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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

BAY CITY VIEW, LLC, et al.,

Cross-complainants
and Respondents;

v.

SF BAY BUILDERS, INC.,

Cross-defendant and Respondent,

JENNY CHAN et al.,

Objectors and Appellants.

A138982

(San Francisco City and County
Super. Ct. No. CGC-08-481417)

SF Bay Builders, Inc. (SFBB) was found liable by an arbitrator for breach of a construction contract with Bay City View, LLC (BCV). The arbitration award was confirmed by the trial court, and BCV successfully moved to add Jenny Chan, the 50 percent shareholder in SFBB, and her husband Derrick Chan as additional judgment debtors on an alter ego theory. The Chans argue that before shareholders may be declared alter egos of a corporation, wrongful intent must be shown, and that such evidence was absent here. They also challenge the trial court's finding of a unity of interest between them and the corporation. We affirm the trial court's order.

I. BACKGROUND

A. *Incorporation of SFBB*

SFBB was incorporated in December 2002. At the time of SFBB's formation, Derrick¹ was a licensed contractor who performed construction work as a sole proprietor under the business name DCK Construction. After SFBB was formed, Derrick assigned his interest in four pending projects to SFBB. The projects included a commercial renovation, a three-unit building, a mixed-use project, and a residential remodel. SFBB thereafter listed DCK Construction's experience as its own.

Jenny explained that "SFBB was originally contemplated to be a women-owned business, with the intent to qualify for certification as a WBE or Woman's Business Enterprise." She averred that she contributed 50 percent of the initial capital in the form of construction equipment (which she valued at \$100,000) and became a 50 percent shareholder. Grace Ko and Yasmine Wu purportedly each contributed 25 percent of the initial capital in cash (\$50,000 each), and each became a 25 percent shareholder. Each shareholder signed a postnuptial settlement agreement with her spouse (Derrick, Ronald Ko and Eric Tang, respectively) acknowledging that her shares were community property and agreeing to sell her community interest in the shares to her husband upon her death or disability or upon their divorce.

The shareholders and their spouses also signed a shareholders' agreement providing that Jenny, Grace and Yasmine would be elected as directors and officers annually, with Jenny serving as president and chief executive officer, Grace as chief financial officer, and Yasmine as secretary. In March 2003, the shareholders adopted the bylaws and elected themselves directors. Thereafter, Jenny rarely talked to or met with Grace or Yasmine.

As a licensed contractor, Derrick served as the responsible managing employee for SFBB, qualifying the corporation as a licensed contractor. Derrick and Ronald worked as

¹ First names are utilized to avoid confusion between persons with shared surnames. We intend no disrespect.

SFBB's project managers, with Derrick running day-to-day operations and Ronald reporting to him. Both Derrick and Ronald also had other jobs—Derrick as an engineer and Ronald as a pharmacist. Eric received no compensation from SFBB. Jenny handled the company's accounting. Grace and Yasmine were not on the SFBB payroll and did not have any day-to-day responsibilities with respect to the business. Diana Chan, a paralegal for a law firm that assisted SFBB with corporate legal matters, averred that “[o]n several occasions [she] corresponded directly with either Derrick . . . or Eric . . . , both of who[m] were acting for their wives who were and are shareholders, officers and directors of [SFBB].”

Corporate formalities were generally not followed. In 2012, SFBB produced annual “Actions of Board of Directors” that purported to reelect the officers each year and ratify all officer actions during the previous year by unanimous written consent, effective February 2004 to February 2009. Similar annual “Actions of Shareholders” purported to reelect the board of directors and ratify all officer actions during the previous year. In October 2012, these documents had been “recently signed” by Jenny, Grace and Yasmine.

B. *SFBB Construction Projects*

SFBB did business from 2003 through approximately 2012, although it took on no significant new construction projects after 2008. Derrick averred that the company had over \$15 million in revenue over this period. In 2003 and 2004, SFBB commenced the following construction projects that were ultimately completed between 2005 and 2007: a \$246,000 residential addition; a \$556,000 new single family home; a \$1.4 million residential addition and renovation project;² a \$577,000 new home; a \$103,000 building addition; and a \$760,000 residential foundation and framing project.

In October 2004, SFBB entered into a \$5,652,600 contract with BCV to build 18 apartment units and three commercial units in San Francisco (BCV Project). SFBB

² Derrick reported \$280,546 in additional income from the first three projects that he was unable to attribute to a specific project.

had engaged primarily in residential construction before “venturing into commercial construction” with the BCV Project. The contract provided for periodic progress payments based on the percentage of completion of the project and included an arbitration provision. SFBB agreed to achieve substantial completion of the project no later than 554 days from the commencement date, triggered by BCV’s notice to proceed by January 3, 2005. SFBB worked on the BCV project from 2005 until it was terminated in July 2008, as discussed in greater detail *post*. During that time period, SFBB received a total of \$3,045,451 in progress payments from BCV.

