

1997

Herman Reedeker, Ruth Reese, Gayle Theurer, Joan Valentine, Robert Valentine, and Tom Plummer v. NORMAN J. SALISBURY, in his capacity as President of the American Towers Owners Association, SPENCER KIMBALL, in his capacity as Vice President of the American Towers Owners Association, GLEN GETZ, WILLIAM S. RICHARDS, JOAN HOLMES, WILLIAM T. MATLOCK, DON CLARK, STERLING RIGBY, JOHNNY BOWNE, VICTOR ROMERO and CRAIG THORLEY, in their capacities as past and present Trustees and Directors of the American

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Towers Owners Association, and John Does I through X, : Brief of Appellee

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

HERMAN REEDEKER, RUTH REESE,
GAYLE THEURER, JOAN
VALENTINE, ROBERT VALENTINE,
and TOM PLUMMER,

Plaintiffs-Appellants,

v.

NORMAN J. SALISBURY, in his
capacity as President of the American
Towers Owners Association, SPENCER
KIMBALL, in his capacity as Vice
President of the American Towers
Owners Association, GLEN GETZ,
WILLIAM S. RICHARDS, JOAN
HOLMES, WILLIAM T. MATLOCK,
DON CLARK, STERLING RIGBY,
JOHNNY BOWNE, VICTOR ROMERO
and CRAIG THORLEY, in their
capacities as past and present Trustees
and Directors of the American Towers
Owners Association, and John Does
I through X,

Defendants-Appellees.

Appeal No. 970032-CA

Priority No. (15)

OPENING BRIEF OF APPELLEES

On Appeal From a Final Judgment of the Third Judicial
District Court for Salt Lake County, State of Utah
Honorable David S. Young, District Judge

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STATEMENT OF JURISDICTION

Appellants have appealed a final order of the district court. This Court has jurisdiction pursuant to Utah Code Ann. §§ 78-2-2(3)(j), 78-2-2(4).

STATEMENT OF ISSUES PRESENTED FOR REVIEW AND STANDARD OF REVIEW

In their docketing statement, Appellants' contend that there are eighteen separate appealable issues in this case. [Docketing Statement, at 10-15.] In their opening brief, Appellants' have reduced those claims to seven. [Opening Brief of Appellants, at 1-3 ("App. Br.").] A review of the record, however, reveals that there are only two issues on appeal:

Issue Number 1: Did the trial court properly dismiss plaintiffs' claims on the basis that the Trustees of the Association are not liable for the contracts of the Association because the plaintiffs did not allege that the Trustees breached the applicable standard of care in discharging their duties as Trustees?

Standard of Review: A trial court's decision to grant or deny a motion to dismiss is a question of law which this Court reviews for correctness. Tiede v. Utah Dep't of Corrections, 915 P.2d 500, 502 (Utah 1996).

Preservation of the Issue: [R. 289-90, 294-96; 462.]

Issue Number 2: Does the Utah Nonprofit Corporation and Co-Operative Association Act (the "Nonprofit Corporation Act") provide the appropriate standard of care for trustees of a homeowners association incorporated under the Utah Nonprofit Corporation Act?

Standard of Review: Interpretation of a statute is a question of law which the reviewing court reviews for correctness, giving no deference to the trial court's conclusions of law. Stephens v. Bonneville Travel, Inc., 935 P.2d 518, 1997 (Utah 1997).

Preservation of the Issue: [R. 289; 462-64.]

DETERMINATIVE CONSTITUTIONAL AND STATUTORY PROVISIONS

1. Utah Code Ann. § 16-6-107(l).

A trustee or officer of a nonprofit corporation is not personally liable to the corporation or its members for civil claims arising from acts or omissions made in the performance of his duties as a trustee or officer, unless the acts or omissions are the result of his intentional misconduct.

2. Utah Code Ann. § 57-8-35(1).

The provisions of [the Utah Condominium Act] shall be in addition and supplemental to all other provisions of law, statutory or judicially declared, provided that wherever the application of the provisions of this act conflict with the application of such other provisions, this act shall prevail

STATEMENT OF THE CASE

1. Nature of the Case.

In this case, Appellants, owners of condominiums in the American Towers Condominium Project, have sued their neighbors in their capacities as past and present voluntary members of the Board of Trustees ("Trustees") of the American Towers Association (the "Association"), a Utah nonprofit corporation. Appellants challenge the Trustees' decision to pursue and fund litigation against the builders and developers of the project on behalf of the Association and for the benefit of the Association. Although Appellants seek in this litigation to obtain personal judgment against these current and former Trustees, Appellants have not alleged that these individuals profited in any way from their management of this nonprofit organization. The Trustees are alleged to have

acted negligently, with gross negligence and contrary to the Association's Declaration and Bylaws. They are not alleged to have engaged in intentional misconduct.

The Trustees are alleged to have approved litigation against CCI Mechanical, Inc. ("CCI Mechanical") to recover millions of dollars from them to repair the substantial defects in the building's mechanical system. These defects effect the entire project. To fund this litigation, the Trustees are alleged to have used the Association's reserve account, the account into which the proceeds derived from the litigation would be deposited. The Trustees are alleged to have used reserves on the advice of the Association's outside accountants and lawyers.

The Trustees moved to dismiss Appellants' Complaint on the basis that under Utah law, trustees of a nonprofit organization are not liable except in circumstances where they engage in "intentional misconduct." Which means that such volunteers are liable only if they intentionally do something they know to be wrong. Because the Appellants have never alleged that these Trustees engaged in intentional misconduct, the district court dismissed the Appellees' Complaint but granted Appellees' Leave to Amend to add a claim of intentional misconduct. Appellees elected not to amend but instead chose to pursue this appeal.

2. Course of Proceedings and Disposition Below.

On June 10, 1996, Defendants/Appellees filed a Motion to Dismiss the Amended Verified Complaint for Failure to State a Claim Upon Which Relief Can Be Granted. A hearing was held on Defendants/Appellees' motion on August 9, 1996, before the Honorable David S. Young. After hearing arguments of counsel, Judge Young ruled that Defendants/Appellees' Motion to Dismiss would be granted. [R. 497, 374.] On August 21, 1997, the Order Granting Motion to Dismiss was entered. The Order provides that the Plaintiffs' Verified Complaint was dismissed,

with prejudice, with leave to amend to assert only claims of intentional misconduct. [R. 375-76.]

The Court specifically found that “the only applicable standard of care for directors or trustees of a Utah nonprofit condominium association is intentional misconduct.” [R. 376.] Appellants elected not to amend their complaint. The instant appeal followed.

3. Statement of Facts.

The operative documents in this case--the American Towers Declaration and Bylaws--are before the Court and any gloss which the parties may add is superfluous and improper.

Appellants’ Statement of Facts, however, contains just such a gloss on various provisions of the operative documents as well as numerous inappropriate legal conclusions which are not “facts.”

Accordingly, Appellees submit the following Statement of Facts:

1. American Towers is a condominium project located at 44 West Broadway, Salt Lake City, Utah, which contains both commercial and residential units. [R. at 61-63, 197.]

2. The Association is a Utah “nonprofit” corporation. [R. at 101, 197.]

3. The Board of Trustees (the “Board”) of the Association manages the property, affairs, and business of the Association. [R. at 101, 197.]

