New Legal Requirements for California Mutual Water Companies

Posted on March 7, 2012 by Wes Strickland 34 Comments

Effective January 1, 2012, California law imposes new requirements on mutual water companies that own and operate a public water system. Adopted as Assembly Bill 54 (Solorio), and codified at several places in the California Corporations, Government, and Health and Safety Codes, the new requirements are intended to improve the quality of water served by domestic mutual water companies throughout the state. Assemblyman Solorio introduced the bill in response to failure of technical, managerial and financial capacity at the Diamond Park Mutual Water Company in Santa Ana, although that company is in the process of being dissolved after connection to the City of Santa Ana water system.

The new statute departs from existing law in several ways. First, it includes a legislative declaration that "[r]egardless of the form of the organization that operates a public water system, these organizations provide a public service that remains one of the core duties of the people's government." Defining the business of a mutual water company as a "public service" is directly counter to a long history of court decisions that recognize the private nature of mutual water companies. It is that purely private nature that allows mutual water companies to remain exempt from regulation by the California Public Utilities Commission (CPUC). The legislative declaration that mutual water companies may be providing a public service is legally questionable, as well as unnecessary for improved oversight of public water systems that happen to be mutual water companies. While Assemblyman Solorio and the Legislature may not have intended to interfere with historical legal doctrines regarding mutual water

Categories

Second, by declaring the distribution of water to be "a public service that remains one of the core duties of the people's government," the Legislature has made a bold statement on a question that is widely debated among legal and policy experts. While the 20th Century saw substantial growth in the provision of water services by local governments in California, the same is not true globally or historically, where water service is frequently (and successfully) provided by the private sector subject to public regulation. While there are some civil society activists who argue that water service should be provided exclusively by the government, by no means is that a universal opinion, and the California Legislature's declaration that water service is a core duty of government appears either ill informed or out of place in a statute that addresses only the relatively tangential matter of mutual water company operations.

Third, AB 54 subjects mutual water companies to a broad range of regulation by the Local Agency Formation Commission (LAFCO) in each county. Traditionally, LAFCOs have provided limited oversight of local government entities that provide water service, while the CPUC has comprehensively regulated the operations of investor-owned utilities. Mutual water companies have not been regulated by either of those agencies, although they have been subject to regulation by the California Department of Public Health if they operate a public water system, the California Department of Real Estate if they are formed to serve a residential subdivision, and the California State Water Resources Control Board related to water rights.

New Corporations Code § 14301.1 requires that each mutual water company submit to the LAFCO for its county a map showing its service area by December 31, 2012. In addition, a mutual must respond to a request for non-confidential information from a LAFCO in conjunction with that agency's preparation of a municipal service review or sphere of influence. The statute does not require the mutual to undertake a new study or investigation, but merely turn over information already generated. It also does not require a mutual to disclose information about shareholders, such as their names, addresses or water usage.

New Government Code § 56375(r) grants authority to a LAFCO to approve the annexation of a mutual water company's service area to a city or special district. This provision does not insulate a city or district from having to pay just compensation for any mutual water company property taken by eminent domain, including, apparently, any compensation due under the Service Duplication Law (Cal. Pub. Util. Code §§ 1501 *et seq.*).

New Government Code § 56430(c) and (d) allows a LAFCO conducting a municipal service review to investigate whether a mutual water company that

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Drinking Water Acts. This new power overlaps with the existing jurisdiction of the Department of Public Health over public water systems.

Under the new law, Corporations Code § 14300(b) defines a mutual water company as the type of corporation described in § 14300(a), i.e., a "corporation organized for or engaged in the business of selling, distributing, supplying, or delivering water … only to owners of its shares." Previously, the California statutes did not include a definition of the term "mutual water company," although there was a common understanding of what constituted such a company. This is a minor, and possibly helpful, clarification.

New Corporations Code § 14301.3(a) requires that all improvements to a public water system owned by a mutual water company be designed and constructed in accordance with the California Waterworks standards found in Chapter 16 of Title 22, California Code of Regulations. New Corporations Code § 14301.3(b) requires that a mutual water company maintain financial reserves at a level sufficient to repair and replace its facilities in compliance with the federal and state Safe Drinking Water Acts (42 U.S.C. §§ 300f *et seq.*; Cal. Health & Safety Code §§ 116270 *et seq.*). These are helpful changes in the law and directly support the provision of high quality water supplies without challenging the nature of mutual water companies.

