

Decision No. 29707.

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the  
CITY OF LOS ANGELES, and the BOARD OF  
PUBLIC SERVICE COMMISSIONERS OF THE CITY  
OF LOS ANGELES, to the Railroad Commission  
to fix and determine the just compensation  
to be paid for certain electrical distribut-  
ing systems and properties of the Southern  
California Edison Company.

Application No. 10882.

Jess E. Stephens, City Attorney, W. B.  
Mathews and Geo. T. Warren, for  
applicants.

Roy V. Reppy, B. F. Woodard, and E.W.  
Cunningham, for Southern Calif-  
ornia Edison Company.

J. J. Deuel and Edson Abel, for Calif-  
ornia Farm Bureau Federation.

SEAVEY, COMMISSIONER:

O P I N I O N

This is a proceeding under section 47-b of the Public Utilities Act in which the City of Los Angeles and the Board of Public Service Commissioners of the City of Los Angeles, hereinafter jointly referred to as the City, ask the Railroad Commission to fix and determine the just compensation to be paid by the City of Los Angeles to Southern California Edison Company, hereinafter referred to as the Company, for the taking of certain land, property and rights of the Edison Company. Such land, property and rights are described in Exhibits "A" to "H," inclusive, attached to the application, and made a part thereof, and consist of the electric distributing system and franchise rights of the Edison Company in certain territories annexed to the City since 1922, the City having heretofore purchased from the Edison Company, and since operated, the electric system within the City as it existed in 1922.

Two distinct theories of arriving at just compensation are presented to the Commission in this record, and the question as to which shall prevail must be decided first.

The Company bases its claim of compensation upon the theory expounded by Dr. A. T. Hadley in Applications 9767 and 9768, now pending before this Commission, which testimony was stipulated into this record. Briefly, this theory is that the value of a utility business property depends upon and should be measured by its income. In applying this theory two methods were used by the Company. One method consisted of making estimates of loss of revenue for a number of years in the future, the net revenue for each year, after being corrected for the additional investments necessary to conduct the business, being reduced to its present value by use of present worth tables based upon 6% interest. Under the other method the estimated net revenue of the property during the first year after the date of valuation was capitalized at 6.2%, which was shown to be the average yield of money invested in the Company's securities outstanding at market prices at the date of filing the application. From each of these results was deducted the calculated amount that should be in the depreciation reserve to go with the physical property, and to each was added the estimated cost of the actual reconstruction work necessary to mend the remaining property because of the separation. The following figures summarize the results of these methods:

Present worth of future annual losses of net revenue, corrected for additional investment . . . . .	\$3,639,122.20
Deduct Depreciation Reserve . . . . .	112,884.24
Just Compensation for Property and Business . . . . .	<u>\$3,526,238.56</u>
Add cost of reconstruction made necessary by severance of part of system . . . . .	13,800.00
Total Just Compensation . . . . .	<u>\$3,540,038.56</u>
Capitalization at 6.2% of first year's loss of net revenue, . . . . .	\$3,266,045.00
Deduct Depreciation Reserve . . . . .	112,884.24
Just Compensation for Property and Business . . . . .	<u>\$3,153,160.76</u>
Add cost of reconstruction made necessary by severance of part of system . . . . .	13,800.00
Total Just Compensation . . . . .	<u>\$3,166,960.76</u>

The position of the City was that the value to be fixed should be obtained by finding a figure of reproduction cost new less depreciation, to which should be added going value and severance damage. The results obtained by the City in using this method are as follows:

Reproduction Cost New (C.R.C. Eng. Dept.)	\$909,867.00
Deduct Depreciation (City's evidence)	<u>241,537.23</u>
Value of Physical Property, Add Going Concern Value,	\$668,329.77
	<u>35,000.00</u>
Value of Property and Business Add Severance Damage,	\$703,329.77
	<u>13,800.00</u>
Total Just Compensation . . . . .	\$717,129.77

