

1954

South Cache Water users Association et al v. Stockholders of the South Cache Water Users Association et al : Brief of Appellant

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

SOUTH CACHE WATER USERS ASSO-
CIATION, a corporation,

Plaintiff,

— vs. —

THE STOCKHOLDERS OF THE SOUTH
CACHE WATER USERS ASSOCIA-
TION, a corporation, and THE OWN-
ERS AND MORTGAGEES OF THE
LAND WITHIN THE HYRUM IRRI-
GATION RECLAMATION PROJECT,

Defendants.

— vs. —

HYRUM IRRIGATION COMPANY, a
corporation,

Third Party Plaintiff and Appellant.

— vs. —

WELLSVILLE-MENDON CONSERVA-
TION DISTRICT, a corporation;
WELLSVILLE CITY IRRIGATION
COMPANY, a corporation; and CACHE
VALLEY DEVELOPMENT COM-
PANY, a corporation,

Third Party Defendants.

Case
No. 8137

Appellant's Brief

FILED

MAR 22 1954

CLYDE & MECHAM,

351 South State Street
Salt Lake City, Utah

Clerk, Supreme Court, Utah

INDEX

	Page
STATEMENT OF FACTS.....	3
Facts Offered to Prove that an Equal Assessment is Not Equitable Here.....	11
STATEMENT OF POINTS ON APPEAL.....	23
1. That the court erred in holding that the provisions of the South Cache Water Users Association Articles, requiring an equitable assessment of its stock, does not apply to assessments for the purpose of paying con- struction costs	23
2. The court erred in holding that the various contract documents including Hyrum's subscription contract, its mortgage, and the South Cache Water Users Associa- tion Articles, require Hyrum to pay an equal share of all project construction costs.....	23
3. The court erred in holding that the indebtedness of South Cache Water Users Association could, without the consent of the Hyrum Irrigation Company, be increased beyond the original authorized limitation of \$930,000.00.....	23
4. The court erred in holding that a legal board of directors authorized the making of the amended contract.....	23
5. The court erred in holding that the amended contract had been properly ratified by the stockholders of South Cache Water Users Association.....	23
ARGUMENT	23
(a) The provisions requiring equitable assessments of stock to pay construction costs are matters of contract and can not be circumvented by the directors.....	28
(b) It is not equitable to assess stock equally unless the benefits are equal.....	31
(c) The Board of Directors has no discretion and must follow the mandate of the Articles.....	44
(d) The Court erred in permitting South Cache to increase the indebtedness above \$930,000.00.....	49
(e) The Amendatory contract ought not to be ratified and confirmed by the Court.....	50
(f) The Contract was never approved by a proper Board of Directors and by the Stockholders.....	53

TEXTS CITED

American Jurisprudence, Vol. 13, Corporations.....	28, 29, 31, 44
Corpus Juris Secundum, Vol. 18, Sec. 486.....	44
Fletcher on Corporations, Vol. 13.....	44
Kinney on Irrigation & Water Rights, Vol. 3, Sec. 1286.....	5

INDEX—(Continued)

STATUTES CITED	Page
Section 73-5-1, U.C.A., 1953.....	32, 34

CASES CITED	
Bacon v. Gunnison Fayette Canal Company, 75 Utah 278, 284 Pac. 1004	32, 33, 34
Bacon v. Plain City Irrigation Co., 87 Utah 564, 52 P. (2d) 427.....	34
Beecher v. Pehastin Irrigation District, et al., 234 Pac. 4.....	39
Boston Acme Mines v. Clawson, 66 Utah 103, 240 Pac. 165.....	54
Charles Dewey, Inspector of Finance v. the St. Albans Trust Co., 57 Vt. 332.....	45
Cheney v. Canfield, 158 Cal. 342, 111 Pac. 92.....	46
Child v. Idaho Herver Mines, 155 Wash. 280, 284 Pac. 80.....	31
Clark v. Oceano Beach Resort Company, 289 Pac. 946.....	46
Enterprise Ditch Co. v. Moffet, 45 L.R.A. 647.....	30
Forsyth v. Selma Mines Company, 58 Ut. 142, 197 Pac. 586.....	47
Garry v. St. Joe Mining Co., 32 Utah 497, 91 Pac. 369, 12 L.R.A. (N.S.) 554	30
Great Falls and Conway Railroad v. Copp, 38 N.H. 124.....	45
Harris, et al. v. Northern Blue Grass Land Co., 185 Fed. 192.....	47
McLean, et al. v. Truckee-Carson Irrigation District, 245 Pac. 285	40, 42
Nampa & Meridian Irrigation District v. Petrie, et al., 223 Pac. 531	37, 41
Payette-Oregon Slope Irrigation District v. Coughanour, et al., 162 Ore. 458, 91 Pac. (2d) 526.....	37, 47, 48
Raht v. Sevier Mining Company, 18 Utah 290, 54 Pac. 889.....	46
Raish v. M. K. & T. Oil Company, 7 Cal. App. 667, 95 Pac. 662.....	46
Ruck v. Caledonia Silver Mining Company, Cal. App. 1907, 92 Pac. 194.....	46
Richmond v. Utah Power & Light Co., 115 Utah 352, 204 P. (2d) 818	12, 19, 35, 36
Schwab v. Frisco Mining & Mill Company, 60 Pac. 940.....	46, 53
Seattle Trust Co., v. Pitner, 51 Pac. 1048.....	31
Singer v. Salt Lake City Copper Manufacturing Company, 17 Utah 143, 53 Pac. 1024.....	54
Stanislaus County v. San Joaquin & K. River Canal & Irrigation Company, 192 U.S. 201, 48 L.Ed. 406, 24 S.Ct. 241.....	30
Wall v. Basin Mining Co., 16 Utah 313, 101 Pac. 733, 2 A.L.R. (N.S.) 1013	30
Wellsville East Field Irrigation Co. v. Lindsay Land & Livestock Company, 104 Utah 448, 137 P. (2d) 634.....	19
Western Imp. Co. v. Des Moines Natl. Bank, 103 Iowa 455, 72 N.W. 657	19

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Case
No. 8137

Appellant's Brief

On October 9, 1953, South Cache Water Users Association entered into a contract with the United States of America for the construction of a water reclamation project known as the Hyrum Project. Since the comple-

tion of the Hyrum Project, South Cache Water Users Association has assessed its stockholders annually in an amount sufficient to repay to the Government the \$955,900.00 construction costs and to defray the expenses of operation and maintenance. Hyrum contends that South Cache is incorrectly assessing its stock. Hyrum's contention is that the stock should be assessed "equitably". South Cache is assessing the stock "equally" and contends that an equal assessment is equitable. The trial court so held, and Hyrum appealed. Hyrum Irrigation Company, the appellant here, is one of the stockholders of South Cache owning about one-third of all outstanding stock. The respondents are South Cache and its remaining stockholders.

On May 24, 1950, South Cache entered into an amendatory contract with the United States. It filed this suit against all of its stockholders to have the District Court adjudge and decree that the amendatory contract was valid and binding on South Cache and its stockholders. Hyrum contended that the amendatory contract had not been properly adopted by South Cache, nor ratified by its stockholders, as required by its Articles. Hyrum also filed a counterclaim against South Cache and all of its stockholders. In the counterclaim Hyrum contended that South Cache was not properly assessing its stock and asked the court to so adjudge. This primarily involved the construction of Article XI of South Cache's Articles, which provides in part that assessments against the outstanding shares of stock for the raising of revenues "shall be *equitably*, but need not be

equally, assessed.” It is not contraverted that South Cache has been assessing its shares *equally*. Hyrum contended in its counterclaim that under the facts of this case it was not “equitable” to assess the stock “equally”. The court held that the stock had to be equitably assessed for any future construction costs, and for operation and maintenance, but that by reason of the contract documents signed by Hyrum back in the 1930’s, Hyrum had agreed that it should be equally assessed for paying the initial construction costs.

Hyrum has appealed both from the holding on the assessment of the stock and from the order of the court adjudging that the amendatory contract is binding on South Cache and its stockholders.

STATEMENT OF FACTS

South Cache Water Users Association was organized September 30, 1933, by nine individuals, who took one share of stock each, (R. 161, Ex. A). The total number of shares of stock authorized was 14,000 shares, (R. 162, Ex. A). But only the initial nine shares were issued at that time.

