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When Corporate Stock Becomes Real Estate

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When Corporate Stock Becomes Real Estate

BY CHARLES J. BEISE*

Ordinarily, a lawyer thinks of a certificate of stock in an incorporated company as an instrument bearing many of the characteristics of a negotiable instrument transferable by endorsement. And that is the general impression of the legislature (1935 C. S. A., Ch. 41, Sec. 87). However, by a process of judicial reasoning it has been established that such stock is real property transferable by deed—at least so far as stock in a mutual ditch company is concerned. This was the practical result of the decision in *Comstock v. Olney Springs Drainage District.*[1]

Ditch companies in Colorado ordinarily are incorporated under any one of three statutes.[2] There are other possibilities for the formation of entities organized for ditch construction,[3] but thus far they have managed to stay out of court so far as the scope of this article is concerned, as no stock is issued by them.[3a]

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[1]Comstock v. Olney Springs Drainage District, 97 Colo. 416, 50 Pac. (2d) 531 (1935).

[2]1935 C. S. A., Ch. 41, SS. 141, 172, 210.

[3]WATER USERS' ASSOCIATIONS, 1935 C. S. A., Ch. 41, SS. 155 ff.; IRRIGATION DISTRICT LAW OF 1905, 1935 C. S. A., Ch. 90, S. 377; IRRIGATION LAW OF 1921, 1935 C. S. A., Ch. 90, S. 432; PUBLIC IRRIGATION DISTRICT LAW OF 1935, 1935 C. S. A., Ch. 90, S. 472; COLORADO RIVER CONSERVANCY DISTRICT, 1935 C. S. A., SUPP., Ch. 138, S. 199 (1), S. L. 1937, Ch. 220, p. 997; WATER CONSERVANCY DISTRICT, S. L. 1937, Ch. 266, p. 1309, amended S. L. 1939, Ch. 174, p. 592.

[3a]A water users' association does issue stock.

Generally speaking, ditch companies can be divided into two major classes or divisions—"mutuals" and "quasi-public" corporations.

> Where all owners of land within the service capacity of the canal will possess the right as members of the public to use the water which may be diverted into such canal the use is clearly public and the company is therefore a public agency—on the other hand where several separate owners of water rights by appropriation form a corporation for the purpose of distributing water to themselves alone, the use is not thereby rendered a public one * * *.[4]

Thus, in a mutual company shares of stock represent specific quantities of water and a right to supply rests on stock ownership.[5] But a "mutual" company can become a "quasi-public" company when by a course of practice it no longer insists on stock ownership before delivering water and it thereby enters public service.[6] A transition by such course of conduct has been declared in Colorado.[7]

"Quasi-public" ditch companies ordinarily dispose of their water and ditch space by annual contracts,[8] or by deed conveying water rights and reserving the right to levy annual charges and to make rules and regulations.[9] Transfer of water rights of consumers or customers is consequently made by written assignment of the water contract or by deed conveying the water rights. The law was well summarized by Judge Lewis[10] when he said:

> If I rightly understand these cases, they hold: (1) the owner of the carrying ditch in making the diversion from the natural stream acts solely as the agent or trustee for him who applies the water to a beneficial use, (2) gets no title in or right to the use of the water and has no property in it subject to disposal, and (3) he who applies the water thus diverted to beneficial use acquires a property right in the use of the water thus applied which he, and he only, can sell, dispose of and convey by deed separate and apart from the land to which it has been applied or with the land to which it has been applied. The last proposition is made more cer-

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[4]2 WIEL, WATER RIGHTS IN THE WESTERN STATES (3d ed. 1911) 1159.

[5]*Ibid.* 1170.

[6]*Ibid.* 1175-1176.

[7]Combs v. Agricultural Ditch Co., 17 Colo. 146, 28 Pac. 966 (1892). The company apparently was incorporated under the general corporation laws and a restriction in the by-laws prohibited sale of water to anyone but a stockholder. The restriction was made ineffective by public sales of water and the ditch was held to be a quasi-public carrier.

[8]Commissioners v. Rocky Mountain Water Co., 102 Colo. 351, 79 Pac. (2d) 373 (1938); Denver v. Brown, 56 Colo. 216, 138 Pac. 44 (1914).