It will be seen from the above that there is a wide divergence in the results obtained under the two theories, a difference which must come about through some basic fault in one or both of the proposals. The income theory advocated by the Company in substance has been advanced in other proceedings before this Commission and has not been adopted. As a measure of value it has been considered too unstable. It is based upon adopted constants which are in fact variables. It assumes for the indefinite future that this Commission will not change the rate of return; that the net return, the losses and the risks incurred will remain the same; that there will be a definite future program of building with depreciation charges and prices remaining the same; that future cost of financing will follow the present; that there will be a certain future population; that no other form or mode of heat, light or power will transplant, modify or compete differently with the present electric service; that certain estimated but unknown revenues and operating and maintenance expenses will accrue; and that many other intangible things will come to be realities. The whole structure is built upon the amount of net earnings per meter, which is estimated. The only definitely known figure underlying net earnings is the average gross revenue per meter per

year for one year.

It might also be noted that the reproduction cost new of this property, undepreciated, including overheads, is, according to this record, approximately \$900,000.00. That just compensation for a property of this kind could be four times such reproduction cost is not from a practical standpoint conceivable.

As an instance of how the figures under the Company's theory may fluctuate through estimates and the exercise of judgment, it appears that if we take the comparable testimony of the City, which does not appear to be broken down, and apply the same method of calculation used by the Company there results a present worth of loss amounting to \$2,349,065.60, as against the Company's figure of \$4,408,505.95.

Surely enough has been said to indicate that the theory advanced by the Company is not a method of arriving at value and damages for taking, but in reality is a means of estimate by which a value is put upon the property with the business attached which would wholly consume and render the property more than useless to any possible purchaser. It is a form of shadow boxing with the future potentialities of this property which, in my opinion, cannot be considered seriously for the purposes of this proceeding. This is not saying, however, that the facts surrounding this property from the standpoint of income should not be seriously considered. Such facts will be considered along with the other factors that form a basis for discovering value.

The process of arriving at a figure of just compensation will therefore proceed generally along the lines indicated by the City, taking into consideration the other factors tending to establish value, which method has heretofore been used by the Commission in condemnation cases. The matter of just compensation will be considered under two main heads, - "Property to be Taken" and "Severance Damages", the law requiring the Commission to set up these amounts

separately.

#### PROPERTY TO BE TAKEN

The inventory of the property to be taken as of March 2, 1925 was made by Commission's engineers, with the close check and cooperation of the engineers of the Company and City, and the total inventoried quantities were agreed to by these parties. The unit costs used in arriving at reproduction cost new were the average prices over a one year period from March 1, 1924 to February 28, 1925. Complete agreement was not reached as to these unit costs. The City in effect accepted them by using the Commission engineers' reproduction cost including overheads. No testimony rebutting these unit costs was introduced by either the City or the Company.

Several matters of importance connected with the reproduction cost new and value of the property as a whole are in controversy and will be dealt with under their respective sub-heads.

#### Interest During Construction:

The Commission engineers estimated this at 2% upon the experience of the Company in its regular extension field work. While it is true that this Company did, and the City or other utility probably would, experience about the same interest expense in occupying the territory in the usual order of development, yet we have here a somewhat different situation. The property exists and is to be taken as a whole. Its cost is estimated on material and labor prices and other considerations as of a certain definite time. Generally it appears that the approach has been as of a wholesale rather than a piecemeal construction and for these reasons interest during construction will be allowed on the basis of 3½ per cent.

Substituted Meters:

The Company questions the principle involved in the substitution by the Commission engineers of the price of a present day meter to represent the present day cost of the 1394 Type I meters, which are installed as part of this property but which are no longer manufactured and in the market. The Company contends that irrespective of these facts the meter should be treated as the rest of the property and a present cost developed as is. Where does this lead us? If these Type I meters were now manufactured and in the market certainly they could not sell for more than another type of meter which is more preferred in use. But not being in the market, does the Company contend that our engineers should determine what it would cost to have identical meters manufactured for this particular job, even though such cost might mean several times the cost of the meters originally installed? The reproduction cost of this property to be acceptable must be a reasonable one. It would seem beyond question that the Commission engineers had acted within reason.

Depreciation:

On this subject the City supports the straight line method with certain additions for observed deferred maintenance, inadequacy and obsolescence. The Company claims the inspection method should be used, but maintains if the life table basis is employed the sinking fund method properly should be the one to adopt. The Commission engineers here set up results under both the straight line and sinking fund methods and indicate that it is their opinion that the

sinking fund method more accurately reflects the facts.

