

ALJ/md

Decision 84 08 120 AUG 7 1984**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Petition of the)
 Winton Sanitary District requesting)
 the Public Utilities Commission to fix) Application 83-07-03
 just compensation for the acquisition) (Filed July 1, 1983)
 of the public utility property of)
 Winton Water Company, Inc.)

Graham & James, by James D. Scueri, Attorney
 at Law, for Winton Sanitary District,
 applicant.

John F. Farrell, Attorney at Law, for Irvin
Heppner, and James J. Milam, Attorney at
 Law, for George Orr, interested parties.

Susan N. Weber, Attorney at Law, for
California Department of Water Resources,
 intervenor.

O P I N I O N

Winton Sanitary District (District) requests under Public Utilities (PU) Code § 1401 et seq. that the Commission fix the just compensation which shall be paid by the District under the law, for the lands, property, and rights of the Winton Water Company, Inc., (Company). Such lands, property, and rights, which are fully described in Paragraph VIII of the application, are intended to comprise all of the water utility properties of the Company lying within its service area.

In accordance with PU Code § 1405 the Commission issued on August 3, 1983, Decision (D.) 83-08-021, its order to show cause, directing District, Company, and any claimants to appear on August 31, 1983, at a prehearing conference to show cause why the Commission should not proceed to hear the application and to fix the just compensation to be paid for the Company's water utility properties.

The prehearing conference was held as ordered; and evidentiary hearings were held on January 9, February 27, and April 6, 1984, before Administrative Law Judge Baer.

Evidence and testimony was offered at hearing by District, Company, Department of Water Resources (DWR), and George Orr, and the matter was submitted after the receipt of late Exhibit 15 and concurrent briefs on June 21, 1984.

District's Evidence of Market Value

The District's expert witness was John D. Reader. He testified to the market value of the Company's property based on the historical cost of the facilities actually installed. He divided the Company's facilities into two parts: (1) facilities installed recently (1982) with Safe Drinking Water Bond Act (SDWBA) funds, which are not included in rate base, and (2) old facilities, which are included in rate base.

He valued the new facilities at \$787,700, the total amount of the SDWBA loan. In his opinion the improvements installed with SDWBA funds have depreciated slightly, but their replacement cost has also appreciated due to increasing construction costs. He stated that \$787,700 was a reasonable estimate for the cost new, less depreciation, for the SDWBA funded improvements.

For the old facilities he started with the staff estimate of net plant in Application (A.) 83-03-19 (Company's general rate increase proceeding) of \$247,150. Assuming that the District will agree to refund advances for construction of \$135,840, he then deducted that sum from net plant. ($\$247,150 - \$135,840 = \$111,310$). He then multiplied \$111,310 times a factor of 2.15 to arrive at the value of \$239,320 for the old facilities.

New Facilities (SDWBA funded)	\$ 787,700
Old Facilities ($\$111,310 \times 2.15$)	<u>+239,320</u>
Total Market Value	\$1,027,020

Reader's factor of 2.15 was derived from the average of the ratios between net plant less advances and sale prices of six water companies, as follows:

<u>Company</u>	<u>Ratio</u>
Rio Dell	2.29
Rancho Mirage	1.97
Patterson City	2.02
Tomarisk	2.17
North Los Altos	2.23
Niles-Decoto	<u>2.19</u>
Average of Ratios	2.145
Rounded Average	2.15

In addition, Reader testified that the value to the Company of the addition of 148 customers from two tracts would be about \$9,300 when 2/3 of the lots are developed. When this occurs, the rate base per customer will be about \$63. (1,595 customers¹ times \$63/customer = \$9,300.) Adding \$9,300 to the market value, supra, gives a market value of \$1,036,320.

Reader compared this figure with two appraisals commissioned by Heppner and the District. Municipal Consultants, Inc., for Heppner, suggested two values in its October 7, 1982, letter to the District:

\$1,031,888 (District assumes all company debts,
\$148,365, except two personal loans).

\$1,082,400 (Heppner assumes all debts).

facilities at \$975,000.

The various figures are from high to low:

Municipal Consultants - Heppner	\$1,082,400
Reader - District	1,036,320
Municipal Consultants - Heppner	1,031,888
James J. Palmer - District	<u>975,000</u>
Average	\$1,031,402

¹ Staff R/O Report shows 1,497 customers plus (2/3 (148 new lots) = 98 lots) equals 1,595 customers.

