

Directors and Officers Training for Ditch Companies

Panel Discussion and Ditch Company Input

Denver, CO

Jan 27, 2010



Corporations

- **History**
- **The Corporation as a Legal “Person”**
 - *Treat it like its own being!*
 - *It can enter into contracts, hold property, sue, be sued, etc.*
 - *When signing, sign on behalf of the corporation.*
 - *Piercing the corporate veil – e.g. creditors going after the directors for debts, need to maintain separateness and be adequately capitalized See Walker Ditch Company case*
- **Characteristics of Corporations**
 - **Limited Liability of Shareholders**
 - **Free Transferability of Shares**
 - **Perpetual Existence**
 - **Centralized Management**
 - **Ability to Raise Capital**

Classifications of Entities In the Water Arena

Profit Corporations

Shareholders are owners

Nonprofit Corporation

**Members are not owners and can't derive
pecuniary gain from the corporation**

**An exception is created for ditch companies
where there are shareholders.**

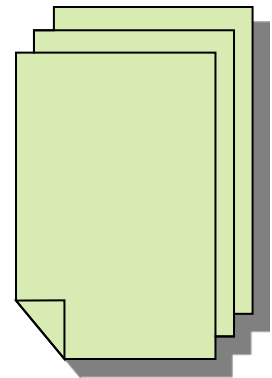
Mutual Ditch Companies

Shareholders are owners

Irrigation Districts

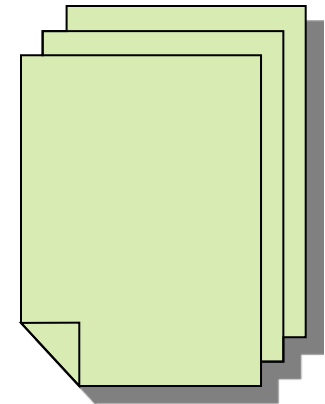
Sources of Corporate Law

- **State Statutes**
 - Title 7 of C.R.S. - Corporations and Associations
- **Common Law**
- **Precedent**
 - A rule of law established in a court decision. Lower courts must follow the precedent established by higher courts.



Ditch Company Corporate Law

- Territorial Legislature
- ***Are you classified as a mutual ditch company or as a nonprofit corporation?***



Nonprofit Corporate Status

- You may elect to accept the statutory requirements of the Nonprofit Corporation Code 7-121-101 to 7-137-301.

Corporate Documents

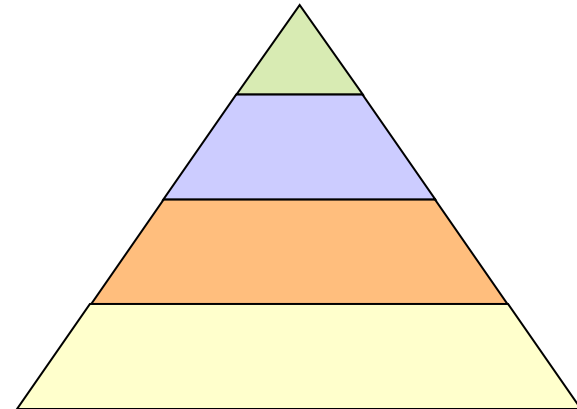
- Articles of Incorporation
 - Filed with the secretary of state. Statutory requirements.
 - Purposes
 - Limitations
- Bylaws
 - Provisions for managing the ditch company
 - Please refer ***to DARCA Bylaws for Ditch Companies Handbook***
- Rules and Regulations
 - How many have them?

Board of Directors

- Elected by Shareholders
- Manage the Company
- Makes the decisions for benefit of the Ditch Company and Stockholders
- Duties of obedience, loyalty, and care.
- Qualifications
 - Stockholder
 - Defined in Articles of Incorporation or Bylaws

Corporate Powers

- **Express Powers**
 - The U.S. Constitution
 - State Constitutions
 - Federal Statutes
 - State Statues
 - Articles of Incorporation
 - Bylaws
 - Resolutions of the Board of Directors
- **Implied Powers**