Prior to entering into any stock subscription contracts, South Cache Water Users Association entered into a contract with the United States of America, for the construction of the Hyrum Project. This contract is dated October 9, 1933. Under that contract the Government limited its obligation to advance funds to a sum

not exceeding \$930,000.00, and insofar as said sum would permit agreed (a) to build the Hyrum Reservoir, (b) to build the Wellsville Canal and Pumping Plant, (c) to build the Hyrum-Mendon Canal, and (d) to build the Hyrum Feeder Canal, (R. 165, Ex. B). It was contemplated that the Hyrum Reservoir would have storage capacity of 14,000 acre feet, and that 14,000 shares of stock of South Cache would be sold. In addition the Hyrum Project owned various direct flow water rights, which will be more specifically defined below, (Ex. B). In the contract with the United States, South Cache agreed to pay as the construction charge the actual cost of the project, as determined by the Secretary of the Interior, but not to exceed \$930,000.00, (Ex. B). This was later increased to \$955,930.00, (Ex. F). The contract also provided that the Association would "cause to be made and collected all necessary assessments, including assessments to make up for the defaults for those who do not pay construction or other charges to the United States * * *", and to use all powers of the Association to levy and collect assessments against its shares of stock, to collect and pay to the United States the sums provided for by the contract, (R. 165, Ex. B).

Thereafter subscription contracts were made with Hyrum Irrigation Company (under the terms of which Hyrum agreed to purchase 3300 shares of stock) (R. 165, Ex. C) with Wellsville-Mendon Irrigation Company, (under the terms of which that company agreed to purchase 6125 shares of stock) and two separate contracts

with Wellsville City Irrigation Company, which agreed to purchase a total of 1700 shares of stock, (R. 237).

It is obvious from the wording of the various subscription contracts that it was not known exactly what the cost of the project would be, nor was it known whether the 14,000 shares of authorized stock of South Cache could be sold, (Ex. C, par. 11).

The project, of course, was a reclamation project. From the very beginning of the Reclamation Act of June 17, 1902, 32 Stat. L. page 388, the Reclamation Act has provided:

“That upon the determination by the Secretary of the Interior that any irrigation project is practicable, he may cause to be let contracts for the construction of the same * * * and thereafter he (the Secretary) shall give notice * * * of the charges which shall be made * * * and the number of annual installments, not exceeding ten, in which such charges shall be paid and the time when such payments shall commence. The said charges shall be determined with a view of returning to the reclamation fund the estimated cost of construction of the project, and *shall be apportioned equitably.*”

The Reclamation Act has been amended on numerous occasions, but the provision requiring that the costs of construction “be apportioned equitably” has always appeared in the law. It now is Section 461, Title 43, U.S.C.A. In “Kinney on Irrigation and Water Rights”, Vol. 3, Section 1286, there is set forth the standard forms of Articles of Incorporation, by-laws and sub-

scription contracts used by water users associations and the Government in the building of such projects. It is stated:

“everything in connection with the organization of these associations must be in accordance with the government’s method, as approved by the Secretary of the Interior, or not at all.”

The Articles of South Cache were introduced in evidence, (Ex. A). On page 8 of those Articles in Article XV, the manner of paying for the stock which would be sold is outlined. It is provided that:

“At the time such shares of stock are sold to the subscriber therefor, such subscriber shall be required to pay an assessment of fifty cents per share, and annually on or before the first day of February of each year, the board of directors shall prepare a budget covering the estimated cost of operation, maintenance, *construction work, payments due on contracts* or bond, and any other expense or *costs* for the ensuing year and shall apportion the estimate so prepared by an assessment or assessments *equitably, but not necessarily equally*, against each share of stock outstanding.”

It was also provided in Article XI of the South Cache Articles that revenues for the payment of “*construction costs*” should be raised from the assessment of stock and that stock “shall” be “equitably”, but need not be “equally” assessed. In this regard Article XI provides:

“Revenues for the accomplishment of the purposes of this corporation shall be raised:

“(a) From income arising from the carriage, rental or delivery of water for irrigation or other purposes or from the sale, rental, lease, or furnishing otherwise of electric or other power, or power privileges, or from any other lawful operations of the corporation.

“(b) From assessments against the shares of stock of the corporation so far as they may be from time to time necessary to meet:

“1. *The cost of construction, improvement, enlargement, betterment, repairs, operation and maintenance of the irrigation and other works of the corporation, or of those managed, controlled, operated or maintained by it.*

“2. *Payments due the United States under any contract or contracts between the United States and the corporation, or payments under any contract between the United States and other parties which are assumed or guaranteed by the corporation.*

“3. Deficiencies caused by the failure of some of the shareholders of the corporation to pay assessments upon their share of stock.

“4. Any and all lawful obligations of the corporation.

“(c) *Assessments against the outstanding shares of stock for the raising of revenues, as aforesaid, shall be equitably but need not be equally assessed.*

“This provision for equitable but unequal assessments is to take care of situations where expenditures are made or are necessary for purposes that are of benefit to a part only of the stockholders, or where existing or future contracts with the United States or the laws or regu-

lations of the United States now or hereafter require unequal assessments, or where unequal assessments are required or permitted by the terms or conditions of any contract between the corporation and any stockholder.”

It is important to note that the Articles were drafted and filed prior to the time Hyrum subscribed for any stock. The Articles were filed on the 30th day of September, 1933, (Ex. A), and the subscription contract with Hyrum was signed January 5, 1934, (Ex. C). Hyrum thus subscribed for its stock, knowing that the provisions set forth above were a part of South Cache’s Articles; that it would be required to pay 50 cents per share at the time of its stock subscription and that thereafter all of the revenues for the company necessary for paying all operation, maintenance and construction costs and payments to the Government and all other expenses would be paid from the annual stock assessments, which would be “equitably but not necessarily equally assessed.” The court’s attention is directed to the use of the word “shall” in reference to the making of assessments. The court’s attention is also directed to the fact that both in Article XV and in Article XI the language expressly provides for the making of equitable assessments to pay (1) *the cost of construction*, and (2) *the payment on the contracts with the United States*. Article XI even explains why the provisions for unequal assessments are made, and says that it is to provide for situations where expenditures are made for purposes that are of benefit to a part only of the stockholders. These matters are of importance, because of Hyrum’s contention that these

Articles required that South Cache make equitable assessments to pay the construction costs of the Hyrum Project. The trial court ruled that these provisions did not apply to original construction costs, but only to future construction costs. It also ruled that the provision did not apply to assessments for the purpose of making payments to the Government, (R. 109).

One other provision of the contract documents is important in the Statement of Facts. We believe that it is this provision upon which the court based its ruling that South Cache was to make equal assessments to pay for the original Hyrum construction project. The provision in question is contained in the Hyrum contract, (Ex. C).

The eighth “whereas” clause recites that:

“The Association will levy assessments upon its stock from time to time for the purposes of raising funds with which to meet installments due the United States under said Association-Government contract, and to raise funds for other expenses and charges of said Association.”

The contract further provides in paragraph 10 that Hyrum will pay to South Cache the full purchase price of Hyrum’s share of stock and “*any and all assessments assessed * * * as may be necessary to enable the Association to pay in full when due the Association’s indebtedness to the United States under said Association-Government contract. Assessments levied by the com-*

pany hereunder shall conform to the requirements of the federal reclamation laws now or hereafter enacted."

The contract then provides (and this is the clause which we believe the respondents rely upon), that:

*"The company shall pay for the benefit of the United States, as the purchase price of the shares of stock in the Association herein subscribed for, that portion of the total sums and charges required to be paid by the Association to the United States under said Association-Government contract, that the number of shares of the Association stock subscribed for by the company shall bear to the total number of shares of such stock outstanding and assessable at the time the construction of the works described in Article II hereof is authorized by the Secretary, unless permitted by the secretary to use a different number of shares as the basis of computation. * * *"*

We construe this language, as our argument will develop, to be a provision for the benefit of the United States, so that the United States would be assured that the construction costs would be repaid. We, therefore, italicized in the quote the language "for the benefit of the United States". But it is our contention that as between the stockholders themselves, the other provisions of the subscription contract and Article XI and XV of South Cache Articles of Incorporation, contemplate and expressly provide that these repayments to the Government will be made from an equitable assessment of the stock. This is the primary issue for determination on this appeal. If we are right in this conten-

tion, then we respectfully submit that under the facts of this case it is not equitable to assess Hyrum equally. The evidence which was introduced primarily related to the benefits which each of the parties received from the project, as the same related to this issue.

FACTS OFFERED TO PROVE THAT AN EQUAL ASSESSMENT IS NOT EQUITABLE HERE

The facts which support our contention that it is not equitable to assess Hyrum on an equal basis with the other stockholders are as follows: First, the entire project construction costs totalled \$955,930.00. Exhibit F shows the breakdown of this cost. In round figures, this Exhibit discloses that \$733,000.00 was expended for the impounding dam and \$222,000.00 for canals. It is not disputed that the two main canals which were constructed with the approximately \$210,000.00 were not to any extent constructed for the benefit or use of Hyrum. Hyrum does not and can not use them, (R. 228, 236). They were built entirely for the purpose of furnishing water to new lands which had not theretofore been irrigated. The three canals which were constructed were the Hyrum-Mendon Canal at a cost of \$139,000.00; the Hyrum Feeder Canal (which is used by Hyrum) at a cost of \$13,000.00; the Wellsville Canal and pumping plant, at a cost of \$58,000.00, and the diversion works costing \$11,900.00, (Exhibit F). The only one of these facilities which Hyrum can use is the \$13,000.00 feeder canal.

