

<p>DISTRICT COURT ARAPAHOE COUNTY, STATE OF COLORADO Arapahoe County Justice Center 7325 South Potomac Street Centennial, Colorado 80112</p>	<p>EFILED Document CO Arapahoe County District Court 18th JD Filing Date: Dec 1 2009 3:20PM MST Filing ID: 28289254 Review Clerk: N/A</p>
<p>Plaintiff: STATE OF COLORADO, ex rel. JOHN W. SUTHERS, ATTORNEY GENERAL</p> <p>v.</p> <p>Defendants: COLORADO HUMANE SOCIETY & S.P.C.A., INC.; MARY C. WARREN, an individual; ROBERT WARREN, an individual; and STEPHENIE L. GARDNER, an individual</p>	<p>Case No. 08CV2659</p> <p>Courtroom: 404</p>
<p align="center">ORDER RE: MOTION TO ALLOW (1) THE CUSTODIAN, ON IN THE ALTERNATIVE THE RECEIVER, TO SELL ASSETS OF THE CUSTODIANSHIP ESTATE BY JUDICIAL SALE FREE AND CLEAR OF CLAIMS, LIENS, AND ENCUMBRANCES AND (2) FURTHER MOTIONS TO ESTABLISH SALE PROCEDURES AND TERMS ; AND INDIVIDUAL DEFENDANTS’ MEMORANDUM CONCERNING REINSTATEMENT FOLLOWING TRIAL</p>	

THIS MATTER comes before the Court on Waverton Group, LLC, as Custodian for the Colorado Humane Society & SPCA’s (hereinafter “Custodian”) Motion to Allow (1) the Custodian, or in the Alternative the Receiver, to Sell Assets of the Custodianship Estate by Judicial Sale Free and Clear of Claims, Liens, and Encumbrances and (2) Further Motions to Establish Sale Procedures and Terms (hereinafter “Motion”). Additionally, the Court will address the Individual Defendants’ Memorandum Concerning Reinstatement Following Trial. The Court being fully advised in the premises finds and orders as follows:

I. Statement of the Case

The Custodian filed its Motion arguing that in order to rehabilitate the Colorado Humane Society (hereinafter “CHS”) in light of its inability to

financially continue its operations, the Court should permit the Custodian to liquidate the assets of the CHS and conduct a judicial sale free and clear of any claims, liens, or encumbrances. In its Response, the defendants Mary C. Warren, Robert Warren, and Stephenie L. Gardner (hereinafter “Individual Defendants”) argue that the dissolution of CHS prior to a trial on the merits would amount to a “guilty verdict.” Additionally, the Individual Defendants claim to be creditors of the CHS and argue that such a sale would prohibit the Individual Defendants from recouping its claim against the estate. Finally, the Individual Defendants claim that such a resolution would prevent the Individual Defendants from returning to CHS if they were found not liable for the claims against them. The Attorney General, in its Reply, argues that the Individual Defendants were at-will employees and thus have no right to employment, that the Individual Defendants may avail themselves of the claims process, and that the Custodian is charged with managing the affairs of the CHS in the CHS’s best interest, which under the current financial climate requires a judicial sale. The Custodian also filed a Reply wherein it argues that a “free and clear” sale is the only way to accomplish the sale in order to secure potential bidders. The Custodian also reiterates the Attorney General’s argument that the Individual Defendants do not have any proprietary interest in the CHS.

In addition to the Custodian’s Motion, the Court also has before it the related issue of the Individual Defendants’ Memorandum Concerning Reinstatement Following Trial. In their Memorandum, the Individual Defendants argue that the Court has an equitable power to reinstate the Individual Defendants to their respective positions within CHS following the trial. The Individual Defendants argue that they only temporarily ceded their authority to the Custodian for the duration of the litigation and that the relief sought against the Individual Defendants is only to enjoin them from committing future deceptive trade practices and not to permanently bar their employment with CHS. The Attorney General subsequently filed its Plaintiff’s Brief Regarding the Ability of Mary Warren, Robert Warren, and Stephenie Gardner to Return to the Colorado Humane Society & S.P.C.A. In its Brief, the Attorney General again reiterates its argument that the Individual Defendants were at-will employees with no proprietary interest in CHS or their employment there. The Attorney General also voices its concerns over the impact the potential return of the Individual Defendants to CHS would have on the ability to seat a new Board of Directors and on CHS’s ability to maintain its contracts with the City of Littleton.