In later testimony Reader valued the old facilities using the depreciated original cost method as of the end of 1983. He used staff and Company estimates since a decision in A.83-03-19 had not then been issued. His calculations are:

		<u>Utility</u>	<u>Staff</u>
Utility Plant	12/31/83	\$367,600	\$353,080
Dep. Reserve	12/31/83	<u>117,170</u>	<u>105,930</u>
Depreciated Original Cost		\$250,430	\$247,150

Reader then averaged the two figures to arrive at \$248,790 for the depreciated original cost. He then notes that this figure differs from the rate base because rate base does not include unrefunded money advanced or money contributed by customers or developers. Since the Company's 1982 Annual Report showed unrefunded advances of \$135,840, Reader subtracted that sum from his depreciated original cost of \$248,790, yielding a value for the utility's old facilities of \$113,000 (rounded).² This figure includes contributions of \$17,652 as shown on Company's 1982 Annual Report.

Reader also testified concerning a method to derive the value of public utility facilities based upon their earnings. At the time of his testimony, however, the Commission had not yet issued a decision in the Company's general rate proceeding, so that the data necessary for making the calculation were not then available. On March 21, 1984, the Commission issued D.84-03-060 in A.83-03-19. That decision contains the information necessary to make the calculation Reader described, i.e. adopted net revenues after taxes (\$11,510) divided by adopted rate of return (11.5%). The calculation yields a value of \$100,086.95, a number within a few dollars of the

² For comparison purposes the average depreciated rate base for 1983 adopted by D.84-03-060 in A.83-03-19 was \$100,270.

average depreciated rate base (\$100,270) adopted by the Commission in D.84-03-060.³ In later testimony Reader adopted the figure \$100,270 as his value of the old facilities based upon capitalized earnings. These figures do not take into account the Company's investment funded by the SDWBA loan, which is not in rate base, nor the surcharge revenues collected by the Company to amortize the principal of and interest on that loan.

The range of values to which Reader testified may be summarized as follows:

<u>Method</u>	<u>Value</u>
Comparable Sales*	\$1,036,320
Depreciated Original Cost, Less Advances	113,000**
Adopted Average Depreciated Rate Base (D.84-03-060)	100,270**
Capitalized Earnings	100,270**

* This is actually a hybrid method, based on the SDWBA loan amount, the historical cost of old facilities, a multiplier developed from market data, and an adjustment for new customers coming into the system.

** These methods depend upon accounting data, which, for ratemaking purposes, exclude the cost or value of or income from facilities installed using the SDWBA loans.

The Company's Evidence of Market Value

The Company called James P. Sievers, a professional appraiser, as its valuation expert. He used three methods to determine fair market value: (1) reproduction cost new less depreciation (RCNLD), also known as the cost, replacement cost, or depreciated cost approaches, (2) market data, and (3) income.

In arriving at RCNLD Sievers first determined the size, length, and types of pipe and other fixtures comprising the system. The pipe was broken down by type and size. Each type and size was

³ The difference is due to rounding.

multiplied by a cost factor per linear foot. These cost factors were obtained from various sources:

1. Marshall-Swift Valuation Service, a standard publication in the appraisal business.
2. Farrell Back-hoe Service, San Carlos, for contemporary costs of trenching, backfitting and boring.
3. Gross Weldrilling, Galt, for contemporary costs of drilling wells and inserting casings.

After he determined the contemporary cost of each type of component in the system, he also calculated the installation cost of these components. He added the costs of components and installation, and factored this sum by a cost multiplier to bring it up to date. This process produced a replacement cost of \$1,701,000. He calculated depreciation of \$86,000, which he deducted, leaving RCNLD of \$1,615,000.

For the income approach Sievers assumed 1,834 connections, which he multiplied times assumed income of \$200 per connection arriving at \$366,000. He deducted a 10% vacancy and collection loss factor of \$36,600 to arrive at effective gross income of \$329,400. He then assumed that expenses would be 60% of gross effective revenue, or \$197,640.

Subtracting those expenses from effective gross income, he arrived at net operating income of \$131,760. He then capitalized this income at 11.5% to reach the indicated value of \$1,158,000⁴ by the income approach.

For his market data approach Sievers obtained data on six privately owned water companies sold in California between 1968 and 1981. From the sales prices and number of connections he derived prices per connection as follows:

⁴ The indicated value by Siever's income approach should be \$1,145,739 ($\$131,760 \div .115$).