4. Appellants are members of the Association and owners of condominium units at American Towers. [R. at 196.]

5. Appellees John Zinn, Sandra Ridges, Glen Getz, Bill Melville, William S. Richards, Judith Anderson Giesa, Joan Holmes, William T. Matlock, Don Clark, Sterling Rigby, Wayne Lantz, Von Callister, Brian Jeppson, Kim Hibbert, Glen McKay, Mike Jones, Johnny Bowne, Victor Romero, Craig Thorley, Norman J. Salisbury, and Spencer Kimball are alleged to be past and present directors and members of the Board. [R. at 197.]

6. Construction on American Towers began in 1981. [R. at 198.]

7. CCI Mechanical was the mechanical subcontractor that designed and constructed the mechanical, plumbing, fire protection, heating, ventilating, and air conditioning systems. [R. at 198.]

8. In 1991, the Association filed a complaint against CCI Mechanical and other defendants for faulty construction (the “CCI Litigation”). [R. at 199.]

9. In Declaration Article XIX titled “Mortgagee Protection,” the Association is to provide for establishment of an adequate reserve:

Section 19.05. Revenue Fund And Working Capital Fund Required. The Association shall establish an adequate reserve to cover the cost of reasonably predictable and necessary repairs and replacements of the Common Areas and any component thereof and shall cause such reserve to be funded by regular monthly or other periodic assessments against the Condominiums rather than by Special Assessments.

[Decl. § 19.05 (R. at 84).]

10. No other provision of the Declaration or Bylaws mentions or refers to a reserve fund or directs how or under what procedures the Association’s reserves are to be used. [See R. at 47-110.]

11. Pursuant to Declaration Article 10.03 the Association has the following power:

The Association may obtain and pay for the services of such personnel as the Association shall determine to be necessary or desirable for the proper operation of the Project, whether such personnel are furnished or employed directly by the Association or by any person with whom it contracts. The Association may obtain and pay for legal and accounting services necessary or desirable in connection with the operation of the Project or the enforcement of this Declaration. In addition to the foregoing, the Association may acquire and pay for out of the Common Expense Fund water, sewer, garbage collection, electrical, gas, and other necessary or desirable utility services for the Common Areas (and for the Units to the extent not separately metered or billed), insurance, bonds, and other goods and services common to the Units; provided, however, that any such item which is separately

metered or billed and which relates exclusively to the Residential Limited Common Areas or the Commercial Limited Common Areas shall be paid for, respectively, out of the Special Residential Fund or the Special Commercial Fund. (Emphasis added.)

[Decl. at § 10.03 (R. at 66-67, 202).]

12. Declaration Article 10.08 also grants the Association all necessary implied powers:

10.08 Implied Rights. The Association may exercise any right, power, or privilege given to it expressly by this Declaration or by law, and every other right or privilege reasonably implied from the existence of any right or privilege given to it herein or reasonably necessary to effectuate any such right or privilege.

[Decl. at § 10.08 (R. at 68).]

13. Allegedly on the advice of a lawyer and an accountant, the Board used funds from the Association's reserves to finance the CCI Litigation. [R. at 212.]

14. By an Order dated September 19, 1994, Judge Dennis Frederick granted summary judgment against the Association in the CCI Litigation, in part, based upon statutes of limitations. [R. at 199.]

15. The Association appealed that decision to the Utah Supreme Court. [R. at 200.]

16. On December 20, 1996, the Supreme Court affirmed the trial court's summary judgment. American Towers Owners Ass'n. v. CCI Mech., Inc., 930 P.2d 1182 (Utah 1996).

17. Appellants allege that the Trustees misappropriated approximately \$750,000 from the reserves to finance the CCI Litigation. [R. at 200.]

18. Appellants asserted claims for breach of contract, breach of implied covenant of good faith and fair dealing, negligence, gross negligence, breach of fiduciary duty, and corporate mismanagement and waste of assets but have not alleged any intentional misconduct by the Trustees. [R. at 217-32.]

19. Appellants assert that the Declaration, entered into by American Towers, Inc. and Block 58 Associates, the Association's Articles of Incorporation ("Articles"), and Bylaws form a contract between and among the Association, the owners and the Board. [R. at 219.]

20. Appellants allege that the Board has a contractual duty to comply "strictly" with the Articles, Bylaws, and Declaration. The contractual source of this duty is alleged to be Declaration Article XVII § 18.01, which provides: "Each Owner shall comply strictly with the provisions of this Declaration, the Articles of Incorporation and Bylaws of the Association" [R. at 218-19.]

21. Appellants seek an accounting of the source and monies used to finance the CCI Litigation and the dates and minutes of the Board's meetings at which the Board voted to use money from the Common Expense Fund or the Reserve Fund to finance the CCI Litigation. [R. at 234-35.]

22. Appellants state their right under Utah law to inspect the books and records of the Association, but do not allege that this right has ever previously been asserted or denied. [R. at 235.]

23. Appellants allege that the law imposes a constructive trust on the defendants because of their alleged breach of fiduciary duty. [R. at 234-35.]

24. On May 29, 1996, Defendants/Appellees filed a Motion to Dismiss for Failure to State a Claim Upon Which Relief Can be Granted. [R. at 278.]

25. On August 9, 1996, after a hearing on Defendants/Appellees Motion to Dismiss, the district court granted Defendants/Appellees' Motion. [R. at 374-76.]

26. On September 11, 1996, Appellants filed their Notice of Appeal. [R. at 380.]

SUMMARY OF ARGUMENT

Under Utah law, volunteer directors of nonprofit corporations such as the Association incur liability to the corporation only if they engage in intentional misconduct. Utah law further provides that nonprofit corporations can “sue and be sued.” In this case, the volunteer directors of the American Towers Association, acting on behalf of the Association, pursued litigation against a contractor who had performed faulty work on the American Towers Project. Six of the over 300 American Towers owners, purportedly on behalf of the Association, brought suit against the Trustees of the Association, seeking to impose personal liability on these directors, for their decision to fund the litigation on behalf of the Association.¹ Appellants have never alleged, however, that the Trustees engaged in intentional misconduct,² and it is plain that, under the law,

¹ There is a significant question regarding the propriety of this “derivative” action. Under Utah law, a derivative action is inappropriate where “the injury is one to the plaintiff as a stockholder and to him individually, and not to the corporation.” Richardson v. Arizona Fuels Corp., 614 P.2d 636, 639 (Utah 1980). Appellants, however, claim that the Trustee’s alleged misconduct has “caused Homeowners substantial actual damages” and “have caused Homeowners depreciation in the fair market value of their condominiums.” App. Br. at 5. These claimed damages are to six individuals, not the Association.

² Appellants have never claimed that the Trustees engaged in intentional misconduct. Nevertheless, without ever signing pleadings making such a claim, see Utah R. Civ. P. 11, Appellants now assert to this Court that “the Complaint’s alleged facts and gross negligence claims do assert intentional misconduct in that the Trustees knowingly, intentionally and repeatedly acted *ultra vires*” App. Br. at 35.

This statement is patently incorrect. In Golding v. Ashley Cent. Irrigation Co., 793 P.2d 897 (Utah 1990), the Supreme Court held that “‘willful misconduct,’ in a tort context is not equivalent to gross negligence or reckless indifference, mental states where constructive knowledge suffices for liability.” In re Worthen, 926 P.2d 853, 868 (Utah 1996) (citing Golding, 793 P.2d at 901). Thus, Appellants’ claim that the Complaint’s allegations of “gross negligence” suffice to plead intentional misconduct is legally incorrect. Moreover, as discussed in detail below, Appellants’ assertion that the Trustees acted *ultra vires* not only confuses a standard of care with the concept of corporate authority, but it also suffers from a faulty legal premise as to what constitutes an *ultra vires* act. Accordingly, Appellants are raising, for the first time in this appeal, the issue of “intentional misconduct.”

these Trustees have done nothing improper. Accordingly, each and every claim raised by Appellants fails as a matter of law and the district court properly dismissed the action pursuant to Rule 12(b)(6) of the Utah Rules of Civil Procedure.