Lastly, new Health and Safety Code § 116755 requires that each board member of a mutual water company complete a two-hour training course within six months of joining the board, or by December 31, 2012 if already serving on the board as of the effective date of AB 54. The course must cover the duties of board members, including: the fiduciary duty of a corporate director; avoiding conflicts of interest; the duty of a public water system to provide clean drinking water; and long-term management of a public water system. A qualified trainer may include a California attorney, a person accredited under ANSI/IACET 1-2007, or a program sponsored by the Rural Community Assistance Corporation or California Rural Water Association.

During 2012, I will be offering the required training to mutual water company board members in several cities. Please contact me at wstrickland@bhfs.com if you are interested in participating in one of those sessions, or to schedule a training course for your board as a group. That training will include all required topics, as well as an overview of the laws related to mutual water companies, water rights and water quality. I look forward to seeing many of you during this year.

Category: Mutual water companies, Private v. public, Water companies

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Introduction to the California Infrastructure Finance Act →

34 Comments on "New Legal Requirements for California Mutual Water Companies"

Roy Harthorn
July 12, 2012

Do any of the new (or old) regulations speak to how meetings and proposed board and member actions are noticed before significant matters of the board and members are being acted on?

Reply

Wes Strickland
July 12, 2012

There are no special rules for mutual water companies and the notice they must provide of board or member meetings. Those rules are found in the Corporations Code sections applicable to all corporate governance, as well as the bylaws of each company. While the rules are somewhat similar to those governing public agencies (i.e., the Brown Act), the public agency rules do not apply either. When looking for the rules governing a particular mutual water company, just make sure you are looking at the statutes applicable to the specific type of corporate entity, e.g., a general corporation or non-profit mutual benefit corporation, since the rules can be slightly different.

Wes

Wes Strickland
September 12, 2012

I have received some questions about whether unincorporated associations fall within the requirements of AB 54. New Corporations Code section 14300(b), as well as 14300(a), refer specifically to corporations engaged in the business of delivering water to their members, so unincorporated associations do not fall within the statutory

Managers of such associations are welcome to join the training if they desire, but state law does not mandate any participation.

Reply

D King
March 7, 2013

If I have a dispute with my local mutual water company (and I am one of the share hold, as i was told my the water company) Where exactly can I file my complaints to resolve the dispute (my local mutual water company is not regulated nor governed by CPUC.)?

Reply

Wes Strickland
March 7, 2013

Mutual water companies are not under the oversight of any government agency for most aspects of their organization and operations. You are correct that mutuals are not governed at all by the CPUC. They are subject to limited oversight on service area issues by the Local Agency Formation Commission of the relevant county, and on public health issues are governed by the California Department of Public Health or County health department, depending on the size. Internal disputes within a company are governed by the typical laws on corporate governance. Many mutual shareholders will not be personally familiar with those rules, but may be more familiar with the rules regarding homeowners' associations, which are similar in being small, community managed organizations. The best route for internal company disputes is to resolve problems through negotiation, but if necessary a mutual shareholder has access to the courts based on the laws of corporate governance.

lenny matthews
April 17, 2013

I do not see the CPUC as "comprehensively regulated the operations of investor-owned utilities". I live in Lucerne California. We are held hostage by California Water Service Company and have now made it to the top of the pyramided as ratepayers! A small impoverished town of mostly seniors, 1800 strong on the largest fresh water lake in all of California,

Why? 1/2 have worked for CWSC and 1/2 have worked for the Public Utilities. Old time friends making money from what I would consider core insider tradeing! This must end! Flat out, you are wrong…there needs to be improved oversight! Additionally, “While there are some civil society activists who argue that water service should be provided exclusively by the government, by no means is that a universal opinion” I live alone, showering with a trickle 3 X a wk. Only flush when needed. Kitchen and bathroom sink run dry. No outdoor watering. My average water bill every 2 months…$240.00!! My PG&E, $25.00/mth I’ll take a gov’t program, thanks.

Reply

Wes Strickland
April 17, 2013

Thank you for your perspective. I cannot speak to your specific situation, although I did review the approved tariffs for Cal Water in your service area, and they do not seem outside the typical range for water utilities in many parts of California, the US and the world.

Regarding regulation by the CPUC, the agency is responsible for regulating every aspect of service quality and financial management of investor-owned utilities, including capitalization, debt and equity issuance, water supplies and demand management, personnel levels, training, compensation and benefits, and, most directly of concern to you, tariffs and other fees. In my experience, the Division of Ratepayer Advocates is a consistently zealous advocate for lower rates for consumers. In fact, my criticism would be that DRA often takes positions that would provide short-term rate benefits to consumers at the expense of longer-term rate and service quality benefits. While DRA is not always effective in their advocacy, I have never seen anything to suggest they are biased in favor of the water companies; in fact, many DRA representatives display a virulent disdain for the companies.