II. Findings and Order

The Court will first turn to the issue of whether the Individual Defendants have the right to return to the CHS following the resolution of the litigation. Next, the Court will address Robert Warren and Mary C. Warren's ability to continue of the CHS Board of Directors. Finally, the Court will address whether to liquidate the CHS or simply to close its doors pending the outcome of the litigation.

A. The Individual Defendants Do Not Have a Right to Return to CHS Following Resolution of the Litigation

The Custodian and Attorney General argue that since CHS is a nonprofit corporation in which the Individual Defendants have no ownership interest, the Individual Defendants were at-will employees with no right to employment. *Brammer-Hoelter v. Twin Peaks Charter Academy*, 492 F.3d 1192, 1209 (10th Cir. 2007). The Individual Defendants, however, counter the Custodian and Attorney General's positions by arguing that the Individual Defendants never resigned but merely temporarily stepped aside pending the outcome of the litigation. Moreover, the relief sought by the Attorney General against the Individual Defendants is merely to enjoin the Individual Defendants from committing further deceptive trade practices. The Court, however, agrees with the Custodian and Attorney General position, and as the Court stated in open court, the Individual Defendants appear to be employees at will with no right to return to the CHS now that they have left. The Court bases its opinion on the fact that Colorado is an employment-at-will state and because there does not appear to be a contractual agreement between CHS and any of the Individual Defendants as to the length of their employment. As the Individual Defendants stated on the witness stand, the Individual Defendants do not have a written employment contract. Since the Individual Defendants cannot produce a written employment contracts stating they were hired for a finite period of time, under Colorado law, they are considered at-will employees. *Continental Airlines v. Keenan*, 731 P.2d 708, 711 (Colo. 1987) (holding that an employee hired for an indefinite period of time is considered to be an "at-will" employee). Furthermore, an at-will employee does not have a property right to continued employment. *Brammer-Hoelter*, 492 F.3d at 1209. Therefore, the Individual Defendants do not have a right to return to their employment positions following the resolution of the litigation now that they have left CHS.

B. Mary C. Warren and Robert Warren's Do Not Have the Right to Return to the CHS Board of Directors

As stated during the contempt hearing, Robert Warren was appointed to be a temporary member of the Board of Directors when the other members, with the exception of Mary Warren, resigned following the Channel 7 news report. As a temporary Board member, Robert Warren was never elected or appointed as a full Board member and was only to fill in until a permanent board member could be appointed to replace him. Pursuant to the Stipulated Order appointing the Custodian, the Custodian has assumed all the duties of the CHS Board of Directors, and Robert Warren has been replaced, or at a minimum, is no longer needed in a temporary capacity. Therefore, he has no rights as a full Board member.

Moreover, Mary C. Warren was not a legitimate member of the Board of Directors. As stated in open court, Mary Warren has held a position on the Board of Directors continuously over the past 18 years. According to the CHS bylaws, “[n]o director shall serve more than two (2) consecutive terms. A one (1) year absence from the Board requalifies one for nomination for election.” *See* Bylaws, Art. VII § 3. Each term is three years. *Id.* It appears from the testimony in Court that Mary Warren has not abided by the CHS bylaws since she has served continuously on the Board of Directors for 18 years without participating in the mandatory 1 year absence before requalifying for nomination. As stated above, the only remaining members on the Board of Directors when the Custodian took over CHS were Mary Warren and Robert Warren since all other members resigned following the news story. Thus, it appears that CHS does not have a legitimately functioning Board. *See e.g. King County Dept of Community & Human Services v. Northwest Defenders Ass’n*, 75 P.3d 583, 586 (Wash. App. 2003). Only the Custodian appears to be a legitimately operating individual serving as the surrogate Board of Directors. Robert Warren has been either replaced or is no longer needed in his temporary capacity, and Mary Warren, as the sole remaining member of the Board, is not even properly a Board member because she has not abided by the bylaws. Thus, since Mary Warren has held her position on the Board of Directors in violation of the Bylaws, it appears that she does not have a right to retain her position on the Board of Directors following the resolution of the litigation. However, in following with the provisions of the bylaws, she might have a right to requalify for reelection after an absence of one year.

