

Decision No. 17794

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

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ORIGINAL

In the Matter of the Application of the CITY OF MARYSVILLE, a municipal corporation, that the Railroad Commission of the State of California fix and determine the just compensation to be paid by the said City of Marysville for the water system of the MARYSVILLE WATER COMPANY, a corporation.

) Application No. 10,302

W. P. Rich, A. M. Bundy, for the City of Marysville.
Richard Belcher and Devlin & Brookman, by Douglas Brookman, for Marysville Water Company.
E. DeLos Magee, for California Safe Deposit and Trust Company.

BY THE COMMISSION:

O P I N I O N

This is a proceeding upon petition under section 47(b) of the Public Utilities Act in which this Commission is asked to fix the just compensation to be paid by petitioner, the City of Marysville, a municipal corporation, hereinafter referred to as the City, to the Marysville Water Company, a public utility corporation, hereinafter referred to as the Company, for all of the lands, properties and rights of said Company used for the production and distribution of water for domestic, commercial, municipal and other purposes in and about said City of Marysville.

This petition was filed on July 21, 1924, and is a petition of the second class under the statutory provision above mentioned. At the hearing upon the order to show cause herein, the Company objected to the prayer for an alternative valuation

of said properties with and without a certain building, and the petition was amended to include all properties of this Company, as above stated, it being stipulated that said amendment should be deemed to have been made as of the original filing date. The value of these properties is therefore to be fixed as of July 21, 1924, and will be found, pursuant to the statute, in a single sum, said sum to represent all elements properly cognizable and legally to be included therein.

A series of public hearings were held before Examiner Wheat both at Marysville and San Francisco, at which testimony was introduced by the City, the Company and the Commission's engineering staff. Complete valuation reports covering the Company's properties, as well as testimony concerning certain intangible values, were presented for the Company by Otto Von Geldern, C. E. Grunsky, and Edward Von Geldern, consulting engineers. Phil J. Divver, Jr., City Assessor of Marysville, also appeared as a witness for the Company. N. Randall Ellis, consulting engineer, testified for the City of Marysville, and Wm. Stava and M. I. Reed, Hydraulic Engineers, E. P. McAuliffe, land expert, and Paul Theßen, Engineer, appeared and testified on behalf of the Commission's staff.

The properties herein to be valued comprise, in general, the complete water producing and distributing system of this Company. They include certain wells and pumps, a brick building, combining the functions of office building and tank structure, a large flat storage tank resting upon said building, certain land and the distributing pipes, services and meters used to carry the water to the premises of the Company's consumers. By arrangement between the engineers representing the City, the Company, and the Commission, the several reports of value were based upon a common and agreed inventory, and upon a construction and pricing period of two years immediately preceding July 21, 1924, which period was adopted by the engineers as ^{the most} reasonable

period to be used for the determination of the cost to reproduce new the properties of the Company. This two-year period will be accepted by the Commission, and will be used as the basis for the finding of value hereinafter contained.

GENERAL TESTIMONY AS TO REPRODUCTION COSTS

Otto Von Geldern, for the Company, testified that, in his opinion, the reproduction cost new, less accrued depreciation, exclusive of paving over mains uncut by the Company, totals the sum of \$500,020, which amount includes \$420,020 for lands and physical properties, \$60,000 for water rights and \$20,000 for going concern value. The reproduction cost new less accrued depreciation as presented by the engineers for the Commission amounted to a total of \$328,422, which includes no allowance for water rights, going concern value or development costs, as well as no allowance for cutting and replacing paving over mains and services not actually disturbed by the Company. The last item, however, was estimated by the Commission's engineers to amount to \$40,000 in case allowance should be made for this item by the Commission.

N. Randall Ellis, for the City, accepted the estimate of reproduction cost new less depreciation as presented in the report of the engineers for the Commission, including the lands, but exclusive of paving over mains and services not out by the Company. He deducted therefrom, however, the sum of \$25,000 to cover functional depreciation, mainly obsolescence, leaving a total of \$303,422. According to the City this amount includes what it believes to be reasonable allowances for intangible values such as going concern value and development costs, it being further claimed that the Company is not entitled to any especial amount to cover claimed values for water rights in connection with its underground sources.