This court may know from its previous decisions relative to the Little Bear River what the physical conditions are. See *Richmond v. Utah Power & Light Co.*, 115 Utah 352, 204 P. (2d) 818. Hyrum is located upstream from Hyrum Reservoir, (Ex. H). It gets its water from a canal known as the Avon Canal. This Avon Canal diverts at a point several miles upstream from the reservoir and water is applied to the Hyrum Bench, all of which is at a higher elevation than the reservoir, (R. 246). Hyrum's Avon Canal was constructed in 1860 at Hyrum's sole expense. Under the Kimball Decree, which is introduced in evidence as Exhibit J, page 55, Hyrum owns 63 c.f.s. of water with priority dates all many years earlier than any of the Hyrum Project filings. Hyrum, therefore, did not need any canal, and no canal was constructed for Hyrum's benefit, except the \$13,000.00 Feeder Canal which diverts below the reservoir, (R. 228, 301), (Ex. K).

On the other hand, the Wellsville Pumping Plant and the Hyrum-Mendon Canal were both new canals to irrigate new lands which had never been under irrigation prior to the Hyrum Project. Therefore, nearly \$210,000 of the \$955,930 was spent for the construction of canals which were exclusively for the benefit of part only of the stockholders. Since Hyrum has subscribed for nearly one-third of the South Cache stock, it is presently paying nearly one-third of the construction cost of the canals which were constructed exclusively for the other stockholders. It has already paid for its own canal. It is, therefore, Hyrum's contention that it is not equitable

to assess the stock equally, and make it pay for one-third of the cost of the private canals of the other stockholders. An equitable assessment would require the stockholders who use those canals to pay for them.

A second basis of inequality concerns the use of project direct flow water. As is recited in the Government contract with South Cache, the project owned enough water to store 14,000 acre feet of water in the Hyrum Reservoir and in addition has 280 c.f.s. of water, which it can use by direct flow, (Ex. B, page 32). The lands under the Hyrum-Mendon Canal and the lands under the Wellsville Pumping Plant (constructed at a cost of \$210,000.00 for exclusive use of part only of the stockholders) could never have used the flood waters of Little Bear River until after the Hyrum Project, (R. 238), (Ex. O). By reason of the construction of their canals and of the pumping plant, and of the reservoir, the water is at an elevation and the facilities exist, so that these stockholders can now use the direct flow water, (R. 238-239, Ex. K).

In other words, before the Hyrum project, the lands now irrigated by the flood waters of Little Bear River under these two new canals, could not be irrigated at all, (R. 319, 320, 321, 182). On the other hand, Hyrum had a canal at Avon capable of taking over 60 c.f.s. of water, (R. 300-301). Hyrum has decreed water rights adequate to completely fill its canal and irrigate its lands whenever there is sufficient water in Little Bear River to permit the Hyrum project to take water either for

storage or by direct flow. Hyrum's priorities are all earlier priorities than any of the rights in the Hyrum Project. If the project is able, either to store water or to use any direct flow water under its 1928 filings, Hyrum's water rights, which it owned long before (as early as 1860) the project was ever constructed, were sufficient to fill its canal, (R. 306). The net result is that the other stockholders of South Cache, by reason of the construction of the Hyrum Project and its water filings, are able to use and do use large quantities of direct flow water. These stockholders utilize both their project storage water and in the Spring they take large quantities of flood water, (R. 320). It was stipulated that Hyrum did not use project direct flow water, except a very small quantity through the Hyrum Feeder Canal, which is below the reservoir, (R. 305-306, Ex. K) and even this canal can be substantially filled with Hyrum's early priority water.

It is not disputed that these other stockholders do get large quantities of these direct flow project waters and Hyrum does not. It is likewise not disputed that in the making of assessments these direct flow waters have never been required to bear any portion of the construction cost of the Hyrum Project or even of operation and maintenance costs. It is Hyrum's contention that the assessments made for the purpose of repaying the Government the construction costs should take into consideration this direct flow water and make the users of it pay some portion of construction costs.

Third, Hyrum contends that it is not able to get and does not get its storage water. This, we think, is the least important of all of our arguments, although more time was spent on it in the evidence because of the difficulties of proof.

Hyrum is admittedly benefited to some extent from the construction of the Hyrum Dam. The water which accumulates under its 3300 shares of stock is stored in the dam, and is exchanged to Wellsville East Field Irrigation Company for that company's direct flow water, to the extent that it can be captured at Avon. The exchange works this way—Wellsville, under the Kimball Decree, Ex. J, has a priority of April 1860, for 30 c.f.s. of water, (see page 55 of said exhibit). Hyrum has 3 c.f.s. with the same priority, (see page 56 of said exhibit). Hyrum's big water rights carry a priority one month later, to wit, May 1, 1860, (see page 56 of said exhibit). Thus, whenever the river at Wellsville's point of diversion, which is below the Hyrum Dam, is 30 c.f.s. or less, Hyrum would be required to let sufficient water pass its diversion point at Avon to yield Wellsville's water at Wellsville's diversion. By reason of its stock subscription, it can store water in the Hyrum reservoir. When the river drops below 30 c.f.s. at the head of the Wellsville canal, Hyrum still takes all the water at Avon and releases the storage water to Wellsville. Therefore, Hyrum does get some benefits from the reservoir and has been and is willing to pay for those benefits, but it does not benefit from the canals, constructed exclusively

for the other stockholders at a cost of \$210,000.00, and it should not be required to pay for them.

Still, under any view of the evidence, it is clear that Hyrum does not get its 3300 acre feet of water, simply because the river will not yield 3300 acre feet of Wellsville's water at the mouth of Hyrum's Avon canal. In other words, the only water which Hyrum can take from the storage project is the amount it needs to release to Wellsville to make up for Wellsville's water which Hyrum takes in Hyrum's Avon canal, (R. 301, 319, 350). A small quantity of water can be taken in the Hyrum Feeder Canal, which is located downstream from the reservoir, but Hyrum in that vicinity has a water right for 3 c.f.s. of water with a priority equal to that of Wellsville, (April 1, 1860, Ex. J). The canal is not large. The lands under it do not consist of much acreage and the quantity of project water actually taken into the feeder canal is always small. It was basically intended that Hyrum would benefit from the Hyrum reservoir simply by reason of its exchanges with Wellsville. But, whenever the river is yielding at Wellsville's point of diversion its 30 c.f.s. of water, Hyrum is entitled to take under its own priorities all the water in the river at Avon. It is only when Wellsville is not able to get its water that Hyrum would be required to let any water pass its canal, or in lieu thereof to release reservoir water.

It should be noted that there are great quantities of inflow into Little Bear River below Hyrum's canal, but

above the Wellsville Canal. Even though Hyrum maintains a tight dam at Avon, there will often be sufficient accumulations in the river below to give Wellsville all of the water to which it is entitled, (R. 146, 206-212). At the few times in the season when the river flow recedes to a flow so low as to permit Wellsville to make Hyrum let some water pass its Avon Canal, the river is so low at Avon that Hyrum can not get 3300 acre feet of Wellsville's water at that point. Therefore, Hyrum was "sold a bill of goods" and does not get its 3300 acre feet. In other words, when the river flow is high, Wellsville can and does get its 30 c.f.s. from tributaries below Avon. When the river is low, part of the water at Avon belongs to Wellsville. Hyrum takes it and releases water to Wellsville from the reservoir. But when the river is low, the flow at Avon is also low and Hyrum cannot get 3300 acre feet of Wellsville's water at that point.

Exhibit K, and Exhibit 9, which were prepared by the River Commissioners, show that on a ten year average Hyrum does not get its water. This is the Exhibit upon which the respondents relied, (R. 279-280, 310). Even accepting this chart at its face value, Hyrum year in and year out can not get its water. Worse still, we conclusively proved that the chart is erroneous. The chart is made up from readings of an automatic measuring device at Hyrum's Avon Canal and a similar device at a station known as the Paradise station in the Little Bear River. The total flow of the river is assumed by the chart to be the amount of water in the Hyrum Canal, plus the amount of water at the Paradise station. If

Hyrum is taking 10 c.f.s. of water in its canal at Avon, and the river at the Paradise station below Avon shows accumulations of another 15 c.f.s., the water available for distribution to Wellsville is assumed by the chart to be 25 c.f.s., (R. 204-210). Hyrum would thus need to release 10 c.f.s. to give Wellsville the 25 c.f.s. The error comes from the fact that the Paradise station is considerably upstream from Wellsville's canal. There are great quantities of water reaching the river below the Paradise station, but above the Wellsville Canal. These quantities were measured during the entire irrigation season of 1953 by the River Commissioner. His measurements show an average inflow below the Paradise station of 15 c.f.s., (Ex. L). These flows were also observed by Engineer David I. Gardner who estimated the flow to be above 10 c.f.s. Therefore, if to the flow of the river at Paradise, as shown in the River Commissioner's Reports (Ex. K), which are in evidence, there is added the 10 to 15 c.f.s. of water which accumulates below the Paradise station, (which obviously must be added because they are available to Wellsville), there is seldom a year when Hyrum can use as much as 1,000 of its 3300 acre feet of water. Mr. Gardner recomputed year by year the correct amount of reservoir water which Hyrum released to Wellsville from the reservoir, and this delivery is shown by Exhibit M, (R. 205-212). It is far below the 3300 acre feet.