There are a number of factors leading to the price for water utility services in any given area, most of which are independent of whether the entity owning the utility is a government or investors. In many areas, government-owned utility rates are as high or higher than Cal Water’s tariffs in your area. That is especially true when considering the non-tariff revenues received by government utilities, such as taxes and tax subsidies like the income tax deduction for interest on

transfers, although this is substantially limited in California based on Proposition 218. The municipalization of an investor-owned utility comes with substantial costs, since the government has a legal obligation to pay just compensation for the property that is seized through eminent domain.

Consumers may not be happy about it, but water and wastewater utility rates are highly likely to increase substantially faster than inflation for the next 20 years. Individual consumers can reduce their bills somewhat through improving their water use efficiency, but also need to recognize that many times they will need to pay more in future because of their utility's past failure to make adequate investments in the system. That lack of investment has been common across all types of water utilities in the US for several decades, as citizens have preferred to consume goods today rather than save for the future. It is a problem that the US faces in a number of infrastructure sectors beyond water. Of positive note is that many leaders and citizens in the US have begun recognizing and trying to change our historic underinvestment.

Al Smith
May 16, 2013

Small mutual water companies are bad (Harper Valley PTA kind of bad), Big government regulation is worse (government can't do anything right). Government regulations created the bottled water industry by making our water both safe and virtually undrinkable.

Reply

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lenny matthews
May 26, 2013

Privatized Water is totally out of control and Lucerne California, under California Water Service Company, is the poster child thereof!
We want them the hell out of our town. They can build their own second story on their main San Jose building site!!
1)Private Water is a business that undermines Water Quality for profit rather than public good
2)Companies are accountable to shareholders not consumers
3)Privatization fosters corruption with closed door sessions and minimal transparancy

6)Privatization leads to job losses
7)Privatization can leave the poor with no access to clean water
8)Privatization would leave the door open for bulk water exports

With the World Bank predicting two-thirds of the worlds population by the year 2025 running out of fresh water, Fortune Magazine defines water as the “oil of the 21st Century”.

Rally Time!!!! Harbor Park Lucerne California 95458 June 22nd. Telling Cal-Water to get the hell out of Lucerne!! We cannot afford to pay more for our water than anyone else this side of the Mississippi!!! Average one person bill with the new proposed rate increase of RDA 51% (plus the approved 22% 2nd story addition in San Jose!!), approx. $150/mth

Reply

Wes Strickland
May 27, 2013

Thanks for reading and posting. After a number of years working with both public and private water utilities, I disagree thoroughly with your assertions regarding differences between private and public organizations. Several of your assertions conflate entirely different business models, e.g., investor-owned water utilities regulated by the California Public Utilities Commission (like Cal Water) versus “privatization,” which is controlled entirely by local governments that own water utilities. There are both well-run and poorly-run utilities across the public and private categories, and there is no real pattern suggesting that one form of organization is inherently superior.

It appears you are opposed to a Cal Water rate increase. While rate increases may not be desirable for many consumers, they are necessary to maintain infrastructure and allow safe, reliable deliveries of water directly to homes and businesses. Without adequate revenues, utilities are forced to underinvest in their infrastructure, which leads to deteriorating service quality. I believe there is wide support in the US for high quality infrastructure, across ideologies and political parties. Public participation in the details can be helpful, and the CPUC has a process for such input.

Al Smith
June 3, 2013

companies (who simply undo the harm that code compliant companies have been forced to do to the taste of our drinking water).

Remember God's first law "governments cant do anything right".

Robert Perez
August 23, 2013

Regarding private non-profit mutual water companies: Do we have to pay interests on deposits?

Reply

Wes Strickland
August 26, 2013

I assume you are asking about member deposits with the company for water service. If so, then "no" there is no legal requirement that the company pay interest on such deposits. In fact, it would be unusual to do so. The amounts are small enough typically that it should not make a significant difference to a member.

Dave
September 9, 2013

What about private, Non-Mutual water companies?

Reply

Wes Strickland
September 9, 2013

I assume you are referring to the question above regarding an obligation of a water utility to pay interest on customer deposits. As with mutual water companies, there is no legal requirement that a private, investor-owned water utility (or a government-owned utility) pay interest on any customer deposits.

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dcblasdel@ehblawyers.com
September 13, 2013

by a third party, and thus the shareholder has never received any water or a meter, does the shareholder have any basis, legal or equitable, to refuse to pay a portion or all of the assessments?

