

Decision No. 69301**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Petition of ALDERCROFT HEIGHTS COUNTY ) WATER DISTRICT for the fixing of the ) just compensation to be paid for the ) acquisition of property of ALDERCROFT ) HEIGHTS COMPANY, a public utility ) and corporation. )	Application No. 43869, Amended
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Robert Francis Jacobs, for petitioner.  
E. William Grischy, with Earl A. LaPorte,  
 President, for Aldercroft Heights Company.  
Elinore Charles and Hugh N. Orr, with  
Gustave Weck, for the Commission staff.

O P I N I O N

Petitioner, a county water district, seeks by a petition of the second class (Public Utilities Code, Sections 1401-1421), filed October 24, 1961, to have the Commission fix the just compensation to be paid for certain properties, described in the petition, of Aldercroft Heights Company, a public utility which supplies water to some 100 customers in a certificated service area located on the steep easterly slopes of Los Gatos Creek, near Los Gatos, California.

The Commission took jurisdiction after a hearing on January 4, 1962 on its order to show cause (Decision No. 63393, dated March 13, 1962). Petitioner, after some delay in determining the basis of the cost study it desired for the proceeding, finally requested the Commission staff to prepare and present a study of the original cost, depreciated, of the utility's rate base components. Hearings were then held at Los Gatos on April 22 and 23, 1963, before Examiner Gregory; the original cost study was received in evidence (Exhibit No. 1) and petitioner rested.

The utility, at the April 23 hearing, moved to dismiss the petition on the grounds that evidence of original cost, alone, would not afford an adequate basis for determination of just compensation; that the Commission should have the benefit of a study of reproduction cost new, less accrued depreciation; and that the expense of such a study should be borne by the district. The district opposed the motion, asserting that a review of earlier Commission just compensation cases indicated that depreciated historical cost was the proper basis for valuation of unprofitable properties such as the record showed these to have been.<sup>1/</sup> The motion was submitted and the case was taken off calendar at the utility's request (opposed by the district) for about six months additional time to prepare the utility's showing.

The Commission, on May 21, 1963, authorized an amendment to the petition to delete from the original property description certain office equipment and small tools, estimated by the staff at \$272.68.

The case was again set for hearing for October 31, 1963 (after agreement by counsel as to the date), following several months of inaction by the utility in reporting progress on the reproduction cost study it had previously indicated it would present. About three weeks after notice of this hearing had been mailed, the utility's attorney wrote a letter (Exhibit 7) stating that an engineering firm had been retained to make the study but he gave no estimated date for its completion. He requested a further continuance or that the case again go off calendar. The district opposed the request and appeared at the hearing, ready to submit the petition for decision

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<sup>1/</sup> City of Oroville, 21 CRC 823; City of Eureka, 19 CRC 952; Fair Oaks Irrigation District, 15 CRC 304. Annual reports of Aldercroft Heights Company for the years 1955 through 1961, following acquisition by the present owners, reflect average annual net losses, after depreciation and taxes, of about \$1422, for service to an average of 112 customers during the period. The annual reports have been incorporated into this record by reference.

on the record. The utility did not appear. The case was then taken off calendar and the parties were informed that it would be restored if, by November 15, 1963, the Commission were advised that the utility would be in a position to proceed with its showing.

On November 1, 1963 the Commission received a letter from the utility's engineering consultant to the effect that the study would be completed within four to six weeks. The case was then restored to the calendar for hearing at Los Gatos on January 23, 1964 and, after three days of hearing, was finally submitted for decision on February 4, 1964.

The only issue presented by this record concerns the proper measure and amount of just compensation to be paid for the properties, since the utility, by electing to proceed with evidence relating to reproduction cost, must be deemed to have abandoned its motion to dismiss for lack of such evidence in the earlier stages of the proceeding.

Resolution of the issue is attended by some unusual circumstances pertaining to these properties, among which are uncertainty of future water supply sources, the dearth of suitable building sites for future development and the difficulty of supplying water in the steep terrain. The system was in substandard condition when the present owners, Earl A. LaPorte and his family, purchased the stock of the utility corporation in 1954 for \$2,500. The Commission's records of rate applications and service investigations, in evidence, are replete with accounts of operational and financial crises both before and after acquisition by the LaPorte family. There is little doubt that the district was formed largely because of the dissatisfaction of many consumers with recurring summer water shortages, low pressures at certain points on the system and other deficiencies in supply or facilities. The evidence shows, however, that service improved during 1962 and 1963, due to strenuous efforts by the

management aided by a rate increase in 1962 (Decision No. 63740, Application No. 43786), and donation of about \$250 by a consumers association for repairs to the main pump station in the latter part of 1961.

