Valley (Eskaton Village), and Eskaton Properties Inc. (collectively, the Eskaton entities) are related corporations that develop and support common interest developments for older adults in Northern California. Ronald F. Coley owns a home in one of their *744** developments, Eskaton Village Grass Valley (the Village). He brought this suit against the Village's homeowners association, two of the directors on the association's board, and the directors' employers (the Eskaton entities), alleging these directors ran the association for the benefit of the Eskaton entities rather than the association and its members.

The trial court agreed with Coley in part, finding these directors breached their fiduciary duty to the homeowners association and its members in several respects. In particular, the court found one director improperly shared with the Eskaton entities the association's privileged communications with its counsel, and both directors, in violation of the association's governing documents, approved certain assessments that benefited the Eskaton entities and harmed many of the association's members. Based on this conduct, the court found the directors' employers, the Eskaton entities, were liable for any ***948** damages Coley suffered as a result, though it declined to find the directors liable in their

personal capacities. It awarded Coley damages of \$2,328.51 and attorney fees of \$654,242.53.

Both parties appealed. The Eskaton entities and the two director defendants (collectively, the defendants) contend the court should have afforded the directors more deference under the business judgment rule—a rule under which courts tend to defer to the decisions of corporate directors. They also claim the court misread the association's governing documents, miscalculated appropriate damages, and misapplied vicarious-liability principles in finding the Eskaton entities liable for their employees' conduct even though their employees were not liable themselves. Finally, they assert the court awarded an excessive amount of attorney fees. Coley, in his cross-appeal, raises several additional issues. He contends the court should have found the two directors personally liable for their conduct, and alleges the court wrongly rejected several of his claims against the defendants.

We agree in part with both of the parties. We find, as the defendants contend, that the court miscalculated the damages on certain claims and should, after reducing the damages award on remand, reconsider the awarded attorney fees in light of this reduction. We also agree, as Coley asserts, that the court should have found the two directors personally liable for their actions. In all other respects, we affirm the judgment.

BACKGROUND

I. The Village and the Association

The Eskaton entities, among other things, develop and support common interest developments for older adults in Northern California. One of those developments is the Village. The Village consists of 130 homes known as the “Patio” homes and 137 rented residences housed in a building known as the “Lodge.” It also consists of several common areas accessible to both Patio and Lodge residents, including walking paths and a maintenance building. Eskaton Village, an Eskaton subsidiary, owns the Lodge and its 137 residences, and various individual homeowners, including Coley, own the 130 Patio homes. Eskaton Properties, another Eskaton subsidiary, is responsible for the Village's day-to-day management.

Eskaton Village and the Patio homeowners are members of the Eskaton Village, Grass Valley Homeowners Association (the Association), a nonprofit mutual benefit corporation.

A five-member board of directors runs the Association subject to the requirements of the Association's governing document, *949 the “Declaration of Covenants, **745 Conditions and Restrictions for Eskaton Village-Grass Valley Homeowners Association” (or the CC&Rs).

II. The Association's Governance Structure

Since the Association's inception, Eskaton Village has controlled three out of the five seats on the Association's board. Under the CC&Rs, the owners of the 267 housing units (the 137 Lodge residences and 130 Patio homes) are entitled to one vote per housing unit owned. Because Eskaton Village owns a majority of these units (137 of 267), it holds a perpetual voting majority.

Exercising its majority voting power, Eskaton Village has consistently elected three employees of the Eskaton entities to sit on the Association's board. And, at least in recent years, it has appointed directors who are financially incentivized to run the Association for the benefit of Eskaton Village. Two of those employees are defendants here, Todd Murch and Elizabeth L. Donovan. Murch is the chief executive officer and president of all the Eskaton entities. Donovan is the chief operating officer of all the Eskaton entities. Both are paid by Eskaton Properties and receive bonuses and incentive compensation in part based on Eskaton Properties' performance. Eskaton Properties' performance, in turn, is based in part on Eskaton Village's performance. The higher Eskaton Village's operating losses, for example, the lower Eskaton Properties' profits given the latter's subsidizing of Eskaton Village in years of operating losses—which, in fiscal year 2015 alone, amounted in a subsidy of hundreds of thousands of dollars. Given Murch's and Donovan's pay structure, the lower this subsidy (i.e., the better Eskaton Village performs) the higher their potential compensation.