From 2005 to 2010, SFBB apparently completed several jobs: two planning projects (\$10,500), two “demo” projects (\$11,000), swimming pool infill (\$11,000), three unspecified or “misc. work” projects (\$15,500), commercial tenant improvement (\$19,000), site preparation (\$40,000), five repair projects (\$50,800), fire repair and structural upgrade (\$271,000), two apartment remodeling projects (\$537,000), two renovation and/or addition projects (\$987,000), and the “SF Chinese Baptist Church” (\$2.3 million). SFBB also started work in 2006 on a \$4 million San Rafael townhouse project that ended prematurely in April 2012 when the property was sold in a short sale.³ SFBB apparently then went out of business, and its contractor’s license was suspended.

C. *SFBB Finances*

SFBB had three bank accounts: an operating account, a payroll account, and a “cash maximizer account.” In 2005 and 2006, during the period that SFBB was receiving progress payments on the BCV Project, SFBB charged substantial corporate purchases to the Chans’ personal credit cards and then paid those charges (with checks written directly to the credit card companies). These charges totaled more than \$100,000 and included single purchases of \$14,000, \$19,000 and \$19,800 for lumber. SFBB also paid some of

³ The real property in San Rafael was owned by 1515 Lincoln, LLC. Eric Tang, Yasmine’s husband, was the managing member of 1515 Lincoln, LLC and SFBB was a member investor with a \$100,000 ownership interest. Eric averred: “Unfortunately, as a result of the recession, the LLC ran out of funds to complete the project and . . . the lender[] ultimately agreed to a short sale.”

the Chans' personal credit card bills that were not linked to corporate purchases. SFBB obtained its own credit cards at some point, but the record does not disclose precisely when, or the credit limits on those cards. Certain cash withdrawals from SFBB accounts purportedly were for equipment purchases, but no supporting documentation was produced.

Other questionable corporate expenditures in the same period included SFBB payments totalling \$3,900 for hardwood flooring at a residence the Chans bought in June 2005 and \$8,000 for plumbing at both the residence and a construction project. SFBB paid to move items to the Chans' new personal residence.⁴ In August 2005, SFBB paid \$75,000 for a Burger King franchise, but this transaction was later cancelled and the company recovered all but \$2,500 of this expense. In the spring of 2006, SFBB bought a Mercedes Benz automobile for \$59,000. Finally, in about June 2006, SFBB loaned \$350,000 to 1515 Lincoln, LLC (see fn. 3). SFBB received repayment on this loan in the amount of \$90,000 in July 2006, and \$150,000 in 2010, leaving an unpaid balance of \$110,000.

When SFBB went out of business, its property consisted of trucks, equipment and tools that were sold at auction for about \$65,000. The company never made any profit that was distributed to the shareholders as dividends. It carried liability and workers' compensation insurance throughout its existence, and it filed its own tax returns and paid its payroll taxes.

D. *Lawsuit and Arbitration*

In October 2008, SFBB sued BCV and others for breach of contract and foreclosure of a mechanic's lien, alleging BCV still owed it more than \$1 million on the contract as well as \$4 million in damages caused by delay. BCV's petition to compel arbitration was granted, and BCV raised counterclaims in the arbitration proceeding.

⁴ Jenny averred that SFBB property was moved to the Chans' house for storage in July 2005. In 2006, SFBB moved its corporate office into the Chan residence.

Money to pay attorneys in the litigation was loaned to SFBB by Derrick, Ronald and Eric, contributing \$150,000, \$75,000 and \$75,000 respectively. Jenny testified that she agreed to the loans on behalf of SFBB. However, Derrick apparently executed the promissory notes on behalf of SFBB (including his loan to SFBB). Derrick's and Ronald's loans were repaid with interest, and Eric was repaid \$37,979.25.

In a 2010 preliminary arbitration award, the arbitrator made the following findings. Under the terms of the contract, "the project was anticipated to be completed no later than July 11, 2006. [¶] . . . Construction by SFBB commenced in January of 2005 and proceeded to July of 2007 at which time BCV's lender, as a result of construction delays, required BCV to hire a construction manager. BCV then hired Richard Avelar & Associates (RAA) [¶] On July 18, 2008, SFBB was terminated from the project [citation]. Around the same time RAA was also terminated. [¶] Thereafter BCV retained Rohan Wallace & Ahern (RWA) to complete the project. A Certificate of Final Completion and Occupancy was issued by the City and County of San Francisco on March 26, 2010 [citation]. [¶] . . . BCV seeks damages against SFBB for delays and defective work of SFBB. . . . [¶] . . . SFBB . . . seeks against BCV . . . damages for fraud in the inducement of contract, breach of contract, and wrongful termination, among other claims.

"The evidence presented in this action clearly establishes that from the inception of its involvement with the project the work of SFBB was poorly scheduled, improperly and inadequately managed and understaffed with insufficiently skilled workers. SFBB failed to provide a full-time superintendent and failed to keep the jobsite clean and safe. [¶] Derrick Chan[,] the responsible managing employee of SFBB, was employed full-time as an engineer for the City and County of San Francisco. Ronald Ko, Chan's partner at SFBB, was a pharmacist. Neither could be on site for any extended periods of time. Canon Cheung, who was put in charge of framing, held a Masters Degree and had previously done 'some estimating,' but had never previously worked in the construction industry and had never previously worked as a construction manager. According to Ko, site supervision was often left to a carpenter or a plumber. Testimony established the

lack of understanding of English by these workers and their inability to communicate with suppliers and others on site. [¶] By July of 2008, the project was two years behind schedule and SFBB had spent the prior year doing only repairs as directed by RAA. In spite of a year of correction work, construction was still defective and incomplete. There remained defective framing and structural work, defective electrical and plumbing work, substantial stucco deficiencies and water infiltration and drainage problems. According to RAA representative, Greg Cole, as of July 2008[,] SFBB was continuing to delay the project and was continuing to underman the job.”