Phil J. Diver, Jr., the City Assessor of Marysville, testified on behalf of the Company that the present assessed valuation of the properties of the Company for taxation purposes as now used was prepared for and at the request of the City of Marysville by one James G. Stafford, a valuation expert on properties for tax assessment, and amounts to \$318,434. It is the contention of the Company that as this valuation is placed upon its properties by the City itself, the City cannot in fairness at this time claim a lesser value. It seems evident, however, that estimates of this character cannot be given any great weight in proceedings for the purposes mentioned in the statute under which this petition was filed,--particularly when, as here, the person who actually made the appraisal is not produced for examination and cross-examination as to the methods followed and items included in his appraisal.

The following presents a table showing the totals found by the various witnesses upon the main items of value here in question:

REPRODUCTION COST DEPRECIATED

	<u>Reed, Stava McAuliffe</u>	<u>Ellis</u>	<u>Von Geldern Grunsky</u>	<u>Diver</u>
Land	\$69,000	\$69,000	\$72,000	-
Physical Property	242,376	242,376	332,786	\$318,434
Paving Cut by Company	350	350	234	-
Total	\$ 311,726	\$ 311,726	\$405, 020	\$318,434
General Equipment sub- ject to adjustment)	16,696	16,696	15,000	-
Water Rights	-	-	60,000	-
Going Concern	-	-	20,000	-
Paving not cut by Company	40,000			
Suggested Deductions:				
Thelen (to be mentioned later)			-\$9,655	
Ellis			- 25,000	

By reason of the fact that the various engineers pursued slightly different methods in the grouping of certain classes of property and equipment, as well as in the treatment of allowances for overhead costs, it has been necessary to rearrange the figures presented in the exhibits as filed in order to give a reasonably accurate basis for comparison upon the main classifications of physical property. This has been done in the following table:

I T E M	: Reproduction Cost + C.E. :		: Reproduction Cost + O.E.	
	: Less Accrued Depreciation :		: Less Accrued Depreciation :	
	C.R.C.	Company	C.R.C.	Company
	Engineers	Engineers	Engineers	Engineers
	Stava, Reed,	Stava, Reed,	Stava, Reed,	Stava, Reed,
	McAuliffe	Von Geldern	McAuliffe	Von Geldern
A. Landed Capital	\$69,000	\$72,000	\$69,000	\$72,000
B. Non-Landed Capital				
1. Organization Expense	\$5,350	(Included in Overhead)	\$5,350	(Included in Overhead)
2. Buildings	93,953	\$104,827	49,014	\$75,785
3. Wells	25,730	25,913	17,857	23,886
4. Pumping Equipment and Intake Connections	46,734	44,321	28,097	29,470
5. Distribution System	157,200	183,735	105,347	144,686
6. Tanks	17,021	22,488	8,511	11,828
7. Services	31,981	61,070	23,986	41,605
8. Meters	5,619	5,439	4,214	4,079
9. Paving cut by Company	350	234	350	234
10. Misc. not assignable	---	---	---	1,447
TOTAL NON-LANDED CAPITAL	\$383,938	\$448,027	\$242,726	\$333,020
TOTAL LANDED AND NON-LANDED CAPITAL	\$452,938	\$520,027	\$311,726	\$405,020

Paving not cut by Company	\$40,000	----	\$40,000	----
General Equipment, subject to Adjustment at time of Transfer	\$16,696	\$15,000	\$16,696	\$15,000

NOTE: Taxes and Interest During Construction are included in all items.

From the figures above set forth it will be seen that between the engineers for the Company and those for the Commission there is a difference of opinion in the amount of \$64,089 upon the question of the total cost to reproduce new the physical properties, exclusive of paving over mains and services not cut by the Company, and a difference of \$90,294 in the respective totals of reproduction cost new less depreciation. From the evidence before us it appears that the principal reason for the difference in the figures of reproduction cost new may be attributed to the difference in the methods used in pricing materials and in the theories of construction and installation of plant and equipment which were followed. In determining the unit costs the Commission's engineers used prices based upon the assumption that the materials and supplies for the entire project would be purchased in the open market in such quantities as to reflect to the best advantage of the buyer, such prices being fixed upon a weighted time average of the various prices in effect throughout the two-year construction period, together with the further assumption that the labor cost of the installation and construction would be determined upon the adoption of a plan of organization such that the construction program could be carried out efficiently and economically, and completed within the allotted two-year period. While in general the Company's engineer used a similar method in pricing materials and supplies, nevertheless, in many instances where construction had been done by the Company during the above construction period, the costs of such materials and labor as were thus actually incurred have been used as the basis upon which the unit costs were developed. It is the contention of the Company that wherever possible its actual experience in labor and material costs on construction installed during the two-year period should apply, and that where such work was not done during this period the local costs of labor and materials

