BEST BEST & KRIEGER LLP
ATTORNEYS AT LAW
400 Capitol Mall, Suite 1650
Sacramento, California 95814
(916) 325-4000
(916) 325-4010 Fax
BBKlaw.com

INDIAN WELLS
(760) 568-2611
IRVINE
(949) 263-2600
LOS ANGELES
(213) 617-8100
ONTARIO
(909) 989-8584

RIVERSIDE
(951) 686-1450
SAN DIEGO
(619) 525-1300
WALNUT CREEK
(925) 977-3300

Andrew J. Morris
(916) 551-2836
Andrew.Morris@bbklaw.com
File No. 82426.00000

April 5, 2011

Margot Garcia, Board President
Squaw Valley Mutual Water Company
P.O. Box 2276
Olympic Valley, CA 96146

Re: Squaw Valley Mutual Water Company—Powers of the Board of Directors—USDA Loan Inquiries

Dear Ms. Garcia:

The Squaw Valley Mutual Water Company ("Company") is interested in applying for a Rural Development loan through the United States Department of Agriculture ("Loan") to fund capital improvements to the water system ("Project"). The Project will require some homeowners to move their water connections from the rear of the house to the front of the house, and the Company Board of Directors ("Board") is considering giving members three years to perform this function at the members' expense. You have asked for an opinion regarding the Project. Please find below responses to your inquiries, as well as general responses to the February 15th letter received from Roger Pierucci.

1. Can the Project be approved by a majority of the Board (versus requiring a vote of the full membership)?

Yes. As you noted, the Company's By-Laws allow the Board to fix the amount of assessments from time to time and by the methods prescribed by the Board. (By-Laws 8.4.1.) The By-Laws do not require a vote of the full membership; rather, the By-Laws acknowledge that membership voting rates are based on proportional liability to an assessment (i.e., members subject to assessment may vote based on proportional liability *if a vote is called*). (By-Laws 8.1.4.)

Mr. Pierucci's letter claims the Board must put the Project to a vote because Project approval is outside the scope of Board powers. The letter relies on a 1949 case regarding company actions determined to exceed the company's powers and to lack a relation to the cost of production and delivery. (*Pritchard v. Whitelock* (1949) 95 Cal.App.2d 144.) This case is distinguishable from the circumstances surrounding the Project. *Pritchard* involved (1) a board action imposing a charge on each lot within the district while the articles of incorporation only

permitted liens against shares of stock, and (2) a charge on lots with no actual water connections as well as lots without shares. We do not read *Pritchard* as standing for the proposition that all mutual water companies must put major projects to a membership vote.

Here, the Company's Articles of Incorporation expressly permit the Company to supply water "at actual cost plus necessary expenses" and to charge assessments, in accordance with the By-Laws, on memberships. (Articles II, V, VII.) The By-Laws specify that assessments are levied on membership and based on the premise that each lot has value enhanced by the existence and maintenance of the Company and its assets. (8.1.4.) Additionally, the By-Laws provide that assessments may only be levied for a proper purpose and with advantage to the company membership as a whole. (8.1.4.) With this in mind, the Project does not appear to be outside the scope of the Board powers or to lack a relation to the cost of production/delivery (provided the assessment is proportional). The Project will improve delivery infrastructure, which is directly related to delivery.

Mr. Pierucci's letter also alleges a lack of a membership vote will deny shareholders due process, and relies on a water district case for its authority. (*Kern County Builders Inc. v. North of the River Municipal Water District* (1989) 214 Cal.App.3d 805.) This case is simply not applicable to the Company.[1] The court in *Kern County Builders* invalidated a water charge imposed by a water district, as the process lacked notice, a hearing and the opportunity to be heard (i.e., the water district failed to provide due process). However, the charge at issue was governed by the extremely complex laws that apply to public entities like water districts, not the completely different and simpler requirements that apply to mutual water companies, so the holding in that case is not relevant to the Company. Nevertheless, the Company did provide notice by sending out a letter advising members of the board meeting.

2. Is the Board empowered to take on indebtedness to fund the proposed Project?

Yes. As you noted, the By-Laws expressly permit the Board to incur indebtedness and fix the amount of assessments. (4.4.4, 8.4.1.) Indebtedness for capital improvements is not expressly provided for; however, this power can be implied from the Board's ability to conduct the Company's business and the Directors' ability to equalize proportionately the capital investment of the Company. (4.4.3, 8.4.2.)

Mr. Pierucci's letter states the Loan (assuming the Loan is between four and five million dollars) exceeds the legal authority vested in the Board. The Letter does not provide authority for this statement, but simply states that the decision is outside the ordinary course of Company business. The Articles and By-Laws do not provide a financial cap on the amount of indebtedness, and the ability to fund capital investments appears to be an implied and necessary power arising out of the Company's authority to distribute water. Interpreting the Articles and

[1] In addition to involving a public entity rather than a mutual water company, the *Kern County Builders* opinion was ordered not to be published by the court that issued the opinion. This means that the case has no value as legal precedent, and cannot even be cited in court. We are somewhat surprised Mr. Pierucci even mentioned this case.