C. The Custodian has the Power to Judicially Dissolve the CHS

The Custodian seeks dissolution of the CHS at a Judicial Sale. The Custodian, as the only legitimately functioning individual operating as the Board of Directors, has the power to judicially dissolve the CHS. The Stipulated Order appointing the Custodian clearly states that the Custodian has the “power of the CHS” and may operate “in place of its Board of Directors.” *See* Stipulated Order Appointing Custodian and Issuing Preliminary Injunctive Relief at p. 3, ¶ 5. Additionally, the Custodian “is the only acting officer, director, or member of CHS.” *See Id.* As stated above, neither Robert Warren nor Mary Warren are properly members of the CHS Board of Directors. Thus, it appears that the Custodian is the sole individual on the CHS Board of Directors.

A court should only grant “the drastic remedy of dissolution with great caution and not in doubtful cases. It is fundamental that a receiver [or custodian] shall be interposed to conserve and not to destroy.” *In re Lalaland Development Corp.*, 152 N.W.2d 758, 765 (Minn. 1967). Here the Custodian has attempted to conserve the assets of the CHS, but such conservation is no longer feasible, and thus dissolution is necessary. Under the Colorado Nonprofit Corporations Act, a nonprofit corporation may be judicially dissolved by a director or member if it is established that the corporate assets are being misapplied or wasted. *See* C.R.S. 7-134-301(2)(d). While this Court will not comment on whether the Individual Defendants are liable for wasting or misapplying corporate assets since that is an issue for a trial on the merits, it is clear that under the current state of affairs the corporate assets are being wasted, or at the very least consumed, to such a degree that the CHS can no longer operate past January 1, 2010. As stated in Court, the Custodianship costs at least \$20,000 per month to maintain and contributions and revenue have dried up significantly during the pendency of the litigation. Thus, there are not enough corporate assets to sustain the CHS past January 1, 2010, when the city contracts expire. Therefore, in light of the rapidly dissipating corporate assets, the Custodian, as the only operating “director or member” of the CHS, may judicially dissolve the CHS.

D. The Court will Redesignate the Custodianship into a Receivership in Order to Facilitate the Liquidation and Judicial Sale of the CHS

While the Custodian has the power to judicially dissolve CHS, the Court believes a redesignation of the Custodianship into a receivership is the best method for facilitating a judicial sale. Under the Colorado Nonprofit Corporations Act, a custodian is charged only with managing the affairs of the nonprofit corporation in

the best interest of its members and directors. *See* C.R.S. 7-134-303(1), (4). Only a receiver may wind up the affairs of the nonprofit corporation and dispose of all or any part of the nonprofit corporation's property at a public or private sale if so authorized by the court. *See* C.R.S. 7-134-303(1),(3). However, the statute provides that a court may redesignate the custodianship into a receivership if doing so is in the best interests of the nonprofit corporation and its members and creditors. *See* C.R.S. 7-134-303(5). Additionally, when it appears to the Court that property in the hands of a receiver/custodian can only be conducted at a loss, the court can order the assets to be sold. *Webber v. Genesee Circuit Judge*, 184 Mich. 112, 115 (Mich. 1915).

Under the present circumstances, the Court believes redesignating the custodianship into a receivership in order to wind up the affairs of CHS and liquidate all its property in a judicial sale would be in the best interests of CHS's creditors. This belief does not comment on or make any sort of finding of whether or not the Individual Defendants are liable of the claims against it. Such a finding is an issue squarely for resolution after a trial on the merits. This finding is founded on the totality of the circumstances based on the current state of affairs facing the CHS. As stated not only in the Custodian's pleadings but also in open court, the CHS is unable to continue its operations past January 1, 2010, when the City of Littleton has indicated it will not renew any of its contracts with CHS's to operate the shelter or clinic. Moreover, the Custodian claimed in open court that the CHS does not have the revenue to pay any bills or any place to store CHS equipment once this deadline lapses. Thus, as of January 1, 2010, the shelter and clinic operations will cease. The Individual Defendants proposal to shut the doors of the CHS pending the resolution of the litigation, therefore, is impractical in light of the lack of revenue and lack of contracts facing the CHS. Since the CHS does not have the funds or the contracts as of January 1, 2010, to continue its operations, it is in the best interest of the creditors to liquidate the CHS and approve a judicial sale of its assets. Moreover, the liquidation and judicial sale of the CHS is also in the best interest of CHS since selling the CHS name will allow the goals of the nonprofit corporation to continue under new ownership.