should apply in accordance with quantities purchased and the construction methods used in the Company's actual experience. The determination of reproduction cost new by the adoption of such piecemeal pricing results in a higher total cost than by the use of methods embracing large quantity purchases and a continuous construction program.

The estimate submitted by the Company's engineers may be described as an estimate of the investment if the property had all been built under price level conditions equal to that of the two-year period, except that interest during construction assuming wholesale construction was applied. To this extent it is inconsistent in application.

The Commission's engineers' estimate, on the other hand, is based on the assumption that the entire plant was built during the two-year period as one main job, conditions of wholesale purchase and construction being assumed. It is apparent that, to reproduce the properties in 1923-1924, paving actually existing would have to be cut, even though historically this had not been necessary. Under the assumption made by the Commission's engineers, some weight should be given to the total cost to reproduce the properties in 1923-1924. Under the Company's basis, no consideration should be given to paving not cut. Both estimates have merit and bearing on the question of the determination of the value of the property; neither is controlling, however. One represents what it would cost in 1923-1924 to duplicate the existing plant; the other is a determination of the investment assuming the prices of 1923-1924 to have existed during the period of time within which the property was being constructed.

There appears some confusion on the part of the Company of the two functions of estimating the cost of reproduction and finding the fair value of the properties in question. The estimate of reproduction cost new is not the final measure of fair value. It is merely one of the methods used to assist the Commission in arriving at such a value. It is based upon a certain series of assumptions, all of which are supposititious in character, and it cannot be pushed to its logical end without creating absurdities almost too numerous to mention. We seek here a just equivalent in dollars of this Company's property, not a technically accurate or exact cost to reproduce under any particular theory of arriving at such cost estimate. We will, therefore, give such weight as we deem proper and reasonable to the pricing theory advocated by the Company and the reproduction cost new basis used by the Commission's engineers without following either exactly, and will consider both as elements which will affect our final determination of fair value.

ACCRUED DEPRECIATION

The next major difference in the two reports under consideration is in connection with the theories used in arriving at the depreciated value of the physical properties. A greater part of this difference may be attributed to difference in opinion among the engineers, the principles and methods followed ^{them} by being principally the same. However, Mr. Von Geldern, for the Company, in arriving at the "condition per cent." of such structures and equipment as wells and pumping plants does not depreciate the entire installation but only those parts which he considers perishable. In the case of wells, the lining or casing only is depreciated by Mr. Von Geldern, the major items

of cost, such as the labor of drilling and setting the casing and the cost involved in the construction of the well pits and their concrete linings being considered permanent and of indefinitely long life. In a similar manner he does not depreciate the pump pits and wells and the pump and motor foundation, although these were designed especially for the type of equipment installed.

Although wells may be relined, this is not the general practice, and the success of such action is often more or less speculative. This Company has itself relined one well, but the evidence shows that the well has not been used since that time. If this theory of partial depreciation should be accepted as to the unperishable parts of wells, pump pits and foundation, there is no logical reason why it should not be extended to many other items of property, such as building foundations, cellars, excavation for pipe lines, gate valve pits, manholes, etc.. To segregate the various component items of equipment and structures into those perishable and those unperishable would not only be impracticable but would result in the utmost confusion. In view of the fact that many other factors beside the probable period of existence of the component elements of a structure or a machine enter into the determination of depreciation, it appears to us that it is sounder and certainly more practicable to consider such structures and equipment as wells, pumps, motors, etc., as complete units, basing the depreciation estimate upon composite condition or the probable life of the unit according to the best judgment and experience of the engineers making the estimate.

