



Note: The opinions, analysis and conclusions contained in this memorandum are solely those of the State Coastal Conservancy. Any potential Buyer of the Victorine Ranch Property should not rely on the analysis, opinions or conclusions contained herein and should consult with its attorney, undertake its own independent investigation and analysis and reach its own independent opinions and conclusions. Copies of documents referenced in this memo will be provided on request.

MEMORANDUM

TO: Kelly von Schack
President, Victorine Ranch Mutual Water Company

FROM: Jack Judkins
Staff Counsel

DATE: October 16, 2014

SUBJECT: Victorine Ranch: Victorine Ranch Water Company (Water Company)
Subscriber Costs and Road and Utility Improvement issues

This will respond to your memo to the Conservancy dated June 6, 2014. I apologize for the delay in getting back to you with a response. I spent a fair amount of time tracking down and reviewing a multitude of documents regarding the Water Company and road and utility access easement issues associated with the Conservancy Victorine Ranch (CVR) property. Based on my research I have reached the following conclusions:

1. There is clear documentation that the Conservancy paid its full share of the Formation and Construction Expenses to the Water Company, as required under the Subscription Agreement. The Water Company is obligated to issue shares in the Water Company to the Conservancy’s successor(s), on demand of the Conservancy and without any preconditions or impediments to the issuance of such shares. No additional payment, such as payment of past costs of maintenance, repair, operation, improvements or replacement, is required.
2. The Conservancy (or its successor(s)) has no obligation to pay for access road and utility costs, absent documentation that the Conservancy agreed to share in such costs or that written notice was provided the Conservancy “as soon as practical after such emergency expenditures”. The Conservancy did provide payment for the new electric gate on the road and for at least one emergency repair of the access road.

Before moving on to the discussion of the basis for these conclusions, I should note that these are the conclusions the Conservancy has reached. Any successor who takes title to the CVR will have access to all of the documentation in possession of the Conservancy, but will need

to review those documents and reach its own conclusions and accommodation with the Water Company and with the other users of the access road and utilities.

Below is a description of the relevant documentation and an explanation of how I reached my conclusions.

A. Water Company.

We are in agreement with the first paragraph of your memo, in which you conclude that the Conservancy paid its share of the “Formation Expenses”, the first step in becoming a subscriber and potential shareholder of the Water Company, under the “Subscription Agreement” (see description below), to which the Conservancy is a party. We also agree with the principle expressed in the second paragraph of your memo that the Conservancy was obligated (as were all other other subscribers) to pay within a certain timeframe its share of the “Construction Expenses”, in order to retain its status as a subscriber. However, we firmly believe that you are incorrect when you state in the second paragraph:

. . . the Conservancy chose not to subscribe at that time and instead, to defer active subscription until the parcels were sold for development (which it retains the right to do so in Section 13). Additionally, we have no record of payment [of the Construction Expenses] in our corporate files and shares were never issued to the Conservancy.

In fact, the Conservancy did provide payment of the Construction Expenses, as evidenced by a multitude of documents and, while shares were not issued to the Conservancy (nor could they be, as expressly noted in Section 13 of the Subscription Agreement), the Conservancy satisfied all pre-conditions for the issuance of shares to its successor(s) under Section 13 of the Subscription Agreement.

The Conservancy and Bibbero, the prior owner of your property, adjacent to the CVR, entered into a “Water Right Agreement and Grant of Easement” on December 11, 1995, which was subsequently recorded on December 22, 1995 (the "Water Agreement", attached as Exhibit 1). The Water Agreement acknowledges that the Conservancy (or successor owner of the CVR property) will be given the right to participate in the Victorine Ranch Mutual Water Company (Water Company) for the use of the water well located on the Bibbero property. In addition, Bibbero granted and conveyed to the Conservancy the right to obtain water and serve up to four residences on the CVR property, along with an easement to access, construct, maintain, operate and repair infrastructure to provide water from the Bibbero well and across the Bibbero property. The Water Agreement also references the 1995 Subscription Agreement (described below) and, in essence, requires the Conservancy to relinquish its right and easement under the Water Agreement (by conveying, by quitclaim, the right and easement back to Bibbero or successor), when the Conservancy (or successor) are granted the right to shares in the Water Company and credited with any expenditures the Conservancy has made for water service improvements.