The arbitrator found BCV was justified in terminating SFBB for cause. He also found that SFBB was in breach of contract as of the date of termination and awarded BCV the reasonable cost of correcting construction defects and completing the project in excess of the original contract price. The arbitrator determined these contract damages to be \$1,109,186. BCV also was awarded the costs of its mechanics lien release bond, \$67,097, for a total of \$1,176,283. In a final arbitration award, BCV was awarded \$605,931.16 in attorney fees, expert witness fees, deposition costs, and arbitration fees.

As to SFBB’s claims, the arbitrator rejected a claim that BCV fraudulently induced it to enter into the contract by concealing defects in preliminary construction performed by a prior contractor. He also rejected SFBB’s mechanics lien claim: “At the time of termination SFBB had been paid \$3,548,597 [citation] and the project was between 60 and 70 percent complete. The cost records of SFBB presented to support its claims are far from complete and are based on weak general ledger information and limited verification by invoices, checks, and other reliable data. But on analysis of the testimony of [witnesses] I find that at most SFBB expended between \$2,700,000 and \$3,000,000 on the project. (Even allowing an additional adjustment of 20% for overhead and profit, SFBB’s costs do not exceed the amount paid by BCV.) I also find no merit to SFBB’s claims for extended overhead, acceleration, or lost productivity

[¶] Therefore, at the time of the valid termination for cause on July 18, 2008, nothing was then owed to SFBB”

The arbitrator earlier granted SFBB's motion to exclude evidence of individual liability from the arbitration, finding that a determination of alter ego status was more appropriately a judicial determination which could be made in the trial court following confirmation of any arbitral award. BCV's petition to confirm the arbitration award was granted and, in April 2011, the court entered judgment against SFBB for \$1,782,214.16.

E. *Motion to Amend the Judgment*

BCV moved in the trial court to amend the judgment by adding the Chans as judgment debtors. They argued the Chans were the alter egos of SFBB because Jenny and Derrick ran the corporation, SFBB was undercapitalized, and the Chans commingled corporate and personal funds.

Opposing the motion, the Chans submitted an expert declaration by a certified public accountant, Chun Wong, who created a general ledger of deposits and withdrawals from SFBB's operating account from May 2003 to August 2012, and reconciled it with bank statements for that account. Wong matched reimbursements to the Chans with expense reports and receipts, and he "verified that all reimbursements were for proper business expenses of SFBB." Wong's declaration, however, discussed only one of three SFBB bank accounts. As discussed *post*, the Chans filed two supplemental declarations to respond to BCV's reply, and BCV filed a supplemental brief and declaration.

After consideration of the parties' declarations and deposition testimony, the trial court granted the motion and amended the judgment to include the Chans as judgment debtors. In support of its decision, the court cited several factors. "First, I find that there has been a disregard of corporate formalities. [Derrick] Chan did not even know if he had shares [in the company]. Jenny Chan could not recall the last time she spoke with the other officers, but it was more than three years prior. The corporation didn't have regular meetings. It was not clear when the corporate documents were signed. But, apparently, it was recently, somewhat after the fact. [¶] The corporate paralegal who filed a declaration in opposition to the motion communicated with Derrick Chan or with Erick Tang, . . . neither of whom was an officer of the corporation."

The court further found “an identification of the equitable owners here with the control of the company. Jenny Chan owns 50 percent of the company and is president and CEO. Derrick Chan runs the day-to-day operations of [SFBB] and is the boss and the decisionmaker. Derrick Chan was the qualifier for [SFBB’s] contractor license. Derrick Chan held out his own experience as the experience of the company when he entered into the contract for the project with [BCV]. Jenny Chan is solely responsible for the books and accounts. [¶] [SFBB’s] office is located in the Chans’ home. They employed the same attorney. Derrick and Jenny Chan are represented by the same law firm as the company Derrick and Jenny Chan were present at the arbitration and they were the people who were controlling what happened in the arbitration for [SFBB]. [¶] Derrick Chan and Jenny Chan loaned the company money to pay for the company’s attorney[] fees at the arbitration.”

The court also found evidence of diversion of corporate assets to personal uses and undercapitalization. As to diversion of corporate assets, the court noted: “Money from the company was used to pay for expenses of Jenny and Derrick Chan. . . . [M]oney was paid for hardwood flooring and plumbing at the [Chan] house on [SFBB] checks in 2005.” As to the issue of capitalization, it stated, “This is a major construction company. It was set up at the time with two people contributing \$50,000 apiece and equipment valued at \$100,000, for purposes of estimating the opening capitalization. This, to me, is undercapitalized. [¶] . . . [O]ver the course of the company, it had \$15 million in contracts. [¶] Further, Jenny Chan testified that the money to run the business came from payments by the clients. [¶] In addition, [SFBB] said it never made a profit. [¶] The further evidence of undercapitalization, at its inception, is that the corporation relied on the personal credit cards of Jenny Chan and Derrick Chan for the payment of substantial amounts of building material that was to be used in connection with the construction projects. [¶] This, to me, is evidence that the company was undercapitalized, at the beginning. It’s also evidence of a commingling of funds and the reliance of the company on the personal credit of the two princip[al]s, Derrick and Jenny Chan.”