[9]Northern Colorado Irrigation Co. v. Commissioners, 95 Colo. 555, 38 Pac. (2d) 889 (1934).

[10]Pioneer Irrigation Co. v. Commissioners, 236 Fed. 790, 792 (D. Colo. 1916).

> tain by *Strickler v. Colorado Springs*, 16 Colo. 61, 26 P. 313, 25 Am. St. Rep. 245; *(Cache la Poudre) Irrigation Co. v. Res. Co.*, 25 Colo. 144, 148, 53 P. 318, 71 Am. St. Rep. 123.

Thus relatively few cases exist concerning transfer of water rights in a "quasi-public" ditch company.[11]

The confusion arises in cases involving the transfer of shares of stock in "mutual "companies. Are such rights to water transferable by deed or by delivery of the stock certificate?

Kinney[12] in approaching this field ventured the following observation:

> * * * But, where the title to water rights, and the ditch, canal, and other works, is in one of these mutual corporations, which issues shares of stock representing both the water rights and the works by means of which the water rights are used, such shares are considered in law personal property, and a sale and transfer of these shares operate as a sale and transfer of both the water rights and the interest in the works. * * *

and the editors of *Corpus Juris* qualified this general statement:

> Stock, not appurtenant to land, is personal property, and, under a statute so providing, no stock is appurtenant to land unless the corporation adopts and records in the county recorder's office a by-law declaring it to be appurtenant to land. A by-law declaring that stock shall be located only on land of the purchaser and that water shall be distributed only on lands on which stock is located, does not make such stock appurtenant to the land, but by a by-law providing that stockholder shall be entitled to water only for land described in the certificate, or a by-law providing that stock is transferable only with land, does make it appurtenant. * * *[13]

thereby emphasizing the importance of provisions in the corporate charter, by-law and stock certificate limiting the use of water represented by the certificate to lands described therein.

The Colorado decisions can be divided into three major divisions: (1) cases involving the taxation of such water stock and involuntary transfers thereof by tax deed; (2) voluntary transfers resulting from credit transactions, and (3) taxation of the property of irrigation com-

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[11]Most cases involving quasi-public ditch companies are actions to determine the rate of charge for the conveyance of water. See Wheeler v. Northern Colorado Irrigation Co., 10 Colo. 582, 17 Pac. 487 (1887); Wright v. Platte Valley Irrigation Co., 27 Colo. 322, 61 Pac. 603 (1903), and cases cited in notes 8 and 9 *supra*. Stock in such companies is held for profit, not for water alone.

[12]3 KINNEY, IRRIGATION AND WATER RIGHTS (2d ed. 1912) 2669.

[13]67 C. J. 1368 (S. 1103).

panies or districts. The latter cases [under (3)] have little in common with the subject but are cited as precedents by our court.

Consider first the decisions involving the taxation of shares of stock of a mutual ditch company. *Commissioners of Montezuma County v. Cortez Land Co.*[14] was a statutory proceeding to cancel an assessment of general taxes against stock in a mutual ditch company which had issued stock on the basis of one share per acre of land served. There was, however, no provision making the water represented by the certificate appurtenant to any particular described tract. The court decided that article 10, section 3 of Colorado's constitution controlled and if the ditch system itself was exempt from taxation, the stock which represented merely an interest in the ditch was likewise exempt. This decision apparently was reversed in effect in *Beatty v. Commissioners*[15] for the reason that the stock was assessed as an "improvement on the land" and not as stock in a company. This decision drew a sharp dissent from Justice Bouck on the ground that the *Cortez* case was determinative of the issue.

It is worthy of note that although Justice Bouck states the two cases to be "on all fours," the report of each case shows this difference—the stock certificates in the *Beatty* case:

> described her 458 acres of land as the limited situs of the application of the water she was entitled to receive from the canal

and the by-laws required:

> Each certificate of stock shall designate the lands upon which the stockholder intends to apply the water represented by the certificate and such water shall not be applied to any other land than that specified in the certificate.

The writer believes this distinction is the crux of the entire subject under discussion, although the court lays little emphasis on this point and prefers to discuss "mutual companies" as distinguished from "corporations organized for profit," and refers to the *Comstock* decision.[16, 17] The *Comstock* case was decided two years before the *Beatty* case. The *Comstock* decision held that title to shares of stock passed by treasurer's tax deed (woe the secretary of the ditch company in trying to keep up a stock ledger). The majority opinion merely affirmed the lower court's finding. It is the concurring opinion that unfortunately causes the difficulty and often is cited improperly.