A further cause for the difference in the engineers' estimates of accrued physical depreciation is the fact that witnesses Stava and Reed adopted and assumed life-expectancies upon much of this system which are less than those assumed by

witness Von Geldern. For example, Von Geldern assumed a life expectancy of one hundred years for the cast-iron pipe of which practically all of the distribution system is constructed, whereas, Stava and Reed used lives for such facilities varying from fifty to seventy-five years, depending upon the size of the pipe. The evidence discloses that these shorter assumed lives were based generally upon an investigation into the actual experience of this utility, and that this experience has, in turn, been greatly affected by the necessity for replacing pipes because of inadequacy resulting from municipal growth.

The value of a given system to its owners, or to a purchaser, is affected without question by its ability to take care of normal growth without excessive expenditures. A system that has leeway is more valuable than one on which no additional customers can be served without extensive reconstruction. To the extent that a system is partially inadequate, weight must be given to the shorter lives used. However, the evidence is not such as to justify the use of lives as short as estimated by the Commission's engineers. We shall give to this factor of inadequacy such weight as may seem reasonable in view of the general condition of the system here under consideration. It is evident that a larger life-expectancy than was assumed by the Commission's engineers must be used in this connection, and this will be done.

MAIN OFFICE BUILDING

Considerable controversy arose over the value of the main office building, a four-story brick structure, the lower floor of which is used as the Company's office, the second floor rented for living quarters, and the two upper stories (third and fourth) taken up by the structural steel supports of the 200,000 gallon flat steel storage tank or reservoir

forming the top or roof of the building. While there are several smaller buildings, the main office building makes up the bulk of value assigned to this item. The reproduction cost new and the depreciated value of all buildings as presented by the Company's engineer amounted to \$11,000 and \$27,000, respectively, more than the corresponding figures submitted by the engineers for the Commission.

This relatively large variation in the estimated depreciated values for the main building results from the different method of estimating the present condition of the structure, the Company's witnesses estimating it at 75% new, and the Commission's engineers considering it to be but 50%. The testimony shows that the original building on this site was built in 1859, the height being thirty feet. In 1887 the interior was destroyed by fire, and the building was then rebuilt but raised to a height of 45 feet to provide better pressure for the distribution of water. In 1911 it was again necessary to increase the height of the building twenty feet to provide additional elevation for the storage tank.

In ascertaining the depreciation to be deducted from the cost to reproduce this building the Company's engineer considered it as having a probable life varying from 160 to 200 years, and upon this assumption and the results of inspection he estimated its present dependable service condition to be 75%. The estimate of 50% condition made by the Commission's engineers was based upon their inspection of the building. From the evidence it appears that the estimate of the condition of this building made by the Company is perhaps unduly optimistic. On the other hand, the estimate of the Commission's engineers is rather low. The real condition of the structure may be considered very properly as lying between these two estimates, and no injustice will be done by assuming them to be extremes.

A special report on the value of the main office building storage tank and pumping equipment was presented by Paul Thelen, one of the Commission's engineers. This appraisal was based upon a comparison of the estimated cost of a modern office building, a steel tank and tower and centrifugal pumping equipment, all of equivalent serviceability and capacity. Because the two upper stories of the main office building cannot be used for commercial purposes, a two-story brick building of modern design was used for this comparison. Consideration was also given to the cost of adapting the present building either to a two or a complete four-story structure.

Eliminating that part of the building devoted to supporting the tank, the present building for commercial purposes was appraised by Thelen at \$19,000, which was checked by the method of capitalizing the present rental value of the building, which gave a figure of \$21,788. Using the cost of a hemispherical bottom steel tank and tower of equivalent height and capacity as a measure, the tank was valued by Thelen at \$19,900. Using the capitalized saving in operating expenses assumed to be gained by the use of centrifugal pumping equipment, instead of the present displacement or triplex pumps, Thelen estimated the present pumping machinery to be worth \$15,000.

The depreciated values of the main building, tank and pumps as submitted by Von Geldern were predicated upon his judgment as to the present physical condition of the property and included such allowances as he considered proper for changes in the arts or obsolescence. The estimates made by Stava and Reed embraced physical depreciation due to age and use and present condition only and excluded any consideration of such factors as savings in operation and maintenance expenses due to the possibility of substituting more modern construction and design. The appraisal made by Thelen was based upon his judgment of the value of this specific property in the light of what a

prospective purchaser could reasonably afford to pay for it in view of the present improvements in the arts and sciences of building and water works construction.