The district has urged that the just compensation to be fixed by the Commission not exceed \$25,205.52, which was shown by the staff's study to be the depreciated original cost, on October 24, 1961, of rate base components, together with lands, rights-of-way and water rights, after making a small deduction for consumer contributions for pump repairs.

The company asserts that its evidence shows that the reproduction cost new, less accrued depreciation, for the total utility plant and land would be \$67,540, which sum includes 11 percent for general overhead (Exhibit No. 9).

The district, in rebuttal, offered evidence purporting to show that the market value of the properties, as of October 24, 1961, was \$20,000. If the depreciation reserve shown in the staff's study were restated to reflect field conditions, the market value of the rate base components, according to the district's witness, would be \$18,000.

The determination of "just compensation" by the Commission involves a judgment representing what it considers to be the fair value, in money, of the sought properties, including landed capital. The standard is frequently said to be fair "market" value, where the existence of a market value can be shown. In order to arrive at such a judgment, the Commission may look to what the record shows concerning the physical plant and land as of the date on which the petition was filed. This record contains evidence directed to: (1) the original cost, depreciated, of the utility's rate base components, plus land and intangibles; (2) the reproduction cost new, less accrued depreciation, of the physical plant (with and without

overhead), plus estimated land values and intangibles; (3) the recorded annual gross income and expenses, including depreciation and taxes, the recorded net revenues or losses and the number of consumers, for the years 1955 through 1963 under present ownership and for previous years under predecessor owners.

The term "market value" was defined by the district's engineering consultant as "the highest price estimated in terms of money that could be obtained by a willing seller negotiated with a willing purchaser who has knowledge of the uses and capabilities of the property". The Commission, in City of North Sacramento, 56 C.P.U.C. 554, 561, stated:

"In determining just compensation the Commission should consider those matters which would be considered by a willing seller and by a willing buyer each of whom has knowledge of all the uses and purposes to which the property is best adapted and for which it is capable of being used."

Informed parties to the sale of the utility properties involved here would certainly be aware of at least the following facts, ascertainable by inspection or revealed by the record:

1. The properties are dedicated and limited to public use and are being operated lawfully by a public utility water corporation in the community of Aldercroft Heights under visible conditions of terrain and area development, and must continue to be so used until lawfully abandoned to the public or until some other use is authorized by this Commission.
2. No other private entity may operate as a public utility within the company's service area in Aldercroft Heights unless it obtains a certificate of public convenience and necessity from this Commission, and this Commission may grant such a certificate only after making a finding that public convenience and necessity require or will require the construction of the system needed for such operation.

3. The district may parallel the company's lines and operate a competing water system in Aldercroft Heights without authorization from this Commission.

4. The company's presently authorized rates for water service are those which this Commission has found will allow the company an opportunity to earn a reasonable return on the original cost of its properties (plus an allowance for working capital) after deducting the depreciation reserve, advances for construction (none are involved herein) and contributions in aid of construction.

Other items which have been considered in determining just compensation for public utility properties are: original cost, less depreciation; rate base; comparable sales; capitalized earnings; and present day cost, sometimes defined as the sum of (1) reproduction cost new less depreciation of physical properties other than lands and rights-of-way; (2) the market value of lands, easements and rights-of-way; (3) the market value of water rights; and (4) organization costs and going concern value.

Generally, and without regard to the status of petitioner as a public agency, a willing purchaser and a willing seller of water utility properties would undoubtedly consider both the present and potential earning power of the properties and the present day cost as factors affecting market value. The willing purchaser would expect to be able to earn a reasonable return on his investment in the properties and he would be unwilling to pay much, if anything, in excess of the present day cost of the properties in view of the possibility of the water system being paralleled or condemned by a public agency.

There is no substantial dispute, on this record, as to the original cost of the properties depreciated. We find that the original cost, depreciated, of the properties and the rate base components, as of October 24, 1961, is as set forth in Exhibit No. 1 (with the adjustments noted) as follows:

Total utility plant, including intangibles, land rights and water rights	\$28,701 <sup>a</sup>
Depreciation reserve	3,396
Subtotal	<u>25,305</u>
Contributions in aid of construction	261 <sup>b</sup>
Total	<u>25,044</u>

<sup>a</sup> Excludes office furniture and tools deleted by amendment to petition (\$272.68).

<sup>b</sup> The record indicates that \$260.66 was contributed in October or November, 1961 by the Aldercroft Heights Improvement Association for pump repairs.

