

LAW OFFICES

FULLERTON, LEMANN, SCHAEFER & DOMINICK, LLP

THOMAS W. DOMINICK*
EMMA D. ENRIQUEZ
WILFRID C. LEMANN
LEE B. MADINGER
MICHAEL R. SCHAEFER
CRAIG E. WILSON

215 NORTH D STREET, FIRST FLOOR
SAN BERNARDINO, CALIFORNIA 92401-1712
TELEPHONE (909) 889-3691
TELECOPIER (909) 886-5119
FIRM WEBSITE: WWW.INLANDBUSINESSLAW.COM

OF COUNSEL
ROBERT V. FULLERTON*
DANIEL W. HOLDEN
A PROFESSIONAL CORPORATION
PALM DESERT OFFICE
(760) 779-9572

December 1, 2004

Robert Friedman
350 West Fifth Street #101
San Bernardino, CA 92401

Re: Cedarpines Park Mutual Water Company

Dear Mr. Friedman:

Section 2.15 of the bylaws of Cedarpines Park Mutual Water Company sets the quorum for a shareholders meeting at a majority of the shareholders. At least 50% plus 1 of the shareholders must be present in person or by proxy at the meeting in order for business to be conducted. The Company has had difficulty obtaining a quorum for the shareholders meetings. You have asked if the Company can lower the quorum to 20% of the shareholders.

Background

You have told me that Cedarpines normally solicits shareholder proxies for the annual meeting by mailing them with the monthly water bill. The total number of returned proxies, combined with those shareholders who actually attend the meeting, is far less than the 50 percent quorum requirement. It is also frequently less than 20% of the total voting power of the shareholders. The only times when a quorum has been obtained is when the meeting agenda features a discussion of considerable interest in the community. There has not been a contested election for a seat on the Board of Directors within the memory of anyone presently serving on the Board. You have told me that there may be a feeling by some shareholders that the quorum requirement is effectively depriving them of the right to vote and be heard on corporate matters. But it does not appear that anyone has tried very hard to obtain the votes and proxies necessary to be elected to the Board of Directors or to bring matters to a vote before the shareholders.

Section 1.02 of the bylaws provides that Section 2.15 shall not be altered, amended or repealed except by the unanimous written consent or vote of all of the members. As a practical matter it is impossible to obtain a unanimous vote of the shareholders.

In 1966, at an annual meeting of the shareholders, a motion was adopted to reduce the quorum requirement from a majority of the shareholders to 20% of the shareholders. In 1984 legal counsel advised that if challenged, this amendment would likely be held by a court to be invalid because the quorum was not changed by a unanimous vote as required by Section 1.02. Counsel noted that bylaw provisions which require unanimous vote for corporate actions for corporations such as yours are explicitly authorized by Corporations Code Section 7151(e).

In 2002 counsel was asked to present possible solutions which would allow the Board of Directors, or, in the alternative, less than 50% of the shareholders, to lower the quorum requirements for shareholder meetings. Two ideas were proposed: 1) Create a new entity and merge it with the existing corporations, or 2) Adopt an amendment to the Articles of Incorporation which might trump an inconsistent provision in the bylaws.

Creation of new entity

Prior counsel suggested that a new corporation with new articles of incorporation and bylaws could be created and then merged with the existing company. This approach would do away with the restrictive bylaw provisions but might be costly to implement. You have asked how much my firm might charge for the legal work associated with the merger. I estimate that it could be accomplished for approximately \$15,000.00 so long as there is no opposition to the merger by shareholders.

The merger would have to be approved by a majority of the shareholders of the existing corporation. Corporations Code Sections 1200, 1201. This means that the proponents of the merger must obtain the affirmative votes of 50% plus one of all the shares. Simply getting a quorum, and then approving the merger by a majority of those present, would not be sufficient. The vote in favor would need to be 50% plus one of all of the outstanding shares.

Technical invalidation of the bylaws

Prior counsel also suggested that the corporation's Articles of Incorporation could be amended to contradict the supermajority provisions contained in the bylaws. Under Corporations Code Section 212(b), the corporation's bylaws are not permitted to contain any provision in conflict with its Articles of Incorporation. However, amendment of the Articles of Incorporation requires approval of the majority of the shareholders. Corporations Code Section 902. As with the merger, this means the affirmative votes of 50% plus one of all outstanding shares.

Corporations Code Section 7515

I have identified one additional method by which the quorum requirement may be reduced. Corporations Code Section 7515, which is applicable only to nonprofit mutual benefit

corporations,¹ provides that “if for any reason it is impractical or unduly difficult for any corporation to call or conduct a meeting of its members ... in the manner prescribed by its articles or bylaws ... then the Superior Court ... may order that such a meeting be called or that a written ballot or other form of obtaining the vote ... be authorized, in such a manner as the court finds fair and equitable under the circumstances.” Corporations Code Section 7515(a). It further authorizes the court to “dispense with any requirement relating to the holding of and voting at meetings or obtaining of votes, *including any requirement as to quorums or as to the number of votes needed for approval*, that would otherwise be imposed by the articles, bylaws, or this part.” Corporations Code Section 7515(c). (Emphasis added). Therefore, it appears a court is empowered to issue an order which effectively overrides either or both Section 1.09 and Section 2.15 of the bylaws.