The following tables will show the character and extent of the property, together with the results flowing from the treatment by the engineers of the respective parties:

Railroad Commission Engineers Set-up

C.R.C. Acct. No.	Classification	Priced Inventory	Depreciated Cost	
			Sinking Fund	Straight Line
302	Franchises	\$1,700.	\$1,700.	\$1,700.
342	Lands and Rights of way,	22,356.	22,356.	22,356.
343	Distribution Structures,	2,828.	2,189.	2,189.
344	Dist.Substation Equipment	31,091.	26,323.	21,821.
346	Dist.Poles, Towers and Fixtures,	227,586.	184,692.	170,505.
347	Dist. Overhead Conductor,	158,713.	144,234.	131,261.
350	Line Transformers,	91,450.	76,722.	68,559.
351	Services,	74,922.	65,141.	57,957.
352	Meters	125,898.	107,622.	94,768.
355	Inst. on Consumers Premises	1,415.	1,355.	1,288.
357	Street Lighting Equipment,	45,979.	41,432.	37,200.
382	Comm. System Equipment,	130.	69.	55.
TOTAL EXCLUSIVE OF O.H.,		\$784,068.	\$673,835.	\$609,659.
Overhead Percentage,		16.28	16.28	16.28
Overheads,		\$123,730.	\$105,784.	\$ 95,336.
TOTAL INCLUDING O.H.,		\$907,798.	\$779,619.	\$704,995.
Adjustment for Hardware,		2,069.	1,679.	1,550.
<u>TOTAL</u>		\$909,867.	\$781,298.	\$706,545.
Deduction for Major Traffic Plan,		-	-	-
<u>TOTAL</u>		\$909,867.	\$781,298.	\$706,545.

City Engineers Set-up

C.R.C. Acct. No.	Inventory Priced	Depreciated Cost by S.L. Method	Extra Deductions, Inad. Obsol., etc.	Depreciated Cost
302	\$1,700.	\$1,700.	-	\$1,700.
342	22,356.	22,356.	-	22,356.
343	2,828.	2,176.	\$1,536.	640.
344	36,536.	23,420.	10,795.	12,625.
346	227,586.	164,796.	8,440.	156,356.
347	178,444.	147,563.	8,665.	138,898.
350	98,390.	77,749.	2,435.	75,314.
351	74,922.	58,068.	1,440.	56,628.
352	125,898.	90,773.	-	90,773.
355	1,415.	1,182.	-	1,182.
357	13,863.	10,301.	-	10,301.
382	130.	68.	-	68.
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Total exclusive of O.H.,	\$784,068.	\$600,152.	\$33,311.	\$566,841.
Overhead Percentage	16.28	16.28	16.28	16.28
Overheads,	123,730.	93,788.	5,423.	88,365.
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TOTAL INCLUDING O.H.,	\$907,798.	\$693,940.	\$38,734.	\$655,206.
Adjustment for hardware	2,069.	2,069.	-	2,069.
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TOTAL	\$907,867.	\$696,009.	\$38,734.	\$657,275.
Deduct for Major Traffic Plan,	-	-	4,800.	-4,800.
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TOTAL	\$909,867.	\$696,009.	\$43,534.	\$652,475.

Company Engineers Set-up

C.R.C. Acct. Nos.	Weighted Average Condition Percent - R. E. Cunningham	Weighted Average Condition Percent - C. W. Koerner
302, 342, 343, 344, 346, 347, 350, 351, 352, 355, 357, 382	89.90%	88.36%
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TOTAL EXCLUSIVE OF O.H.,	\$704,877.	\$692,802.
Overhead Percentage,	19.68	19.68
Overheads,	138,720.	136,343.
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TOTAL INCLUDING O.H.,	\$843,597.	\$829,145.
Adjustment for Hardware,	1,860.	1,828.
<u>TOTAL</u>	\$845,457.	\$830,973.
Deduction for Major Traffic Plan	-	-
<u>TOTAL</u>	\$845,457.	\$830,973.