For purposes of comparison of the various values placed upon the property discussed above, it is necessary to group the tank and main building together. The items below, while not absolutely comparable by reason of slight differences in the treatment accorded by the different engineers, approximately cover the items as listed.

	<u>DEPRECIATED VALUE</u>		
	<u>Von Geldern:</u>	<u>Stava & Reed</u>	<u>: Thelen</u>
Tank and Main Building	\$67,546	\$41,830	\$38,900
Pumping Equipment	<u>24,540</u>	<u>21,725</u>	<u>15,000</u>
Total-	\$ 92,086	\$63,555	\$53,900

While the suggestions of Witness Thelen have much to commend them from the practical standpoint of ascertaining what a "willing buyer" could afford to pay, they, like the estimates of "reproduction cost", are not to be considered as the exact measures of "fair value"- the end sought here. We shall give them weight, but do not find them controlling as to our determination of fair value in this proceeding.

OBSOLESCENCE

The City contended that the fact that the only water storage on the entire system consisted of the tank forming a part of the top of the main building, not only reduced the value of the building for commercial purposes but was a serious handicap to the system as a storage tank, because increased pressure demands would require the future raising of the tank and building at considerable expense, or the installation of additional pumping equipment. It was further contended that a considerable

saving could be made in operation and upkeep by the use of more flexible and more modern pumping machinery, susceptible of automatic control. To cover this item the City claimed that a deduction of twenty-five thousand dollars should be made from the value of the physical properties as set out in the main report of the Commission's engineer. This deduction may, in general, be said to have been suggested to cover the City's engineer's estimate of the present realized functional depreciation or obsolescent condition of these facilities.

In this connection the Company sets forth that the existing equipment is now rendering good and adequate service at proper pressures and is maintained in good working order and condition; that at the time of installation and construction the buildings and equipment conformed to established standards of water works practice; that substitution of any of its present plant for equipment of improved design at this time is unnecessary from a service standpoint and unsound for economic reasons; and therefore that it is entitled to compensation for its equipment and plant in its present condition without reduction for functional depreciation, obsolescence or any other factors which directly or indirectly reflect present or prospective changes in the arts. It is further claimed that the City of Marysville, in seeking to divest the Company, against its wishes, of its public utility properties by the exercise of the powers of eminent domain, has specifically designated certain property which it desires and for which identical property the City must pay a fair value, based upon its present condition and not upon an assumed standard of the value of some other "substitutional equipment" or improved type of construction considered more pleasing to the eye or more efficient in operation.

The controversy appears to us to arise largely because methods of determining value are seemingly confused with the "final fair value" sought to be ultimately established by this Commission. The property which the City seeks to acquire here is definitely known and set out. There are, however, several methods which may be pursued to measure its value. One of the measures is the cost to reproduce the property new, less accrued physical depreciation. This depreciated figure itself, except by accident, is not the final value sought and may be affected by many other factors which should be given proper consideration, one of which is the result of a reasonable comparison with the present cost of an installation of recognized and approved standards, capable of rendering an equivalent service. This does not mean that the existing equipment is not being appraised, but merely that in arriving at an estimate of its value it is being subjected to a yard-stick of comparative values.

Changes in the arts do not ordinarily affect the worth of machinery and equipment of relatively long lives, such as usually comprise water works systems, as greatly as do such changes in some other lines of business, and many a water system can still be operated satisfactorily which would not be duplicated if equivalent service were to be sought by more modern methods.

In the present instance it is our opinion that the existing building and tank of this company do not, regardless of the theoretical cost of duplication and regardless of their actual physical condition, possess a "value" in excess of what would be the cost of a new and modern structure and tank of equal serviceability and annual cost. A consideration of the testimony herein adduced leads us to the conclusion, however, that it has not been shown that the reproduction cost of such structures less accrued physical depreciation is, in fact greater than the probable cost, original or actual, of such "modern"

equipment. The evidence upon which we must base our determination in this proceeding does not, therefore, warrant a finding of value for such items less than the depreciated cost of the existing equipment.

