Court Decides A "Division Of The Waters" Does Not Violate The Corporations Code

By Keith Paul Bishop on November 16, 2011

Anyone who is familiar with California knows that water is the key to its agricultural abundance and vast urban spaces. It should be no surprise then that the legislature has devoted significant attention to corporations dedicated to the delivery of water. These are commonly referred to as "mutual water companies". *See* Public Util. Code § 2725. (This post isn't just about mutual water companies, so please keep reading.)

Earlier this week, the Second District Court of Appeal issued an interesting decision involving a mutual water company and the General Corporation Law, De Boni Corp. v. Del Norte Water Co. (Case No. B226767, Nov. 14, 2011). The plaintiff, a shareholder, argued that the corporation's water allocation system violated Corporations Code § 400 which generally provides that classes or series of shares may be issued with rights, preferences, privileges and restrictions as are stated in the articles of incorporation and that all shares of any one class have the same rights, preferences, privileges and restrictions. The Court of Appeal decided that § 400 does not apply because the water company had not elected to be governed by the current General Corporation Law. That is perhaps the least interesting part of the opinion.

The Court of Appeal notes that the water company had been founded in 1910 "as a mutual benefit corporation with 2,500 shares of capital stock". Unfortunately, the Court of Appeal is wrong in several respects. The water company could not have been formed as a mutual benefit corporation because the Nonprofit Mutual Benefit Corporation Law, Corporations Code § 7110 *et seq.* did not take effect until January 1, 1980. Prior to that time, nonprofit corporations were formed under the former General Nonprofit Corporation Law. If the water company were a nonprofit corporation law, the applicable law would not be the General Corporation Law, which is the law that the Court of Appeal applied in the case. Finally, if the water company were a mutual benefit corporation, it would have had *memberships*, not *shares.*

Nonetheless, it is possible to extract out of this confusion an important point. Under current law, water companies may be formed under either the General Corporation Law or the Nonprofit Mutual Benefit Corporation Law. In addition, Corporations Code §§ 14300 – 14303 and 14310 – 14318 set forth a number of specific provisions that are applicable to water companies.

Please contact **Keith Paul Bishop** at Allen Matkins for more information kbishop@allenmatkins.com

I'm also curious about why Corporations Code § 203 was not also raised. That statute provides "Expect as specified in the articles or in any shareholders' agreement, no distinction shall exist between classes or series of shares or the holders thereof."

What are the lessons of *De Boni Corp.*? If you aren't representing a corporation formed before 1978 that hasn't elected to be governed by the General Corporation Law, Section 400 matters (and you will want to consider Section 203 as well). If you are representing a California corporation formed before 1978, you may want to read the transition provisions in Chapter 23 of the General Corporation Law. That will be the case regardless of whether the corporation purports to be a mutual water company. If you do happen to represent a mutual water company, it's a good idea to determine whether it is governed by the General Corporation Law or the Nonprofit Mutual Benefit Corporation Law.

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