III. The Association's Assessments for Security Services

Under the CC&Rs, the Association is authorized to levy various assessments against Eskaton Village and the Patio owners. Using this authority, the Association has assessed both for, among other things, “Security/Emergency Response” services since its creation in the early 2000's.

For its initial 10 years, the Association allocated the cost of providing these security and emergency response services equally between Eskaton Village and the Patio owners, with each covering 50 percent of the total cost. But in late 2012, the Association's board, in a three-to-two vote, approved a new

budget that increased the Patio owners' relative responsibility for the cost of these services. Under the new budget, the Patio owners would cover 83.3 percent of the total costs of security services and Eskaton Village would cover the remaining 16.7 percent. The Eskaton-affiliated directors, including Murch and Donovan, all voted in favor of the new budget. The two other directors, including Coley, voted against.

***950** IV. *Coley's Suit and the Trial Court's Judgment*

In November of 2014, Coley and another Patio homeowner, Karen B. Lorini, filed a class action against the Eskaton entities, Murch, Donovan, and, as a nominal defendant, the Association.¹ In their complaint, the two named plaintiffs alleged that Murch and Donovan, acting pursuant to the direction of the Eskaton entities, were managing the Association for the benefit of the Eskaton entities and to the detriment ****746** of the Patio owners. In particular, the plaintiffs contended that Murch and Donovan unlawfully voted to require the Patio homeowners to cover 83 percent of the cost associated with security services, allowed Eskaton Village to use the Association's maintenance building rent free, and engaged in various other acts of misconduct to benefit the Eskaton entities. In doing so, the plaintiffs asserted, the defendants breached their fiduciary obligations to the Association and its members and committed elder abuse against Patio owners like Coley who were aged 65 or older.

Coley and Lorini later amended their complaint to add additional causes of action in light of the defendants' postcomplaint conduct. The first addition concerned the Association's assessment for legal fees. To cover the cost of litigation in this case, the Association initially relied on assessments imposed on both the Patio and Lodge owners. But beginning in late 2015, it began imposing certain fees on the Patio owners alone. Coley and Lorini contended the director defendants violated the Association's CC&Rs in approving this change. The second addition concerned Murch's disclosure of certain records. The Association's attorneys advised the Association on certain matters relating to this litigation. At some point, Murch shared this information with his personal counsel and the Eskaton entities' counsel. Based on this conduct, Coley and Lorini alleged Murch breached his fiduciary duty to the Association by disclosing the Association's privileged communications.

Before trial, Coley and Lorini moved to certify their action as a class action on behalf of themselves and similarly situated Patio homeowners. But after Coley's individual claims were

severed from the proposed class to expedite the resolution of his claims, the parties agreed to stay the hearing on the motion for class certification until after the resolution of Coley's claims.

The trial on Coley's claims began in December of 2015, and in early 2017, the trial court issued its judgment. Before addressing Coley's specific claims, the court first noted a “principle issue in this case guiding the Court's determination of Plaintiff's claims against Defendants is whether a conflict of ***951** interest was created when Eskaton retained control of the [Association] Board of Directors by filling three positions with its own employees.” The court concluded it was. Although Murch and Donovan, as directors of the Association, were charged with serving the best interest of the Association and all its members, the court found both were financially incentivized to operate the Association for the benefit of one member in particular—Eskaton Village. The court explained that both directors were paid in part based on Eskaton Properties' performance, and that Eskaton Properties' performance in turn was based in part on Eskaton Village's performance. Thus, the court reasoned, “the conclusion is inescapable that the financial success of [Eskaton Village] plays a role in determining [the directors'] compensation and advancement, even if is not the only factor.” The court found this pay structure left the directors in an “irreconcilable conflict of interest.”

Turning to Coley's specific claims, the trial court agreed in part with six of his 12 causes of action, several of which overlapped. It found Murch and Donovan breached their fiduciary duties and violated the Association's CC&Rs when they voted to raise the Patio owners' share of the security and emergency response costs from 50 percent to 83.3 percent. It found they further breached their fiduciary duties and violated the Association's CC&Rs when they voted to charge certain legal expenses to the Patio owners alone. ****747** And it found Murch also breached his fiduciary duty when he disclosed the Association's privileged communications with its counsel to further his own “interest rather than the interest of the [Association].” Because of this conduct, the court found all the defendants—including the corporate defendants—were liable to pay damages to Coley that resulted from the various breaches of fiduciary duty. The court calculated these damages to be \$2,328.51.