Notwithstanding Appellants' convoluted arguments, this case, at its heart, is quite simple. The Trustees of the Association, pursuant to their charge to manage the affairs of the Association, and on behalf of the Association, opted to pursue litigation against CCI Mechanical for faulty work done on the American Towers Condominium Project. The Appellants have never claimed that the Board exceeded its authority in pursuing that litigation on behalf of the Association. The Association, acting through the Board, financed the litigation from the Association's reserve funds. Appellants claim that the CCI Litigation should have been funded from another Association fund, the Common Expense Fund. As a result of their disagreement with the Board's funding decision, these disgruntled homeowners filed the instant lawsuit.

While claiming that the Trustees are individually liable to repay the funds expended on the CCI Litigation, Appellants have not claimed that the Trustees, or any one of them, acted in bad faith, fraudulently, with an intent to deceive, or with intentional misconduct. Nor have Appellants alleged that any Trustee derived a secret profit, engaged in self dealing, or broke the law. The sole basis for this lawsuit and the instant appeal is Appellants' contention that the Trustees should have taken money to finance the CCI Litigation from the Common Expense Fund rather than the reserve

It is well settled that "matters not put in issue before the trial court may not be raised for the first time on appeal." Wade v. Stangl, 869 P.2d 9, 11 (Utah Ct. App. 1994); see State v. Mohi, 901 P.2d 991, 1001 (Utah 1995); Warren v. Provo City Corp., 838 P.2d 1125, 1128 n.4 (Utah 1992) ("With limited exceptions, our practice has been to decline consideration of issues raised for the first time on appeal."). This Court is urged to disregard, therefore, Appellants' belated and suspect claim of intentional misconduct.

funds.³ Thus, it is the propriety of that action, and that action only, that is currently before the Court.

Once the Court culls through the Appellants' legally unsupported arguments and critically examines the plethora of "issues" Appellants purport to raise, it is clear that this case involves two, and only two, questions of law: (1) Does the Utah Nonprofit Corporation Act apply to this Association which is properly organized and operated as a nonprofit corporation? (2) If so, are these Trustees held to the standard of care set forth in that statute for officers and directors-- intentional misconduct? The answer to both of these questions is yes. Because Appellants have never alleged intentional misconduct on the part of the Trustees, there simply is no legal basis to sustain an action against the Trustees. Accordingly, the district court properly granted Defendants/Appellees' motion to dismiss and this Court should affirm that decision.

ARGUMENT

I. The Association is Properly Organized as a Nonprofit Corporation and the Utah Nonprofit Corporation and Co-operative Association Act Applies

A fundamental premise of Appellants' complaint is that, notwithstanding the organization of the American Towers Owners Association as a nonprofit corporation, the standard of care established under the Utah Nonprofit Corporation and Co-operative Association Act (the "Nonprofit Corporation Act"), Utah Code Ann. § 16-6-54 to -112 (1996), does not apply. Instead, Appellants claim that the Utah Condominium Act, Utah Code Ann. § 57-8-1 to -36 (1994) (the "Condominium Act"), supersedes the Nonprofit Corporation Act in its entirety. However, the

³ The Trustees reasoned in part that they could use the Association's reserves because any proceeds derived from the CCI Litigation would be deposited into the reserve account. Although it occurred after the record in the matter, it is nevertheless undisputed that on February 6, 1997, the underlying litigation with CCI was settled and \$425,000 was deposited into the Association's reserve account.

Condominium Act does not contain a standard of care to govern the conduct of condominium trustees. Appellants are therefore left with a policy argument that it makes more sense for condominium associations to be treated as “for-profit corporations” notwithstanding that they are organized as nonprofit corporations. They ask this Court to add an exception to the Nonprofit Corporation Act that if the nonprofit corporation has as one of its functions the management of a condominium, the standard of care applicable to “for-profit corporations” should apply. The legislature chose not to add Appellants’ exception, this Court too should decline Appellants’ invitation to legislate.⁴

While Appellants make a strenuous argument that the Nonprofit Corporation Act should not apply, they nowhere allege that this Association is not properly organized and operated as a nonprofit corporation. A “nonprofit corporation” is defined as one which “does not distribute any part of its income to its members, trustees, or officers, and includes a nonprofit cooperative association.” Utah Code Ann. § 16-6-19(11) (1996). Appellants have never alleged that this Association distributes profits to members, trustees, or officers. Accordingly, regardless of how other condominium owners associations may be operated, there is no basis to allege that this Association is not a nonprofit corporation, governed accordingly by the Nonprofit Corporation Act.

⁴ Appellants raise for the first time a unique claim that the “due process rights” of individual homeowners have been violated. As noted earlier, a claim raised for the first time on appeal asserting an individual cause of action in a derivative suit is improper. They also disregard the rather fundamental requirement that they must allege “state action” to implicate the due process clause. See Shelley v. Kraemer, 334 U.S. 1 (1948). However, since Appellants find analogy to municipal government so appealing, perhaps they should examine the analogy to be drawn to the doctrine of governmental immunity as well as the means by which a dissatisfied citizen changes the manner in which it is governed -- through election of new officials.

Appellants' policy argument is not only specious, it is factually wrong. First, regardless of whether condominium associations ought to be organized as for-profit corporations or nonprofit corporations is irrelevant. The fact is that this Association has been organized as a nonprofit corporation. Appellants have not challenged that status nor sought its dissolution.⁵ Moreover, the "overwhelming majority of corporate [property owners associations] are organized on a nonprofit basis." Robert G. Natelson, Law of Property Owners Associations § 3.2.2.2 at 74 (1989 & Supp. 1996). Indeed, only one jurisdiction even expressly allows condominium owner associations to be incorporated as for-profit corporations, see Fla. Stat. Ann. § 718.111(1)(a). Thus, even Appellants' policy argument begins to unravel.

Appellants' textual argument that the Condominium Act supersedes the Nonprofit Corporation Act is even more tenuous. The argument is contrary to the text of the Condominium Act and inconsistent with general principles of statutory construction. The Condominium Act provides:

The provisions of [the Act] shall be in addition and supplemental to all other provisions of law, statutory or judicially declared, provided that wherever the application of the provisions of this act conflict with the application of such other provisions, this act shall prevail.

Utah Code Ann. § 57-8-35(1) (emphasis added). The Condominium Act thus supplements the Nonprofit Corporation Act where the two do not conflict. In an attempt to disguise the fact that the two acts do not conflict on the issue of officer and director liability, Appellants cite other alleged differences between the Acts. See App. Br. at 33-34. The two Acts do not conflict,

⁵ Appellants rely extensively throughout their brief on Turner v. Hi-Country Homeowner's Ass'n., 910 P.2d 1223 (Utah 1996). Appellants fail to note, however, that the association in that case, like the Association here and the "overwhelming majority" of condominium associations around the nation, was organized as a nonprofit corporation. Id. at 1224.

however, on the central issue of this case because only the Nonprofit Corporation Act establishes a standard of care for officers and directors. See Utah Code Ann. § 16-6-107(1). Appellants' argument that the Condominium Act displaces the Nonprofit Corporation Act is impaled on the point that they must look to a third act, the for-profit corporation code to supply the standard of care which they claim the Condominium Act somehow displaces from the Nonprofit Corporation Act.

