

UTC Water Rulemaking – HOA, etc. (UW-131386)

Background Information
(September 5, 2013)

Commission Staff believes it would be helpful to persons interested in this rulemaking to understand the primary impetus behind the Staff proposal to repeal the exemption in WAC 480-110-255(2)(e) and (f) for “homeowner associations, cooperatives and mutual corporations”, and to instead address the status of these entities in a policy statement.

In short, the primary impetus is the need to assure the Commission’s rule is consistent with the law. Because a wide variety of factors can affect an entity’s jurisdictional status (some of these factors are discussed below), and it is not always clear how every factor or combination of factors will be considered by a court, a policy statement is the preferable way to address these issues.

In its current form, WAC 480-110-255(2)(e) and (f) could be (and have been) interpreted to create a blanket exemption for any homeowner association, cooperative or mutual corporation, no matter how it is operated.

The problem is that under the applicable court decisions, what an entity does is critical to whether it is exempt from Commission regulation. The bottom line is that not all homeowners’ associations, cooperatives and mutual corporations that provide water service are exempt from Commission regulation under the law.

Note: For any homeowners’ association, cooperative or mutual corporation that meets the definition of “water company” in RCW 80.04.010, but satisfies the standards enunciated by the supreme court in the cases discussed below, Commission Staff would consider such company not subject to Commission regulation.

At the outset, we note that the definition of “water company” includes “every corporation, company, association, joint stock association partnership and person”. RCW 80.04.010(30(a)). Therefore, for the Commission to exempt a water company that is a “corporation” or an “association” from regulation, there needs to be a firm legal foundation for that exemption.

Mutual corporations. In *Inland Empire Rural Electrification, Inc. v. Department of Public Service*, 199 Wash. 527, 92 P.2d 258 (1939) (*Inland Empire*), the court ruled that while a mutual corporation providing electric service met the literal definition of “electrical company” in RCW 80.04.010 (199 Wash. at 534-35), the company nonetheless was exempt from Commission regulation.

The company was a mutual corporation that provided electric service to its own members/shareholders exclusively. After evaluating the way the corporation was structured and operated, the court concluded the corporation did not offer service “to the public” because it was not “engaged in business for profit for itself at the expense of a consuming public that has no

voice in the management of its affairs and no interest in the financial returns”. 199 Wash. at 539. Therefore, customers did not require protection of the public service laws. *Id.*

The court emphasized that the corporation served only its members, at cost, and the corporation returned any surplus funds to its members ratably each year. 199 Wash. at 540. Each member had one vote. 199 Wash. at 529. The court was able to conclude there was a “*complete identity of interest* between the corporate agency supplying the service and the persons who are being served. It is a league of individuals associated together in corporate form for the sole purpose of producing and procuring for themselves a needed service at cost.” *Id.* (emphasis added).

The problem is that the law does not require every mutual corporation to have the attributes the court found to be critical in *Inland Empire*. For example, under Washington statutes, a mutual corporation may have several different classes of shareholders with different rights in the corporation. RCW 24.06.025(5)(b). A mutual corporation is not required to distribute any surplus on a ratable basis, or only to shareholders. Rather, a mutual corporation may distribute its surplus in another manner or to persons other than shareholders, as spelled out in the corporation’s articles of incorporation. RCW 24.06.015(13) and RCW 24.06.035(1). (Note that in the later decision in *Nob Hill*, the court indicated that it was acceptable for an exempt water company to retain earnings for use in the business). Upon dissolution, a mutual corporation’s remaining assets (assets left after paying costs and any required return of assets) are not required to be distributed equally among the members/shareholders, but only in the manner stated in the articles of incorporation. RCW 24.06.305.

Consequently, because all mutual corporations need not share the attributes the court found determinative in *Inland Empire*, the Commission cannot exempt all mutual corporations/water companies from regulation.

Cooperatives. In *West Valley Land Co., Inc. v. Nob Hill Water Association*, 107 Wn.2d 359, 729 P.2d 42 (1986) (*Nob Hill*), the court applied its analysis in *Inland Empire* to a cooperative providing water service. Similar to what it did for the mutual corporation in *Inland Empire*, the court indicated that the cooperative, the Nob Hill Water Association (Water Association), also met the literal definition of “water company” in RCW 80.04.010. However, the court held the Water Association exempt from Commission regulation. According to the court, the Water Association did not provide service “to the public” because it “did not conduct its operations for gain to itself, or for the profit of investing stockholders, but functions entirely on a cooperative basis.” 107 Wn.2d at 367.

In particular, under the Water Association’s articles of incorporation, the cooperative would earn no profit and would not declare any dividends. Upon dissolution and liquidation, each stockholder would receive a pro rata share in the assets of the corporation. 107 Wn.2d at 361. The court also noted that the Water Association served only its shareholder members, all of whom “have a ‘voice’ in the management of its affairs.” 107 Wn.2d at 368.

The court concluded that the Water Association was not subject to Commission regulation because it was not a corporation “engaged in business for itself at the expense of a consuming public which has no voice in the management of its affairs and no interest in its financial returns.” 107 Wn.2d at 368.

The problem is that the law does not require every cooperative to have the attributes the court found to be critical in *Nob Hill*. For example, under Washington statutes, a cooperative may have several different classes of shareholders with different rights in the corporation. RCW 23.86.050(6)(a) - (c). A cooperative may deny certain of its member/shareholders the right to vote (i.e., a “voice” in management of the cooperative’s affairs). RCW 23.86.115(1). A cooperative may pay dividends, and at a different rate to different classes of members/shareholders. RCW 23.86.160. Upon dissolution, the cooperative’s remaining assets (assets left after paying costs and any required return of assets) need not be distributed pro rata among the members/shareholders, but simply in the manner stated in the articles of incorporation. RCW 24.06.305 (applies per RCW 23.86.250).

Consequently, because all cooperatives need not share the attributes the court found determinative in *Inland Empire*, the Commission cannot exempt all mutual corporations/water companies from regulation.

Homeowners’ Associations. There are no Washington court cases addressing the jurisdictional status of homeowners’ associations that otherwise meet the definition of a “water company” in RCW 80.28.010. However, the same problem applies here that applies to mutual corporations and cooperatives.

For example, in the chapter of the Washington statutes devoted to homeowners’ associations (RCW 64.38), there are very few limitations on how a homeowners’ association may structure its business and operate. There is no requirement that each member/shareholder have a vote or an interest in the financial returns of the association. A homeowners’ association may be organized as a corporation, and, if so organized, may “exercise all other powers that may be exercised in this state by the same type of corporation as the association.” RCW 64.38.020(12). Accordingly, the same corporate power analysis that applies to mutual corporations and cooperatives, addressed in some detail above, can apply to a homeowners’ association.

Consequently, because all homeowners’ associations need not share the attributes the court found determinative in *Inland Empire* and *Nob Hill*, the Commission cannot exempt all homeowners’ associations/water companies from regulation.

The foregoing provides just some of the factors and issues that can apply in determining the jurisdictional status of a particular entity. Nonetheless, Staff hopes this will aid an understanding of the impetus behind the proposal.