The court, however, clarified in a prejudgment order that only the corporate defendants were in fact liable to pay this amount. Following the court's proposed statement of decision,

Coley asked the court to clarify that Murch and Donovan were liable in their personal capacities. But the court declined to find the two directors liable, reasoning that Coley had failed to show they acted in self-interest, benefited from their breach of fiduciary duty, or mismanaged the Association. The court went on to note, however, that Eskaton Properties and Eskaton Village were “vicariously liable” for damages caused by the directors within the scope of their employment.²

Following the court's judgment, Coley moved to obtain attorney fees under [Civil Code section 5975](#), which allows the prevailing party in any action to enforce the CC&Rs of a common interest development to obtain attorney fees ^{*952} and costs. Coley contended the court should find all his attorneys' time compensable, apply a positive multiplier to enhance the fee award, and award total fees in the amount of \$1,140,445.03. The defendants, in opposition, contended the court should instead apply a negative multiplier and award fees only for the time spent on claims that allowed attorney fees. The court struck a middle path. Because it believed the considerations in favor of either a positive or negative multiplier canceled out, it rejected the parties' competing demands for a multiplier and instead declined to apply any multiplier. And because it found “the factual issues between fee-eligible and non-fee eligible claims were inextricably intertwined,” it also rejected the defendants' request that Coley be awarded fees only for the time spent on fee-recoverable claims. The court awarded Coley attorney fees in the amount of \$648,058.25 plus accrued interest of \$6,184.28, for a total of \$654,242.53.

Both parties timely appealed the court's judgment.

DISCUSSION

I. The Defendants' Appeal

A. The Corporate Defendants' Liability^{**} [NOT CERTIFIED FOR PUBLICATION]

B. Application of the Business Judgment Rule

[1] The defendants' next claim the court misapplied the business judgment rule. The business judgment rule is a policy of deference to a corporate board's decisionmaking. (*Lamden v. La Jolla Shores Clubdominium Homeowners Assn.* (1999) 21 Cal.4th 249, 257, 87 Cal.Rptr.2d 237, 980 P.2d 940 (*Lamden*)). But the trial court here found the rule inapplicable because the Eskaton entities' employees who

sat on the Association's board had an “irreconcilable conflict of interest” that “preclude[d] the business judgment rule as a defense to liability in this case.” According to the defendants, rather than finding this ^{**748} conflict precluded the business judgment rule altogether, the court instead should have afforded the defendants an opportunity to reclaim the benefit of the rule by showing they acted in good faith after reasonably investigating material facts. We view the law differently.

1. Background law

[2] [3] California recognizes two types of business judgment rules: one based on statute and another on the common law. (^{*953} *Lamden, supra*, 21 Cal.4th at p. 259 & fn. 6, 87 Cal.Rptr.2d 237, 980 P.2d 940.) [Corporations Code section 7231](#) supplies the relevant statutory rule for nonprofit mutual benefit corporations like the Association. Under that statute, a director is not liable for “failure to discharge the person's obligations as a director” if the director acted “in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.” ([Corp. Code, § 7231, subds. \(a\), \(c\).](#)) The common law business judgment rule is similar but broader in scope. It is similar in that it immunizes directors for their corporate decisions that are made in “good faith ... to further the purposes of the [corporation], are consistent with the [corporation's] governing documents, and comply with public policy.” (*Nahrstedt v. Lakeside Village Condominium Assn.* (1994) 8 Cal.4th 361, 374, 33 Cal.Rptr.2d 63, 878 P.2d 1275; see *Lamden, supra*, 21 Cal.4th at p. 257, 87 Cal.Rptr.2d 237, 980 P.2d 940.) And it is broader in that it also “ ‘insulates from court intervention those management decisions’ ” that meet the rule's requirements. (*Lamden, supra*, 21 Cal.4th at p. 257, 87 Cal.Rptr.2d 237, 980 P.2d 940.)