Concurrently, owners of property within Victorine Ranch entered into the “Mutual Water Company Subscription Agreement, Victorine Ranch Mutual Water Company”, effective as of December 21, 1995 (the “Subscription Agreement”, which you reference and apparently have in your possession), which provides for the issuance of shares to property owners in the Water Company within the defined Victorine Ranch “service area”. The Conservancy is a party to the Subscription Agreement and the CVR property is specifically defined as being within the service area. The Subscription Agreement sets forth certain preconditions for the parties becoming “Initial Subscribers”. The Subscription Agreement requires that in order to achieve this status, a party, including the Conservancy, must pay (or make direct expenditures for) its share of the Formation Expenses for creating the Water Company (i.e. the costs of establishing the water company as a corporation and provider of water service) and the Construction Expenses, consisting of the preconstruction and construction costs for the main water service infrastructure, but excluding the costs of any “Lateral” infrastructure, required to connect the respective parcel to the main water service infrastructure. If a party to the Subscription Agreement made its proportionate contributions for the Formation Expenses and the Construction Expenses, it would be considered an Initial Subscriber and be entitled to the issuance of its shares in the Water Company. Under paragraph 13 of the Subscription Agreement, the parties to the agreement acknowledge that the Conservancy “is an agency of the State of California, and cannot itself acquire or hold shares in the Mutual” and, thus, if the Conservancy makes payment for the Formation Expenses and the Construction Expenses as required, the parties agreed that “the Conservancy shall receive the guaranteed credit and right for its successors or assigns to obtain shares in the Mutual”. Finally, the Subscription Agreement provides for the subsequent recovery of “ongoing expenses” associated with operating, maintaining and repairing the main water service infrastructure, through the sale of water to its shareholders who have been issued shares or through the levy of charges to its shareholders.

Consistent with the requirements of the Water Agreement and the Subscription Agreement, the Conservancy took all appropriate steps to meet the requirements that would qualify its successors to become shareholders in the Water Company, up to and including the payment of the Construction Expenses. These steps included the following:

1. In preparation for the expected future payment of the Construction Expenses, at the Conservancy board meeting of June 26, 1996, Conservancy staff requested Conservancy board approval to disburse funds for the Construction Expenses. The June 26, 1996 staff recommendation for this purpose specifically requested board authorization “to disburse up to \$100,000 to pay for the Coastal Conservancy's share of construction expenses for a water delivery system and for other expenses associated with the preparation and processing of the Conservancy's subdivision map application for its ‘Craven-Nation’ property on the Victorine Ranch”. The staff recommendation and the subsequent minutes documenting that the board approved the recommendation to disburse funds for the Water Company Construction Expenses are attached as Exhibit 2.
2. Due to the vagaries of the State process for issuing a warrant (i.e. a State check), Conservancy staff decided to utilize an existing contract with Bestor Engineering, Inc. (Conservancy Contract No. 91-076, originally for services related to the CVR property)

as the vehicle through which the Construction Expenses would be paid to the Water Company¹. Accordingly, the Bestor Engineering contract was amended after the June 1996 board approval, first to allow for the payment by Bestor of the Construction Expenses to the Water Company and to add additional funds to cover the approximate expected amount of Construction Expenses (Amendment No. 4), and then to allow for the direct payment by the Conservancy to the Water Company of the Construction Expenses rather than the Conservancy paying Bestor and Bestor paying the Water Company (Amendment No. 5). Copies of the contract amendments and a contemporaneous Conservancy staff memo describing the purpose of the amendments (to pay for the Construction Expenses) are attached as Exhibit 3.