The original costs were developed for this proceeding by including all surviving components of the original plant as set out in an appraisal, dated February 13, 1947, made in connection with a rate application, complaint and service investigation. (See Decisions Nos. 40422, dated June 17, 1947, and 40658, dated August 26, 1947, in Application No. 28018 and Cases Nos. 4853, 4856.) Facilities added after February 13, 1947 and prior to October 24, 1961 were included in this proceeding at costs established and adjusted by the Commission's staff in Application No. 43786 (in this record by reference). Unrecorded plant additions were analyzed and added at estimated costs after giving consideration to any available records of material and labor expended and the dates of installation.

For purposes of the staff exhibit in this proceeding, the physical inventory of visible facilities such as reservoirs, tanks, springs, pumping equipment, water treatment equipment, office furniture and tools, was based on a survey made in connection with the

utility's last rate increase application, granted in 1962 (Decision No. 63740, May 28, 1962, Application No. 43786), supplemented by the detailed 1947 appraisal; various adjustments to plant made by the staff in Application No. 43786; the company's annual reports of 1947 to 1961, inclusive; available company records; and a detailed questioning of the company's president as to what comprised the additions to plant since 1954, the year in which the utility was acquired by its present owners.

With regard to mains, meters and services, no physical check in the field was made to verify their size, type or location. The inventory of these facilities was based wholly on an examination of existing records and a review, with the utility's president, of the entire distribution system to ascertain which of the original facilities were still in use and which had been retired, plus a detailed itemization of all additions made by the present owners since acquisition.

The record reveals that the utility, prior to October 24, 1961, did not keep a satisfactory set of records on additions and retirements of plant. Analysis of the system, the 1947 appraisal and the company's annual reports showed that there was on the books \$10,385.21 worth of facilities no longer in use. That amount includes adjustments made by the staff in Application No. 43786, totalling \$8,301.80, and in the original cost study herein, for retirements of mains, services and meters, amounting to \$2,083.41. The depreciation reserve of \$3,395.73, shown in the study, gives effect to the foregoing adjustments and to depreciation expense on the remaining plant for the first 10 months of 1961 in the amount of \$800.87.<sup>2/</sup>

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<sup>2/</sup> The depreciation reserve requirement for this utility was established by the 1947 appraisal, using a 5 percent sinking fund method. A subsequent decision (Decision No. 55561, September 10, 1957, Case No. 5494, Application No. 38538) revised depreciation accruals to the straight-line remaining life method using an annual rate of 3.1%, reduced to 3% in 1962 by Decision No. 63740, supra.



The company's study, dated January 2, 1964, of reproduction cost new less accrued depreciation (Exhibit No. 9) notes that while the valuation of the system is as of October 24, 1961, in order to allow comparison with the original cost developed by the staff, there have been significant additions and retirements since that date which, when included, will materially affect the reproduction cost new of this system.

A summary of the results indicated in the reproduction cost study and those developed by the staff in its original cost exhibit is shown below (from Exhibit No. 9, p. 4 and Exhibit No. 1, pp. 6, 7):

Acct. No.	Acct. Title	Reproduction Cost New		RCN (incl. OH) Less Total Acc. Depr. of \$28,710	Original Cost (Nearest \$)
		Excl. Gen.OH	Incl.Gen. OH @ 11%		
<u>Intangible Plant</u>					
301	Organization	\$ 1,720	\$ 1,720	\$ 1,720	\$ 126
<u>Tangible Plant</u>					
306	Land, land rights, & water rights	16,610	16,610	16,610	3,115
312	Source of supply plant	5,800	6,440	6,180	2,225
324	Pumping Equipment	1,950	2,160	1,470	1,300
331	Water treatment equipment	500	560	480	500
342	Reservoirs & Tanks	19,900	22,090	13,240	6,845
343	Transmission & Distribution Mains	35,400	39,300	23,200	10,479
345	Services	3,010	3,340	2,950	2,633
346	Meters	3,480	3,860	1,660	1,344
348	Hydrants	150	170	110	134
372	Office Furn. & Equipment				206 (a)
374	Other Gen. Equip.				66 (a)
Sub-total-Tangible Plant		\$86,800	\$94,530	\$65,820	
Total-Utility Plant		88,520	96,250	67,540	\$28,973

(a) Deleted by amendment to petition.