[4] [5] A director, however, cannot obtain the benefit of the business judgment rule when acting under a material conflict of interest. (*Everest Investors 8 v. McNeil Partners* (2003) 114 Cal.App.4th 411, 430, 8 Cal.Rptr.3d 31 (*Everest Investors*); *Gaillard v. Natomas Co.* (1989) 208 Cal.App.3d 1250, 1263, 256 Cal.Rptr. 702.) Deference under the business judgment rule is premised on the notion that corporate directors are best able to judge whether a particular transaction will further the company's best interests. (*Gaillard, supra*, 208 Cal.App.3d at p. 1263, 256 Cal.Rptr. 702.) But that premise is undermined

when directors approve corporate transactions in which they have a material personal interest unrelated to the business's own interest. And it is particularly undermined when a majority of these directors approve transactions while having a material conflict of interest. Under those circumstances, the directors carrying this conflict of interest are precluded from seeking the benefit of the business judgment rule. (See *Everest Investors, supra*, 114 Cal.App.4th at p. 430, 8 Cal.Rptr.3d 31; *Gaillard, supra*, 208 Cal.App.3d at p. 1263, 256 Cal.Rptr. 702.)

[6] [7] [8] But although the business judgment rule is inapplicable under these circumstances, that is not to say that corporate decisions affected by these types of conflicts are improper as a matter of law. As with the business judgment rule generally, statutory and common law requirements are again relevant in this context. *Corporations Code section 7233* supplies the relevant statutory rule. It provides, among other things, that an interested director who casts a deciding vote on a transaction must show the “transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.” (*Corp. Code, § 7233, subd. (a)(3).*) *Section 7233*, however, only applies to transactions “between a corporation and one or more of its directors, or between a corporation and any domestic or ****749** foreign corporation, firm or association in which one or more of its directors has a material ***954** financial interest.” (*Corp. Code, § 7233, subd. (a).*) The common law rule, as before, is similar but broader in scope. It is similar in that it requires interested directors to “prove that the arrangement was fair and reasonable”—a rigorous standard that requires them “‘not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.’” (*Tenzer v. Superscope, Inc. (1985) 39 Cal.3d 18, 31-32, 216 Cal.Rptr. 130, 702 P.2d 212 (Tenzer).*) And it is broader in that, unlike *Corporations Code section 7233*, it is not concerned only with transactions between a corporation and either its directors or a business in which its directors have a material financial interest. (See *Corp. Code, § 7233, subd. (a).*) Rather, recognizing the potential for self-dealing may also exist outside this particular context, courts have found directors must also satisfy the common law requirements when they approve other transactions in which they have a material financial interest distinct from the corporation's own interest. (See *Heckmann v. Ahmanson (1985) 168 Cal.App.3d 119, 127-128, 214 Cal.Rptr. 177 (Heckmann)* [directors who approved corporate action intended to stave off a company takeover and protect their board positions were required to

show “the transaction was entered in good faith” and was “inherent[ly] fair[] from the viewpoint of the corporation and those interested therein”]; see also *Remillard Brick Co. v. Remillard-Dandini (1952) 109 Cal.App.2d 405, 416-421, 241 P.2d 66* [common law requirements of “good faith” and “inherent fairness” exist independent of statutory “‘just and reasonable’” requirements].)

2. The trial court's application of the business judgment rule

[9] Turning to the trial court's decision here, we find the court appropriately summarized the relevant principles governing the business judgment rule. It correctly explained that directors acting under a conflict of interest cannot obtain the benefit of the business judgment rule. (See *Everest Investors, supra*, 114 Cal.App.4th at p. 430, 8 Cal.Rptr.3d 31.) And it rightly added that although “a conflict does not necessarily establish actionable impropriety,” it shifts the burden to the director to show the transaction was “‘fair and reasonable.’”³ (See *Tenzer, supra*, 39 Cal.3d at pp. 31-32, 216 Cal.Rptr. 130, 702 P.2d 212.)

***955** The defendants make no effort to satisfy this “just and reasonable” standard, but instead assert the trial court should have shifted the burden to the Eskaton directors to show they approved the disputed transactions in “good faith” after a “reasonable inquiry.”