By-Laws as allowing the Company to distribute water but not to pay for the capital improvements necessary to do so simply does not make sense.

3. Is a member's water right diminished by requiring the individual to move their lateral connection from the back of the house to the front where the new water main will be installed?

The By-Laws specify that each member has a right to have water delivered to the lot, but neither the Articles of Incorporation nor By-Laws provide that a member may choose the location of a connection. Additionally, these documents do not indicate that a water right is diminished or affected by a change in connection location. The member has the responsibility to get the water from the service box to their house, unless the Company has specified otherwise, such as by entering into an agreement to furnish the lateral connection. The Company's only responsibility seems to be providing the water to the edge of the street.

Mr. Pierucci's letter implies that a member's water rights are diminished because the connection may be turned off. However, the ability to receive water remains and is not cut off. The only change is to the connection location. We view the Company's ability to temporarily discontinue service to members who elect not to connect to the system as being analogous to the Company's ability to temporarily discontinue service for nonpayment of assessments. In either case, the member has the ability to have water service restored at any time simply by meeting his or her obligations.

4. Can the Company turn off the old water main after giving three years notice and require members to connect to the new water main at their own expense?

Yes, we believe the Company can turn off the old water main and require members to connect at their expense. It may be possible for the Company to advance the cost of connecting individual members' lots and collect the appropriate amount via assessment. We would suggest requiring any member wishing to have the Company perform this work to sign an agreement pledging to repay the cost of connection and agreeing that this cost can be collected as an individual special assessment.

The Letter claims that shutting off existing water supplies for 117 shareholders, should they fail to hook up to the new connections, is outside the ordinary course of Company business. Mr. Pierucci has not provided any support for his argument that turning off water is outside the ordinary course of Company business, or that even if true, this would somehow preclude the Board from taking this action. Service would be temporarily discontinued only for shareholders who decide not to connect to the new pipelines, but service will remain available at all times for members who wish to receive it.

5. Could the Company go onto private land and install a lateral connection from the water main to the house? After installation, would the Company be responsible for that lateral connection's maintenance? Could the Company use the money it collects in assessments from all its members to pay for these lateral connections on roughly half of the member's private property?

The Company needs permission to enter private property (i.e., written consent or contract), and an easement or license should be obtained prior to the Company installing a lateral connection from the water main to the house. Generally, if the Company were going to own the lateral, you would want an easement, but if the member were to own the lateral, the Company would just need a temporary license or a temporary construction easement. Unless the Company takes on the maintenance responsibility, the private property owner should be responsible for the lateral connection's maintenance. The Company should not grant benefits to private property owners that are paid by property owners not receiving the benefit, so we do not suggest paying for these lateral connections without agreements from each member to repay this cost in the form of special assessments.

6. Can the Board abandon easements no longer needed and leave the abandoned pipe in the ground?

The Board can abandon easements, and the interest will go back to the underlying property owner. However, if you plan on leaving the pipe in place the Company should retain the easement.

7. The existing easements are overgrown and some homeowners have built walls, swimming pool, and other encumbrances over the easements. Who is financially responsible for maintaining access and ensuring no physical structures are erected that impede access to these easements?

The property owner has an obligation to not impair the Company's easement (including access to the easement). The Company should inspect the easements and determine which easements have walls, pools, etc. When these conditions are present, the Company should send a demand letter requesting removal at the property owner's expense. The Company may be able to remedy the situation and then seek reimbursement if the property owner does not take the action, but we would suggest trying to get the Company's rights clarified prior to taking these actions. This might take the form of filing suits against members who have obstructed the easements.

8. If trees need to be cut, and walls torn down, who is financially responsible for doing that? And for replacing that which is removed?

The Company needs to maintain the easement itself, and this may include tree trimming on the easement property at Company expense. Walls impeding access (that were not present at the time of the easement grant) should be removed by the property owner at the property owner's expense, because the Company's use of its easement cannot be impaired by construction of structures that conflict with easement rights.

9. CEQA issues raised by Mr. Pierucci's letter.

Mr. Pierucci's letter raised a number of issues concerning compliance with the California Environmental Quality Act ("CEQA"). We frankly do not understand the points he is making. The California Department of Public Health has already issued a Notice of Exemption for work

which includes the Project, finding that the work is simply exempt from CEQA review. The deadline to challenge this determination has long since passed, assuming the Notice of Exemption was filed when it was issued. In addition, Mr. Pierucci's comment about evaluation of "growth-inducing impacts" (generally required under CEQA) is difficult to reconcile with the restriction in Section 8.1.5 of the By-Laws that no assessments may be imposed to expand the Company's water system beyond areas that were being served as of August 12, 1961. In light of that restriction, it is difficult to see how any change to the water system would or could have growth-inducing impacts.

CONCLUSION

It appears clear that the Board can take action to enter into the USDA loan and upgrade the water system without a vote of Company members. It also appears that the Company can require members to pay for the construction of new laterals, and turn off water service for members who do not do so.

Please do not hesitate to contact me with any additional questions or comments.

Sincerely,

Andrew J. Morris
of BEST BEST & KRIEGER LLP