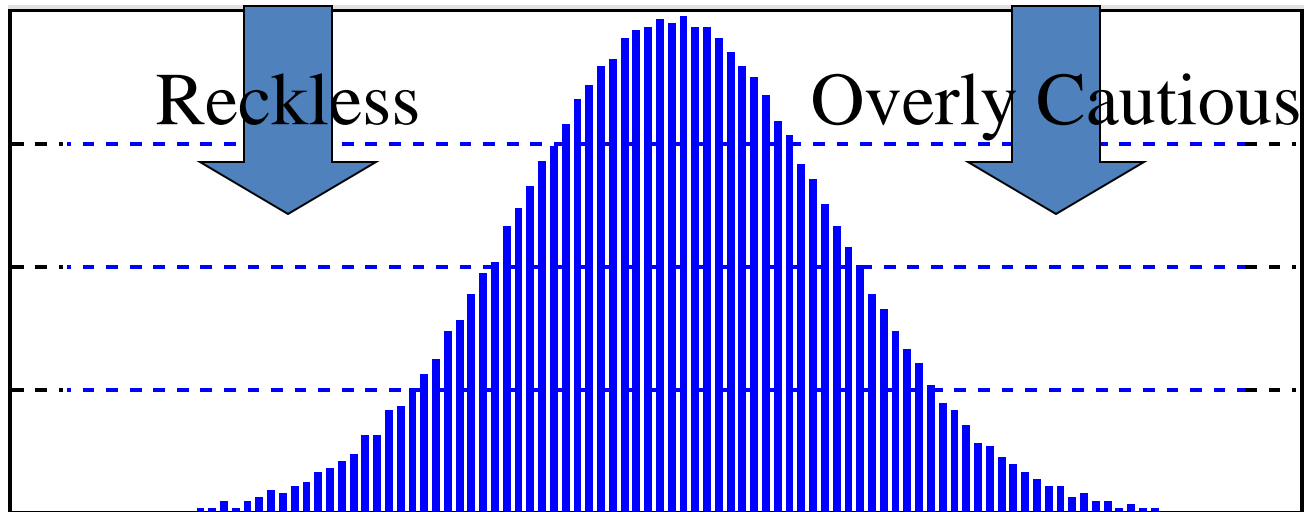


Ultra Vires Acts

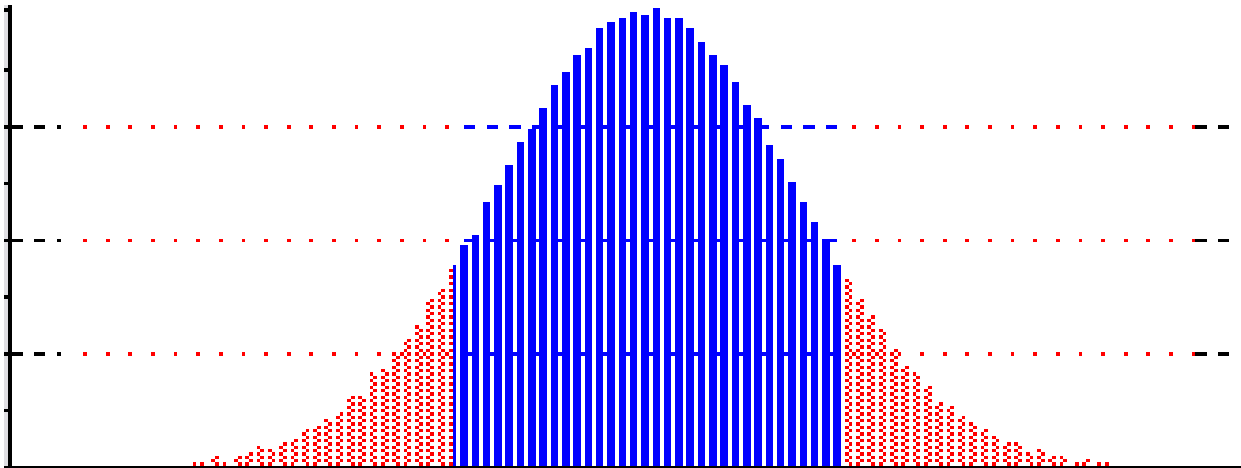
- An act by a corporation that is beyond its express or implied authority.
- Remedy
 - Injunction by a shareholder

How Dutiful Are You?

Duties of obedience, loyalty, and care.



Try to be somewhere in the middle.
You have a Ditch Company to run.