In support of this alternative standard, the defendants rely on *Katz v. Chevron Corp. (1994) 22 Cal.App.4th 1352, 27 Cal.Rptr.2d 681* and ****750** *Lee v. Interinsurance Exchange (1996) 50 Cal.App.4th 694, 57 Cal.Rptr.2d 798*. *Katz* concerned a corporate board's defensive actions in response to an attempted corporate takeover—actions that were reviewed under Delaware law. (*Katz, supra*, 22 Cal.App.4th at pp. 1367-1368, 27 Cal.Rptr.2d 681.) Applying Delaware law, the *Katz* court found that because the board directors might have acted to protect their own interests in adopting these defensive measures, the board was not entitled to deference under the business judgment rule unless it first passed the “enhanced” scrutiny test—that is, unless the board showed (1) it had reasonable grounds for believing that “‘a danger to corporate policy and effectiveness existed because of another person's stock ownership’”—which could be established by “‘showing good faith and reasonable investigation’”—and (2) its action was “‘reasonable in relation to the threat posed.’” (*Id.* at p. 1367, 27 Cal.Rptr.2d 681.) The *Lee* court, in turn, relied on *Katz* in discussing California's general

background rules on conflicts of interest—even though the *Katz* decision concerned Delaware, not California, law. (*Lee, supra*, 50 Cal.App.4th at p. 715, 57 Cal.Rptr.2d 798.) Never mentioning its principles derived from Delaware law, the *Lee* court suggested that a director is not entitled to the benefit of the business judgment rule in the event of a conflict of interest, unless the director first shows “good faith and reasonable investigation.” (*Ibid.*) But that suggestion was ultimately irrelevant to the case, as the appellants there did not even allege facts establishing a conflict of interest. (*Id.* at pp. 701, 715, 57 Cal.Rptr.2d 798.)

The defendants, in sum, rely on one case that summarized Delaware law, and another case that, in dictum, summarized a case that summarized Delaware law. Belatedly recognizing this heavy reliance on Delaware law after oral argument, the defendants submitted a postargument letter asserting that California courts “may properly rely on corporate law developed in the state of Delaware given that it is identical to California corporate law for all practical purposes.” (*Oakland Raiders v. National Football League* (2001) 93 Cal.App.4th 572, 586, fn. 5, 113 Cal.Rptr.2d 255.) But even if that were true, it would not favor the defendants’ argument.

To begin, even under Delaware law, the defendants’ position would fail. Under Delaware law, courts apply “[e]nhanced” scrutiny—the type of scrutiny the defendants’ request here—in a narrow set of cases; specifically, “‘whenever the record reflects that a board of directors took defensive measures in response to a perceived threat to corporate policy and effectiveness which touches on issues of control.’” (*956 *Gantler v. Stephens* (Del. 2009) 965 A.2d 695, 705.) But they apply “even more exacting scrutiny” when there is evidence of “actual self-interest” that “affects a majority of the directors approving a transaction.” (*Paramount Communications Inc. v. QVC Network Inc.* (Del. 1994) 637 A.2d 34, 42, fn. 9.) And it is the latter scenario, not the former, that describes the facts of our case. Under those circumstances, the directors must prove the “entire fairness” of the transaction—a test requiring directors to “demonstrate both their utmost good faith and the most scrupulous inherent fairness of transactions in which they possess a financial, business or other personal interest which does not devolve upon the corporation or all stockholders generally.” (*Mills Acquisition Co. v. Macmillan, Inc.* (Del. 1989) 559 A.2d 1261, 1280; see *Weinberger v. UOP, Inc.* (Del. 1983) 457 A.2d 701, 710 [“When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain”].)

****751 [10] [11]** California law, more importantly, demands the very same of majority directors who approve transactions while operating under a material conflict of interest. Directors faced with such divided loyalties must show the approved transaction was “fair and reasonable”—meaning they must not only “‘prove the good faith of the transaction but also ... show its inherent fairness from the viewpoint of the corporation and those interested therein. [Citation.]’” (*Tenzer, supra*, 39 Cal.3d at pp. 31-32, 216 Cal.Rptr. 130, 702 P.2d 212; see *Heckmann, supra*, 168 Cal.App.3d at pp. 127-128, 214 Cal.Rptr. 177.) And again, we find the trial court fairly captured this requirement in concluding the Eskaton-affiliated directors, because of their conflict of interest, had the burden to show their approved assessments were “just and reasonable.” The defendants here, however, never made this showing.⁴