3. On February 20, 1997, Anthony Lombardo, the attorney for the Water Company, mailed a letter to the Conservancy, requesting payment of the Conservancy's share of the Water Company "Construction Expenses" for the CVR property, in the total amount of \$61,605.10. A copy of this letter is attached as Exhibit 4.
4. On or about April 8, 1997, the Conservancy requested that the State Controller's Office issue a warrant in the amount of \$61,605.10 (the exact amount of the Construction Expenses requested by the Lombardo letter) for the Construction Expenses. On April 14, 1997, Conservancy staff followed up that request with a memorandum to the State Controller, Accounting Unit, confirming the request for a warrant for the Construction Expenses and confirming that the warrant would be sent by overnight mail and providing the corrected street delivery address for Anthony Lombardo and Associates. A copy of this memorandum is attached as Exhibit 5.
5. The Conservancy's Accounting Unit maintains records of all warrant claims submitted to the State Controller's Office and identifies the amount of funds taken from each separate Conservancy fund that has been used to fulfill that claim. In the case of the Bestor contract, three separate funds were used as the source of payment to the Water Company for the Construction Expenses. The accounting sheets associated with these three funds evidence that the following amounts were applied as of April 8, 1997, to the payment for the Construction Expenses: \$8,799.50, \$17,681.60 and \$35,124. The total of these three amounts is \$61,605.10, which, again, matches the total Construction Expenses requested by the Lombardo letter. Copies of the three Accounting Unit drawdown sheets described above are attached as Exhibit 6.

In sum, these documents evidence that: the Conservancy board authorized the disbursement of funding for the Construction Expenses; the Conservancy staff identified a vehicle for the disbursement of those funds to the Water Company (the Bestor contract) and added funding and terms to that contract which would allow for the disbursement of the Construction Expenses; under that contract, the Conservancy staff requested that the State Controller's

¹ This approach was used by the Conservancy at least two other times to provide funding to outside entities for the CVR property: 1) to meet its share of the Water Company "Formation Costs", the Conservancy provided funding under a contract with Whitson Engineering for engineering services needed and provided in the formation phase; and 2) the Conservancy paid for its share of emergency VR access road repairs through a contract with Flake Engineering (this latter contract will be discussed further below).

Office disburse and deliver the funds directly to the agent for the Water Company by overnight delivery; and the three Conservancy funds used to pay the Construction Expenses were drawn down in the exact amount of the Conservancy's share of the Construction Expenses.

The fact that the Conservancy did pay for its share of expenses is further substantiated by what followed. On July 23, 1999, Wendy Elliot, an attorney with Lombardo and Gilles, the attorneys for the Water Company, provided a letter with enclosures to the Conservancy's attorney, regarding the Conservancy's current entitlement to the issuance of shares in the Water Company. (A copy of the July 23, 1999 letter and its enclosures, described below, are attached to this memo as Exhibit 7). First, Ms. Elliott confirmed that the State of California, Department of Corporations had granted a "Permit", dated May 11, 1999, authorizing the issuance of shares by the Water Company and provided a copy of that Permit. Second, she notified the Conservancy that the Water Company "stands ready to issue, upon demand, shares in the Mutual [i.e. the Water Company] to the Conservancy or any future owners of the Craven-Nation properties" and that it had adopted a "Resolution" to that effect. A copy of the signed June 4, 1999 "Minutes of Action Taken by Written Consent of the Victorine Ranch Mutual Water Company", was provided with the letter to document the Resolution. The Resolution, in pertinent part, reads as follows:

RESOLVED, that the issuance of two shares of the Corporation to the Conservancy or any future owner(s) of the Craven-Nation properties for water service for two primary structure water connections and accessory structure connections is hereby ratified and approved;

RESOLVED, FURTHER, that the Corporation acknowledges that there are no preconditions or impediments to the issuance of such shares of the Corporation, except for demand by the Conservancy and as set forth in the Bylaws of the Corporation and the Subscription Agreement, and further acknowledges that the Conservancy will reconvey the water easement over the Bareilles property in reliance thereof . . . [emphasis added]

Finally, Ms. Elliott's letter requests that the parties move forward with the reconveyance by the Conservancy of the water easement over the Bareilles (formerly Bibbero) property that had been previously conveyed to the Conservancy by the Water Agreement. Under the Subscription Agreement and the Water Agreement such reconveyance is required only if the Conservancy has met all of the preconditions to the issuance of shares – i.e. has paid its full share of expenses.