The court ultimately found “there is a unity of interest and ownership between the individuals here and the corporation,” and “there would be an inequitable result if the corporate structure was permitted to shield Derrick Chan and Jenny Chan from liability, not simply because the prevailing party in the arbitration wouldn’t be allowed to collect, but because the mismanagement and lack of observation of the corporate formalities appear to be what got [SFBB] into this situation to begin with. And here, I’m pointing to [the] preliminary arbitration award, which I’m taking judicial notice of, which describes that [SFBB] was poorly scheduled, improperly and inadequately managed, and understaffed with . . . insufficiently-skilled workers.”

II. DISCUSSION

“ ‘Judgments may be amended to add additional judgment debtors on the ground that a person or entity is the alter ego of the original judgment debtor. . . . ‘Amendment of a judgment to add an alter ego ‘is an equitable procedure based on the theory that the court is not amending the judgment to add a new defendant but is merely inserting the correct name of the real defendant. . . . ‘Such a procedure is an appropriate and complete method by which to bind new . . . defendants where it can be demonstrated that in their capacity as alter ego of the corporation they in fact had control of the previous litigation, and thus were virtually represented in the lawsuit.’ ” . . . [Citations.] ‘The decision to grant an amendment in such circumstances lies in the sound discretion of the trial court. ‘The greatest liberality is to be encouraged in the allowance of such amendments in order to see that justice is done.’ ” [Citation.]’ (*Greenspan v. LADT LLC* (2010) 191 Cal.App.4th 486, 508.)

We first consider whether BCV presented sufficient evidence to establish that SFBB was the alter ego of the Chans, and then consider whether the Chans had sufficient individual control of the arbitration such that they can be added to the judgment as additional judgment debtors without relitigation of the underlying claims.

A. *Alter Ego*

“Whether a party is liable under an alter ego theory is normally a question of fact. [Citations.] ‘The conditions under which the corporate entity may be disregarded, or the

corporation be regarded as the *alter ego* of the stockholders, necessarily vary according to the circumstances in each case inasmuch as the doctrine is essentially an equitable one and for that reason is particularly within the province of the trial court.’ [Citation.] Nevertheless, it is generally stated that in order to prevail on an alter ego theory, the plaintiff must show that ‘(1) there is such a unity of interest that the separate personalities of the corporations no longer exist; and (2) inequitable results will follow if the corporate separateness is respected.’ [Citation.]

“ ‘The alter ego test encompasses a host of factors: “. . . [c]ommingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses[;] . . . the treatment by an individual of the assets of the corporation as his own[;] . . . the failure to maintain minutes or adequate corporate records, and the confusion of the records of the separate entities[;] . . . the failure to adequately capitalize a corporation; the total absence of corporate assets, and undercapitalization[;] . . . the use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation[;] . . . [¶] This long list of factors is not exhaustive. The enumerated factors may be considered “[a]mong” others “under the particular circumstances of each case.” ’ [Citations.] ‘No single factor is determinative, and instead a court must examine all the circumstances to determine whether to apply the doctrine. [Citation.]’ [Citation.]” (*Zoran Corp. v. Chen* (2010) 185 Cal.App.4th 799, 811–812; see *Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825, 838–840 (*Associated Vendors*)).

We conclude the court’s findings that four of these factors were present are supported by substantial evidence, and that the court’s equitable ruling that the Chans were alter egos of SFBB fell well within the bounds of its discretion.

1. *Factors Supporting Alter Ego Determination*
 - a. *Disregard of Corporate Formalities*

Evidence supports the court’s finding that the Chans disregarded corporate formalities while running SFBB. After initial steps were taken to incorporate SFBB and elect its first directors and officers, only one of the three officers ever performed services

for the company, and the directors and shareholders rarely if ever again met or conferred. Only in 2012, after SFBB had ceased doing business, did the directors and shareholders sign blanket post hoc authorizations and ratifications for all corporate actions taken between 2004 and 2009. Significant corporate actions without specific director or shareholder authorization included the 1515 Lincoln, LLC \$100,000 investment and \$350,000 loan, relocation of the corporate office to the Chans' residence and payment of related renovation costs, and purchases of a Burger King franchise and Mercedes Benz.

Despite Jenny's assertion that "SFBB was originally contemplated to be a women-owned business," evidence supports an inference that the Chans never intended the ostensible all-female corporate structure to function as the actual decisionmaking structure of the company, and that de facto corporate control rested with others, principally Derrick. Rather than functioning as the chief executive officer of SFBB, Jenny kept the books and accounts. The Chans suggest that the men virtually represented their wives in running the company and thus the corporate structure was respected. However, they fail to show that the husbands had any legal authority to serve as proxies for their wives: the postnuptial agreements did not grant the husbands corporate decisionmaking authority, but merely acknowledged their community property interest in the wives' SFBB stock and ensured that the wives could not transfer their own community property interest in the stock to others. Nor have the Chans shown that the men actually took direction from their wives, or that Ronald and Eric had any decisionmaking authority in the company, shared or otherwise.