Reply

Wes Strickland
September 17, 2013

A mutual has a duty to supply water to its shareholders on reasonable terms and conditions. Without knowing all the circumstances, it would be hard to say whether a specific mutual has met that obligation, but it sounds like there may be grounds to compel the mutual to act, or to seek cancellation of the membership shares if that is desired. As part of the process, you might seek some consideration on assessments, yes. But again, it depends on the totality of the circumstances in the specific case.

Jennifer
May 4, 2014

What facts are taken into account when determining the amount of Financial Reserve which is sufficient under this law?
How often must the directors take the training? For example must a board member which has taken the training and is reelected take the training again?

Reply

Wes Strickland
May 5, 2014

The statutory language on reserves is that “a mutual water company that operates a public water system shall maintain a financial reserve fund for repairs and replacements to its water production, transmission, and distribution facilities at a level sufficient for continuous operation of facilities in compliance with the federal Safe Drinking Water Act and the California Safe Drinking Water Act.” Facts that would be relevant include the components of a company’s system, the age, expected life and condition of each component, and the cost to repair or replace each. An engineer could provide an opinion on the proper size of a reserve fund, and a company should

Under AB 54 (2011), training was once in a lifetime, but AB 240 (2013) changed the requirement to once every six years. Re-election does not affect the timing.

Jennifer

July 11, 2014

What kind of engineer would a mutual water company hire to assess the system and approve a reserve plan? Also how can I find such an engineer?

Wes Strickland

July 13, 2014

It would be an engineer who regularly works with water supply systems. They could prepare a prudent capital repair and replacement program and estimate the associated costs. If you email me at wstrickland@jw.com with your company name and location, I can send a couple names of firms in your area.

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steve martin

July 6, 2014

Can our mutual water company (non-profit) charge unimproved lots within our service area fees/assessments based on a proportion of costs due to maintenance, replacement etc? These lots have a corporation stop (valve) installed by the original developer dedicated to each respective lot. According to our bylaws these lot owners are not members until they request membership by application.

Reply

Wes Strickland

July 8, 2014

Your question raises two separate issues. First, a mutual water company has the authority to impose standby or other fees, charges or assessments on members who are not currently receiving water service. Those charges would be based on the value provided to the member's property by having access to water service in the future,

but would not include costs for current operation or maintenance of the water system.

Second, the relationship between a mutual water company and its customers is based on their membership in the corporation. The corporate articles and bylaws function like a contract between the corporation and all of its members, and provide the basis for all charges by the corporation to the members. In addition, California common law and statutes create some rules that apply to mutuals regardless of what is contained in their articles and bylaws. A mutual does not have any authority to impose charges on non-members, unlike a municipal or investor-owned utility that has an inherent relationship with all owners of lands within its designated service area. The approach taken by your mutual is not uncommon, but you should consult an attorney to determine whether changes need to be made in its structure and policies.

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bob zaidman

August 23, 2015

Our California Mutual Water Company (non-profit) has bylaws (dating to 1988 without revision) and a mission statement dating to 1973 for tax filings that strongly affirm that it can only sell water to shareholders and the State, or agencies thereof within its territories (which are named). There are less than 800 shareholders.
The Company, against considerable objections from shareholders has announced using the tally of an incongruous and threatening ‘rate survey’ mailer, that it now has the right to sell water to any entity it decides to, if the manager decides there is surplus or excess water.
In the survey If a shareholder were to answer that they object to outside sales .. the survey threat is that the Company will immediately raise their rates on the next water bill. Is this a legal or accepted practice in your opinion?

Reply

Wes Strickland

August 24, 2015

I cannot speak to this particular situation without knowing all the facts and circumstances. But in general, a mutual may legally transfer or sell water in bulk to non-shareholders, unless there are express

their organizing documents. It is the board of directors that has the authority and responsibility to consider and approve or disapprove a transfer. The main role of the shareholders is to elect directors, not to directly govern the company.

The survey you reference does not sound like a “threat” to me, but an assertion that without the outside income from the water transfer, a greater share of the company’s costs will need to be paid by the shareholders collectively. That would likely mean an increase in rates for the company to make up the lost revenue from the water transfer. Without knowing your company’s finances, I cannot say whether a rate increase would be necessary or not, but the logic is reasonable.

Mary Lenigk
May 1, 2018

We are an independent Mutual with approx 110 members and we have no water meters. We are located in Contra Costa County. We have heard that a law will require us to install water meters by year 2025! Can you tell me if that is a Law for small mutuals such as ours? And if so, where can I find information to give out to our members.