PAVING OVER MAINS NOT ACTUALLY CUT

The Company's engineer estimated the reproduction cost of cutting and replacing such paving as was actually removed during the existence of the company in the installation of mains and service connections to be \$234.00. The Commission's engineers estimated this cost to be \$350.00, and in addition to this presented to the Commission for its information the estimated cost of cutting and replacing all paving over mains and services in place on July 21, 1924, but which had not been actually cut by the Company. This amounted to \$40,000.00, which was accepted as a reasonable figure by the company and the city.

In determining reproduction cost new, all improved methods of construction have been given weight, better transportation facilities due to paving are considered, and the excess cost of cutting paving in determining that estimate is an element. The question still remains,--what weight in determining the fair value of the property should be given to the reproduction cost less depreciation determined on such a basis, and in particular, of this item of cutting paving over mains. We shall give to this item what we believe to be a proper weight in determining "fair value" in this case.

WATER RIGHTS

The Marysville Water Company obtains its entire water supply by pumping from nine wells all located within a circle having a radius of one hundred feet. These several wells tap five different water-bearing strata, and are located on property belonging to the company in the rear of its office building in the heart of the city. They have a capacity with the present pumping equipment of approximately five million gallons daily, which, according to the company, can be augmented to six million gallons daily if necessary. Mr. Otto Von Geldern in his report has stated that he places a value of \$60,000. on the right of this company to take water from this underground source. C. E. Grunsky and Edward Von Geldern both testified that in their opinion the underground "water rights" of the company are reasonably worth \$60,000.00.

N. Randall Ellis, for the City of Marysville, testified that generally throughout that portion of the river valley in which Marysville is situated the lands are underlain with numerous strata of water-bearing gravels so that water can be and is obtained in large quantities from underground sources practically anywhere

within the immediate vicinity of Marysville. The City, therefore, takes the position that water being readily obtainable from wells throughout the City, this Company is not entitled to any special increment of value for water rights in addition to that included in the values of the land.

In support of its claims for water right values, the Company, through the testimony of its engineers, contends that it has a proven supply of potable, pure and uncontaminated water, used from the same sources continuously for considerably over sixty years; that it has a right against all others to pump at least five million gallons daily from underground sources; that there is great strategic value in the fact that underlying the well field of the Company there are five distinct water-bearing strata from which water may be developed in large quantities; and that it is not proven that such a condition obtains in any other section of the City or in the immediate vicinity.

The evidence shows that water is obtainable from wells generally throughout Marysville. Yuba City, located just across the Feather River, obtains its water supply from wells. There are several industrial plants in Marysville that have drilled their own wells and have obtained water therefrom, and are now using the same in varying quantities, presumably sufficient for their requirements. Apparently such private use of other wells in this locality has not in any manner diminished the yield of nor interfered with the underground water resources of the Company. No evidence was submitted tending to indicate that the Company has a prescriptive right to any of its waters, as against any other person or persons, or that it has ever at any time sought to stop or enjoin any one from obtaining water from the other underground sources in Marysville or its general vicinity.

No testimony was presented to the Commission showing that any sales of rights to acquire and pump underground water of similar type have ever been made in or about Marysville. We are, therefore, of the opinion that the Company has failed to establish the existence of any especial or separate value for its "water right" to pump from underground sources, aside from those values already included in the value of the lands as water bearing.

This Commission has repeatedly held that where water is obtained from underground sources as distinguished from appropriation from natural surface stream flow, there attaches thereto no water right value, separate and distinct from the land, other than that fixed for such land as water bearing, unless a prescriptive right is established by the use of the water in such a manner as to interfere with the rights of other owners, or unless there has been established by adverse use a right to more than the taker's fair share thereof. (Hudson vs Dailey, 156 Cal. 617; City of Coalinga vs. Pleasant Valley Water Company, 6 C.R.C. 33.) We shall not depart from this conclusion in the present instance.