Except for some minor differences, the inventory used in the reproduction cost new study is identical with the inventory detailed in the staff's original cost study. The author of the RCND study defined "reproduction cost new" as "that cost which is estimated to be required to replace the entire system as a single unit". It includes the new construction cost of the physical plant as well as the cost of land and right-of-way, engineering and legal fees, interest during construction and all other costs required to construct the system complete in operating condition. The general overhead of 11 percent shown in the study includes costs applicable to the construction of the physical plant as a unit, engineering and administration costs, interest and taxes. Intangible plant (i.e., organization) costs used approximate the actual costs required to organize, in 1962, a water company with financial characteristics similar to those of Aldercroft Heights Company.

With respect to landed capital (main station, five reservoir or spring sites, associated water rights, pipeline and reservoir easements and rights-of-way), the value of which was the subject of considerable controversy, the study notes that there were very few sales in the area from which to judge comparative prices. Also, the topography and irregular shapes of the relatively few parcels were considered to give to each potential building site a character that would appeal only to a select group of buyers. Examination of each parcel included consideration of lot size requirements (10,000 sq.ft. minimum), location of lot lines, topography and adequacy of access. The reproduction cost of each parcel was based on the author's opinion of the fair market value of each building site comprising a parcel, as well as consideration of the value of each parcel in its entirety. In estimating the present (October 24, 1961) value of the land, the author of the study gave consideration to sales prices of

similar lots in Aldercroft Heights and in similar (i.e., mountainous) areas; opinions of local realtors; opinions of appraisers in local lending institutions; and the assessed value only of land.

The company also called three local realtors who, in addition to the president of the utility, expressed their opinions concerning the market value of the utility's landed capital, excluding water rights, rights-of-way and easements; the costs of these excluded elements were estimated in the original cost and reproduction cost new studies at \$560 and \$310, respectively.

The average value of the six parcels described in the cost studies, according to the company's witnesses, amounts to about \$17,370, ranging from a high of \$19,300 (by the company's president) to a low of \$15,570 (by witness Friend, a local realtor).

The district, by way of rebuttal, presented testimony of an experienced real estate appraiser who was familiar with properties in Aldercroft Heights and similar mountainous areas. Based on sales data of two improved lots in Aldercroft Heights in 1959 and an inspection of the sites involved in this proceeding, but excluding easements, rights-of-way and water rights, he placed a total market value of \$4,300 on the six parcels, or \$1,185 more than the original cost study figure which includes easements, rights-of-way and water rights.

In general, the utility's witnesses considered that a good building site in Aldercroft Heights, with a view and adequate access, would have a market value of about \$3,000 for those who might desire such property. The only district witness who testified in some detail concerning land values indicated that his appraisal of \$4,300 for the six parcels was influenced by considerations of small size, precipitousness, or difficulty of access. The staff's estimate of \$3,115 for land, land rights and water rights was included as its estimate of the original cost of those properties, without regard to

any subsequent appreciation in value or possible use for residential building sites which might be pertinent to a study based on reproduction cost new.

Summary and Findings

Determination of the market value of the sought properties, pursuant to the guides for fixing just compensation previously adverted to, requires that we give due consideration to what is revealed by the entire record. Apart from the cost studies and the various opinions concerning land values, from which we must derive a judgment as to what we consider to be the market value of the properties, we cannot overlook what the record reveals concerning the underlying physical and economic facts.

It is clear that the company, with few minor exceptions, has not been making earnings sufficient to meet operating expenses, including depreciation and taxes, or a return on its investment. Thus, the utility can be considered a "going concern", as of October 24, 1961, only in the sense that it was in actual operation, but not in the sense that it was doing a profitable business. Hence, there is lacking a foundation in this record for consideration of "going concern" value (other than nil) as an element in fixing just compensation, or for the use of capitalized earnings as a standard for valuation of the properties.

Other facts having an adverse effect on market value (questionable continuity of the Los Gatos Creek source of supply; difficulty of maintaining adequate transmission or distribution of available spring water in the hilly service area; lack of prospects for any substantial increase in revenues due to the geographically restricted consumer base) must also be considered. Under the circumstances, any purchaser of the properties as of October 24, 1961 would be faced not only with the problem of placing the system and its

facilities in adequate working order, but, having done so, with the additional problem of devising some method of increasing earning power, if only to recover depreciation and other charges applicable to its operation.

In arriving at a figure for the fair value of the sought properties, we have considered that, with the exception of one or two private systems installed by former consumers dissatisfied with recurring summer water shortages, they afford the only presently feasible means of supplying water to the community under any form of ownership or operation.