The Chans argue that their failure to observe corporate formalities was not significant because SFBB was a small family corporation. They cite Corporations Code section 300, subdivision (e), which provides: "The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in connection with the management of its affairs, pursuant to an agreement authorized by subdivision (b), shall not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations." However, SFBB was not formed or

identified as a “close corporation” as required by Corporations Code,⁵ and disregard of corporate formalities here did not occur pursuant to a shareholders’ agreement as provided for in Corporations Code section 300, subdivision (b). Given the inapplicability of the statute, it was a matter of the court’s discretion to determine whether the disregard of corporate formalities was significant or not in the totality of the circumstances of this particular case.

b. *Domination and Control*

Evidence also supports the court’s finding that the Chans dominated and controlled SFBB. The Chans ran the company on a day-to-day basis (eventually out of their own home) and personally made all significant corporate decisions. Indeed, the corporation was essentially a continuation of Derrick’s business, which had previously operated as a sole proprietorship. SFBB took over the sole proprietorship’s open contracts, qualified as a licensed contractor by way of Derrick’s contracting license, and listed Derrick’s prior work as its own on the corporate résumé.

c. *Commingling and Diversion*

The bulk of the record focuses on BCV’s allegations that the Chans commingled corporate assets with their personal assets and diverted of corporate assets to their personal use, particularly during the period when SFBB was receiving progress payments for work on the BCV Project. While some of these allegations appear overblown, substantial evidence of improper commingling and diversion remains.

The practice of charging corporate purchases on personal credit cards is evidence of commingling: both corporate and personal purchases were charged to a single account, and the corporation’s use of the Chan’s personal credit represented corporate use of a personal asset. The record further discloses the following evidence of diversion.

⁵ “ ‘Close corporation’ means a corporation, including a close flexible purpose corporation, whose articles contain, in addition to the provisions required by Section 202, a provision that all of the corporation’s issued shares of all classes shall be held of record by not more than a specified number of persons, not exceeding 35, and a statement ‘This corporation is a close corporation.’ ” (Corp. Code, § 158, subd. (a).)

First, four cash withdrawals from SFBB's "cash maximizer" account were not matched with corresponding deposits into other SFBB accounts: \$300 and \$6,100 on April 7, 2006; \$2,500 on September 25, 2006; \$38,625.52 on December 8, 2006; and \$17,705.27 on March 26, 2007. In her supplemental declaration, Jenny averred that these withdrawals were used for equipment purchases. However, she produced no receipts to corroborate the assertion and the Chans' expert averred, "I performed a limited inter-bank account reconciliation and determined that the substance of [Jenny's supplemental declaration] are correct. I did not, however, review any invoices related to SFBB's equipment purchases"

Second, the Chans provided no explanation for five SFBB checks (all from SFBB's operating account) that were used to pay their personal credit card bills: check #1830 to "Citi Card" for \$5,339.59 on July 24, 2005; check #1867 to Discover for \$3,366.99 on August 31, 2005; check #1892 to "Citi Cards" for \$18,262.99 on September 16, 2005; check #1996 to Discover for \$3,184.78 on December 5, 2005; and check #2029 for \$16,000 to Citibank on December 29, 2005.

Third, the evidence shows that corporate funds were spent on renovations and moving expenses related to the Chan residence: SFBB check #1805 to Golden Gate Moving for \$580 on July 1, 2005; checks #1803, 1816 and 1876 to Travis Hardwood for a total of \$3,900 between June and September 2005; and check #1811 to Star Plumbing for \$8,000 on July 8, 2005, which apparently paid at least in part for plumbing costs related to the Chan residence and an SFBB construction project. The Chans argued these expenses were legitimate corporate expenditures on the corporate office that was relocated to the Chan home, but they did not provide any supporting evidence and the trial court apparently found the contention not credible.

Finally, substantial corporate funds were spent on a Mercedes Benz (\$59,000), a Burger King franchise (\$75,000, with \$72,500 redeposited after the transaction was cancelled), and a loan to 1515 Lincoln, LLC (\$350,000). The Chans provided corporate

rationales for these expenditures,⁶ but again failed to provide any supporting documentation—or any evidence of specific corporate authorization. The court reasonably could have questioned the credibility of these explanations.

The Chans argue that a finding of diversion was inconsistent with the arbitrator’s findings. The arbitrator specifically rejected BCV’s claim for “under-absorbed overhead costs” (i.e., a claim that SFBB did not spend the full amount of the progress payments it received from BCV on legitimate expenses related to the BCV project) as unproved. However, in rejecting SFBB’s claim that it had been *underpaid* on the project, the arbitrator wrote: “The cost records of SFBB presented to support its claims are far from complete and are based on weak general ledger information and limited verification by invoices, checks, and other reliable data. But on analysis of the testimony of [witnesses] I find that *at most* SFBB expended between \$2,700,000 and \$3,000,000 on the project. (Even allowing an additional adjustment of 20% for overhead and profit, SFBB’s costs do not exceed the amount paid by BCV.)” (Italics added.) This passage demonstrates only that evidence provided at arbitration concerning SFBB’s project costs was unsatisfactory and unconvincing to the arbitrator.