Ms. Elliot's letter and the Resolution of the Water Company alone provide all the documentation needed to evidence that the Conservancy has satisfied all conditions for issuance to its successors of shares in the Water Company and that the issuance of those shares is without any "preconditions or impediments", except for "demand by the Conservancy". Thus, under the Resolution, the Water Company has confirmed that it will issue shares to the Conservancy's successor, without any additional conditions or demands, such as the monetary demands, which your June 2014 memo proposes.

Even if the plain language of the Resolution is not fully dispositive (which, of course, it is and must be), the mere fact that the Water Company adopted the Resolution, certifying that the Conservancy is entitled to shares upon demand, evidences that the Conservancy must have paid its proportionate share of the Formation and Construction Expenses. This is exactly what section 13 of the Subscription Agreement required as a precondition to the guaranteed right to receive shares and it is difficult to imagine that the Water Company would have granted this right in the absence of payment of the requisite share of expenses. Section 13 reads as follows:

[T]he Conservancy is entering into this Agreement to secure the right for its successors in interest to obtain such shares in the Mutual and to the extent that the Conservancy makes expenditures for the benefit of the Mutual, as provided in Paragraph 6(c) or payments to the Mutual as provided in Paragraphs 6(a) and/or 6(b), the Conservancy shall receive the guaranteed credit and right for its successors or assigns to obtain shares in the Mutual. [Section 13, *emphasis added*]

In short, there is no basis for your demand for the payment of the Construction Expenses (which were already paid) or for any other monetary precondition or impediment to the issuance of shares. Your June 2014 memo references two water system costs: “Well improvement” costs and “Water System” costs. If either of these reflect the initial construction costs, then the Conservancy has already paid its share, as discussed at length above. If, on the other hand, as it seems likely, these costs reflect, in whole or in part, post-construction maintenance, improvements, repairs, replacement or upgrades, neither the Conservancy nor its successors are responsible for those costs. The Subscription Agreement, under Section 6, is clear that operational, maintenance, repair and replacement and improvement costs are to be borne by shareholders through revenues generated by charges to shareholders for water usage and assessments of shareholders for future replacement, improvements and upgrades to the water system. Below are the relevant excerpts:

Normal on- going expenses of the day-to- day operation of the Mutual plus normal maintenance of the Water System will be paid for from revenues derived from the sale of water to the shareholders. [Section 6, first paragraph, *emphasis added*]

(f) On-going Expenses. The Mutual will collect revenues (the "Revenues") derived from metered water usage by individual shareholders at a yet to be determined rate based on cost of service necessary to pay the expenses of the Mutual from the sale of water to its shareholders who have been issued shares pursuant to Paragraph 7 below. The Revenues will be applied to cover the on-going operating expenses of the Mutual plus normal maintenance and repair of the system and the hiring of a licensed operator for bacteria testing as required by the regulatory agencies. The Mutual shall have the power to levy charges to its shareholders for a reserve fund and to assess its shareholders equally to cover the replacement cost and installation of any major part to the Main Water System in case of failure and in the event that the Mutual has insufficient reserve funds to cover such costs. [Section 6, subparagraph (f), *emphasis added*]

Even though the Conservancy has the right to demand on behalf of its successors that the Water Company issue shares to its successor(s), it is not now nor has it ever been a "shareholder". Under the Subscription Agreement it is the "shareholders" who are required to shoulder the expenses of the water system. Not only is this what the Subscription Agreement requires, but it makes complete sense. Those who are actively using the water system should bear the costs of its ongoing operation and maintenance and the costs of repair, replacement or improvement needed as a result of the effects of that long-term usage. It would be inequitable and contrary to the terms of the Subscription Agreement to seek to have a successor to the Conservancy, who has never had any advantage from the water system to date, pay for these types of costs.