There is also evidence from witnesses back over the years to the effect that even before the Hyrum Reservoir, Hyrum Irrigation Company was able to and did main-

tain a tight dam at Avon, (R. 201). Such had always been pretty much the contention of the parties, as can be seen from arguments of these parties in the earlier cases where this particular issue (use of storage water) was not before the court. See, for example, *Wellsville East Field Irrigation Company v. Lindsay Land & Livestock*, 104 Utah 448, 137 P. 2d 634; *Richmond Irrigation Company v. Utah Power & Light*, 115 Utah 352, 204 P. 2d 818. In this latter case there is a map of the system which shows the Hyrum-Avon Canal, the Hyrum Dam and Reservoir and the Hyrum-Mendon, etc. canals. This map is shown on page 362 of the Utah reports, and is substantially the same as Ex. H. An official of Wellsville said that occasionally his company had to go upstream in low water and take the water from Hyrum. But during most of the time before the Hyrum project Hyrum maintained a tight dam in Little Bear River at Avon and accumulations below Avon were sufficient to supply the 30 c.f.s of water for Wellsville, (R. 201, 202, 179, 182, 183, Ex. L). The River Commissioner for 1952 and 1953 admitted that the charts which are contained in his Commissioner's Report are erroneous, because they ignore inflows below Paradise, but he nevertheless continued to make similar computations, because previous water commissioners had done likewise, (R. 186, 187, 192). It is clear that when these inflows below the Paradise station are added to the flow of the river (as they must be to get the river's total flow), it then becomes obvious that during most of the time Hyrum is entitled to take all of the water at Avon under its own rights. There is

little water at Avon belonging to Wellsville—only a fraction of the 3300 acre feet of storage Hyrum has in the Hyrum Dam, (R. 182, 186, Ex. K).

In contrast with this it is clear that Wellsville-Mendon is getting all of its storage water year in and year out, and in addition is getting its flood water, and in addition is utilizing part of the unsold storage water. Reference to Exhibit 9 shows the water taken from storage by the Wellsville-Mendon Conservation District and Wellsville City. Wellsville-Mendon subscribed 6125 shares of stock, (R. 165, Ex. C), and Wellsville City Irrigation Company subscribed 1700 shares, (R. 237). Combined, this would entitle these two organizations to divert 7825 acre feet of water from storage. There is no argument concerning the accuracy of the measurements of water used by these two companies, because their total water is diverted from the reservoir direct into their canals, and there are no variables, such as in the case of Hyrum. During several of the years these two stockholders used more than the 7825 acre feet. For example, in 1937, they used 8482 acre feet; in 1938 8393 acre feet; in 1939 8349 acre feet; in 1940 8621 acre feet; in 1941 8557 acre feet; in 1942 8210 acre feet.

Also during all of the years Wellsville-Mendon and Wellsville City Irrigation Company utilized very substantial quantities of direct flow waters. In the years from 1937 through 1942, there was not a single year when these companies used a total of less than 9200 acre feet against their stock ownership of 7825 shares.

This over use is, of course, possible because of two things. First, direct flow waters are available to them and are extensively used; and secondly, there is 2800 acre feet of water stock in Hyrum Reservoir which was nevtr sold, (R. 237-38). The contract documents provide that in the event some of the stock is not sold, the other stockholders will pay their proportionate share of the reservoir cost pro-rated against the outstanding stock, (Ex. C, page 50). Thus, Hyrum is in effect carrying one-third of this 2800 acre feet of unsold water stock. If Hyrum used its full 3300 shares (which it doesn't), and Wellsville-Mendon and Wellsville City used only their 7825 shares, there would still be this 2800 acre feet of unused water in storage. With Hyrum consistently using less than its 3300 acre feet, there are very considerable quantities of unused water in the reservoir. Since year in and year out the reservoir will fill from the flood waters, no one is concerned about carryover storage problems, and Wellsville-Mendon and Wellsville City can and do utilize more water from storage than their stock would entitle them to use. They pay nothing extra for this excess use and, of course, would have little interest in attempting to sell the 2800 shares of unsold stock.

Because Wellsville-Mendon owns more than 50 per cent of all outstanding stock, it is in complete control of the affairs of South Cache. With the 2800 acre feet of unsold water there is always a reserve which will permit Wellsville-Mendon and Wellsville City to utilize all of the water their stock would entitle them to use and

all the additional water they have any conceivable need for. They add to this nearly 2,000 acre feet of water which they use every year by direct flow, (Ex. 9) and then set up the assessment so that Hyrum pays one-third of all operation and maintenance charges, one-third of the cost of construction, including the construction of these companies' canals and pumping plant, and one-third of the unsold stock.

Hyrum, therefore, has contended that it is inequitable to assess it on an equal basis with these other companies. First, because it is inequitable to require Hyrum to pay any portion of the \$210,000.00 cost of building Wellsville-Mendon's and Wellsville City's canals and pumping plants. Second, that these other stockholders who use great quantities of direct flow water and who also use part of the 2800 acre feet of unsold water should be required to pay some portion of the project costs based on that use. The project made the direct flow water available to them and they have no right to utilize the 2800 acre feet of unsold water without paying for it. Neither should they be permitted to have a free ride. Third, Hyrum does not get the water for which it subscribes. This latter argument admittedly has its weakness, because Hyrum did subscribe for 3300 shares. However, the Articles do provide for equitable assessment of the stock, and the Reclamation Law contemplated that reclamation costs would be equitably apportioned. We think this third factor should be given some consideration.

STATEMENT OF POINTS ON APPEAL

1. That the court erred in holding that the provisions of the South Cache Water Users Association Articles, requiring an equitable assessment of its stock, does not apply to assessments for the purpose of paying construction costs.

2. The court erred in holding that the various contract documents, including Hyrum's subscription contract, its mortgage, and the South Cache Water Users Association Articles, require Hyrum to pay an equal share of all project construction costs.

3. The court erred in holding that the indebtedness of South Cache Water Users Association could, without the consent of the Hyrum Irrigation Company, be increased beyond the original authorized limitation of \$930,000.00.

4. The court erred in holding that a legal board of directors authorized the making of the amended contract.

5. The court erred in holding that the amended contract had been properly ratified by the stockholders of South Cache Water Users Association.

ARGUMENT

When this matter was submitted on detailed written memoranda, the trial judge at first ruled that the Articles of South Cache required that the stock be equitably assessed. He announced his decision from the bench

several months after the trial and said at page 339 of the Record:

“* * * I’ll declare that it is the duty of the Board of Directors in assessing outstanding shares of stock for the raising of revenues to equitably make the assessment, but the court declines to go any further.”

Thereafter in the proceeding to settle the Findings, the court changed its position, and ruled that for “future” construction costs and on all maintenance and operation costs, the stock had to be equitably assessed, but that the provisions did not relate to payment of the initial cost.

In opening our Argument, we state that the line drawn by the court is one which we think is clearly erroneous. Article XI and Article XV of the South Cache Articles both expressly provide that assessments are to be made for the purpose of paying for construction costs and making payments on the Government contract. The only Government contract then existent was the one for the original construction. We have quoted Article IX in full herein. We repeat it here in part for emphasis. Article IX says:

“Revenues for the accomplishment of the purposes of this corporation shall be raised * * * (b) from assessment of the shares of stock of the corporation, insofar as they may be from time to time necessary to meet (1) the cost of construction * * * (2) payments due to the United States under any contract * * * deficiencies caused by failure of some of the shareholders of the corporation to pay assessments upon their stock.”

Article IX then expressly goes on to provide that assessments against the outstanding shares for the raising of revenues “as aforesaid” shall be equitably but need not be equally assessed. The reason for the unequal assessment is given. The Article says that this provision “for equitable but unequal assessments is to take care of situations where expenditures are made or are necessary for purposes that are of benefit to a part only of the stockholders.”

Article XV is equally as explicit. In about the third paragraph thereof, it says that stockholders at the time of the subscription shall pay 50 cents per share and annually thereafter the Board of Directors shall make an assessment. This Article says that the Board “shall prepare a budget covering the estimated cost of operation, maintenance, construction work, payments due on contracts * * * and shall apportion the estimate so prepared by an assessment or assessments equitably but not necessarily equally, against each share of stock outstanding.”

It is thus, respectfully submitted that the Articles expressly provide that the construction costs and payments to the United States on the contract will be raised by the assessment of the stock and that the assessment shall be made on an equitable rather than an equal basis. Hyrum signed its subscription contract, knowing of this provision. It was required by Article XV to pay only 50 cents a share for its stock and all of the other revenues of the company and all other payments for the

stock were to be made by an assessment on an equitable basis.