The Chans’ other arguments regarding evidence of commingling and diversion also fail. The court was not required to credit their explanation that some of these expenditures represented in-kind payment for back compensation given the lack of any contemporaneous documentation or verification of “compensation” payments. Nor was the Chans’ argument persuasive that these expenditures were irrelevant because they occurred years before SFBB’s dispute with BCV. The *origin* of the dispute between the companies—SFBB’s poor work and failure to adequately staff and supervise the BCV project—occurred in the same time period (2005–2008) when corporate funds were commingled with personal funds and diverted to personal uses. Finally, the Chans argue the alleged diversion amounts are *de minimis* in comparison to the size of the Chans’

⁶ Jenny Chan contended that the Burger King expenditure was for a contemplated transaction in which SFBB would develop the property where the Burger King franchise was located.

business, the BCV project's full value, and the judgment amount. While the amounts may be relatively small, they are not so minimal that the court's alter ego ruling was beyond the bounds of reason and thus an abuse of discretion, particularly when considered in combination with the other evidence supporting the alter ego ruling.

d. *Undercapitalization*

Finally, we conclude substantial evidence supports the trial court's finding of undercapitalization.

The Chans first argue that capitalization is properly assessed only at the time of incorporation, and that SFBB's capitalization was adequate because it initially took on only modest construction projects. We disagree. The cases they cite do not so hold. (*Carlesimo v. Schwebel* (1948) 87 Cal.App.2d 482, 490 [holding only that the party seeking to pierce corporate veil had not met the burden of proof on undercapitalization]; *Seymour v. Hull & Moreland Engineering* (9th Cir. 1979) 605 F.2d 1105, 1113 [holding that the corporate veil will not be pierced simply because an initially adequately capitalized company later becomes insolvent due to bad financial times].) Undercapitalization must be assessed in light of a corporation's prospective liabilities. (*Automotriz etc. De California v. Resnick* (1957) 47 Cal.2d 792, 797.)⁷ A corporation adequately capitalized for smaller residential construction projects is not necessarily adequately capitalized for large commercial ones. The relevant question here is whether SFBB was sufficiently capitalized at the time it accepted the BCV Project.⁸ Substantial evidence supports the conclusion that it was not.

⁷ “The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts. It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities. If the capital is illusory or trifling *compared with the business to be done and the risks of loss*, this is a ground for denying the separate entity privilege.” (*Automotriz etc. De California v. Resnick, supra*, 47 Cal.2d at p. 797, italics added.)

⁸ The trial court found that SFBB was undercapitalized at its inception.

The Chans argue BCV had the burden of proving what level of capitalization would be adequate for a company like SFBB and failed to do so. They imply that BCV should have presented expert evidence to meet this burden. The Chans, however, cite no authority for the proposition that expert evidence on the appropriate level of capitalization for a particular enterprise is necessary. On the contrary, courts regularly cite nonexpert evidence on the ability, or inability, of a business to meet its ordinary operating expenses on the issue of undercapitalization in alter ego cases. (See *Associated Vendors, supra*, 210 Cal.App.2d at pp. 841–842 [sufficient capitalization found on basis of on-time bill payment for two years]; *Schoenberg v. Romike Properties* (1967) 251 Cal.App.2d 154, 165–166 [undercapitalization found on basis of \$1,000 initial capital contribution, \$3,000–\$20,000 in monthly expenses, and shareholder withdrawal of substantial sums from the corporation]; *Claremont Press Pub. Co. v. Barksdale* (1960) 187 Cal.App.2d 813, 816–817 [undercapitalization found on basis of \$500 initial capital, \$650–\$1,000 in weekly expenses, and \$1,800 corporate deficit after less than two months].) BCV presented such evidence, which the trial court found persuasive.

SFBB’s need to use the Chans’ personal credit provides substantial evidence of undercapitalization, indicating that SFBB had insufficient operating capital to purchase required construction materials and/or lacked its own credit facilities with vendors to make such purchases. Also, while the Chans contend adequate capitalization is shown by the fact that SFBB *received* no loans until 2012, there was evidence that SFBB was in *need* of loans far earlier when it proved unable to adequately staff and complete the BCV Project and incapable of remedying its own construction deficiencies.

2. *Findings of Unity of Interest and Control and Inequitable Result*

Disregard of corporate formalities and domination and control of SFBB by the Chans clearly support the court’s finding of a unity of interest and control between the Chans and SFBB. The Chans do not seriously argue to the contrary. The Chans’ primary argument on appeal is that the evidence was insufficient to support the trial court’s finding on the inequitable result prong of the alter ego test. They argue subjective bad faith is required under this prong and there was no evidence of bad faith in this case.

BCV argues that bad faith in the sense of wrongful intent or fraud is not required and urges us to affirm the trial court’s inequitable result finding. We agree with BCV.

a. *Is Subjective Bad Faith Required?*

The Chans contend that “[E]ighty years of California Supreme Court and appellate jurisprudence [demonstrate] that the ‘inequitable result’ part of the alter ego test requires a showing of bad faith.” We disagree.