It is a fundamental tenet of statutory construction that a court will interpret statutes to make the statute harmonious with other statutes relevant to the subject matter. Business Aviation v. Medivest, Inc., 882 P.2d 662, 666 (Utah 1994); Stahl v. Utah Transit Auth., 618 P.2d 480, 481 (Utah 1980); see also Clover v. Snowbird Ski Resort, 808 P.2d 1037, 1045 (Utah 1991) (courts strive to avoid "absurd meaning" in statutory interpretation). It also is fundamental that "[p]rovisions in an act which are omitted in another act relating to the same subject matter will be applied in a proceeding under the other act, when not inconsistent with its purpose." Murray City v. Hall, 663 P.2d 1314, 1318 (Utah 1983).

Not surprisingly, there are differences between the Condominium Act and the Nonprofit Corporation Act. One statute regulates all condominium associations, whether incorporated or not -- the other statute regulates all nonprofit corporations, regardless of their underlying purpose. Differences between two statutes, however, do not translate into irreconcilable conflict. The failed savings and loan cases are instructive in this regard. In FDIC v. Isham, 777 F. Supp. 828 (D. Colo. 1991) cited by Appellants, the U.S. District Court held that section 1821 of FIRREA, which provided a "gross negligence" standard for directors of federally insured savings and loans, did not serve to limit director liability in those states that imposed a higher standard of care, i.e.,

negligence. Id. at 832. Similarly, in FDIC v. Canfield, 957 F.2d 786 (10th Cir.), aff'd, 967 F.2d 443 (10th Cir. 1992) (en banc), the Tenth Circuit held that “[n]o reasonable construction of ‘may’ [in FIRREA] suggests that it limits the liability of officers or directors to gross negligence. In other words, in states where an officer or director may be held liable for simple negligence, the FDIC may rely on state law to enable its action.” Canfield, 957 F.2d at 788. Thus, as these cases demonstrate, the permissive language in one statute is not “contrary” to the mandatory language of another statute.

In this case, the Appellants make much about the mandatory nature of the Condominium Act versus the permissible provisions of the Nonprofit Corporation Act. See App. Br. at 33-34. There is, however, no conflict in relevant provisions. Nothing in the Condominium Act is inconsistent with the Nonprofit Corporation Act. There are mandatory provisions in the Condominium Act which are permissive in the Nonprofit Corporation Act. This simply means that, just as with the savings and loan cases, where one statute provides a standard, that standard will be imposed. And, where one Act is silent, the provisions of the other Act will control. See Murray City, 663 P.2d at 1318. For example, under the Condominium Act, bylaws are mandatory, see Utah Code Ann. § 57-8-10; under the Nonprofit Corporation Act, bylaws are discretionary, see Utah Code Ann. § 16-6-44. Thus, a condominium association organized as a nonprofit corporation in Utah must have bylaws.

The American Towers Owners Association was incorporated as a nonprofit corporation and thus is governed by the Nonprofit Corporation Act. See Decl. Art. XX § 20.02, Complaint Ex. A [R. at 85] (emphasis added) (“This Declaration shall be governed by and construed in accordance with the laws of the State of Utah The provisions hereof shall be in addition and

supplemental to the provisions of the Condominium Act and all other provisions of applicable law."). The Association's Bylaws refer specifically to the Nonprofit Corporation Act:

Pursuant to the provisions of the Utah Nonprofit Corporation and Cooperative Association Act, the Board of Trustees of American Towers Owners Association, a Utah nonprofit corporation, hereby adopts the following Bylaws for such nonprofit corporation.

Bylaws, Complaint Ex. B, at 45 (emphasis added). [R at 111.]

By its express terms the Nonprofit Corporation Act, including the standard of care, applies to: "(a) all corporations organized under this chapter." There is no exception for owners associations. Utah Code Ann. § 16-6-20(1)(a).

The treatise cited extensively by Appellants, *Liability of Corporate Officers & Directors*, similarly notes that:

Some condominium associations are subject to both state condominium statute and state nonprofit corporation laws. While there are similarities among state condominium acts, there are also substantial differences. Accordingly, generalized observations as to questions of tort liability are not possible.

1 W.E. Knepper & D.A. Bailey, *Liability of Corporate Officers & Directors* § 12-3(c) (citations omitted) (emphasis added). Such "generalized observations as to questions of tort liability" are exactly what Appellants attempt to present. In doing so, however, Appellants ignore established Utah law on the liability of officers and directors of nonprofit organizations and its standard of intentional misconduct. These two statutes may be read harmoniously and Appellants' argument that the Condominium Act entirely supersedes the Nonprofit Corporation Act is not well taken.⁶

⁶ The transcript of the district court argument, to the extent it is accurate, indicates that Judge Young stated that the Utah Revised Model Business Corporation Act is implicated here and that the Nonprofit Corporation Act "goes, if at all, to torts." [R. 496.] Although the transcript omits it, Judge Young appears to be merely restating the Appellants' argument which he clearly rejects in holding that the only applicable standard of care is intentional misconduct.

II. Individual Trustees of the Association May Be Held Liable For Contracts of the Association Only if the Trustee Engages in Intentional Misconduct

Appellants have advanced a most unusual argument for holding the individual Trustees liable. Appellants first state that the Declaration and Bylaws, together with the provisions of the Condominium Act form a “contract” between individual owners and the Association. App. Br. at 17. This unremarkable proposition is indeed the law in Utah. See Turner v. Hi-Country Homeowner’s Ass’n, 910 P.2d 1223, 1225 (Utah 1996). Appellants go on to assert, however, that the Trustees can be sued individually for actions taken by them in their capacity as board members because, in their role as owners, each of these individuals is “bound strictly to comply with the Declarations and Bylaws.” App. Br. at 18. This argument finds no support in statutory or case law. First, the argument suffers from a fatal technical flaw because there is simply no contract between the owners and individual Trustees. Under fundamental principles of agency, as agents of the corporation, directors are not liable for a “contract” of the corporation unless they breach the standard of care they owe the corporation. Second, Appellants’ “strict compliance” argument is contrary to the text of the statute, the Declaration, and the Bylaws.

A. The Owners, Acting Derivatively, Lack Standing to Sue the Trustees

The Appellants claim that the Trustee breached the Association’s Declarations by spending reserves without authorization. However, the obligation which the owners claim was breached is an obligation of the “Association.” The “Association shall establish an adequate reserve to cover

[R. 497.] If the district court was stating its own reasoning rather than restating Appellants’ argument, this misstatement of the law is harmless in this context and the Court can affirm the order of the district court although one of his stated reasons is incorrect. See Berube v. Fashion Centre, Ltd., 771 P.2d 1033, 1039 (Utah 1989) (“[W]e will affirm the trial court on any proper ground, even if the court below assigned an incorrect reason for its ruling.”); see also Stephens v. Bonneville Travel, Inc., 935 P.2d 518, 520 (Utah 1997).

the cost of reasonably predictable repairs and replacements.” Section 19.05. This is not an undertaking by the Trustees or by the owners and there is no other provision in the Declaration that dictates how reserves are to be spent or even mentions reserves or reserve funds.

The Appellants, acting derivatively, have not stated a cause of action against the Trustees based on contract. Citing Turner v. Hi-Country Homeowner’s Ass’n, 910 P.2d 1223 (Utah 1996), Appellants correctly note that the Utah Supreme Court held that corporate bylaws, together with the articles of incorporation, the statute under which it was incorporated,⁷ and the member’s application constitute a contract “between the member and the corporation.” Id. at 1225.