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[14]81 Colo. 266, 254 Pac. 996 (1927).

[15]101 Colo. 346, 73 Pac. (2d) 982 (1937).

[16]Comstock v. Olney Springs Drainage District, 97 Colo. 416, 50 Pac. (2d) 531 (1935).

[17]It may be that the *Cortez* case involved a ditch company with similarly restrictive provisions as to the place for the use of water. If so, that does not appear in the report and Mr. Justice Bouck's comments certainly are in point.

The following quotation in the concurring opinion is often referred to:

> (1) Counsel for the plaintiff in error admit—and it is the law—that water rights for irrigation are real property. They say, however, that shares of stock are personal property. That is true of shares of stock in corporations, including irrigation corporations, organized for profit; but where the company is a mutual irrigation company, or, as here, a mutual reservoir company, organized, not for profit, but for the convenience of its members in the management of the irrigation system and in the distribution to them of water upon their lands in proportion to their respective interests, ownership of shares of stock in the corporation is but incidental to ownership of a water right, which is appurtenant to the land upon which the water is used.

whereas this language (also in the concurring opinion) is overlooked:

> (2) Moreover, a corporation may provide that the water rights represented by the stock shall be attached to the land and shall pass only with it. 3 Farnham, *Water and Water Rights*, p. 2001. The corporations in the present case provide that the water rights represented by their stock shall be used only in connection with the designated land.

and I submit that the *Comstock* and *Beatty* cases fall within the recognized distinction as used by *Corpus Juris, supra.*

The decisions involving voluntary transfers of stock in mutual ditch companies are more numerous than the decisions involving taxation. The first decision, made in 1892,[18] was in an injunction proceeding in which the plaintiff who held tax certificates and a sheriff's deed to land claimed title to two certificates of water stock not specifically described in his deed and which represented water used for the irrigation of such land. The stock certificates had been pledged with defendant. The opinion is silent as to whether or not any restriction existed limiting place of use of water. In denying the claim of plaintiff to the water stock, the court said:

> These (speaking of stock certificates) he could legally transfer only by assignment on the books of the corporation.

and again:

> Even though, under certain circumstances, such rights may be considered appurtenant to the land—a point we do not decide—they may undoubtedly be severed from the land, and may be sold and conveyed separate and apart therefrom; and where such sever-

[18]Oppenlander v. Left Hand Ditch Company, 18 Colo. 142, 31 Pac. 854 (1892).

> ance sale, and conveyance have taken place, as by the assignment and sale of stock representing water rights in an incorporated ditch company, a subsequent sale and conveyance of the land does not pass the title to such water rights.

The decision makes the stock certificate and not the deed the test.

Three years later (1895) our court in the *Hastings* decision[19] had to determine the ownership of shares of stock in an action between an attaching creditor (bank) and a purchaser who had acquired possession of the stock certificate prior to the levy but neglected to have the transfer show on the ditch company's books. Both parties claimed under the former owner. To support his claim defendant (purchaser of land) offered his deed from original owner conveying "all the water rights in any way pertaining or belonging to the land." The court said:

> The deed was improperly received. Water rights belonging to land and stock in a ditch corporation are two essentially different kinds of property. A real estate owner may have the right to water for the purpose of irrigating his land without owning any ditch stock, and a stockholder in a ditch company may be without right to water for irrigation or without land to irrigate. Water rights for irrigation are regarded as real property, and shares of stock in a corporation are personal property. The deed conveyed all rights in water pertaining to the land described for the purpose of its irrigation, but it no more conveyed the grantors water stock than it conveyed his horses.

The attaching creditor was held to be the owner of the stock because of failure of purchaser to comply with section 269 G. S. requiring entry of transfer on company's books in sixty days.[20] The applicability of general statutes governing transfers of stock certificates to ditch companies is not questioned.