Board of Directors

- Want competent, independent management.
 - Perspective, experience, skills, etc.
- Size of the board
- Frequency of Board Meetings
- Making a Board more effective.
 - DARCA Role

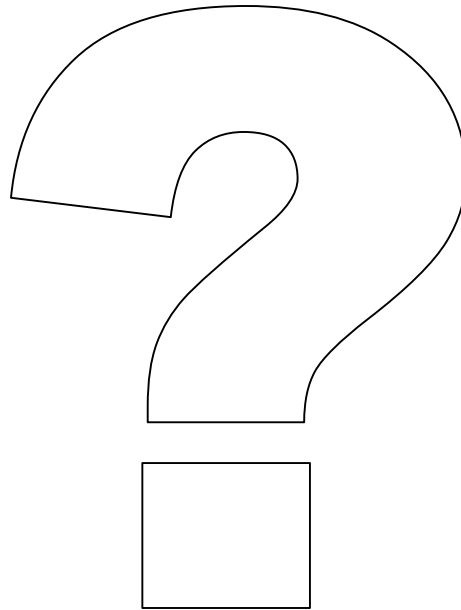
Board of Directors

- Elected by Shareholders
- Manage the Company
- Makes the decisions for benefit of the Ditch Company and Stockholders
- Duties of obedience, loyalty, and care.
- Qualifications
 - Stockholder
 - Defined in Articles of Incorporation or Bylaws

Fiduciary Responsibilities

- Duty of Obedience – must act within their express or implied authority, follow the rules
- Loyalty and Due Care
- Good faith
- Standards of Conduct for Nonprofits
 - 7-128-403 to 7-128-501

What cases are we seeing against Ditch Companies and their Directors?



Duties

- The duties described on the next slides look to general common law and can be used as a guide as to what is acceptable behavior or not.
- First, read the Colorado statute and any Colorado case law.
- Business law textbooks can be good resources.

Duty of Care

- To both the company and the entire body of stockholders - look at the greatest good - balance the interests of the various stockholders. municipal shares v. farmer owned

Duty of Care

- Negligence - but in practice based more on gross negligence
 - Doing something improperly
 - Failing to do something (act of omission)
- Make decisions on “All material information reasonably available”
- Need reasonable knowledge of the business, need to get credible info on issues and understand the consequences

Duty of Care

- Can make mistakes – don't need to find the optimal solution and your decisions may turn out to be a mistake - no standard of infallibility.
- Can rely on the records of the company and reports from any of the officers, employees, or committees
- Need to ask questions, make reasonable inquiries into matters.

Conduct which could be a breach of the Duty of Care

- Hasty Decisions.
 - Some require a quick decision
 - Some do not
- Lack of Preparation
 - Use agendas and advance material for Board Members
- Lack of Asking Questions
- Not a rubber stamp or window dressing
- Need to review and understand decisions

Violation of Due Care

- Business Judgment Rule presumes the BOD is exercising due care
 - Honest mistakes of judgment are not actionable
- Courts don't want to look over their shoulder
- Courts don't want to second guess them
- Want to encourage people to sit on boards and take calculated risks

Business Judgment Rule

- The standard used by courts to determine whether a directors decision is actionable
- Presumption – that directors acted on an informed basis, with due care, loyalty and in good faith
- Burden is on stockholder to rebut some element of the presumption
- If the stockholder can defeat any of the presumptions, the burden shifts to the director that the transaction was “entirely fair”

Duty of Loyalty

- To protect the interests of the Ditch Company and its stockholders, can't deprive the ditch company of an advantage through your role as a director
- Can't act adversely to the interests of the Ditch Company.

Breaches of Loyalty

- Self Dealing
- Usurping a Corporate Opportunity
- Competing with the Corporation

Duty of Loyalty - Self Dealing

- Purchasing, selling, or leasing property with the Ditch Company
 - Must be fair to the Ditch Company
 - Is voidable by the Company unless it has been fully disclosed and approved.