Every stock subscription contract and every mortgage has so recited. In the stock subscription contract of Hyrum Irrigation Company (Ex. C), it is expressly recited in the second "whereas" clause that South Cache was organized for the purpose of contracting with the United States for the construction of the Hyrum Project. In the third "whereas" clause, it is recited that South Cache has entered into a contract with the United States for the construction of the Hyrum Project and that the contract is identified as "the Association-Government Contract". Then in the eighth "whereas" clause, it is expressly recited: "The Association will levy assessments upon its stock from time to time for the purpose of raising funds with which to meet installments due the United States under said Association-Government Contract". Thus, in the Hyrum Subscription contract, it is expressly recited that assessments will be levied for the purpose of paying the installments due on the Government-Association contract.

Reference is also made to Exhibit D, which is the mortgage given by Hyrum Irrigation Company. Here again it is recited in the second "whereas" clause that the Association was organized for the purpose of contracting with the Government for the construction of the Hyrum Project. In the third "whereas" clause, it is recited that the Association has entered into a contract for that construction, and that the contract is known as

the Association-Government contract. In the fourth “whereas” clause, it is recited that Hyrum has subscribed 3300 shares of stock in the Association and “is now the owner of * * * 3300 shares of stock”, and then in the tenth “whereas” clause, it is recited that the Association will levy assessments upon its stock from time to time for the purpose of raising funds with which to meet installments due to the United States under the Association-Government contract.

Thus, it is respectfully submitted that the trial court’s decision simply can not stand, insofar as it limits the duty to make equitable assessments to “future” construction. Each and every one of the documents clearly recites that the Association was formed to construct the Hyrum Project, and that it contracted with the United States for the construction of the Hyrum Project; that the construction costs and installments due to the United States would be raised by an assessment of the stock; and that the stock should be equitably assessed. The Articles recite that the purpose of the clause providing for unequal assessments was to take care of situations where facilities were built for the exclusive use of only part of the stockholders. The stock subscription contract signed by Hyrum was signed after the Articles of South Cache were filed. The stockholders subscribed their stock with full knowledge of the requirement for unequal assessments and in the stock subscription contract and mortgage given by Hyrum, the recital clauses expressly recite that the funds for paying installments due to the Government will be raised by assess-

ments of the stock and, of course, the assessments would have to be made in accordance with the Articles. The express recitals are to the effect that the assessments are for the purpose of paying for original construction costs, and we respectfully submit that the holding of the court as to this provision for unequal assessments can not be limited to future construction projects. The authorities to follow demonstrate that it is mandatory that the assessments be equitable and also that under the facts of this case an equal assessment is not equitable.

(a) *The Provisions Requiring Equitable Assessments of Stock to Pay Construction Costs are Matters of Contract and Can Not Be Circumvented by the Directors.*

The only protection that a minority stockholder ever has in regard to the assessment of his stock is the protection given to him by his contract with the other stockholders and with the corporation. This contract consists entirely of the Articles. The authorities uniformly hold that the Articles of Incorporation are contractual in nature and that stockholders may enforce as any other contract the provisions in the Articles. The general law concerning the contractual nature of the relationship of the corporation with its stockholders is stated as follows (American Jurisprudence, Vol. 13, Corporations) :

“Section 77 Generally. It was early established by the Federal Supreme Court in the celebrated Dartmouth college case (1819) that the

charter of a private corporation is a contract and entitled to protection of the provision of the constitution of the United States prohibiting the several states from passing any law impairing the obligation of contracts. This decision has received unanimous approval by the courts and has been followed and cited many times. It is also well settled that the articles of incorporation of a corporation organized and incorporated under the general laws of the state create a contract between the state and the stockholders to the same extent as does a charter specially granted by the legislature of the state. Frequently, the charter is spoken of as a contract between the sovereignty and the incorporators. Consideration for the grant of powers and privileges is found in the liabilities and duties which the incorporators assume by accepting the terms specified in the charter * * *."

In addition American Jurisprudence, Vol. 13, Section 79, Corporations, states the principle as follows:

"Section 79, Relation between corporation and stockholders and stockholders inter se. The charter of a corporation constitutes a contract between it and its stockholders and also between the stockholders inter se which is entitled to protection as against attempted action by the corporation, though with the consent of the legislature and majority of the stockholders, insofar as the interest of nonconsenting stockholders are concerned. Thus, there is a contractual obligation on the corporation with respect to its stockholders and on the stockholders with respect to each other that no fundamental, radical or material change in the purposes of the corporation shall be made, and the corporation even with the consent of a majority of its stockholders has no right to accept an

amendment of its charter so changing the purposes of the corporation as against nonconsenting stockholders * * *."

These principles have received the approval of the Utah Supreme Court in *Garry v. St. Joe Mining Company*, 32 Utah 497, 91 P. 369, 12 L.R.A. (NS) 554, where the court held:

"It is a well recognized principle of law that, 'The charter of a corporation having a capital stock is a contract between three parties and forms the basis of three distinct contracts. The charter is a contract between the state and the corporation; second, it is a contract between the corporation and the stockholders; third, it is a contract between the stockholders and the state.' (2 Cook on Corp., 5th Ed.), section 492; 1 Clark & Mar. Priv. Corp., section 271f."

And, in the case of *Wall vs. Basin Min. Co.*, 16 Utah 313, 101 P. 733, 22 A.L.R. (NS) 1013, the court held:

"Where corporation issues certificates of stock and prints thereon, as a part thereof, the word 'nonassessable', such word becomes a matter of agreement and a part of the contract between the corporation and the stockholder, and may be enforced by the stockholder against the corporation's right to assess such stock."

See also *Western Imp. Co. v. Des Moines Natl. Bank*, 103 Iowa 455, 72 N.W. 657; *Enterprise Ditch Co. vs. Moffit*, 45 L.R.A. 647; *Stanislaus County v. San Joaquin and K. River Canal and Irrigation Company*, 192 U.S. 201, 48 L. Ed. 406, 24 S. Ct. 241.

In view of the fact that the articles of incorporation create a contract, the minority stockholders have a right to have the corporate affairs administered in accordance with the articles of incorporation, which necessarily includes the provisions relating to assessments. The case of *Child v. Idaho Herver Mines*, 155 Wash. 280, 284 P. 80, applied this rule in holding:

“The authorities all hold that provisions such as these incorporated in the articles of incorporation and by-laws (provisions relating to assessments) of a company have the force and effect of a contract between the stockholder and the corporation.”

See also *Seattle Trust Co. v. Pitner*, 51 P. 1048. Moreover, it is a well established principle of corporation law that the directors have a fiduciary duty to all stockholders and by virtue of the majority stockholder's control over the board of directors, the majority stockholders also have a fiduciary duty to the minority stockholders. Am. Jur., Vol. 13, Sections 422, 423 and 424, Corporations.

(b) *It is Not Equitable to Assess Stock Equally Unless the Benefits are Equal.*

Although this provision for equitable apportionment of costs has been in the Reclamation Law for nearly fifty years, it does not appear to have been the frequent subject of litigation. We have not been able to find a case construing the exact language here involved. The principle of equitable assessment has been before our

Utah Supreme Court on three different occasions in connection with Section 73-5-1, U.C.A., 1953, relating to the making of assessments for river administration. In each of these cases the Supreme Court has held that an assessment which does not reflect benefits received is void. The statute in question provides that the salary and expenses of a river commissioner:

“shall be borne pro rata by the users of water from such river system or water source upon a schedule to be fixed by the State Engineer, based on the established rights of each water user, and such pro rata shall be paid by each water user * * *.”

The first case was *Bacon v. Gunnison Fayette Canal Company*, 75 Utah 278, 284 P. 1004. In that case the State Engineer brought suit to collect an assessment made against the canal company. In previous years the State Engineer had made his assessment against the water users pro rata according to the quantity of water distributed to them respectively. In the year in question the State Engineer introduced a new basis for apportionment, whereby the amounts to be assessed were determined, not according to the quantity of water each was entitled to use, or which was actually distributed to him, but according to the respective area of land upon which the users were entitled to use water for irrigation. This later basis ignored benefits and assessed acreage which received little water on an equal basis with that which received large quantities of water. The court said:

“The statute, by providing for payment pro rata, clearly contemplates some method of appor-

tionment having reasonable relation to the services rendered for and benefits received by the respective users. We realize that mathematic exactness is impracticable, but the nearest approximation to a fair and ratable division of the burden ought to be adopted. If the proportion between the water used and the area irrigated was substantially uniform in the river system, we would readily approve the engineer's basis of apportionment. But it is not. Numerous instances are shown where the burden falls with substantial inequality."