E. The Judicial Sale will be Conducted Free and Clear of all Liens, Encumbrances, or Claims, Excepting any Liens of Record.

The Custodian argues that the judicial sale should be conducted free and clear of all liens, encumbrances or claims in order to incentivize potential bidders. The Individual Defendants claim they have lent money to the CHS over the years, which has not been paid back, and thus, they have a valid claim against the estate.

The Attorney General counters that if the Individual Defendants have availed themselves of the claims process, then the Individual Defendants would be entitled to payment of their claims. The Custodian claims that no party will bid on any asset if it is subject to the claims of creditors of the estate later. Additionally, the Custodian directs the Court to a United States Supreme Court case which holds that the court has the power to sell property in its possession and control free of all claims, liens, and encumbrances, so long as there is a reasonable prospect that a surplus will be left for the general creditors. *Mellen v. Moline Malleable Iron Works*, 131 U.S. 352, 367 (1889). The Court agrees with the Custodian that the judicial sale should be conducted free and clear of all liens, encumbrances, or claims. However, the Court will still require payment of any liens of record out of the sale proceeds. This requirement includes all tax liens, as the Custodian points out. *See e.g. Hough v. Lucas*, 76 Colo. 94, 230 P.789 (1924).

As the Custodian has correctly pointed out, additional motions will need to be filed that seek Court approval for a hearing to approve the prospective sale, establish a procedure for the solicitation and qualification of prospective bidders, set an auction if any overbidders appear, and set a hearing for the final Court approval of the sale and any Confirmation Order. Custodian has stated in open court that a potential bidder has already been located. The Court also requests a listing of all cash in the possession of CHS and a listing of all unsecured and secured claims currently existing against CHS. Additionally, as the Court moves forward with the Judicial Sale, the Court requests a statement regarding any further investigation the Custodian believes is necessary in order to locate any assets or, if necessary, any further steps needed to reconstruct the books and record and reasons why such investigation and reconstruction still needs to be completed. In addition, the Court requests a listing of all the steps the Custodian needs to take in order to wind up the now receivership.

F. Order of the Court

Therefore, the Court holds that:

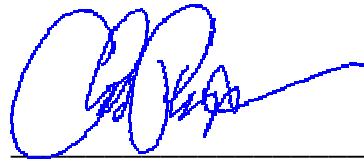
1. The Individual Defendants do not have a right to return to their employment following the resolution of this litigation. The Individual Defendants were at-will employees, and thus have no proprietary interest in their employment.
2. Neither Robert Warren nor Mary C. Warren are entitled to resume their positions on the CHS Board of Directors following the resolution of the litigation as neither are properly Board members. Robert Warren was only appointed temporarily to the Board and has since been replaced or is no

longer needed by the Custodian. Mary C. Warren has violated the CHS Bylaws by holding her Board position continuously for 18 years.

3. The Custodian is hereby converted into a receiver in order to conduct a Judicial Sale of the assets. Such a conversion is in the best interests of the CHS and its creditors.
4. The Judicial Sale will be free and clear of all liens, encumbrances, and claims, excepting all liens of record. The Court requests a listing of all cash in the possession of CHS and a listing of all unsecured and secured claims currently existing against CHS.
5. The Court also requests a statement regarding any further investigation the Custodian/Receiver believes is necessary in order to locate any assets or any further steps needed to reconstruct the books and record, if necessary, and reasons why such investigation and reconstruction still needs to be completed. In addition, the Court requests a listing of all the steps the Custodian (now Receiver) needs to take in order to wind up the receivership.

SO ORDERED THIS 1st DAY OF DECEMBER 2009.

BY THE COURT:



Charles M. Pratt
District Court Judge