However, Appellants have not cited a single case for the bizarre proposition that individual Trustees are bound by the “contract between the association and owners,” a contract to which these individual Trustees are not a party. As Appellants’ cases demonstrate, the parties to the “contract” are the association on one side and the individual owners on the other. Thus, an association could sue an individual owner for breach of contract (see Turner, 910 P.2d at 1225), or an owner might sue the association for a breach (see Wolinski v. Kadison, 449 N.E.2d 151, 156-57 (Ill. Ct. App. 1983)), but there is no provision in the law for an association to sue its agent, i.e., its director, for a breach of a contract to which the director did not agree.

The agreement to establish a reserve account is between the Association and the owners. The Association undertakes to raise money to establish adequate reserves. The owners promise to pay assessments to fund the Association’s obligations. If the Appellants’ argument were to prevail, an Association that failed to assess its members for an adequate reserve could merely sue

⁷ Appellants do not concern themselves with the fact that part of the contract they claim is breached is the Nonprofit Corporation Act which insulates directors from liability for all of their actions except “intentional misconduct.”

the directors on the contract and make claim to their personal assets to fulfill the obligation of the Association. There is no support for such an absurd result. The Trustees are liable to pay an obligation of the Association only if their failure to assess the owners or their use of the reserves was a violation of the applicable standard of care -- intentional misconduct.

It is fundamental that “a corporation only acts through agents. The directors are the managing agents” Baltimore & Ohio R.R. Co. v. Baugh, 149 U.S. 368, 382 (1893). The Trustees of the Association are agents of the Association. In Carlie v. Morgan, 922 P.2d 1 (Utah 1996), the Utah Supreme Court rejected the notion that an agent could be held liable on the contractual obligation of his or her principal. Id. at 6. Again, this is an unremarkable proposition adopted in literally every jurisdiction and set forth in the Restatement (Second) of Agency: “[A] person making or purporting to make a contract with another as agent for a disclosed principal does not become party to the contract One bringing an action on the contract has the burden of showing that the other is a party to it.” Restatement (Second) of Agency, § 343 (1957); see 3 Am. Jur. 2d Agency § 302 (1986) (“If a contract is made with a known agent acting within the scope of his authority for a disclosed principal, the contract is that of the principal alone and the agent cannot be held liable thereon.”). See also Mills v. Polar Molecular Corp., 12 F.3d 1170, 1177 (2d Cir. 1993) (“A director is not personally liable for his corporation’s contractual breaches unless he assumed personal liability, acted in bad faith or committed a tort in connection with the performance of the contract.”).

In this case, as in the agreement, to establish a reserve account does not require that the Trustees personally fund it. By its terms it is between the Association and the individual owners. If the Association breached this contract in funding the CCI Litigation from the Association’s

reserves, then the individual owners may have a cause of action against the Association. The Association would be required to assess its members to establish or augment the reserves. Any claim that the Association has against its agent Trustees, however, would derive exclusively from the Trustees' breach of the applicable standard of care, in this case, intentional misconduct. The Association simply has no direct cause of action against the Trustees based on the "contract." Stated another way, the Trustees were not party to the contract between the Association and the owners and may not, therefore, be sued directly upon that contract.⁸ Appellants' claims based on breach of contract were properly dismissed.

B. Neither the Text of the Declaration and Bylaws Nor the Law Dictate that the Trustees "Strictly Comply" With the "Contract"

Aside from the legal incongruity presented by Appellants' argument, it is inconsistent with the text of the Declaration and Bylaws as well as the law of this state. Section 18.01 of the Declaration, on its face, applies solely to owners, not Trustees:

18.01. Compliance. Each Owner shall comply strictly with the provisions of this Declaration, the Articles of Incorporation and Bylaws of the Association, rules and regulations promulgated by the Association as herein provided, and the decisions and resolutions of the Association adopted pursuant thereto, as the same may lawfully be modified and amended from time to time. [R. at 83.]

Recognizing the futility in arguing that this section imposes a duty of strict compliance upon individual Trustees, Appellants next quote § 9.01 of the Bylaws, claiming that this section creates

⁸ Appellants feign incredulity at the proposition that a contract claim may involve a tort standard of care. See App. Br. at 20 ("No case authority exists, and the Trustees cited none below, that would permit, much less require, dismissal of the breach of contract claims for failure to meet a tort standard of conduct."). Appellants' argument, however, evinces their basic misunderstanding as to whom the parties to the "contract" were. A more preposterous proposition would be holding a party liable on a contract to which he or she was not a party.

a “reciprocal duty” of strict compliance for the Trustees. App. Br. at 18. Section 9.01 does no such thing. It relates solely to rules and regulations:

9.01. Rules and Regulations. The Board of Trustees may from time to time adopt, amend, repeal, and enforce reasonable rules and regulations governing the use and operation of the Project; provided, however, that such rules and regulations shall not be inconsistent with the rights and duties set forth in the Articles of Incorporation, the Declaration, or these Bylaws.

[R. at 121.]

Section 9.01 goes on to provide that rules and regulations relating to the use of the residential and commercial areas must be approved by a majority of the Trustees representing those respective groups and further providing that the members must be provided copies of all rules and regulations adopted by the Board. Id. Even a cursory reading of this provision reveals that it does not serve to create some type of “reciprocal duty” upon individual Trustees. It relates to rulemaking authority and nothing more. This litigation does not involve rulemaking. Thus, Section 9.01 is wholly inapplicable.

Neither the text of the Declaration and Bylaws nor the text of Utah Code Ann. § 57-8-8⁹ require Trustees to “strictly comply” with the Declaration and Bylaws because such a notion is contrary to the purpose of the strict compliance requirement. The very cases cited by Appellants demonstrate this point. See, e.g., Turner, 910 P.2d at 1225; Appeal of Two Crow Ranch, Inc., 494

⁹ This section provides:

Each unit owner shall comply strictly with the covenants, conditions and restrictions as set forth in the declaration or in the deed to his unit, and with the bylaws and/or house rules and with the administrative rules and regulations drafted pursuant thereto

Utah Code Ann. § 57-8-8 (1996). It is obvious that this section serves to regulate the conduct of owners *qua* owners, not owners *qua* trustees.

P.2d 915, 919 (Mont. 1972); Jorgensen Realty, Inc. v. Box, 701 P.2d 1256, 1257 (Colo. Ct. App. 1985).

C. The Trustees Have “Strictly Complied” With the “Contract”

Although owners are bound to “strictly comply” with the contract formed by the Declaration, Bylaws, relevant statute, and the owners’ individual applications, neither the text of these provisions nor the law supports a contention that individual Trustees thereby become “strictly” and personally liable for the obligations of the Association. Even if this Court were to accept Appellants’ argument and conclude that the individual Trustees of a nonprofit corporation are bound to “strictly comply” with a provision of the contract not directed to them, this Court should still affirm the district court’s dismissal because the Trustees have strictly complied. In this case, strict compliance with the Declaration and Bylaws, for Trustees who are given “all of the powers of the Association, whether derived from law or the Articles of Incorporation,” [Bylaws, ¶ 4.01, R. at 114.], means simply that the Trustees will not do anything which they are affirmatively prohibited from doing, either by law, the Declaration, or the Bylaws.¹⁰

The only provision in the Declaration or Bylaws which addresses the Association’s reserve account is Section 19.05 of the Declaration which provides:

The Association shall establish an adequate reserve to cover the cost of reasonably predictable and necessary repairs and replacements of the Common Areas and any component thereof and shall cause such reserve to be funded by regular monthly or other periodic assessments against the Condominiums rather than by Special Assessments.