If applied to the facts of the instant case the principle given by the Supreme Court in *Bacon v. Gunnison Fayette Canal Company*, supra, would require apportionment to be made on the basis of water used. We feel that this is the only basis which is equitable. It would prohibit the direct flow water from having a "free ride", and would apportion the costs of storage water on the basis of storage water distributed to each user. In addition, we think that the canal system which was constructed exclusively for the benefit of the users thereof should be paid exclusively by them. In other words, if the \$733,000.00 cost of the reservoir were apportioned among the users on the basis of the amount of water (both direct flow and storage) actually used, this would be equitable. The approximately \$210,000.00 cost of the Mendon and Wellsville Pumping Canal, pumping plant and diversion works should, of course, be apportioned entirely to the users thereof.

The Articles of Incorporation and the Reclamation Law, in mandatory language, state that the cost of con-

struction “*shall*” be equitably apportioned. It further says that the provision for equitable apportionment is to take care of situations where facilities are constructed for the benefit of only part of the users. We think that the requirement of the Reclamation Law and of the Articles for an equitable apportionment is directly analogous to Section 73-5-1, U.C.A., 1953, requiring administration costs to be pro rated. Our Utah Supreme Court says that in order to pro rate these expenses the State Engineer must take into account the benefits received. The Supreme Court has condemned any attempt by the State Engineer to make his assessment on any other basis except the benefits received, and, of course, the benefits received are always proportionate to the water distributed.

The next case before our Utah Supreme Court was *Bacon v. Plain City Irrigation Company*, 87 Utah 564, 52 P. (2d) 427. The court there cited with approval the previous case of *Bacon v. Gunnison Fayette Irrigation Company*, *supra*, and again condemned an assessment by the State Engineer which ignored the quantity of water delivered. In the Plain City case, the assessment was made on the basis of a water right decreed under the proposed award of the State Engineer in a general adjudication suit. In making the assessment the State Engineer had ignored the doctrine of priorities and had made his assessment on the quantity of water actually awarded, rather than on the quantity which would be delivered under the parties’ respective priorities. In other words, a user awarded 2 c.f.s. with a late priority

was assessed on the same basis as a user who was awarded 2 c.f.s. with an earlier priority. Of course, the user with the early priority would over the season get more water, even though each was awarded 2 c.f.s. The court said that unless the priorities were so near equal that each obtained substantially the same quantity of water, an assessment based on the amount decreed was void. In so holding the court said:

“To assess water users of a river system on the basis of second feet of water awarded by the proposed determination or a decree, may not be objectionable where all of the rights are of equal rank; but generally the rights of users of the waters of natural streams in this state are not of equal rank * * * An established water right is measured by the number of acre feet of water that the owner thereof is entitled to receive from year to year, rather than by the number of second feet awarded by a proposed determination or decree. A water user is primarily concerned with the amount of water which he receives for use, rather than the number of second feet awarded to him by a proposed determination or decree.”

The court said that it would uphold an assessment based on the acre feet actually delivered.

The last case considering this matter was *Richmond Irrigation Company v. Utah Power & Light Company*, 115 Utah 352, 204 P. (2d) 818. In that case the State Engineer made his assessment on the basis of acre feet actually delivered to each water user over a five year average. Two users refused to pay their assessments,

because they contended that their position on the stream made it unnecessary for them to have a river commissioner. Paradise Irrigation Company had in the past been simply assessed on a \$25.00 per year flat fee basis, which completely disregarded the quantity of water actually delivered to Paradise. The State Engineer admitted that the assessments levied were based solely upon the average amount of water used by each user over the past five years, and that he did not include as a factor the actual service to be rendered to each user. The court held that the assessment was valid, because the making of an assessment on the basis of the quantity of water actually delivered was equitable, and that mathematical exactness was not required. This last case involved the same river system and parties as are involved here. In the three cases where the Utah Supreme Court has spoken, it has required that assessments be made which would reflect benefits received. The court has thus unmistakably held that to pro rate the costs of river administration as required by the statute, the State Engineer must confine himself to a consideration of the water delivered and that an assessment on the basis of paper rights or on the basis of lands available for irrigation is void. If that principle is applied here, then it becomes crystal clear that the basis upon which South Cache is making the assessment now is contrary to its articles and is contrary to the Reclamation Law.

In the last case cited above (*Richmond v. Utah Power & Light*), one of the downstream users was excused from paying any assessment because it did not

use any of the facilities under the control of the River Commissioner. This seems to us to be analagous to Hyrum's position insofar as the Mendon Canal, the Wellsville Pumping Plant, etc. are concerned. Hyrum does not, nor can not use them, and it is inequitable to assess it for any part of that cost—just as the Supreme Court held in the Richmond case that it was inequitable to assess the user who did not divert from the Bear River.

Authorities From Other States

There are a few cases from other jurisdictions involving assessments by irrigation districts under the Reclamation Law, which we think are helpful.

In the case of *Nampa and Meridian Irrigation District v. Petrie, et al.*, 223 Pac. 531, (Id.), the Irrigation District entered into a contract with the United States Government for three main purposes: (1) to build a drainage system for the entire district; (2) to furnish full water rights for about 40,000 acres of dry land in the district; and (3) to furnish a supplemental supply of storage water from the Arrow Rock Reservoir to be used upon some lands within the district. The question at issue in the case was whether or not a flat rate assessment of \$7.00 per acre on all lands in the district for the cost of construction of the drainage system was a valid assessment or whether or not the assessment should have been on an apportionment basis for benefits to be derived from the drainage system. The court held at page 533:

“The section of the statute governing the apportionment of benefits and assessments is CS, Section 4362, which provides that assessment must be made in accordance with benefits which will accrue to each of the tracts or subdivisions from the construction of works. Respondent had no more right to assess the cost of the drainage system to the lands regardless of benefits than it had to assess the cost of the irrigation system in the same way. The provision of the statute under which respondent was created and operated compel it to assess the cost according to benefits * * * The method admittedly adopted for assessment of the land for drainage was clearly in violation of the statute. An assessment of all lands in the district on the basis of a flat rate can be made only for maintenance and operating charges. Such a method of assessment can not be resorted to in order to pay for the construction of the irrigation or drainage system. If the land is to be assessed for drainage by the respondent under its present organization, it must be done on the basis of benefits, *in strict compliance with the provisions of the irrigation law by virtue of which respondent exists and by which it is governed.*”

On rehearing of this case the court felt impelled to explain its decision at page 534 as follows:

“In the light of the argument on rehearing, we think it well to clarify two statements made in the original opinion. In the sixth paragraph of the syllabus, we said: ‘An assessment based on a flat rate per acre can be made only for a maintenance and operating expense, and not for the construction of either the irrigation or the drainage system.’ And a similar statement is found in the body of the opinion. By this we did

not mean that benefits could be entirely ignored in assessing for maintenance in violation of C. S., Section 4384. We meant that almost invariably the benefits derived from the maintenance of the project are substantially equal, and therefore, a flat assessment per acre is justifiable. *Colburn v. Wilson*, 24 Od. 94, 132 Pac. 579. So, also, if the benefits derived by different tracts from the construction of irrigation or drainage works are equal, the assessment may be the same * * *."

In *Beecher v. Peshastin Irrigation District, et al.*, 234 Pac. 4, Wash., where validity of certain assessments made by the irrigation district were in question and it appeared that the defendant Beecher had appropriated waters of the Peshastin Creek in 1909 and waters of the Snow Creek in 1912, that the waters of these two creeks flowed onto the land of the defendant through what was known as the Tandy Ditch. The said Tandy Ditch was taken over, maintained and operated by the defendant irrigation district in 1917, and the defendant's lands were included within the District. The assessments were devised for the maintenance and operation of the Tandy Ditch. The irrigation company had no interest in the waters of the Peshastin Creek nor the Snow Creek. Its function was merely the maintenance and operation of the Tandy Ditch. In its decision the court recited the statutory provisions involved as follows:

"Section 7454, Rem. Comp. Stat., provides for the assessment of lands within the irrigation district for the organization, care, operation, repair and maintenance of the ditch. Section 7418, Rem. Comp. Stat., provides that any lands in the district subject to assessment 'shall be given

equitable credit' for any partial or full water right which they may already have."

And in applying the statutory provisions recited above, the court held:

"This latter section seems to have been disregarded by the appellant in fixing the assessments complained of * * *. Just what the 'equitable credit' for the Snow Creek rights amounts to can not be determined from the record, but the appellant having failed to give credit therefor, the assessment made without such credit is erroneous."

In the case of *McLean, et al. vs. Truckee-Carson Irrigation District*, 245 Pac. 285, Nev., the irrigation district had entered into a contract with the United States Government under the provisions of the Reclamation Act of June 17, 1902, and the Warren Act, February 21, 1911 (36 Stat. L. 925) which was an act amendatory to the Reclamation Act, for the construction of a drainage system within the District. The suit was brought to confirm and validate a flat rate assessment for the cost of the construction of said drainage system and protestants contended that the assessment was illegal, unfair, without equity and not apportioned to benefits to accrue to their lands from the construction of the proposed drainage system. Section 1 of the Warren Act provides in part:

"* * * the secretary of the interior, preserving a first right to lands and entrymen under the project, is hereby authorized upon such terms as he may determine to be *just and equitable*, to

contract for the impounding, storage and carriage of water to an extent not exceeding such excess capacity with irrigation systems operating under the Act of August 18, 1894, known as the Carey Act, and individuals, corporations, associations and irrigation districts organized for or engaged in furnishing or distributing water for irrigation * * *."