Finally, as an alternative argument, the defendants argue that the Eskaton-affiliated directors had no improper conflict of interest at all, relying on *Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 103 Cal.Rptr.3d 767, 222 P.3d 214 (*Lexin*). But *Lexin* offers them no support. The court in *Lexin* considered whether six city officials who voted on a matter that affected their government pension benefits violated Government Code section 1090—a ***957** statute barring public officials from being personally financially interested in the contracts they form in their official capacities. (*Lexin, supra*, 47 Cal.4th at p. 1062, 103 Cal.Rptr.3d 767, 222 P.3d 214.) It ultimately concluded most did not as a matter of law in light of a statutory exception to [Government Code section 1090](#) that applies when the official's financial interest is the same as the official's constituency. (*Lexin, supra*, 47 Cal.4th at pp. 1063, 1094, 103 Cal.Rptr.3d 767, 222 P.3d 214.) As the court explained, although the charged officials were financially interested in the matter, their interest was shared by “thousands of their fellow retirement system members.” (*Id.* at p. 1063, 103 Cal.Rptr.3d 767, 222 P.3d 214.)

[12] But the defendants here can point to no similar statutory exception to absolve them of their conflict. Nor would it matter if they could. The city officials in *Lexin* voted on a matter that affected them and their constituents in similar ways. For that reason, the court found, “the financial interest in question is not personal to an employee or official because it is shared with like members of the public agency's constituency.” (*Lexin, supra*, 47 Cal.4th at p. 1095, 103 Cal.Rptr.3d 767, 222 P.3d 214.) But the same cannot be said of the Eskaton-controlled directors. Their financial interest was

personal and distinct from that enjoyed by the Association members generally. As the trial court explained, the directors' incomes were tied in part to the financial performance of Eskaton Village—incentivizing the directors to shift costs from Eskaton Village to the Patio owners. And that is what they ultimately did, to ****752** the benefit of the Eskaton entities and the detriment of the Patio owners.

C.F. *** [NOT CERTIFIED FOR PUBLICATION]

II. Coley's Cross-appeal

A. Murch's and Donovan's Liability

Coley, in his cross-appeal, first contends the trial court should have found Murch and Donovan liable in their personal capacities. The trial court declined to do so because it concluded “the evidence failed to establish (1) conduct by the majority directors was motivated by specific self-interest; (2) the individual directors benefited from their breach of fiduciary duty or (3) that the actions of the directors amounted to mismanagement of the HOA.” According to Coley, the court erred in requiring this showing; it was enough, he maintains, that he showed (1) the directors had a fiduciary obligation to him and other Patio owners, (2) they breached this duty by approving transactions—while acting under a material conflict of interest—that were ***958** unfair to Coley and other Patio owners, and (3) Coley suffered damages as a result of this breach. We agree.

[13] [14] The trial court correctly set out the three elements of the cause of action at issue: existence of a fiduciary relationship, breach of fiduciary duty, and damages. (*Oasis West Realty, LLC v. Goldman* (2011) 51 Cal.4th 811, 820, 124 Cal.Rptr.3d 256, 250 P.3d 1115 (*Oasis West Realty*).) And as it further explained, the directors of a nonprofit mutual benefit corporation, like the Association here, are fiduciaries who must act for the benefit of the corporation and its members. (*Frances T. v. Village Green Owners Assn.* (1986) 42 Cal.3d 490, 513, 229 Cal.Rptr. 456, 723 P.2d 573 (*Frances T.*) [“Directors of nonprofit corporations ... are fiduciaries who are required to exercise their powers in accordance with the duties imposed by the Corporations Code”]; *Cohen v. S & S Construction Co.* (1983) 151 Cal.App.3d 941, 945, 201 Cal.Rptr. 173 [“This fiduciary duty extends to individual homeowners, not just the homeowners association”].)

The court also correctly applied these principles to the facts. It found the directors Murch and Donovan owed a fiduciary duty to the Association and its members—satisfying the first

element for breach of fiduciary duty. It then concluded they breached their fiduciary duties by voting, inconsistent with the CC&Rs, to (1) raise the Patio owners' share of the security services from 50 percent to 83.3 percent, and (2) require the Patio owners alone, and not also the Lodge owners, to cover certain legal fees—satisfying the second element. It found Murch further breached his fiduciary responsibility by disclosing the Association's privileged communications with its counsel. Finally, the court found Coley suffered damages as a result of the directors' breaches of their fiduciary duties—satisfying the third and final element for breach of fiduciary duty.