From the briefs filed is summarized the final set-up of the value of physical property made by the Company and the City:

EDISON COMPANY

Reproduction Cost New - \$784,068. plus 19.98% O.H. = \$940,702.  
Depreciated Cost - 940,702. x 88% = 827,818.

CITY OF LOS ANGELES

Reproduction Cost New -  
\$784,068. plus 16.28% O.H. = \$907,798. plus \$2,069 = \$909,867.  
Depreciated Cost -  
\$909,867. minus (\$202,803. plus \$38,734.) = \$668,330.

The inspection method pursued by the Company's witnesses was to procure maps of the different sectors of the territory and in the field, by observation, determine the condition as compared with new of the different items as they existed as part of the whole, put down for each separate part and parcel inspected its condition per cent and after covering the whole, from the percentages so recorded, arrive at a weighted average. These witnesses, according to the testimony, worked independently and after making adjustments for property not covered by both they each, within a fraction of a per cent, arrived at a condition of 88%, not including the elements of inadequacy and obsolescence.

The Company contends that this method is in accordance with the rule as laid down by the Supreme Court of the United States in the case of McCardle v. Indianapolis Water Company, 272, U.S. 400, 71 L. ed. 316, and is the law of the land. We agree that the ruling of the Supreme Court should be followed in so far as it applies, but we do not agree with the Company as to its applicability here, nor as to its interpretation if it were applied. It is evident from the

record that the Company's witnesses pursued the inspection method in a much narrower sense than indicated in the McCardle decision. It is not probable that the court intended to say that an engineer, however experienced, could walk along under a power line or glance at it from a distance and say when the wires would break from crystallization, how soon seemingly good insulation would drop off, or do any one of perhaps a hundred other impossible things. What happened in the McCardle case? One estimate of depreciation was made by the straight line calculation without inspection, another made of the existing condition by the operating engineer, another based on actual inspection and a consideration of the probable future life as indicated by the conditions found, and still another estimate, after inspection, of the amount necessary to bring the property to a condition new. The court found that the last three methods were preferred over the first, which was "mere calculations based on averages and assumed probabilities." We can find nothing therein which confines the determination of depreciation to inspection and final determination in the field. In fact the court makes it plain that the process was much broader and that life statistics and other factors were necessarily used in forming a judgment.

The City, by inspection, made a thorough investigation of the debits against the property from the standpoint of deferred maintenance, inadequacy and obsolescence, and undoubtedly jeopardized the percentage conditions claimed by the Company's witnesses. The sums so arrived at the City claims should be added to the amount of depreciation obtained by the application of the straight line method.

With this we cannot agree. These items are already taken care of to some considerable degree, as virtually admitted in testimony of the City, in applying straight line calculations. Neither can we agree to the mere calculations on the straight line or sinking fund basis without other considerations.

The Commission engineers, while they went over the property for the purpose of inventory, did not apply this or other inspection of this property in arriving at depreciation. Instead, they assumed lives for this property to be the same as those determined after careful inspection of other property in similar condition and of like character in other utilities in the state. This cannot be accepted as securing a proper answer where value is to be obtained of a specific property as of a certain day.

It is evident no one of the offered figures for depreciation can be accepted as reflecting an equitable amount, but rather that a judgment based upon a knowledge of the witnesses upon the stand and a careful analysis of the record itself must determine a proper allowance within the limits indicated.

#### Going Concern Value:

The engineers of the Commission did not present any evidence as to going value. The Company set up no separate amount for this element of value, admitting that it could not be set aside as a distinct amount under its theory of income compensation, although it was covered in the total. This theory having been rejected as the measure of value of the property involved, there is nothing in the record illuminating the Company's claim for this item except an estimate which was presented by its witness as to the cost of attaching the business on a meter basis amounting in total to \$80,000. This estimate was based upon the average Company cost of attaching new business for 1925 and 1926 and is clearly too high for costs in this territory, which is

principally lighting, as the motor cost used reflects also power costs which are higher than lighting. There are also reflected in these figures some elements of cost because of competitive and other conditions in other parts of the Company's system which do not obtain in these particular localities.