Since imposition of alter ego liability is based on equitable principles, cases have frequently looked to evidence of fraud or “bad faith” to assess whether individual liability is warranted. The Chans point to the Supreme Court’s statement in *Cleaning & P. Co. v. Hollywood L. Service* (1932) 217 Cal. 124, 129 (*Hollywood*) that “[b]ad faith in one form or another must be shown before the court may disregard the fiction of separate corporate existence.”⁹ (See also *Wood Estate Co. v. Chanslor* (1930) 209 Cal. 241, 246 [noting trial court found against appellants “on the issue of bad faith”].) Other Supreme Court articulations of the rule, however, focus on the issue of an inequitable or unjust result if

⁹ In *Hollywood*, the corporation Hollywood Laundry Service (HLS) agreed to solicit dry cleaning, dyeing and pressing business along with its laundry services and to give that new business to Hollywood Cleaning & Pressing Co. (HCP) in exchange for a 37.5 percent share of the payments. The contract would last 10 years and HLS would include any new laundry plants it acquired. HLS was wholly owned by Frank Meline and Frank Meline, Inc. (FMI), which was in turn wholly owned by Meline. During the term of the contract, FMI acquired laundries and did not honor the contract between HLS and HCP. Meanwhile, HLS breached its contract with HCP. The trial court refused to hold FMI liable for not abiding by the HLS-HCP contract. (*Hollywood, supra*, 217 Cal. at pp. 126–127.) There was no evidence that any of the factors ordinarily considered in alter ego cases (such as commingling, diversion of corporate assets, or manipulation of assets and liabilities among related corporations) were present. Indeed, the appeal was taken from the judgment roll alone, with no supporting trial record, so “[a]ll intendments and presumptions [had to] be made in support of the judgment.” (*Id.* at pp. 126, 128.) The only relevant known facts were that HLS and FMI were essentially owned by the same individual and the Supreme Court observed that “the mere fact one or two individuals or corporations own all of the stock of another corporation is not of itself sufficient to cause the courts to disregard the corporate entity” (*Id.* at p. 129.) Indeed, *Hollywood* has been construed by this district as standing for nothing more than the last-quoted proposition. (*McLoughlin v. L. Bloom Sons Co.* (1962) 206 Cal.App.2d 848, 852–853.)

the corporate form is used as a shield, and do not expressly require a showing of bad faith. (See, e.g., *Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 300.) Several cases expressly provide that proof of actual fraud (one form of wrongful intent) is not required (see *Minifie v. Rowley* (1921) 187 Cal. 481, 488; *Wenban Estate, Inc. v. Hewlett* (1924) 193 Cal. 675, 697; *Gordon v. Aztec Brewing Co.* (1949) 33 Cal.2d 514, 523); and one essentially disclaims any requirement of wrongful intent (see *Higgins v. Cal. Petroleum etc. Co.* (1898) 122 Cal. 373, 376 [finding constructive fraud even though the “parties may have supposed, and no doubt did suppose, that the transaction was a legal and valid one, but in so acting they acted at their peril” (italics added)].)¹⁰

More recent intermediate appellate cases have also expressly held that “ ‘[a]pplication of the *alter ego* doctrine does not depend upon pleading or proof of fraud.’ [Citations.] The doctrine can be invoked when adherence to the fiction of the separate existence of the corporation would promote injustice [citation] or bring about inequitable results. [Citation.]” (*Misik v. D’Arco* (2011) 197 Cal.App.4th 1065, 1074 (*Misik*)). In another recent case, our colleagues in the Second District also directly addressed the issue now before us in *Relentless Air Racing, LLC v. Airborne Turbine Ltd. Partnership* (2013) 222 Cal.App.4th 811 (*Relentless*). In that case, a judgment creditor moved to add the debtor partnership’s limited partners and prior and current general partner corporations as judgment debtors. The trial court found that the individuals and corporations were the debtor’s alter egos, but still denied the motion, finding the creditor failed to show an inequitable result. (*Id.* at p. 813.) Reversing, the Court of Appeal held that the trial court erred in requiring the creditor to prove that the individuals acted with wrongful intent. “The law does not require such proof. Relentless was required to prove that the [individuals’] acts caused an “ ‘inequitable result.’ ” [Citation.] Here the [individuals’] intent is beside the point. [¶] . . . Given the trial court’s finding that the

¹⁰ Wrongful intent is present in many alter ego cases, of course. (See, e.g., *Riddle v. Leuschner* (1959) 51 Cal.2d 574, 581–582; *Stark v. Coker* (1942) 20 Cal.2d 839, 847–848.) The question before us, however, is whether an inequitable result will *only* be found when wrongful intent is present.

[entities and individuals] are one and the same, it would be inequitable as a matter of law to preclude Relentless from collecting its judgment by treating Airborne as a separate entity.” (*Id.* at p. 816.)

The Chans argue *Relentless* was wrongly decided. But we believe *Misik* and *Relentless* are consistent with the articulated public policy behind the statutory privilege of the corporate form: “ ‘As the separate personality of the corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted. When it is abused it will be disregarded and the corporation looked at as a collection or association of individuals, so that the corporation will be liable for acts of the stockholders or the stockholders liable for acts done in the name of the corporation.’ [Citation.]” (*Mesler v. Bragg Management Co.*, *supra*, 39 Cal.3d at p. 300.) “ ‘Parties who determine to avail themselves of the right to do business by means of the establishment of a corporate entity must assume the burdens thereof as well as the privileges. . . .’ [Citation.]” (*Shapoff v. Scull* (1990) 222 Cal.App.3d 1457, 1470, italics added, disapproved on another ground by *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 521, fn. 10.)