¹⁰ Appellants’ analogy to municipal government also breaks down here. Appellants argue that, like a city, the Board’s power is strictly limited to express powers and those implied powers reasonably necessary to carry out express powers. App. Br. at 37 n.11 (citing Layton City v. Speth, 578 P.2d 828 (Utah 1978)). The text of the Bylaws is to the contrary, granting the Board all powers under law except those specifically reserved to the owners. [Bylaws, ¶ 4.01].

[R. at 84.] This provision is unambiguous and the Court can interpret its meaning from the words used. Turner, 910 P.2d at 1226. The provision plainly does not prohibit the Association from electing to sue a contractor for faulty work as a means of effecting “repair” of the Project. Thus, this is an area in which the Trustees may exercise the broad discretion granted them under the Declaration and Bylaws. See Decl. at ¶ 10.03 (“The Association may obtain and pay for the services of such personnel as the Association shall determine to be necessary or desirable for the proper operation of the Project The Association may obtain and pay for legal and accounting services necessary or desirable in connection with the operation of the Project or the enforcement of this Declaration.”) [R. at 67.]; Bylaws, ¶ 4.01 (granting Board power to manage affairs of Association) [R. at 114.]. Exercise of discretion granted them cannot, as a matter of law, be considered a failure on the part of the Board to “strictly comply” with the Declaration and Bylaws.

D. Appellants’ Fiduciary Duty Claim

Appellants claim that the Trustees have a fiduciary obligation to the owners. Appellees do not disagree. The fiduciary duty owed by officers and directors of any nonprofit corporation is defined as the duties of loyalty and care. See Resolution Trust Corp. v. Hess, 820 F. Supp. 1359, 1366 (D. Utah 1993). Appellants do not claim that the Trustees breached their duty of loyalty. App. Br. at 29 n.5 (“The Complaint does not allege a breach of the duty of loyalty.”). Thus, the only claim by the Appellants is that the Trustees breached their duty of care.

In Hess, the directors of a failed savings and loan were being sued for negligence and breach of fiduciary duty. While Hess involved the standard of care for directors of a for-profit corporation, the court’s holding is applicable here:

In Utah, the fiduciary duty of care is simply the level of care state law requires a director to exercise in managing corporate affairs. That is the

identical standard of ordinary negligence which underlies a claim for negligent mismanagement. Accordingly, it is this court's judgment that under Utah law, a claim for breach of a director's fiduciary duty of care is tantamount to a claim of negligent mismanagement. See Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (treating a claim for breach of fiduciary duty of care under Delaware law the same as a negligence claim).

Id. at 1366 (emphasis added). This Court recently employed the reasoning of Hess in C&Y Corp. v. General Biometrics, Inc., 896 P.2d 47 (Utah App. 1995). There, as here, directors allegedly breached their fiduciary duties. This Court concluded:

[Gen Bio] argues Condie and Yarter breached their obligation of good faith and fair dealing. Our fiduciary duty analysis effectively disposes of this issue. Cf. Resolution Trust Corp., 820 F. Supp. at 1366 (refusing to address breach of fiduciary duty claim as duplicative of negligence claim).

Id. at 56.

Under C&Y and Hess, the breadth of the fiduciary duty of care owed by a corporate director is gauged by the standard of care set forth in the applicable statute. For nonprofit directors the "level of care state law requires a director to exercise in managing corporate affairs" is intentional misconduct. Utah Code Ann. § 16-6-107. All other allegations which embody a higher standard of care must be dismissed.¹¹

III. The Trustees Have Not Committed Any *Ultra Vires* Act

Appellants take the same shotgun approach to *ultra vires* analysis that they do to the fiduciary duty analysis. However, Appellants confuse the "authority" of the Association to take

¹¹ The cases cited by Appellants do not support their fiduciary duty claim. For example, in Wolinski v. Kadison, 449 N.E. 2d 151 (Ill. Ct. App. 1983), the governing board flagrantly violated a voting requirement "made explicitly in the bylaws." Id. at 156. Significantly, the plaintiff in Wolinski alleged "wilful and wanton" misconduct on the part of individual board members, an allegation which the court concluded stated a separate cause of action. Id. at 157. No such allegation was made here.

certain actions with the means by which the Trustees elect to execute such authorized action.¹² An action is *ultra vires* only if it exceeds the express or implied authority of the corporation as fixed by its charter, statute, or the common law. 7A William M. Fletcher, Fletcher Cyclopedic of the Law of Private Corporations §3399 (perm. ed. 1989). An action that is authorized, but which did not result from the observance of proper corporate formalities is not *ultra vires*. Id. §§ 3401-3402; see Independence One Mortg. Corp. v. Gillespie, 672 A.2d 1279, 1281 (N.J. Super. 1996) (*ultra vires* where official "utterly without capacity" to perform an act; *intra vires* where act is authorized, although imperfectly executed); 18B Am. Jur. 2d Corporations § 2012 (1985) (an "*intra vires*" act is one that is taken without proper authorization of the directors or shareholders). Statutory provisions dealing with *ultra vires* transactions have no bearing on *intra vires* acts. Id.

Appellants attempt to cast their challenge to the Association's prosecution of the CCI Litigation as an "*ultra vires*" act on the part of the Trustees.¹³ This challenge is baseless, however,

¹² Appellants continue misleadingly to cite case law. In S&T Anchorage v. Lewis, 575 So.2d 696 (Fla. Ct. App. 1991), the court affirmed dismissal of the plaintiffs' breach of fiduciary duty claim. Id. at 698. That case does not stand for the proposition that "[c]ourts consider an *ultra vires* act to be a breach of fiduciary duty, or breach of contract, to which the intentional misconduct standard for torts clearly would not apply." App. Br. at 25.

¹³ Were this Court to accept Appellants' argument, nonprofit directors would be placed in a "damned if you do; damned if you don't" posture. It has been held that failing to sue may be an *ultra vires* giving away of corporate assets. See Helvering v. Davis, 301 U.S. 619 (1937). Thus, under Appellants' argument, nonprofit directors such as the Trustees here may face personal liability based on *ultra vires* conduct if they elect to pursue litigation and they may similarly face personal liability if they elect not to pursue litigation. Utah law, however, protects directors from such a Hobson's Choice:

A trustee or officer of a nonprofit corporation is not personally liable to the corporation or its members for civil claims arising from acts or omissions made in the performance of his duties as a trustee or officer, unless the acts or omissions are the result of his intentional misconduct.

Utah Code Ann. § 16-6-107(1).

because the Association, acting through the Trustees, is authorized to sue and be sued: "A corporation is in law, for civil purposes, deemed a person. It may be sue and be sued, grant and receive, and do all other acts not *ultra vires* which a natural person could do." Railroad Co. v. Harris. 79 U.S. 65, 81 (1870); see Utah Code Ann. § 16-6-22; id. § 16-10a-302(1) (business corporations).

