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WHAT IS A MUTUAL WATER COMPANY?

This article is a very brief introduction to mutual water companies.

A mutual water company is defined to mean “Any private corporation or association organized for the purposes of delivering water to its stockholders and members at cost, including use of works for conserving, treating and reclaiming water” (Cal. Pub. Util. Code §2725). In other words, a mutual water company is a *corporation* which delivers water to *its shareholders* (not the public) *at cost*.

A Mutual Water Company is a Corporation. Mutual water companies are corporations, and unlike homeowners’ associations, must be incorporated. Mutual water companies are usually organized as non-profit mutual benefit corporations. The “mutual benefit” is the delivery and sometimes treatment of water to a limited class of persons (i.e., the shareholders) at cost.

The corporate rules governing the operation of mutual water companies are found in three different places. First, Corporations Code §§14300, *et seq.*, specifically addresses mutual water companies, but the treatment is not comprehensive. Second, Corporations Code §7110, *et seq.*, addresses mutual benefit corporations, in general. Third, to the extent the issue is not specifically addressed in §§14300 or §§7110, the general corporate law governs (Corp. Code §100, *et seq.*)

Like any corporation, a mutual water company is governed by a board of directors. The board appoints officers who run the corporation. The mutual water company is internally governed by its articles of incorporation and bylaws.

In addition to the corporate rules, mutual water companies are also regulated by either the Department of Corporations (typically for mutual water companies formed before 1998) or by the Bureau of Real Estate (for mutual water companies formed after 1998 in connection with subdivided lands). The DOC and BRE generally regulate the sale of securities. Share in mutual water companies are securities. In some rare instances, mutual water companies can be classified as public utilities and are regulated by the Public Utilities Commission.

A Mutual Water Company Delivers Water to its Shareholders at Cost. In addition to the corporate rules, a mutual water company must deliver water only to its shareholders and only

at cost. Selling water to non-shareholders may result in the company being classified as a public utility subject to regulation by the Public Utilities Commission.

There are exceptions to the rule a mutual water company must deliver water only to its shareholders. Under Public Utilities Code §2705, a mutual water company may also sell water to a lessee of a shareholder's land and/or shares, any entity under state or federal law (like a city or county), to others in the event of a bona fide emergency, pursuant to a court order or judgment, or pursuant to a contract made in exchange for water rights or an easement for water distribution purposes. In some instances, these transfers are not subject to the "at cost" limitation.

A mutual water company should be very careful when deciding whether to deliver water to non-shareholders. Even if the sale does not result in the mutual water company being classified as a public utility, such sales could cause the entity to lose its tax exempt status or result in unrelated business income tax (UBIT).