[15] [16] Each of these findings were supported by substantial evidence. First, as all parties accept, Murch and Donovan owed a fiduciary duty to Coley and other Patio owners. (See *Frances T.*, *supra*, 42 Cal.3d at p. 514, 229 Cal.Rptr. 456, 723 P.2d 573; *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 108-110, 81 Cal.Rptr. 592, 460 P.2d 464.) Second, substantial evidence supports the court's finding that Murch and Donovan breached this duty. As fiduciaries, Murch and Donovan were bound not to approve a transaction in which they had a material financial interest unless that transaction was “fair and reasonable”—meaning the transaction was ****753** entered in “‘good faith’” and was “‘inherent[ly] fair[] from the viewpoint of the corporation and those interested therein.’” (See *Tenzer*, *supra*, 39 Cal.3d at pp. 31-32, 216 Cal.Rptr. 130, 702 P.2d 212; see also *id.* at p. 32, 216 Cal.Rptr. 130, 702 P.2d 212 [discussing “the standards of fairness and good faith required of a fiduciary” in cases involving potential self-dealing]; *Jones*, *supra*, 1 Cal.3d at pp. 110, 112, 81 Cal.Rptr. 592, 460 P.2d 464 [majority shareholders owe a fiduciary duty of “good faith and inherent fairness to the minority in ***959** any transaction where control of the corporation is material”]; this “comprehensive rule of ‘inherent fairness’” also applies to directors who engage in transactions that conflict with their duty to shareholders]; see *Heckmann*, *supra*, 168 Cal.App.3d at pp. 127-128, 214 Cal.Rptr. 177.)

But they failed to meet this standard. Even if the directors required the Patio owners to pay a greater share of the security-services fees and legal fees in good faith—which is debatable (see fn. 4, *ante*)—it could not be said that their doing so in violation of the CC&Rs was fair from the viewpoint of the Patio owners. Nor do we find Murch's disclosure of the Association's privileged communications was fair from the Patio owners' perspective. Finally, substantial evidence supports the court's finding that Coley

and similarly situated Patio owners suffered damages as a result of these breaches—though, as discussed *ante* in the unpublished portion, some of the awarded damages must be adjusted downward.

Although the trial court found the directors breached their fiduciary duties, it declined to find them personally liable, reasoning in a prejudgment order that something more is required before the directors may be found personally liable for their misconduct. In the court's view, Coley needed to show, in addition to the directors' breach of their fiduciary duties, that they acted in self-interest, benefited from their breach of fiduciary duty, and mismanaged the Association.

[17] This was error. Once Coley established the existence of a fiduciary relationship, breach of fiduciary duty, and damages, he was entitled to damages absent some applicable affirmative defense. (See *Meister v. Mensinger* (2014) 230 Cal.App.4th 381, 395-397, 178 Cal.Rptr.3d 604 [“ ‘Where a breach of fiduciary duty occurs, a variety of equitable [and legal] remedies are available’ ”]; see also *Oasis West Realty, supra*, 51 Cal.4th at p. 820, 124 Cal.Rptr.3d 256, 250 P.3d 1115 [“The elements of a cause of action for breach of fiduciary duty are the existence of a fiduciary relationship, breach of fiduciary duty, and damages”]; *Frances T., supra*, 42 Cal.3d at pp. 503-504, 229 Cal.Rptr. 456, 723 P.2d 573 [corporate directors and officers may be liable for corporate wrongs when they “ ‘authorize[], direct[], or in some meaningful sense actively participate[] in the wrongful conduct’ ”].) As we have explained, although the common law business judgment rule may generally provide a director with immunity for decisions made in good faith, such immunity does not apply when, as here, the director is acting under a material conflict of interest.

[18] In demanding more from Coley before awarding damages, the court asked for too much. The court first faulted Coley for failing to show the “conduct by the majority directors was motivated by specific self-interest.” But even if the directors were not “motivated by specific self-interest,” and even if they *960 acted in good faith, that would not be reason enough to avoid liability. Again, considering the directors' material conflict of interest in the transactions they approved, they were required “ ‘not only to prove the good faith of the transaction but also to show its **754 inherent fairness from the viewpoint of the corporation and those interested therein.’ [Citation.]” (*Tenzer, supra*, 39 Cal.3d at p. 32, 216 Cal.Rptr. 130, 702 P.2d 212.) And for reasons already

discussed, the directors could not show their challenged actions were fair to Coley and other Patio owners.