In a case decided in 1907[21] a landowner who owned stock in two different companies *(A Co.* and *A Extension Co.)* had executed a trust deed which described the land and specifically described the stock in *A Company* but was silent as to *A Extension*. The trust deed included the phrase "all shares of stock in any company" and after default, foreclosure and resale the buyer claimed to own the stock in *A Extension Company*. Ditch was a mutual where each share represented a fraction of water but was not made appurtenant to any one tract of land. The defendant contended the stock was personal property and transaction void because

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[19]First National Bank v. Hastings, 7 Colo. App. 129, 42 Pac. 691 (1895).

[20]Except for the fact that the water was not made appurtenant to any one tract of land, this case closely resembles the *Markham* decision hereafter referred to (n. 26).

[21]Oligarchy Ditch Company v. Farm Investment Co., 40 Colo. 291, 88 Pac. 443.

trust deed was not foreclosed in five years. The court determined that the buyer (plaintiff) owned the stock in *A Company* and treated trust deed as a chattel mortgage to effect such a result; as to *A Extension* stock the decision was for defendant because plaintiff failed to secure possession of the stock. The court said:

> While there are many cases which hold that a water right or a private ditch may pass with a conveyance of land as appurtenant thereto, yet we know of no case, and counsel has called our attention to none, wherein it is held that a corporation owning a ditch, and furnishing the right to carry water to its stockholders only, must continue to carry water for land which has been conveyed to a stranger, while the stock which gave the right remained in the hands of the original owner or had been transferred to other parties.[22, 23]

Next in point of time was the decision in our sister state of Idaho[24] in a contest to determine stock ownership in a mutual ditch company which by by-law provided "* * * water right was dedicated and made appurtenant to the land involved herein and none other." In holding ownership to be in mortgagee because of failure of water company to record its contract, the Idaho court said:

> It is contended by appellant that the shares of stock in the operating company are personal property, and that the water right passed by assignment of them, and did not become subject to the mortgage on the land. While shares of stock in an ordinary corporation, organized for profit, are personal property (section 2747, REV. CODES; *State v. Dunlap*, 28 Idaho, 784, and cases therein cited on page 802, 156 Pac. 1141), and while this court has held shares in an irrigation company to be personal property *(Watson v. Molden*, 10 Idaho 570, 79 Pac. 503) the fact must not be lost sight of that a water right is, as heretofore shown, real estate, and that in case of a mutual irrigation company, not organized for profit, but for the convenience of its members in the management of the irrigation system and in the distribution of water to them for use upon their lands in proportion to their respective interests, ownership of shares of stock in the corporation is but incidental to ownership of a water right. Such shares are muniments of title to

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[22]The *Oligarchy, Hastings* and *Oppenlander* all were "mutual" companies and in each case the stock was held to be personal property distinct from the land.

[23]This decision involved the identical issues of the *Markham* case *(post*, n. 26) except that claimant advanced his claim to ownership on the theory that the stock was personal property.

[24]Ireton v. Idaho Irrigation Co., 30 Idaho 310, 164 Pac. 687 (1917). It is referred to because the *Olney* case emphasizes it.

> the water right, are inseparable from it, and ownership of them passes with the title which they evidence.

which is the language quoted in the *Comstock* decision. This is misleading and unfortunate. The test was not whether the company was or was not a "mutual," rather the test was:

> Furthermore, by the terms of the contract between the state and appellant and of that between appellant and Lansdown the water right was dedicated and made appurtenant to the land involved herein and none other.

Two years later, in a case involving a "mutual" ditch company, the statutes governing transfer of stock certificates generally were again held applicable to stock in a "mutual" company and no mention was made of the "real estate" characteristics of a share of stock.[25]

Then, in 1940, we see the status of a share of stock in a mutual ditch company depends upon "the intention" of the parties.[26] The trust deed included certain lands and "any and all water rights thereunto belonging or in any wise appertaining which are now or hereafter may be used on said premises, together with all shares of stock or shares of water in any ditch * * *." The stock certificate bore a notation as to use of water on some of the real estate described in the deed of trust (the decision is not clear as to the exact limitations—apparently other lands than those in trust deed were also enumerated). Trust deed was foreclosed (by bank) and it claimed title to shares of stock also claimed by defendant under pledge. Bank asserted title under two principal theories:

(1) that shares of stock are mere muniments of title of a water right which is real property;

(2) by reason of by-law making stock appurtenant to land.