The concept of "market value", if applied to these properties, would be unrealistic because of the special circumstances, mentioned above, under which the system has functioned over the years. It is doubtful that an investor, acquainted with the utility's financial history, limited sources of water and unfavorable growth potential, would consider purchase of the properties as a desirable venture. Hence, under the circumstances shown by this record, the value of the properties must be determined by resort to other concepts than reproduction cost or consideration of earning power. Accordingly, although we have considered and weighed the evidence concerning reproduction cost new, less accrued depreciation, we are of the opinion that the proper basis for ascertainment of the just compensation to be fixed in this proceeding is the original cost of rate base components, depreciated, including an allowance for intangibles and landed capital, less contributions shown to have been made by the consumers for the utility's benefit.

We find, on this record, as follows:

1. Petitioner, Aldercroft Heights County Water District, is a duly organized and existing county water district functioning under the laws of the State of California.

2. Respondent, Aldercroft Heights Company, is a public utility water corporation which for many years has been and now is supplying water to approximately 100 consumers in the community of Aldercroft Heights, Santa Clara County, California, pursuant to the regulatory authority exercised by the California Public Utilities Commission.

3. Earl A. LaPorte, in 1954, purchased the stock of Aldercroft Heights Company for \$2,500 cash.

4. Aldercroft Heights Company, during the period from 1955 to October 24, 1961, both inclusive, recorded an average yearly net loss, after depreciation and taxes, of approximately \$1422, for water service to an average yearly number of 112 consumers; for the years 1956 and 1957, the utility recorded net income, after depreciation and taxes, of \$54 and \$131, respectively.

5. The reproduction cost new, less accrued depreciation, of the used and useful properties of Aldercroft Heights Company (including organization costs, land, land rights and water rights and an allowance of 11 percent for general overheads), as of October 24, 1961 is not more than \$67,540 and not less than \$33,000.

6. The original cost of rate base components, depreciated, of Aldercroft Heights Company (including organization costs, land, land rights and water rights, and after deducting contributions in aid of construction), as of October 24, 1961 is \$25,045.

7. This record does not contain evidence to justify use of capitalized earnings as a standard or element in the determination of the fair market value of the properties sought herein, or the just compensation to be paid therefor.

8. The total just compensation to be paid by Aldercroft Heights County Water District for the taking of the lands, properties and rights described in the district's petition, as amended, is the sum of \$25,045.

The Secretary of the Commission is directed to cause certified copies of this order to be served upon the parties. The effective date of this order shall be twenty-one days after the date hereof.

Made and filed at San Francisco, California, this 22nd day of JUNE, 1965.

Fredrick B. Holshoff  
President  
George C. Trover  
Augusta  
Commissioners

*I will file a dissent*  
*Peter E. Mitchell*

*I will file my dissent later.*  
*William W. Dunlop*

WB 10-4-65

STATE OF CALIFORNIA  
OFFICE MEMO

Date October 4, 1965

To William W. Dunlop  
From Commissioner Peter E. Mitchell  
Subject Dissent in A 43869 - D 69301 - Aldercroft Heights Water

I do not plan to file a dissenting opinion  
in connection with the subject decision.

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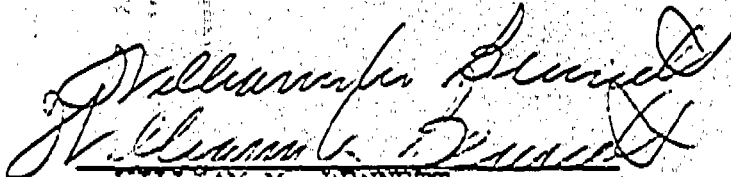
A. 43869, D. 69301

DISSENT

BENNETT, William M., Commissioner, Dissenting Opinion:

I view this decision as a serious break with Commission precedents dealing with just compensation. The concept of "market value" is rejected as being unrealistic. The implication of the decision is that there is no market for such property and this is inexplicable in the face of the fact that the Aldercroft Heights County Water District is a purchaser and has made a market by its offer. While the market may be one special to this case and while the value may be high or low, there is a "market value" in this case. Surely "market" is no less present simply because a public utility is the subject of purchase or because we are not dealing with mass commodities generally associated with the concept of "market".

The opinion discusses the various methods of arriving at market value and even cites from City of North Sacramento, 56 CPUC 554, 561, that the Commission should consider in fixing just compensation those matters which would be considered by a willing seller and a willing buyer. Such a standard admittedly broad should nonetheless be used here but as I view the decision it is rejected and the compensation is fixed as though the Commission were setting rates. Accordingly I dissent to the exclusive use of original cost depreciated for the fixing of compensation. Instead I would adhere to the traditional methods which this Commission has employed which might well result in a different compensation.

  
WILLIAM M. BENNETT  
Commissioner

San Francisco, California  
July 12, 1965