Duty of Loyalty

- Compensation
 - How many Ditch Companies compensate their directors?
 - May fix compensation
 - Must be reasonable in relation to the services provided

Usurping Corporate Opportunities

- Is it in the Ditch Company's line of business and is it of practical advantage to the company?
- Does the Company have an interest or a reasonable expectation in the opportunity – did it come to the director in his fiduciary capacity
- Does the Company have the financial ability to take advantage of the opportunity?
- ***Disclose the opportunity and if the board rejects it, then pursue it.***

Duty of Disclosure

- Need to disclose material information to the stockholder and other board members.
- When stockholders need to vote on a transaction or pursue a remedy, they need to make an informed decision

Some Practical Aspects: Ditch Company Board of Directors

- Water law – How much time do you really spend on water law?
- Real Estate – easements, oil and gas
- Corporate law – procedures
- Contracts
- Employees, subcontractors

Why Are You On The Board?

- Large Shareholder Interests
 - To protect my property rights
 - To keep assessments low
- Self Interest
 - To be involved in decisions that affect me.
- To Keep the Dogs at Bay
 - To Protect the Assets of the Company
- To Enhance the Value of the Company
 - Provide Expertise

Why Are You On The Board

- Ideological Concerns
 - Protect agricultural interests and private property rights
- ...

Is the Board the Problem?

- Pool of Potential Board Members
 - How do you identify the best. Do you want to keep the status quo or power balance.
 - Outside the shareholders. (People with expertise you need)
- Size of Board (3,5,7,9)
 - Consensus, majority, dynamics
- Age of Board Members
- Tenure
 - Term limits

Is the Board the Problem?

- What does the board spend its time on?
 - Do you spend your time on the big ticket items?
 - Do you spend your time planning?
- Is the board or the outside world the problem?
 - Double edge sword – problems and opportunities.
- Does the problem have one or many solutions?
 - Answers to solutions - First a people solution (people based - psychological and sociological), then engineering, finally legal.
- How do you arrive at decisions?
 - System approach, ad hoc.

Is the Board the Problem?

- What do you feel you lack in expertise? What are you not good at? What if you have the expertise, should you delegate it? Being able to recognize that you should seek advice from outside the board.
- Experts (extend to employees)
 - How do you select them? Search? Recommendations? Friends? How do replace them?
 - Telling the client what he needs to know rather than what he wants to hear.

Delegation of Duties To:

- Committees – delegation is limited
- Officers – delegation of management but limited by statute or AOI
- Outside Experts – can rely on them.
 - Attorney
 - Engineer
- Duty of Oversight – No duty to seek wrongdoing which the board has no reason to believe is occurring

Is the Board the Problem?

- Attorney Qualities of your professionals.
 - Water expertise, identification with the water community, value concept of ditch company, explore new ideas, diplomat, business acumen, long range goals, be able to pick fights that you can win.
- Engineer
 - Good listener, and determine what is really needed. Cost effective
- Accountant or Secretary
 - Financial statements

Is the Board the Problem?

- Business Planner (Anticipating and acting – versus - just reacting, looking for emerging opportunities, looking over the hill, taking a fact and converting into a vision)
 - Who is he?
 - What does he do?
- Education, training, knowledge sources.
 - Who is seeking this information?
 - Reaching out, learning from your neighbor.

Is the Board the Problem?

- Leadership
 - What are the qualities?
 - Are you willing to make the hard decisions?
 - Are you willing to explore solutions that may be unconventional, require work, or may not appear to be instantaneous.

Is the Board the Problem?

- Do you have time for reflection?
- Malfeasance, misfeasance, nonfeasance.
- Paralysis of Action
 - Why
 - Fear of the unknown.
 - Exercising the responsibilities of the board.
 - Leadership
- How do you deal with conflict?
 - Pride or psychological roots.
 - Minimal cost
- Dealing with difficult stockholders?
 - Refuses to cooperate
 - Not willing to follow regulations or bylaws.
 - When do you call in the police?

Is the Board the Problem?

- Steps in Conflict Resolution
 - Look at Statutes, Articles, Bylaws
 - Due process
 - Notification
 - Time, place to respond
 - Reality check – have them bring in their own experts
 - The benefit of bringing them to the table.

Protection of Directors and Officers

- Indemnification
 - The Ditch Company may pay for the costs and judgments for a director sued in his corporate capacity.
 - 7-129-101 to 7-129-110
- Directors and Officers Liability Insurance
 - (D&O) insurance
 - Read the policy!
 - What is covered?
 - How and when should you contact your agent and/or insurance carrier?

Thanks for Attending

DARCA

www.darca.org

(970) 412-1960