GOING CONCERN VALUE

On behalf of the Company, Otto Von Geldern estimated the "going concern value" of this property to amount reasonably to \$20,000 in addition to the value of the physical properties and water rights. In his report Von Geldern takes the position that on this system water rights and going concern value are more or less inter-related, and that it matters but little whether the various elements are segregated into water rights, development expense, etc., or whether all items are grouped into a single unit and called, for instance, "Development of the Business". This view is well set out in the following statement in his report:

"Many other examples like this have impressed upon the engineer the justness of the value of this so-called water right, which may be defined as a premium due to the successful effort to establish a water supply for a growing community, or, to put it in another way, a compensation due for a contribution to general prosperity." * * * A water company is therefore entitled to a certain interest in the prosperity which it has helped to create."

However, of the total of \$80,000 estimated by Von Geldern as a conservative allowance for all intangible values, \$60,000 was allocated by him to water rights and the remaining \$20,000 to going value. According to this witness, going concern value should be recognized as a legitimate element of value to cover the expenses necessary for the development of a business toward a self-supporting end. A part of these expenses may go toward the development of water; another part is due to the direct loss of adequate interest on investment over a reasonably long development period, and is an element of value in addition to the value of the physical properties by reason of the fact that the system is not bare and idle but is in actual operation and doing business with large numbers of consumers.

C. E. Grunsky, for the Company, testified that he considered the sum of \$80,000 suggested by Otto Von Geldern to be a reasonable and proper allowance for the intangible values for which the Marysville Water Company is entitled to receive compensation, but did not place an independent value on the water rights as distinguished from going value. All intangible values were considered as a single and undivided entity. This estimate is based upon the theory that every public utility concern is entitled to obtain on the legitimately invested capital at least an ordinary interest return at prevailing market rates for money, and to compensation for management and the risk involved in the business, and is also entitled to a fair share

in the general prosperity which it has helped to create. In further explanation Mr. Grunsky stated that in a valuation for purposes of sale an allowance made in earnings to cover management and risks of business cannot be capitalized because such elements have no value to a purchaser. He assumes that a concern should reasonably be entitled to an allowance of 15% of the volume of business done during the year to cover the above items. In this case the annual earnings are approximately \$64,000, which would make the above allowance \$9,600, segregated into one-third as compensation for risk and management because in this case the business has been long established and the risk therefore not so great and the management comparatively simple, the other two-thirds, or \$6,400, representing the return on the other intangible values which have been created, whether water rights or going concern value, as it is generally called, or, as classified here, a "share in the general prosperity". Capitalization of this figure at six per cent results in a value slightly in excess of \$100,000, which witness Grunsky held to be a fair allowance for these intangible items.

For purposes of comparison, Mr. Grunsky further testified that by capitalizing the difference between a fair return taken at 8% and the cost of money at 6% based upon an assumed legitimate investment of \$350,000 for the physical properties, application of the methods outlined above will result in a value of \$78,000 as the Company's share in the general prosperity. By these methods he concluded that Mr. Von Geldern's estimate of \$80,000 is a reasonable allowance for the intangible values of this system, including water rights and going concern value.

N. Randall Ellis, representing the City of Marysville, contended that under the reproduction cost theory, early development costs and cumulative losses, less than a fair return

sustained during the operating history of the Company are not a proper measure of going concern value. He states, however, that for purposes of sale or condemnation a utility is entitled to reimbursement for the financial lag in earning power or the sacrifice of return on investment incurred during the period of plant construction. Ellis takes the position that as construction is carried on, parts of the system will be placed in operation and will be serving consumers as soon as possible, and as the entire plant is considered to be completed and serving all consumers at the end of the two-year construction period, it is therefore reasonable to assume that on an average, one-half of the plant will be operative during the entire construction period. Based upon this assumption and upon the further consideration that interest during construction should properly cease when equipment becomes operative, he concluded that the Company has already been adequately reimbursed for all financial lag and other intangible values to which it may be entitled through the allowances already made in the valuation of the physical properties, amounting to \$5,000 for organization expense and interest during construction provided in the overhead at 7% covering one-half of the two-year construction period.