B. Access Road and Utility Easement.

The Conservancy, through acquiring title to the CVR property, received the benefit of an existing access and utility easement that runs from Highway 1 across the adjacent properties. This easement had been reserved by an earlier subdivider of the larger Victorine Ranch property and was conveyed to the Conservancy with title to the CVR property.

In 1981 owners of the adjacent properties (Spiegel, Bibbero and Allen) entered into an "Agreement" dated November 16, 1981, recorded as Reel 1550, Page 827 ("Road Agreement"). Spiegel, Bibbero and Allen were the then-owners of the Victorine Ranch properties adjacent to the CVR property. The properties were served by an access road and utilities right of way along that road. The parties entered into the Road Agreement to confirm their understanding that they would "mutually undertake to provide for certain road improvements and for the provision of water and electrical utilities to their respective properties and agree to share in the common costs associated with such improvements and utilities."

Subsequently the Conservancy became the owner of the Allen property and then entered into negotiations with Bibbero for the sale of the Allen property to Bibbero. In connection with the consummation of that sale, the Conservancy and Bibbero entered into an "Acknowledgment of Payment" dated December 15, 1995 ("Acknowledgment"). The Acknowledgment references the Road Agreement, described in the preceding paragraph, indicates that the CVR property is not covered by the Agreement, but that the Allen property, then owned by the Conservancy, is covered by the Agreement and acknowledges the Agreement "permits other property owners in the immediate area who are not parties to the Agreement to benefit from and share in the costs of making those improvements if the parties to the Agreement allow [those other] such parties to participate". The Acknowledgment serves to confirm that the Conservancy, both as the owner of the Allen property and as the owner of the adjacent CVR property has paid its share of costs related to certain "road and utility improvements" made by Bibbero. (My understanding is that those costs were "paid" through discounts or credits against the sale price for the Allen property that were provided to Bibbero by the Conservancy in connection with the sale of Allen property to Bibbero).

The Acknowledgement establishes certain understandings regarding the Conservancy's then-current and future participation in costs for repairs to and improvements of the road and utilities on the road and utility easement. The Acknowledgment establishes the parties' agreement:

1. That the Conservancy, as owner of the Allen property has paid in full "all of the costs of installing any improvements made to date, including the Existing Improvements, which are chargeable to the Allen Property under terms and conditions of the Agreement".
2. That Bibbero warrants that the Conservancy or any successor in the Allen property shall not "be required to pay any additional share of the costs of installing any improvements made to date . . . as a condition of benefitting from the road improvements and utility connections provided by Bibbero to date [as of 12/21/1995], notwithstanding the payment or nonpayment or amount of payments made to Bibbero by other parties to the Agreement as their share of these costs.
3. That the Conservancy has also "paid all of the costs of installing any improvements made to date [as of 12/21/1995] that would be chargeable to the [CVR property] under the Agreement, were the [CVR property] subject to the Agreement".
4. That Bibbero warrants that the Conservancy or any successor in the CVR property shall not be required to "pay any additional share of the costs of installing any improvements made to date . . . as a condition of benefitting from the road improvements and utility connections provided by Bibbero to date, or of entering into the Agreement as an additional party, or into any subsequent agreement to which Bibbero or her successor is a party which provides for sharing the costs of improvements benefitting properties in the Victorine Ranch, notwithstanding the payment or nonpayment or amount of payments made to Bibbero by other parties as their share of these costs.
5. That Bibbero "agrees not to oppose or interfere with the use [by the Conservancy or successor] of improvements made to date . . . and waives the right to any additional payment from the [Conservancy or successor] for the costs of installing any improvements made to date . . . in the event of any future claims or disputes among other parties to the Agreement or any subsequent cost-sharing agreement relating to the costs of installing the improvements made to date . . . or payment therefor.
6. That no further charges for future road and utility improvements for the benefit of the CVR property would be levied against the Conservancy, unless the Conservancy gave its prior consent to those repairs. One exception was made to this: for emergency repairs, provided that notice was provided to the Conservancy promptly after the emergency repairs were made. ("Reimbursement of expenditures made under emergency conditions to protect and maintain access or utilities in their existing condition, to the extent such reimbursement otherwise would be required, if written notice is provided as soon as it he practical after such emergency expenditures").