The City presented an estimate of the cost of attaching this business amounting to \$6,966.06. This undoubtedly is too low for our purpose under this proceeding, as it does not include the usual and proper pro rata allowance of general costs, such as advertising, demonstrating and promoting. The estimate is probably low because of the direct interest the consumers may have on account of the public ownership and also because of the advantages that flow from allied municipal governmental departments and activities.

The City also presented an estimate of going value including cost of attaching business in the amount of \$35,000., based upon the theory of going value as set forth by Dr. W. F. Durand in Applications 9767 and 9768 and stipulated as part of this record. Dr. Durand defines going value as that worth attached to an operating business over and above the cost of the property and material in place, the total over all being the market value. He lays down the following premises which form the ground work upon which to arrive at an answer. The rate base and the historical investment will be practically identical, which means that return received and interest paid will be figured upon the same capital amount. Going concern value to the owner, therefore, will be the capitalization at market rate of money of the difference between return and cost of money. The buyer will be willing to accept a somewhat lower return on his capital, but what this will be depends upon the attractiveness of the enterprise, the overall rate of return from his investment and the obligations, risks (including condemnation) and cares which must be assumed. The offer of the highest bidder fixes the market

value. The cost of attaching the business is included in the going value. And, lastly, while some of the elements of going value may be arrived at mathematically the final answer is the result of the exercise of judgment.

Mr. Scattergood, testifying for the City, adopted in general the theory above outlined. He had in mind that the average yield of Company's securities as of March 2, 1925, was 6.2%; that the commission on the Company's rate base had allowed a return of 7.6%; that the reproduction cost new was about \$908,000. and the rate base would be a somewhat smaller amount; that the market value was affected by the prospective growth, the attitude of the regulatory body and the threats of municipal competition or condemnation. Mr. Scattergood believed that conditions here were not normal and that the entire differential between the 6.2% and the 7.6% could not be considered principally because of the imminence of condemnation or paralleling. Particularly did he believe it true here where the City had already settled the policy and was operating extensively. While in his opinion the actual paralleling would destroy all going concern from the standpoint of market value, yet he believed, in fairness and justice, that some such value would be allowable, particularly there should be considered the cost of connecting a business and idle capital on the growing business, except where the consumers provide the capital that remains idle.

One can follow to a considerable extent the formula for going value herein laid down and followed by the City, but it would seem impossible to agree with all of it and particularly with the extraordinary effect given to the fact that the property in question is subject to condemnation and paralleling. I fail to see how ordinarily the liability of being condemned substantially affects the going value of a public utility. A public utility is not usually bartered and sold as are other businesses. The possibility

of being condemned facing an ordinary business quite likely might seriously affect the property adversely, although this would not always be so. But in the case of a utility which occupies a definite field in a monopolistic way, whose financing, income, rates and service are regulated, and whose taking must be compensated, it would seem that any possible buyer would not depreciate its already restricted going value. The possibility of paralleling would have a very definite effect, but even there we must be aware that usually the municipality is the only party that might do this and that it would be disadvantageous to the City as well as to the Company.

As intimated above, the going value of a public utility is much less elastic and perhaps more stable within its limitations than that of a private business. The private concern takes on no public responsibility, but by means of its wares, service and public relations develops a going value (aside from a good will) wholly by its own efforts and upon which it may trade without limitation. The utility assumes an obligation to serve which it cannot escape, except by consent of governmental authority, and acquires the right to continue with a certain protection. It, in effect, enters into a contract with the public, the result of which is to allot to some extent the value of going concern as well as good will between the contracting parties. The methods of arriving at going concern for a private business, therefore, cannot be applied in full to a public utility.

A substantial going value adheres to this property, however, and this element of value will be considered in the final figure of just compensation.

I recommend, after considering all the evidence, that the Commission find as a fact that the just compensation, not including severance damages, which the City should pay to the Company for the land, property and rights as described in Exhibits "A" to "E", inclusive, attached to the application, including going concern and franchise rights, is the sum of \$245,000.