The court in the McLean case noted that the legal foundation and authority for the Government to enter into contracts like the one in question must be sought in the legislation, namely, the Reclamation Act and the Warren Act, and further noted similar projects in the western states, including Utah. In deciding upon the validity of the assessment in question, the court adopted the rule of *Nampa and Meridian Irrigation District vs. Petrie*, cited above, and stated:

"it is contended that the assessment for drainage in this case of a flat rate of \$10.15 per acre on all irrigable lands in the district is *contrary to the sections of the statute governing apportionment and benefits and assessments which provide that assessment must be made in accordance with the benefits which will accrue to each of the tracts and subdivisions of land from the construction of the drainage system. We agree with counsel that an assessment for drainage, based on a flat rate, and not upon actual benefits accruing to the land, is invalid.*"

The Court adopted the language of the *Nampa* case on rehearing as follows:

"So also, if the benefits derived by different tracts from the construction of irrigation or

drainage works are equal, the assessment may be the same.”

And the court in the *McLean* case further stated:

“We concede that, if we were dealing with the question of the cost and maintenance of an irrigation system, and the company’s lands were charged with an assessment for its maintenance and protection, when in fact the land was not, and could not be, benefited by irrigation, we should decide that a legal fraud would result from the assessment.”

While, we have not been able to find a case which even considers the exact language used in the South Cache Articles of Incorporation and in the other contract documents, the cases cited above represent the almost uniform holding of the courts in the matter of the making of assessments to pay for the benefit of water and drainage projects. They include three cases from our own Supreme Court, and our research has failed to develop any authority to the contrary. Of course, there may be a particular case in which it is equitable to assess equally. We believe, however, that the facts of this case conclusively demonstrate that it is inequitable to make Hyrum pay any part of the cost of constructing canals for other stockholders. Hyrum has constructed and paid for its own canal at Avon and is willing to pay the entire cost of the feeder canal, which is of course relatively low. It violently objects to being compelled to pay any part of the cost of Mendon Canal, the Wellsville Pumping Canal, the pumping plant or the diversion works for those canals.

It was intended to be benefited by one part of the project only. That is, the reservoir itself. It should be required to pay its equitable share of reservoir cost and the total cost of the Hyrum Feeder Canal. It should not be compelled to pay for anything else. In determining what its equitable share of reservoir costs is the principles are announced by our Utah Supreme Court and the other authorities cited above should be followed. Hyrum would have no objection whatever to being assessed on the basis of the water actually delivered to it in comparison to the water actually delivered to the other stockholders. Hyrum also recognizes that the direct flow waters which are taken by the other stockholders may have less value because they occur in the Spring of the year when irrigation is not so valuable as in the late summer season. Still, this direct flow water should not be permitted to "ride free". Also, in making the assessment, South Cache should give effect to the fact that Hyrum frequently can not use its storage water, while the other stockholders get their storage water each and every year and often use more than they subscribe. If these two factors (1. prohibiting South Cache from assessing Hyrum for canals and facilities it can not use, and 2. the making of an assessment on water used) were followed, we believe that the mandate of the Articles would be carried into effect. But we respectfully submit that the Articles requiring an equitable apportionment of construction costs are being ignored by South Cache.

(c) *The Board of Directors Has No Discretion and Must Follow the Mandate of the Articles.*

Regarding the limits of authority of a board of directors in levying and collecting assessments, the law is uniform that such authority is limited to the mandate given by statute or by the articles of incorporation of the corporation levying the assessment. The general rule is set out in *Corpus Juris Secundum*, Vol. 18, Sec. 486, Corporations, as follows:

“Section 486. Liability to Assessment. A, In General. A valid assessment on fully paid stock can be made only as and when authorized by charter, statute, or agreement. An agreement that stock is nonassessable is valid in the absence of the controlling statute.”

Fletcher on Corporations set the rule down as follows: Vol. 13, Limitations on Power of Corporation to Assess, Sec. 6600. General Rule:

“Statutes and charters allowing assessments upon fully paid stock are to be strictly construed and are not to be extended beyond their terms. The assessments can only be levied as authorized.”

Am. Juris., Vol. 13, Section 316, Corporations:

“316 STATUTORY OR CHARTER AUTHORITY. Assessments upon fully paid stock may be made and enforced if authority therefor is conferred either by statute or by the terms of the stockholder's contract with the corporation as set forth in the certificate of stock, provided, of course, the prescribed conditions exist and the

assessment is levied in accordance with the terms of the statute or contract. Although a company has under its charter power to assess fully paid up shares, it can only do so at a corporate meeting duly notified for such purpose * * *."

The rule that assessments can be levied by a corporation only within the authority granted by statute or articles of incorporation is of long standing. This point was early decided in *Charles Dewey, Inspector of Finance, vs. the St. Albans Trust Company*, 57 Vt. 332, where the court held at page 334 of the Vermont Reports:

"Holders of paid up stock are not, nor is their stock liable to assessment unless by express statutory provision, and such assessment can be made only for the purpose and upon the conditions expressly stated in the statute."

Another early case applying the same principle was *Great Falls and Conway Railroad v. Copp*, 38 N. H. 124, where, by the charter of a railroad, the Directors were authorized to make such assessments from time to time, on all shares in the corporation as they might deem expedient and necessary in the execution and progress of the work and the charter provided: "That no assessment shall be levied upon any share in said corporation of a greater amount than \$100.00 in the whole on such share."

The court held at page 126 of the New Hampshire Reports:

"No assessment can be made upon the stockholders beyond what the charter provides for, or the law applicable to the subject authorizes; and

all assessments assumed to be made, which do not come within such authority are invalid.”

The court held, further,

“If a limitation is fixed beyond which the shares cannot be assessed, and upon the faith of that limitation the stock has been subscribed for, no legal assessment can be made beyond it * * *.”

And, finally the court stated:

“The charter limits the amount beyond which the directors can make no assessments * * *.”

In the case of *Cheney v. Canfield*, 158 Cal. 342, 111 Pac. 92, where the mere procedural irregularity of failing to call a board of directors meeting invalidated an assessment in question, the court unequivocally ruled:

“As all proceedings where by an assessment is levied upon the stock of a corporation, and under which a forfeiture of the stockholder may be had are invitum, it is elementary law that they must be strictly followed. The levy of such an assessment can only be accomplished legally by a strict compliance with the statutory provisions relative thereto or with the provisions of the charter of a corporation upon the subject.”

See also in this connection *Clark v. Oceano Beach Resort Company*, 289 Pac. 946, citing *Cheney v. Canfield*, supra, and applying the same rule; *Raish v. M. K. & T. Oil Company*, 7 Cal. App. 667, 95 Pac. 662; *Ruck v. Calledonia Silver Mining Company*, Cal. App. 1907, 92 Pac. 194; *Raht v. Sevier Mining Company*, 18 Utah 290, 54 Pac. 889; *Schwab v. Frisco Mining and Mill Co.*, 60 P.

940; *Harris, et al. v. Northern Blue Grass Land Co.*, 185 Fed. 192. See also *Forsyth v. Selma Mines Company*, 58 Ut. 142, 197 Pac. 586, to the effect that assessments cannot be made unless authorized by statute or articles of incorporation.

In connection with the extent to which a board of directors may deviate from the provision for assessment required by statute or articles of incorporation, the courts have generally held that no discretion exists in the board of directors to assess capital stock for purposes not covered by statute or articles of incorporation, nor does the board of directors have any power to exceed the express limitations imposed by such statute or articles of incorporation.

In the case of *Payette-Oregon Slope Irrigation District v. Coughanour, et al.*, 162 Ore. 458, 91 Pac. (2d) 526, where certain irrigable lands within the irrigation district were not assessed and other lands were assessed the court held:

“The plaintiff irrigation district, a quasi-municipal corporation, is a creature of the statute and possesses only those powers expressly or impliedly granted to it by the legislature. It is also fundamental that the power thus granted must be exercised in substantial compliance with the mode specified in the statute. The legislature having prescribed the method and manner of levying assessments, it follows that it must not be exercised in any other manner. As stated, on rehearing, in *Toohy Brothers Company v. Ochoco Irrigation District*, 108 Ore. 38, 216 Pac. 189,

‘when the mode of exercise of the power is prescribed, the same is a condition precedent to the exercise of the particular power, any essential deviation therefrom renders the act void and ineffectual’.”

In 44 Corpus Juris 596, it is said:

“The requirements of statutory or charter provisions necessary to confer power to impose assessments or special taxes for local improvements must be followed at least substantially, a material departure therefrom rendering the assessment and special tax void.”