It must be frankly conceded that in any attempt to ascertain a definite value for such a vague, elusive and intangible element as "going concern" we enter the realm of speculation usually covered by opinion, evidence and so-called "expert testimony", where economists and engineers cannot agree. There is undoubtedly a value which attaches to a going concern that is not existent when the bare bones of the property are alone considered. In the present instance, however, as above stated, we are not convinced that the claimed water rights in themselves bear any such definite relationship to what we are seeking as

may properly be considered in attempting to arrive at a value for going concern other than the fact that a water system must necessarily have a dependable water supply in order to be a going concern. It can only be to this extent that water rights have any direct bearing upon going concern value. On the other hand, we believe that the contention of the witness Ellis that all intangible values have been fully provided for in the allowances for organization expense and interest during construction, is open to the objection that such allowances should be and undoubtedly were intended to cover only the items of the physical property which they embraced.

If the term "going concern value" is to have any significance it can only mean the value which attaches to bare properties thru and because of the expenditure of funds and effort in developing the business to its present status. We do not desire to be understood, however, as confusing this element of value with what has been called "development cost". They are related in that both refer to the bringing of the business into a live and working status, apart from the mere actual construction of the plant itself, and in some instances attempts have been made to bring the one into play as a measure or check of the other. In the present instance, while the allowance of interest during construction has been made for the purpose of covering the physical property alone, there is merit in Witness Ellis' suggestion that from a practical standpoint certain operations would be commenced before the two-year construction period had fully elapsed and that some of the lag would therefore be taken care of in the allowed interest. This cannot be supposed, however, to cover all the elements of value properly classified under the head of "going concern". This water system may be considered to be in a fairly prosperous and

going condition at the present time, - a system that is earning a return upon the reasonable value of the property used and useful in rendering the service. But even conceding that it is entitled to an allowance in this instance to cover its "going concern value", we are of the opinion that the sum of \$80,000 claimed by the Company's witnesses is excessive. As stated above, however, we are also of the opinion that the contention that the value of these properties does not exceed the mere reproduction cost of the physical properties, less actual accrued physical depreciation and claimed functional depreciation, is unreasonable in this case. We will, therefore, include in the value of these properties as found herein an item to cover what we believe to be a reasonable allowance for going concern value.

OTHER ITEMS

Certain items of property were valued by the respective parties at approximately the same amount, as in the case of lands, where the difference is nominal. While discussion has not been entered into concerning all of the items herein, the Commission has considered each and every factor entering into and affecting the value of the properties of this Company. The order herein will provide the total amount to be paid by the City of Marysville for the properties of the Marysville Water Company, and will include the sum of \$15,000 for general equipment, material and supplies on hand, subject to adjustment at the time the transfer is made, to be confirmed by supplemental order of this Commission. By agreement of the parties herein the value of such properties as shall have been installed subsequent to the date of the filing of this application will be considered from the books and records of the Company, subject to approval at the time of the transfer by supplemental order of this Commission.

Since the entire public utility properties of the Company are herein sought to be valued, there is no severance damage to be fixed in this proceeding.

F I N D I N G S

The City of Marysville, a municipal corporation, having filed with the Railroad Commission on the twenty-first day of July, 1924, a petition as entitled above, and the Railroad Commission having proceeded under the provisions of section 47(b) of the Public Utilities Act to fix and determine the just compensation to be paid by the City of Marysville to the Marysville Water Company, a corporation, for the public utility water system supplying water to consumers in and in the vicinity of the City of Marysville, public hearings having been held thereon, the matter having been submitted and the Railroad Commission being now fully apprised in the premises,--

IT IS HEREBY FOUND AS A FACT that the just compensation to be paid by the City of Marysville, a municipal corporation, to Marysville Water Company, a corporation, for said Company's public utility water system supplying water to consumers in and in the vicinity of the City of Marysville as said water system existed on the twenty-first day of July, 1924, and as more particularly described in Exhibit "A" attached hereto and hereby made a part of the findings herein, is the sum of Three Hundred and seventy-two thousand four hundred dollars (\$372,400.00). Said sum includes the amount of fifteen thousand dollars

(\$15,000) for materials and supplies on hand as of the above twenty-first day of July, 1924, and is therefore subject to adjustment for the fair value of such materials and supplies as may be on hand if and when the above system is acquired by the City of Marysville.

Dated at San Francisco, California, this 21st day of December, 1926.

H. R. ...
O. ...
Emund ...
Thos ...
Commissioners