Appellants' argument is difficult to fathom. There can be no question that the prosecution of the CCI Litigation was authorized. In Utah, a nonprofit corporation may "sue and be sued, complain and defend, in its corporate name." Utah Code Ann. § 16-6-22(2). Furthermore, under the Condominium Act, the management committee (in this case, the Association, acting through the Board of Trustees, see Decl. ¶ 10.07 [R. at 67] is empowered to bring suit on behalf of the Association. Utah Code Ann. § 57-8-33. And the Supreme Court has read this provision broadly, holding that such a management committee is "cloaked with the statutory right to sue."¹⁴ Brickyard Homeowners' Ass'n. Man. Comm. v. Gibbons Realty Co., 668 P.2d 535, 542 (Utah 1983). Finally, the Association Bylaws expressly grant to the Board of Trustees the authority to "exercise all of the powers of the Association" derived from law or Articles, except such powers as are vested solely in the members. Bylaws ¶ 4.01. [R. at 114.] As such, Appellants' argument that the Trustees' decision to pursue and finance the litigation against CCI was *ultra vires* is simply wrong.

In their opening brief, Appellants drum out a parade of horrors which are supposed to demonstrate the "'*ultra vires*' conduct" engaged in by the Trustees. App. Br. at 27. A careful analysis of this very list, however, demonstrates the impropriety of Appellants' argument. For

¹⁴ Given this express power, it follows that the Trustees necessarily have the implied necessary power to finance litigation. Decl. ¶ 10.08. [R. at 68.]

example, Appellants claim that the Trustees committed an *ultra vires* act by “[v]oting in a secret meeting to fund CCI from the Reserve Fund.” *Id.* Even assuming the truth of this allegation--which the Trustees would dispute--there is nothing in the Declaration, Bylaws, Nonprofit Corporation Act, or the Condominium Act which even defines, much less expressly prohibits the Trustees from conducting “secret meetings,” whatever that term means. If Appellants are claiming that the meetings were not properly noticed, *see* Bylaws, ¶ 4.06 [R. at 115] Utah Code Ann. § 16-6-39, that is a waivable defect and plainly does not constitute an *ultra vires* act. If the Appellants are complaining because the owners were not given notice of the Board meeting, it goes without saying that that contention is without merit. Notice of Directors’ meeting generally is not given to shareholders. *See* Utah Code Ann. § 16-6-39; *see also* Utah Code Ann. § 16-10a-322(1). Thus, under Appellants’ rationale, all meetings of all boards of directors would be considered “secret.”

Given that the pursuit of the CCI Litigation was not *ultra vires*, the means by which the Trustees financed the litigation falls squarely within the business judgment rule. Stated simply, the Trustees reasonably believed, allegedly on the advice of the Associations’ lawyer and accountant, that the CCI Litigation could be financed with monies from the Association’s reserves. Nothing in the Declaration prohibits such use. Accordingly, whether this Court--or any court--were to determine that the reserves were not the proper source of funds for the CCI Litigation does not make the Trustees good-faith decision to use those funds an *ultra vires* act. It was, at the very most, an erroneous judgment. The law simply does not impose liability on nonprofit corporate directors for errors in judgment. *See Dockside Ass’n. Inc. v. Detyens*, 352 S.E.2d 714, 716 (N.C. Ct. App. 1987) (“A court should be reluctant to question action taken *intra vires* by the governing board of a nonprofit corporation.”); *see also Gleason v. International Multifoods Corp.*, 577 P.2d

931, 934 (Ore. 1978) (“If there are plausible business reasons supportive of the decision of the board of directors, and such reasons can be given credence, a Court will not interfere with a corporate board’s right to make that decision. It is not our function to referee every corporate squabble or disagreement. It is our duty to redress wrongs, not to settle competitive business interests. Absent any bad faith, fraud, breach of fiduciary duty or abuse of discretion, no wrong cognizable or correctable in the Courts has occurred.”); Gay v. Gay’s Supermarkets, Inc., 343 A.2d 577, 580 (Me. 1975); cf. Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) cert. denied, 460 U.S. 1051 (1983); Resolution Trust Corp. v. Blasdel, 903 F. Supp. 417, 425 (D. Ariz. 1994) (articulating “complete abdication” standard of care in for-profit *ultra vires* analysis).

Appellants’ argument is not that the Trustees did not have the authority to pursue the CCI Litigation on behalf of the Association, but that they disagree with the source of funds the Trustees used to finance the CCI Litigation. Appellants’ remedy for their dissatisfaction with the Board’s decision, however, is not to bring a derivative action and to seek judicial intervention in this “corporate squabble,” see Gleason, 577 P.2d at 934. Their remedy is to rally their neighbors and remove Board members according to the procedure set forth in the Bylaws. See Bylaws ¶ 4.09 [R. at 116]. Having tried and having failed in that effort, see Amen. Verif. Complaint, ¶ 99 [R. at 213], they have elected to pursue litigation.

In this case, Appellants challenge the Board’s decision regarding financing of the CCI Litigation. The Trustees were faced with a decision as to how to remedy defects in the Project. As Judge Young observed, the Board could have hired a second plumbing contractor to redo the work or it could have chosen to sue the first contractor. The Board chose the latter. According to Appellants’ rationale, the Board could have paid a new plumbing contractor from the

Association's reserves, but they are subject to personal liability for seeking redress from CCI Mechanical. The Board's decision was, pure and simple, a business decision. Absent some explicit provision to the contrary, director liability should not turn on whether the remedy a board seeks involves paper versus pipe. The rule protecting valid and informed business decisions -- regardless of whether all shareholders agree -- is designed to protect Trustees from the "most imperfect device" of "after-the-fact litigation." Joy, 692 F.2d at 886; see also Ungeleider v. One Fifth Ave. Apartment Corp., 623 N.Y.S.2d 711 (Ap. Ct. N.Y. 1995), Papalexious v. Tower West Condominium, 401 A.2d 280, 285-87 (N.J. Super. 1979) (business judgment rule requires "presence of fraud or lack of good faith in the conduct of corporation's internal affairs before the decisions of a board of directors can be questioned").

Assuming that financing the litigation from the Association's reserves could be considered an unauthorized act, the Trustees still are not liable because they are not alleged to have committed an act they knew to be wrong. In Simon v. Socony-Oil Vacuum Co., 38 N.Y. S.2d 270 (N.Y. 1942), the court held that, in order for a director to be held liable for an *ultra vires* act, the director must have committed the act "knowingly." Id. at 274. Because the directors in that case "did not knowingly exceed their authority or the authority of the corporation," the court held that they could not be held personally liable for damages. Id.¹⁵

¹⁵ Appellants, claim that the intentional misconduct standard does not apply in *ultra vires* analysis. That statement is plainly incorrect. A director must know the extent of his or her authority and wilfully intend to violate it before personal liability attaches. See Simon, 38 N.Y. S. 2d at 274-75; see also Utah Code Ann. § 78-19-2 (shielding volunteer directors from liability absent wilful, knowing violation).

In this case, the Declaration and Bylaws did not unambiguously prohibit the Trustees from financing the litigation to repair building defects from the Association's reserves.¹⁶ They are alleged to have acted on professional advice. Thus, there was no way for the Trustees to know that such conduct might later be judged to be *ultra vires*. Where directors "act honestly, and for what they regard as the best interests of the corporation and do not wilfully prevent or exceed their powers but only misjudge the same, on the plainest principles of justice, as well as under the adjudicated cases, they could not be held liable." 2 Thompson on Corporation, § 1404 (perm. ed.). Appellants have not alleged willful violation of the Declaration and Bylaws. Indeed they allege the contrary, that the directors acted upon the advice of the Association's lawyers and accountants. Amen. Verif. Complaint ¶ 92 [R. at 212]. Accordingly, their claim of *ultra vires* acts must fail.