Thank you,

Reply

Wes Strickland
May 23, 2018

The Legislature passed a law in 2005 that requires all urban water suppliers to install meters on all municipal and industrial service connections on or before January 1, 2025. That can be found in Water Code § 527. However, an “urban water supplier” is defined in Water Code § 10617 as a water purveyor that delivers water to more than 3,000 customers or supplies more than 3,000 acre-feet of water annually. So your small company will not be required to install meters under § 527.

Be aware, though, that Water Code § 525 does require that a water purveyor install a meter on any new service connection, effective January 1, 1992. That law applies to any purveyor with at least 15 connections, so your company would be subject to that requirement.

Mary Lenigk
May 24, 2018

Thank you for the valuable information… Our mutual members will be very happy not to have meters installed..

CONNIE SKOOG
June 23, 2018

Dear Mr. Strickland,
Your reply to out board member that we would not have to install meters before 2025 was welcome news. I did speak with someone at the county level (Contra Costa County) who told me that we would, since we had more than 15 members. I wondered if you could give me a name of a person or organization at the state level with whom I could ask for a written reply on this matter.

Since we had thought we needed to save money and getting bids for installing 120 meters in our mutual, and now would abandon those plans, I would like to get something from an agency that confirmed our being exempt from California's goal of putting meters on most water users' properties.

Thanks a lot,

Connie Skoog
President Delta Mutual Water Company
5220 Sandmound Blvd.
Oakley, CA 94561
925-421-6260

Wes Strickland
July 22, 2018

Connie, I don't have a good person who would provide that, no. The easiest thing probably is just to cite them the Water Code sections that I referenced. They are fairly straightforward.

Bong Corona
July 3, 2019

Prior to AB 54, a mutual water company can only serve water to their

corporation boundaries but after AB 54 can a mutual water company serve water to a city or special district?

Reply

Wes Strickland
September 11, 2019

The answer to your question is yes, a mutual water company may deliver water to a city or special district, per Corporations Code § 14300(a), which authorizes a mutual to sell water to “any public agency”. In addition, per Public Utilities Code § 2705, a mutual may deliver water to “any city, county, school district or other public district” without losing its exemption from regulation by the California Public Utilities Commission. One last point to note is that a public agency may own shares or memberships in a mutual water company for purposes of receiving water, without violating the constitutional prohibition against public investment in private corporations, per the California Constitution, Art. XVI, § 6. Please note that these laws were not changed by AB 54, as that bill dealt with other issues.

Shannon Pekary
August 8, 2019

“a mutual water company that operates a public water system shall maintain a financial reserve fund for repairs and replacements to its water production”.

What if a water company does not do this? Who is in charge of ensuring compliance with this law? What recourses does that organization, or shareholders have, if the company does not do this? Reading the law, it states the requirement, but seems to offer no enforcement guidelines.

Reply

Wes Strickland
August 12, 2019

This requirement is found in California Corporations Code § 14301.3(b), which states that a “mutual water company that operates a public water system shall maintain a financial reserve fund for repairs and replacements to its water production, transmission, and

U.S.C. Sec. 300f et seq.) and the California Safe Drinking Water Act (Chapter 4 (commencing with Section 116270) of Part 12 of Division 104 of the Health and Safety Code)".

Since the standard is based on compliance with the Safe Drinking Water Act (SDWA), enforcement would most likely be by the agency that administers that law, which is either the Division of Drinking Water of the State Water Resources Control Board or the local county health department (depending on the size and location of the mutual). The SDWA regulator could issue an order requiring reserves of a mutual water company, or condition the issuance of a public water system permit on proof of such reserves. The board of directors of a mutual should have discretion to determine the correct amount of reserves, as the amount depends on both physical attributes of the system and other financial resources the board may have, e.g., access to loans and member assessments. Given that a member of a mutual water company has no control over the actions of the SDWA regulator once the topic is raised, I would be cautious about approaching the regulator with a complaint.

A member of a mutual water company could file suit in superior court seeking to require the company to establish reserves at a certain level. Such litigation would be expensive, as it would require expert testimony on both engineering and financial matters. For small water companies, the money spent on litigation would be better used to boost company reserves, so I would discourage filing such a suit under most circumstances.

Given that both legal avenues above have their challenges, the best first step would likely be to approach the board of directors directly. Only if no acceptable resolution can be achieved should a member think about invoking the assistance of the SDWA regulator or filing suit. Everyone should remember that directors are volunteers, and a member is more likely to successfully petition a board while being polite. Usually with advice from legal counsel and technical consultants as needed, a board will come to a reasonable position, even if it's not the exact position that each member would desire. Remember also that decisions about management of a mutual water company are supposed to be solved through the democratic process, i.e., through member voting for directors.

Leave a Reply

Enter your comment here...

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