[19] The court next took issue with Coley's failure to show “the individual directors benefitted from their breach of fiduciary duty.” But a director may still be liable for damages resulting from his or her breach of fiduciary duties, even if the director did not personally benefit from that breach. (See *St. James Armenian Church of Los Angeles v. Kurkjian* (1975) 47 Cal.App.3d 547, 553, 121 Cal.Rptr. 214 [“where a fiduciary, in breach of his duty of disclosure, causes secret profits to flow to a third party, the fiduciary may be held liable for those profits even though he did not personally receive any part of them”].) To find otherwise would absolve directors of liability when they abuse their positions to benefit, for example, friends and family. It would also inappropriately immunize directors who abuse their positions to benefit themselves but fail to succeed for reasons outside their control.

[20] Finally, the court faulted Coley for failing to show “that the actions of the directors amounted to mismanagement of the [Association].” But the directors' failure to comply with the Association's CC&Rs was mismanagement—at least to the extent of this failure. It may not have been pervasive mismanagement. It may not have been egregious mismanagement. But an unlawful failure to abide by an association's governing documents is mismanagement to some degree nonetheless.

We find, in sum, the trial court should have found both Murch and Donovan personally liable for any damages resulting from their breaches of their fiduciary duties. We remand to allow the court to determine the amount of these damages consistent with the unpublished portion of our opinion. We also remand to allow the court to determine the directors' liability, if any, for Coley's attorney fees.

B., C. † [NOT CERTIFIED FOR PUBLICATION]

DISPOSITION

The judgment is reversed in part and affirmed in part. We direct the trial court to enter a modified judgment finding Murch and Donovan liable in their *961 personal capacities for their respective breaches of their fiduciary duties. We also remand to allow the court to recalculate the damages award consistent with the unpublished portion of our opinion; to consider whether the awarded attorney fees should be reduced

in light of the reduced damages; and to determine Murch's and Donovan's liability for damages and their liability, if any, for Coley's attorney fees. In all other respects, the judgment is affirmed. The parties shall bear their own costs on appeal. (Cal. Rules of Court, rule 8.278(a)(5).)

Mauro, J., and Renner, J., concurred.

All Citations

51 Cal.App.5th 943, 264 Cal.Rptr.3d 740, 20 Cal. Daily Op. Serv. 6832, 2020 Daily Journal D.A.R. 7160

Footnotes

- * Pursuant to [California Rules of Court, rules 8.1105](#) and [8.1110](#), this opinion is certified for publication with the exception of parts IA., IC., ID., IE., IF., IIB., and IIC. of the Discussion.
- 1 Coley and Lorini also originally named Mark T. Cullen and Trevor Hammond as additional defendants, but neither were listed in the plaintiffs' final amended complaint.
- 2 As the defendants note, the court's reference to Eskaton Properties and Eskaton Village alone, and not also Eskaton, was an apparent oversight.
- ** See footnote, *ante*, page 943.
- 3 The trial court derived the "just and reasonable" standard from [Corporations Code section 7233](#). On the facts here, however, we believe it better to find these principles derive from the common law rather than [section 7233](#). As discussed in Part I.B.1. *ante*, [section 7233](#) only applies to transactions between a corporation and its directors or a business in which its directors have a material financial interest. ([Corp. Code, § 7233, subd. \(a\).](#)) And the disputed transactions here do not fit within one of these categories. But even so, we still agree with the court's finding that the director had the burden to show the transaction was just (or fair) and reasonable. (See [Tenzer, supra](#), 39 Cal.3d at pp. 31-32, 216 Cal.Rptr. 130, 702 P.2d 212 [discussing the common law "fair and reasonable" requirements].)
- 4 Although the defendants never contend the directors' actions were inherently fair, they at least assert the directors acted in good faith. But even there, we question whether their showing could be found sufficient. To demonstrate good faith, the defendants rely principally on two points. First, they contend the Department of Real Estate's approval of the creation of the Association (including its management structure) "demonstrates the requisite element of good faith." But that the department initially approved the creation of the Association does not show the Association's directors later governed the Association in good faith. Second, the defendants contend the trial court itself found their appointed directors "did nothing worse than make honest mistakes." But the court only found that Coley failed to show these directors were "motivated by specific self-interest." It never made an affirmative finding that the directors in fact acted in good faith.
- *** See footnote, *ante*, page 943.
- † See footnote, *ante*, page 943.