Also in the *Payette* case the court said as follows:

“Section 48-801 Oregon Code 1930, provides in part as follows: ‘The board of directors shall determine the number of irrigable acres owned by each landowner in the district and the proportionate assessments, as herein provided for, as nearly as may be available from information * * *.’ It is plain from the above section of the statute that it was mandatory on the part of the board of directors of the district to levy an assessment on ‘each acre of irrigable land in the district.’ And that no discretion could be exercised by it in omitting irrigable lands subject to assessment. If 1,000 acres, or about one-fourth of the total irrigable acreage, could be omitted, we see no reason why $\frac{3}{4}$ might not be omitted, thereby resulting in confiscation of the property of those landowners obliged to pay the cost of operation and maintenance of the district. We have no hesitancy in holding that the omission of the land in question was a substantial departure from the statute. See also in connection with this question *Kelor v. Chesley Finance Corporation*, 123 Cal.

App. 4, 10 Pac. (2d) 801, wherein the directors levied an assessment for expenses of a corporation when such was not needed and the court said, 'and no discretion exists in corporate board of directors to assess capital stock for purposes not mentioned in the permissive statute'."

The above disposes of Nos. 1 and 2 of the Points on Appeal.

(d) *The Court Erred in Permitting South Cache to Increase the Indebtedness Above \$930,000.00.*

The original contract between South Cache and the Government contained a provision to the effect that the total cost of the project would not exceed \$930,000.00, (See Ex. B). This is contained in the third "Whereas" clause, the fourth "Whereas" clause, and in paragraph 20 on page 7 of said Exhibit. Hyrum's subscription contract recites in the eighth "whereas" clause that South Cache will levy assessments upon its stock for the purpose of raising funds to meet installments due to the United States under the Association-Government contract. This Association-Government contract is identified as the contract under which the Government agreed to advance not to exceed \$930,000.00. Hyrum agreed to pay its assessments (which under the Articles were to be equitable and not necessarily equal) for the purpose of raising funds to make the payments under the Government contract. Then without any consent on the part of Hyrum, South Cache increased its indebtedness to the United States to a total of \$955,930.00. Eleven thousand dollars of this represented some contributions,

the source of which the record does not identify, but the net result, as shown by Exhibit F, is \$14,000.00 more than Hyrum agreed in any of its documents that it would pay. It is the contention of Hyrum that its indebtedness could not be thus increased without its consent, and the record, of course, fails to show that it did consent to these additional expenditures. Exhibit F is discussed at page 168 of the Record and the objection by Hyrum to being charged for this excess cost is discussed at pages 337 and 338 of the Record.

(e) *The Amendatory Contract Ought Not to Be Ratified and Confirmed By the Court.*

We feel that the Government has constructed a "white elephant", and that Congress should give relief to all of the water users, including the other stockholders on this project. As a result of persistent complaints, the Government has sponsored this amendatory contract, but it does not go nearly far enough. Here is a reservoir capable of impounding 14,000 acre feet of water. The water is available year in and year out so that the reservoir can fill practically every season, but because the reservoir was built so far downstream (below much of the land which could have been irrigated with waters from this river) the water thus placed in storage can not be used. We have already mentioned the inability of Hyrum to get its storage water. Hyrum has sufficient lands to permit it to use its full 3300 acre feet every year, if it could get it. An additional 2800 acre feet of water has never been sold to anyone and can not be

sold, because there are no lands upon which it can be used. Seven hundred additional acre feet were sold to various interests in the community who never intended to use the water, (R. 130, 133). These subscribers intended to get incidental benefits from the economic growth of the community, which would come from the availability and use of 14,000 acre feet of water. Thus, out of 14,000 acre feet there are the following which are never used: 2,800 feet not subscribed; 700 feet subscribed by businessmen; and in addition to this 3500 acre feet, we submit that Hyrum can not get its 3300 acre feet, and in many years like 1952 can not get any portion of it, simply because the reservoir is so located that Hyrum can't get its water. Thus, every year 3500 of the 14,000 acre feet is not intended to be used. In some years when Hyrum can not use water, nearly 7,000 out of the 14,000 goes unused. We believe that if these facts were correctly presented to Congress, further relief from the burdensome costs of this project could be obtained. It is not the policy of Congress to make people pay for water they do not get. This would be of benefit, not only to Hyrum, but to all of the other stockholders. The other stockholders do not seem interested in getting this relief, because (1) they are able to pass one-third of the entire project cost, including their canals, on to Hyrum. (2) They use all the water they pay for and have been able to use part of this 2800 acre feet of unsold water, while assessing against Hyrum one-third of the cost of the 2800 acre feet which have never been subscribed. (3) They are able to get and do get great quantities of

direct flow water free of cost. The net result to them is a cost which they can well afford to pay in return for the benefits which they receive. An economic study of their needs and benefits, therefore, justifies their paying, as they have been paying, and they are content with the amendatory contract. We suspect that if they were compelled to carry these project costs under assessments which are being equitably made, that they would be as anxious as is Hyrum to get relief. If this contract is accepted, it is going to be much more difficult to get Congress to give us further relief.

It is natural that those who were responsible for constructing this reservoir at 14,000 acre feet capacity and at a downstream location will attempt to justify their judgment. It is also natural that those charged with administration would like to demonstrate that Hyrum is actually using the 3300 acre feet which it subscribed, when as a matter of fact everyone who will take the trouble to check the reports knows that such is not true.

The above general statement is made so that the court will understand why Hyrum is contesting the affirmance of this contract. The project under the most favorable view is bad for the users. Too much of the water has never been sold to anyone and many who have purchased water do not use it. Congress could probably be induced to give relief to the parties if they would request it. If they take this amendatory contract, the Government is too apt to take the position that they

tendered an adjustment which was satisfactory to the people concerned, and those people accepted it and they will simply refuse to reconsider the matter. This matter is of as much importance to the other stockholders as it is to Hyrum, but if they can continue to saddle an unfair portion of project costs on Hyrum, as they have been doing, they are content with the contract. If they are required to pay their equitable share, then they will find this contract to be just as burdensome as Hyrum finds it, and will be just as anxious as is Hyrum to get further relief. The technical objections we raise, therefore, are not raised simply as a matter of being a "dog in the manger". We seriously object to the acceptance of this contract. Our objections are based upon the following:

(f) *The Contract Was Never Approved By a Proper Board of Directors and By the Stockholders.*

It was stipulated at the trial that at the time this contract was executed that the board of directors had not signed their oaths of office, (R. 158). This is an intercorporate affair, and in the Utah case of *Schwab v. Frisco Mining and Mill Co.*, 21 Utah 258, it clearly establishes that directors who have not filed oaths may not bind the stockholders who have not acquiesced therein. It is uncontradicted that Hyrum has not acquiesced therein, and the attempted ratification by the directors is not effectual.

Thereafter the board attempted to ratify this contract after they had all signed and filed oaths of office,

but that director's meeting was never noticed or called, and the minutes introduced in evidence show that less than all of the directors attended the meeting. Director's meetings may only be held after due notice to the board. See *Singer v. Salt Lake City Copper Manufacturing Company*, 17 Utah 143, 53 Pac. 1024. Also in *Boston Acme Mines v. Clawson*, 66 Utah 103, 240 Pac. 165, the court held that in the absence of notice to all directors of a special meeting of the board action taken thereat is void. The first attempt by the directors to make this contract is, therefore, void, because the directors had not signed their oaths. The attempted ratification is void, because only part of the directors attended the meeting and it was called without notice.

The articles also required that any contract of this size be ratified by the stockholders. No formal stockholder's meeting was noticed. Hyrum was represented by Mr. Nielson at a stockholder's meeting, which was held without notice, and he dissented insofar as ratifying this contract is concerned. His authority to attend such a meeting was dependent upon an old 1934 authorization by Hyrum Irrigation Company. If Hyrum had been given notice of a special stockholder's meeting and had neglected to send anyone except Mr. Nielson, it may be that this old authorization might constitute all the authority necessary for Hyrum to act. Where, however, a contract involving hundreds of thousands of dollars is sought to be ratified by stockholders without any formal notice of any kind to the stockholders, it seems unreasonable to permit a person to act under an authori-

zation given twenty years ago in connection with the building of the project. We believe and contend that formal notice to stockholders was necessary and that a person who happened to attend without any notice to Hyrum under an authority granted twenty years ago is not valid and, that this contract has never been ratified by the stockholders as is required.

(b) Finally, all of the contract documents recited that the liability of the parties under them should be limited to \$930,000.00. Here is an attempt to increase that liability to \$944,000.00, which flies right in the face of express language to the contrary. This board can in no way increase Hyrum's liability to pay its proportionate share of \$944,000.00, when it has only agreed to pay on a liability which the documents say can in no event exceed \$930,000.00. We reserve the right to answer authorities presented by the petitioner, but felt that this preliminary statement of our position might narrow the issues so that the petitioner does not have to comment on numerous things relating to legality, which we in no way challenge.

Respectfully submitted,

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