The court refused relief to the bank and denied the first contention because the precedent cited *(Comstock* case) was inapplicable, and the second contention because the intention of the parties was to separate the land and water regardless of the by-law.[27]

The third general division heretofore mentioned involves the taxation of the property of the company itself as distinguished from the

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[25]Hexter v. Shahan, 66 Colo. 156, 180 Pac. 92 (1919).

[26]Denver Joint Stock Land Bank v. Markham, 106 Colo. 509, 107 Pac. (2d) 313.

[27]We thus have three general situations: (1) Mutual companies which have no restrictions as to place of use of water—stock is personal property and transferable as such. (2) Mutual companies which by by-law, stock certificate, or charter limit use of water to a certain described tract of land—stock is appurtenant to the land and, ordinarily, passes by deed. (3) A "peculiar situation" where, as in the *Markham* case, the court resorts to the time-honored rule of "intention."

stock it issues. As the writer sees it[28] there is no connection whatever between this situation and that of whether or not stock is an appurtenance to land and passes by tax deed. Anyhow, our court in the *Comstock* decision cites the *Kendrick* decision[29] as precedent. The last word on this phase of the subject is *Logan District v. Holt*,[30] decided in 1943, so that it is now determined what property is or is not tax exempt.[31]

The practitioner meets some phase of this problem frequently in private practice. It is suggested that because of questions which could otherwise arise it is well: (1) to get possession of the stock certificate, properly endorsed; (2) include in any conveyance of land a description of the number of shares and number of certificate involved, and (3) in case of loan secured by trust deed to handle stock as was done in *Oligarchy* case *supra*. In the absence of by-law or other restriction limiting place of use of water (1) is or should be controlling in all cases.

[28]The court saw it differently.

[29]Kendrick v. Twin Lakes Reservoir Co., 58 Colo. 281, 144 Pac. 884 (1914).

[30]110 Colo. 253, 133 Pac. (2d) 530.

[31]Headgates and dams, the bed of the reservoir, ditches, canals, flumes, area adjacent to reservoir for protection from erosion, wind, etc., and lands and improvements thereon for use of the caretaker are all exempt. Liable for taxation are agricultural implements, machinery and livestock. See Shaw v. Bond, 64 Colo. 366, 171 Pac. 1142 (1918); Antero Reservoir Co. v. Commissioners, 65 Colo. 375, 177 Pac. 148 (1918); *ibid.*, 75 Colo. 131, 225 Pac. 269 (1924), and the *Logan* and *Kendrick* cases (*supra*, notes 29 and 30).

New Translation of Roman Law

Translation into English of the complete body of Roman law, never done before, is being undertaken by a committee of the nation's leading Latin scholars and legal critics, of which Dr. Robert S. Rogers, professor of Latin at Duke University, Durham, N. C., is a member.

The project, expected to require five or six years of work in producing a volume three or four times the size of the King James version of the Bible, will make available to scholars who do not possess a technical knowledge of Latin the entire body of Roman law, basis for most of the law codes of the Western world.

Dr. Clyde Pharr, of the Classical Languages Department of Vanderbilt University, is heading the committee, which, along with Dr. Rogers, will include Alfred R. Bellinger of Yale University, noted historian; A. E. R. Boak of the University of Michigan, historian; Mason Hammond, of Harvard University, historian; Allan Johnson of Princeton, historian; Max Radin, expert on Roman law at the University of California; E. M. Sanford of Sweet Briar College; and Roscoe Pound of Harvard Law School, and others.

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HONOR ROLL

Members of the Denver Bar Association Who Have Lost Their Lives in the Service of the United Nations

Alvin Rosenbaum, First Lieutenant, United States Army Air Forces, August 2, 1943.

Again---How Many Times?

BY J. P. HELMAN*

Rule 4 (h) of the RULES OF CIVIL PROCEDURE provides for the publication of summons, and "such publication shall be made at least once a week for four successive weeks." In my opinion, once a week for four successive weeks means four times only, and this was the opinion of Hubert Henry in his article *How Many Times?*[1]

Rule 12 C (a) provides that the answer must be made to the summons within twenty days after service of summons, or if copy of complaint be not served with summons or if summons is served without the state or by publication, within thirty days after service on defendant.

*Of the Grand Junction bar.

[1]19 Dicta 231 (1942).