### SEVERANCE DAMAGES

No estimate or testimony as to damage caused by severance was introduced by the Commission engineers. The California Farm Bureau Federation made appearance in this proceeding and presented testimony regarding severance damages. The City objected to intervention by the Bureau on the ground that the statute provided that "evidence may be presented by the political subdivision, by each owner or claimant named in the petition and by the Commission." I take it, however, that this does not prohibit the Commission from receiving information from any source available, nor does it prohibit intervention by any party desiring to show himself affected. The method followed by the witness of the Bureau was similar to that followed by the Company in arriving at compensation and therefore the results of his estimates will not be considered in this proceeding.

The City also took the position that the consumers' rights represented by the Bureau could not be asserted in a condemnation action but should be urged in proceedings for that purpose provided for in the Public Utilities Act. With this latter position of the City I am in technical agreement.

The Company offered no evidence as to damage due to temporarily idle generation and transmission system or damage from other intangible causes. It did make a showing as to the cost of reconstruction necessary to tie the system together after the taking, which estimate amounted to \$13,800. This was accepted by the City.

The City, through its witnesses, admitted that severance would leave the lines of the Company in the district affected with less load and therefore less useful to the Company until the load upon such lines recovered the amount that was lost. They maintained, however, that the filing of the application had put the Company on notice so that they will have had ample time to adjust themselves to the coming conditions before the taking and therefore recovery of an

equal load being possible no severance damages would be applicable when final taking was consummated. We are unable to see the reasonableness of this contention. If the lines of the Company carry both the acquired load and the load to be taken up to the time of the taking, it would seem impossible from a practical standpoint to then sever without some effect on the remaining system. It is apparent, however, that in this case the effect will be comparatively light in view of the conditions and amount of the remaining property.

In arriving at severance damage to the property not taken, in addition to the cost of mending the physical severance, particular consideration is given to cost of money, depreciation and maintenance on the percentage of the generating and transmission system which is rendered temporarily and permanently idle and the diminution in intrinsic value of the entire property not taken, which results in its being made less profitable and therefore less valuable.

As intimated above, because of the location and comparative amount of and general conditions under which this property is taken, the severance damage is light and very difficult to ascertain. It is, however, some determinable amount and in excess of the mere cost of physical repair necessary to rehabilitate the remaining property.

I recommend, in the light of all the evidence, that the Commission find as a fact that the total just compensation to be paid by the City to the Company as severance damages to the remaining lands, property and rights of the Company after the taking of the land, property and rights described in Exhibits "A" to "H," inclusive, attached to the application, is the sum of \$20,000.

#### FINDINGS

The City of Los Angeles, a municipal corporation, and the Board of Public Service Commissioners of the City of Los Angeles having filed with the Railroad Commission on the second day of March,



1925, a petition as above entitled, and the Commission having proceeded in accordance with 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 Los Angeles and the Board of Public Service Commissioners of the City of Los Angeles to the Southern California Edison Company for the taking of the land, property and rights described in Exhibits "A" to "H," inclusive, attached to the application herein, attached hereto, public hearings having been held, the matter having been submitted and briefs filed thereon, and the Railroad Commission being now fully apprised in the matter, makes the following findings:

1. It is hereby found as a fact that the just compensation to be paid by the City of Los Angeles and the Board of Public Service Commissioners of the City of Los Angeles to the Southern California Edison Company for the land, property and rights described in Exhibits "A" to "H," inclusive, attached to the application, not including severance damages, is the sum of \$845,000.00.
2. It is hereby found as a fact that the just compensation to be paid by the City of Los Angeles and the Board of Public Service Commissioners of the City of Los Angeles to the Southern California Edison Company as severance damages to the remaining land, property and rights of said Company after the taking of the land, property and rights described in Exhibits "A" to "H," inclusive, attached to the application, is the sum of \$20,000.00.
3. It is hereby found as a fact that the total just compensation to be paid by the City of Los Angeles and the Board of Public Service Commissioners to the Southern California Edison Company for the taking of the land, property and rights described in Exhibits "A" to "H," inclusive, attached to the application is the sum of \$865,000.00.

The foregoing opinion and findings are hereby approved

and ordered filed as the opinion and findings of the Railroad  
Commission of the State of California.

Dated at San Francisco, California, this 23<sup>rd</sup> day of  
January, 1929.

Thos. D. Lovell  
C. J. Seaver  
Ernest C. Cott  
Leon Whitell  
W. J. Carr  
Commissioners.