The purpose of Corporations Code 7515 is set forth in its legislative history. “Due to poor record keeping, inactivity for a period of time, or other reasons, some nonprofit corporations are unable to obtain a quorum of members or directors, unable to accurately identify their members or directors, or comply with various provisions of their articles or bylaws. The New [Nonprofit Corporation] law allows a corporation, upon obtaining court approval, to extricate itself from this situation and restore regularity in its organizational structure and operations.” *Greenback Townhomes Homeowners Assn. v. Rizan* (1985) 166 Cal. App. 3d 843, 848.

Greenback Townhomes Homeowners Assn., supra is the only reported appellate case interpreting Section 7515. It holds that the corporation is the proper party to bring an action under the statute.

There is an analogous statute which governs common interest developments (homeowner associations). Civil Code Section 1356 is a part of the Davis-Sterling Act which authorizes court-ordered amendments to CC&Rs. It has been patterned on Corporations Code Section 7515 (See CEB, *Advising Common Interest Communities*, Section 9.44) but includes requirements not found in Corporations Code Section 7515. Like Section 7515, it permits a court to override supermajority provisions and quorum requirements contained in CC&Rs. Unlike Section 7515, the statute sets forth specific findings which must be made prior to any order being made. A petitioner under that section must show: 1) 15 days notice of the court hearing has been given to all members, 2) voting on the proposed amendment was done in accordance with all applicable procedures in the governing documents, 3) a reasonably diligent effort was made to permit all eligible members to vote, 4) more than 50% of the eligible voters have voted in favor of the amendment, and 5) the amendment is reasonable. Civil Code Section 1356 is not directly applicable to Cedarpines Mutual Water Company, but a court may look at its terms in deciding how to act on a petition brought under Corporations Code Section 7515. The troublesome requirement is the one requiring that the proposed amendment be approved by a majority of those eligible to vote.

¹ The Best, Best & Krieger letter dated July 26, 1984 states that by written advice in 1979 the Secretary of State classified Cedarpines Park Mutual Water Company as a nonprofit mutual benefit corporation.

A court cannot grant an order under Section 7515 unless it make a finding that is "impractical" or "unduly difficult" for the Corporation to call a meeting. If the corporation were to file a petition for a Section 7515 order modifying the bylaws and individual shareholders opposed the motion it is difficult for me to predict what a court might do. Although it is undeniable that no meetings have been held it is equally undeniable that no shareholder has tried very hard to have a meeting. No one really knows how much work it would take to obtain a quorum. The result might be different if someone had devoted considerable effort to one or more unsuccessful attempts to obtain a quorum.

I also note that the 50% plus one quorum requirement set forth in the bylaws is not likely to be viewed by the court as presumptively unreasonable. Corporations Code 602 provides that a quorum for a shareholder meeting is to be a majority of the shares entitled to vote unless the articles of incorporation or bylaws provides otherwise. A court may not be willing to make it easy for a small minority of the total number of shareholders to modify this quorum requirement. In *Blue Lagoon Community Association v. Mitchell* (1997) 55 Cal. App. 4th 472, a Civil Code Section 1356 case, the court refused to approve adoption of bylaw changes approved by 69% and 71% of the shareholders on the grounds the court believed the changes were "unreasonable."

In *Greenback*, supra, the issue was a bylaw requirement that required a vote of 75 % of the shareholders in favor of bylaw changes. The court modified the requirement to provide that the bylaw changes could be approved by 75 percent of those voting so long as the total number of votes represented a majority of the total membership. Significantly, the court imposed both a 50% quorum requirement and a supermajority requirement in its order for relief. In *Blue Lagoon*, supra, the matters at hand were approved by 69% and 71% of the total membership but the votes failed due to a bylaw requirement of 75% approval. In that case the court refused to grant relief.

I also believe that the terms of the order sought by the court would affect the likelihood it would be approved. It should be recalled that there are two bylaws at issue here, one setting a quorum requirement and one requiring a unanimous vote of the shareholders to change the quorum. A Section 7515 order could affect one or both of these bylaw provisions. For example, the court might be asked to modify only Bylaw Section 1.02 to require something less than unanimous consent to change the quorum requirement. Under this scenario, the corporation would have to obtain a quorum of a majority of the members, but the requirement of a unanimous vote to modify Section 2.15 would be scaled down.

Alternatively, the court might be asked to modify both Bylaw Section 1.02 and the quorum requirement itself. For example, the court might be asked to rule that the quorum requirement for the vote on changing the quorum requirement be lowered to 20% of the outstanding shares and that the majority required to approve be limited to 50% plus one of those attending the meeting. This would permit the quorum requirement to be lowered by an affirmative vote of only 10% of the outstanding shares (a majority of the 20% quorum). Their approach might be vulnerable to opposition based on the argument that the effort represents an attempt by a small minority to overturn a longstanding company policy.

Robert Freidman

12/1/2004

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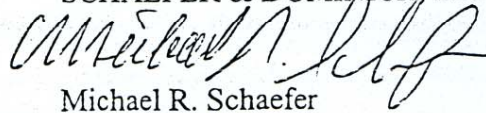
Other permutations on this theme are possible. The proponents of any petition for relief under Section 7515 must carefully consider what they ask the court to do.

You have asked what the cost of bringing a petition for a Section 7515 order might be. Given the complexities of the issues my estimate is \$10,000.00.

The issue which you have presented to me is a complex one. The solution requires balancing corporate, legal and practical issues. I hope that the information I have provided is of assistance to you.

Very truly yours,

FULLERTON, LEMANN,
SCHAEFER & DOMINICK, LLP

A handwritten signature in black ink, appearing to read "Michael R. Schaefer", written over the typed name.

Michael R. Schaefer

MRS:aln