Based on the Agreement, it would appear that the Conservancy (or successor): has the right

to use the road with access and utility improvements; owes nothing for any improvements made up through December 21, 1995; and only owes for charges related to subsequent road and utility repairs or improvements, if the Conservancy gave its prior consent to those repairs or if emergency repairs were made and notice of those repairs and associated expenditures was “provided as soon as practical after such emergency expenditures”.

We have searched our records and find nothing to indicate that the Conservancy was asked for and provided our prior consent to any repairs or improvements or to indicate that the Conservancy was informed within a reasonable time after any emergency repairs, with two exceptions, as follows:

1. By letter dated August 24, 1998, Rick Bibbero informed the Conservancy and all other Victorine Ranch property owners that each was required to pay shared costs, including the costs of the electric gate on the access road. The Conservancy’s share was identified as \$8,675.40 and Mr. Bibbero suggested in his fax cover sheet note that the Conservancy consider disbursing its share out of remaining proceeds in escrow for the Allen property sale to Bibbero. The Conservancy did just that, as evidenced by its letter of September 4, 1998, directing Chicago Title Company to transfer that amount from escrow to Lombardo & Gilles, and by a “Lombardo and Gilles Trust Account” ledger sheet, accompanying a letter from that law firm (on another topic) dated November 1, 1999, that shows that the payment from the Conservancy was received on “9/18/98”. Copies of all documents referenced in this paragraph are attached as Exhibit 8.)
2. In December 1998, the Conservancy entered into a contract with Flake Construction (Conservancy Contract No. 98-053, the “Flake Contract”), the purpose of which was to undertake emergency repairs to the access road from Highway 1 to the Conservancy’s property. A copy of the Flake Contract is attached as Exhibit 9. The “Scope of Work” to be performed under this contract, according to its terms, included: excavation of portions of the road that had been washed out; installation of a new culvert pipe; replacement and compaction of road material in washed out areas; and the planting of seed and placement of jute erosion-controlled material on the banks of the repaired area. Under the Flake Contract, the Conservancy provided \$10,408.65 of the total project cost of \$20, 817.30. As noted by the “Total Cost” section of the contract, the parties agreed that the cost of the repairs were being shared by the owners of the four properties (the Conservancy owning 2 of those) served by the access road, with Flake Construction to recover the balance of \$10,408.65 from the other two property owners. The Conservancy records indicate that the work under the Flake Contract was completed by the end of December, 1998 and payment was made to Flake Construction in the full amount of the contract on or about January 19, 1999. (Copies of this documentation are attached as part of Exhibit 9).

If you have any records which relate to Conservancy consent to any road or utility improvements or repairs (other than the electric gate installation) or notification to the Conservancy of emergency repairs (other than the emergency repair in December 1998), please provide those to us for our review. In the absence of any such records, we must conclude that neither the Conservancy nor any successor is obligated to pay any portion of the expenses of access road or utility repairs or improvements.

C. Additional Information and Future Steps

The Conservancy readily acknowledges that these issues and the documentation related to the issues are complex, given the multiple year history of the Water Company and the road and utility easement and the many twists and turns that occurred in the evolution of each. Added to this complexity is the fact that participants on both sides of the process have changed at least several times over these many years.

In light of this, the Conservancy is committed to working through these issues with you, to the extent possible. Thus, we would welcome the opportunity to review any additional documentation which you have or may locate and which you believe bears on these issues. Moreover, we would offer to verbally walk you through our thoughts on these issues, to the extent that this memorandum raises questions or concerns for you. Indeed, the Conservancy staff believes that it would be helpful to work through these issues together and, to that end, we would offer to meet with you (and any others you think appropriate) in person to do just that. We are willing to travel to Big Sur for that purpose. Please let us know if this is something you are willing to do and, if so, possible dates in the next month or so that would work for you.

I look forward to hearing from you.