IV. Appellants' Claim of Corporate Mismanagement Falls With its Breach of Fiduciary Duty Claim

Continuing to pound the table, Appellants assert that "[t]he Complaint alleges a legally sufficient claim for Corporate Mismanagement and Waste and Assets (Count VIII) through the Trustees' failure to exercise due care to see that the Capital Reserve Fund was used for the Association's benefit and not wasted." App. Br. at 29. This is simply a rehashing of the same mistaken argument that Appellants advance throughout their brief; that is, notwithstanding the Association's organization as a nonprofit corporation, the court should impose a simple negligence

¹⁶ For the financing of the CCI Litigation from the Association's reserves to constitute an *ultra vires* act, the Declaration and Bylaws must affirmatively and unambiguously prohibit such action. In the cases cited by Appellants, directors breached just such unambiguous provisions. See Johnson v. Fairfax Village Condominium IV Unit Owners Ass'n., 548 A.2d 87, 90 (D.C. Ct. App. 1988); Pepe v. Whispering Sands Condominium Ass'n., 351 So.2d 755, 757-58 (Fla. Ct. App. 1972); S&T Anchorage, Inc. v. Lewis, 575 So.2d 696, 698 (Fla. Ct. App. 1991).

standard of care upon the Trustees rather than the intentional misconduct standard set forth in the statute.

As discussed above, Appellants' argument is contrary to law.¹⁷ The Trustees do have a fiduciary duty of care to the Association and that "duty of care is simply the level of care state law requires a director to exercise in managing corporate affairs." Hess, 820 F. Supp. at 1366. Because Appellants have not pled intentional misconduct on the part of the Trustees, their corporate mismanagement claim falls right along side their breach of fiduciary duty claim.

V. Appellants Are Not Entitled to Attorneys Fees or an Incentive Fee

Appellants assert an entitlement to attorneys fees and an incentive fee. Attorneys fees and expenses may be awarded when a derivative action confers substantial benefit on the corporation. Rosenbaum v. McAllister, 64 F.3d 1439, 1441 (10th Cir. 1995). The obvious corollary to the common-fund doctrine, however, is that the litigation must in fact confer a benefit on the corporation. Appellants' Complaint has been dismissed for failure to state a cause of action. The action plainly has not conferred any benefit on the Association.

¹⁷ Appellants' own cases repudiate the very proposition advanced. For example, in Frances T. v. Village Green Owners Ass'n., a homeowner attempted, as Appellants do, to hold directors personally liable for an alleged breach of the association's bylaws. The California Supreme Court dismissed the action, noting:

The board members may not be held personally liable absent allegations that they entered into a contract with plaintiff on their own behalf or purported to bind themselves personally.

723 P.2d 573, 586 n.20 (Cal. 1986); see also Board of Managers v. Fairway at N. Hills, 603 N.Y.S.2d 867, 868 (App. 1993) (dismissing a breach of contract claim against a condominium association trustee "as the claim[] improperly sought to impose personal liability upon him for alleged misdeeds committed by him in his capacity as a corporate officer.").

VI. The District Court's "Speculation" is Irrelevant

Appellants go on for eleven pages about the impropriety of the district court's "speculation" regarding certain matters. This argument is unnecessary and misleading. This court has the transcript of the hearing before it. Although the transcript appears to be garbled in a number of instances the Court can evaluate for itself whether Judge Young was "speculating" or whether he was attempting to clarify the unusual argument being advanced by the Appellants through the traditional method of what-if hypotheticals. In any event, the failure of Appellants' claims does not rest on the district court's hypotheticals; the Complaint fails as a matter of law because the Appellants have not alleged that the Trustees engaged in intentional misconduct. Judge Young clearly so held and any other comments by this Court are irrelevant to the correct decision Judge Young reached. See Berube supra. This inescapable legal failing stands completely apart from any "speculation" on the part of the district court.

VII. Appellants Have Waived Their Right to Amend the Complaint

In the final sentence of their opening brief, Appellants seek the alternative ruling of the Court for "leave to amend further to allege intentional misconduct. App. Br. at 50. At the conclusion of the hearing in this matter, the Court dismissed the Complaint with prejudice, stating - - "the directors are only to be held liable for intentional misconduct, and thus that must be pled in that way in order for them to be liable." [R. at 497.] Counsel for appellants sought clarification of the Court's ruling:

Mr. Gesas: Just so the record is clear, is that with prejudice, or with leave to amend if we have to proceed.

The Court: I will provide the opportunity to plead with leave to amend. [R. at 497-98.]¹⁸

Appellants had a choice: Either amend the Complaint or treat the dismissal as final and appeal. Appellants chose the latter.

Appellants filed the instant appeal of a final order pursuant to Rule 3 of the Utah Rules of Appellate Procedure. Having elected to treat the district court's dismissal as final and pursue this appeal, Appellants have waived their right to further amend. See Williams v. State, 716 P.2d 806 (Utah 1986).

Appellants, like the plaintiff in Williams, seek to have their cake and eat it too. They filed this appeal of an order they elected to treat as final. Yet, they want to treat the order as non-final, and be allowed to amend their Complaint if they lose in this forum. The law does not allow such tactics. Appellants waived their right to amend the Complaint when they filed the instant appeal. Accordingly, this Court should affirm the district court and the case should not be remanded with leave to amend.

¹⁸ The Order Granting Motion to Dismiss provides: “. . . the Court finds that the only applicable standard of care for directors or trustees of Utah nonprofit condominium associations is intentional misconduct. Consequently the court dismisses the entire Amended Complaint, including the contract claims with prejudice, and grants the Appellants' leave to amend to assert only claims for intentional misconduct.” [R. 376.]

CONCLUSION

For the foregoing reasons, the order of the district court dismissing Appellants' Complaint should be AFFIRMED.

DATED this 27th day of June, 1997.

MANNING CURTIS BRADSHAW
& BEDNAR, LLC

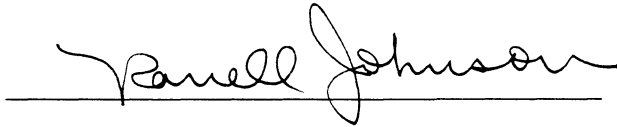
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CERTIFICATE OF SERVICE

I hereby certify that I caused to be hand delivered, a copy of the foregoing Opening Brief of Appellees this 27th of June, 1997, to the following:

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A handwritten signature in cursive script, reading "Daniel Johnson", is written over a horizontal line.

CONCLUSION

For the foregoing reasons, the order of the district court dismissing Appellants' Complaint should be AFFIRMED.

DATED this 27th day of June, 1997.

MANNING CURTIS BRADSHAW
& BEDNAR, LLC

By: 

Brent V. Manning

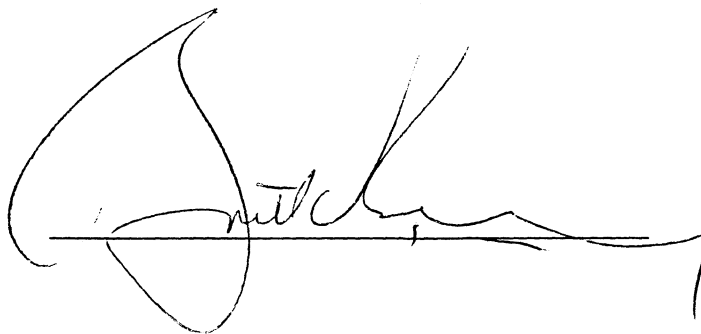
Jack M. Morgan, Jr.

Attorneys for Defendants-Appellees

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