We agree that when a party seeks the benefits of the corporate form but shirks or ignores the corresponding burdens in a manner that unduly prejudices the interests of third parties, an unjust or inequitable result may be found regardless of wrongful intent.

b. *Was there an Inequitable Result in this Case?*

The trial court ruled that “there would be an inequitable result if the corporate structure was permitted to shield Derrick Chan and Jenny Chan from liability, not simply because the prevailing party in the arbitration wouldn’t be allowed to collect, but because the mismanagement and lack of observation of the corporate formalities appear to be what got [SFBB] into this situation to begin with. . . . [The BCV project] was poorly scheduled, improperly and inadequately managed, and understaffed with . . . insufficiently skilled workers.” The Chans argue this reasoning was flawed.

We agree that SFBB’s insolvency and its mismanagement of the BCV project alone are not a sufficient basis for finding an inequitable result.¹¹ Courts have repeatedly held that “it is not sufficient to merely show that a creditor will remain unsatisfied if the corporate veil is not pierced In almost every instance where a plaintiff has attempted to invoke the doctrine he is an unsatisfied creditor,” so such a rule would undermine the legitimate public policy of limited liability for corporations in the ordinary case. (*Associated Vendors, supra*, 210 Cal.App.2d at p. 842; see also *Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 539; *Leek v. Cooper* (2011) 194 Cal.App.4th 399, 418.) Nor is mismanagement alone a sufficient basis for an inequitable result finding. Again, the purpose of the corporate form is to allow individuals to take commercial risks without facing unlimited personal liability. Such risk legitimately includes the risk of incompetence as long as the corporate form is respected.

The grounds for the court’s inequitable result finding, however, were broader than just insolvency and mismanagement. The court ruled that “the mismanagement *and lack of observation of the corporate formalities* appear to be what got [SFBB] into this situation to begin with.” (Italics added.) We construe this statement as an allusion to the Chans’ shirking of the burdens of the corporate form—specifically, failure to obtain corporate authorization for major financial decisions, commingling of assets, diversion of corporate funds to personal uses, and undercapitalization.

Because this analysis is founded on equitable principles, “ ‘ ‘ ‘the general rule [is] that the conditions under which a corporate entity may be disregarded vary according to the circumstances of each case.’ ” [Citations.] Whether the evidence has established that the corporate veil should be ignored is primarily a question of fact which should not be

¹¹ Because we conclude mismanagement was not a relevant factor, we need not address the Chans’ argument that the trial court improperly took judicial notice of the truth of the arbitrator’s findings of mismanagement, or BCV’s counterargument that the Chans were collaterally estopped from denying the truth of those findings.

disturbed when supported by substantial evidence. [Citation.]’ [Citations.]” (*Toho-Towa Co., Ltd. v. Morgan Creek Productions, Inc.* (2013) 217 Cal.App.4th 1096, 1108.)

Substantial evidence here supports the trial court’s finding of an inequitable result. Undercapitalization and diversion of corporate assets rendered SFBB insolvent and unfairly prejudiced BCV in its ability to satisfy its judgment against SFBB. We have already concluded that the court’s findings of these factors were supported by substantial evidence. Thus, the trial court properly ruled that the Chans were the alter egos of SFBB.

B. *Control of the Litigation*

Having affirmed the trial court’s alter ego ruling, we need only determine whether the trial court correctly ruled that the Chans controlled or were virtually represented at the arbitration¹² such that the judgment confirming the arbitration award can be enforced against them as individuals consistent with due process. (See *Greenspan v. LADT LLC*, *supra*, 191 Cal.App.4th at p. 508.) The Chans argue no evidence was before the trial court that either Jenny or Derrick was present at or controlled the arbitration and that the court improperly relied on an unsupported assertion in BCV’s moving papers. There was evidence, however, that the Chans advanced the majority of attorney fees in the arbitration, and that Derrick personally signed the promissory notes (albeit ostensibly on behalf of SFBB) for the fees advanced by Ko and Tang. Additionally, the Chans never disputed BCV’s assertion in their opposition papers below, nor did they argue that the motion to amend should be denied because they were not virtually represented at the arbitration on the merits of the breach of contract claim. Moreover, in light of the other findings the trial court made about how SFBB was operated, the court reasonably could have inferred that the Chans controlled the arbitration. “There was no showing below, and there is not the slightest suggestion in the briefs of appellants, that anyone, other than [the Chans], had control of the litigation. Who else had authority to employ attorneys and provide for the expense? Who else was interested in the fate of the corporation? If

¹² The trial court’s reference to the Chans’ and SFBB’s legal counsel was apparently in error to the extent it could be construed to state that SFBB was represented at arbitration by the same attorneys who represented the Chans in their motion to amend.

not [the Chans], who else?” (*Schoenberg v. Romike Properties, supra*, 251 Cal.App.2d at p. 168.)

III. DISPOSITION

The trial court’s order amending the judgment to add Jenny and Derrick Chan as judgment debtors is affirmed. The Chans shall pay BCV’s costs on appeal.

Bruiniers, J.

We concur:

Jones, P. J.

Needham, J.