<u>Name</u>	<u>Sales Price per Connection</u>
Patterson Water Co.	\$495.00
Southern California Water Co.	536.60
Rio Dell Water Co.	500.00
Escolar Water Co.	526.00
Rancho Mirage Water Co.	634.06
Tamarisk Water Co.	<u>695.95</u>
Average	\$564.60

From these prices Sievers derived \$625 per connection for the Company. This derivation was based on five factors: (1) the majority of the companies have no room left for expansion of their facilities, (2) the Company has almost unlimited expansion ahead, (3) the sales are from 3 to 16 years old, (4) number of connections, and (5) condition of physical plant.

Sievers multiplied \$625 per connection times 1,834 connections to reach \$1,146,000, his indicated fair market value using the market data approach.

Sievers' testimony may be summarized as follows:

<u>Method</u>	<u>Result</u>
RCNLD	\$1,615,000
Income	1,145,739
Market Data	1,146,000

From this analysis Sievers concludes that the current market value for the Company's facilities is \$1,400,000, coincidentally the rounded midpoint between his RCNLD and his market data numbers.

Discussion of the Evidence

During cross-examination of Sievers, he disclosed that his RCNLD valuation of the Company's water system was based upon the date of his appraisal report (Exhibit 12) which was March 16, 1984. He

admitted that he was unaware of the requirement in PU Code § 1411 that the Commission shall fix the just compensation as of the day the petition was filed (July 1, 1983). Accordingly, his appraisal date is wrong by 8½ months. Sievers concluded that there would be a definite difference in his appraisal if he had used the correct date because prices have gone up since July of 1983. The cost per linear foot of pipe and the multiplier he used would be different.

Sievers included in his RCNLD valuation a parcel that the District is not asking to be valued. However, he did not believe the inclusion would have much effect on his valuation.

The parcel involved is Assessor's Parcel Number 146-182-08. It is 30 x 90-foot fenced parcel, known as well site #10. It contains a 40 hp pump and a 10,000-gallon storage tank; it is presently in use and is in good condition (Exhibit 12, p. 11). In his RCNLD exhibit Sievers lists the tank at \$14,000. He also lists a 40 hp pump at \$3,000. We assume that a part of the \$66,353 he lists as the replacement cost of drilling, casing, and sealing an unknown number of wells is attributable to the well at well site #10. Assuming that the total cost of replacing well site #10 would be about \$20,000, Sievers is correct that its inclusion is not significant in his overall valuation. This is clear since he has discounted his \$1,600,000 RCNLD valuation to reach his ultimate opinion of value of \$1,400,000.

Sievers' depreciation appears to be understated. At \$86,000, the figure used in his RCNLD calculation, his depreciation varies significantly from the staff estimate of average depreciation reserve for the year 1983 of \$105,930.

The most significant feature of his RCNLD valuation, however, is the difference between \$1,600,000 and the cost of installing the SDWBA funded facilities in 1982. It is undisputed that the Company borrowed \$787,700 to fund the replacement of much of

its plant. Sievers agreed that nearly 90% of the plant was replaced in 1982. We are asked to believe that between 1982 and July 1983, the cost to replace that plant increased to \$1,600,000. We cannot accept that premise. Assuming that 90% of the plant was replaced at a cost of \$787,700, and further assuming that 100% was replaced at a cost of \$875,222 ($\$787,700 + 0.9$), we would be required to accept an increase in $1\frac{1}{2}$ years of \$724,778 or 83%. This does not appear reasonable to us. Nor can we accept Heppner's claim that much of this increase in value is attributable to his unbooked, donated labor or donated machinery rental. If Heppner or his predecessors have failed to record and, therefore, have failed to capitalize such donations, it is too late now to expect such matters to be reflected. Heppner ought to have petitioned the Commission to adjust his books to reflect such claims and should have supported them with appropriate records and documents. That was not done in the past, and Heppner has in this proceeding offered no documentary evidence of these unbooked capital items.

In concluding that Sievers' RCNLD figure is overstated we note in passing that the State Controller's Office performed an audit of expenditures associated with the SDWBA loan to the Company (Exhibit 4).⁵ It finds that the allowable project costs were \$471,237 and recommends that the overpayment by the State of \$293,462 should be refunded by the Company to the State. We do not pass judgment upon whether the SDWBA loan of \$787,700 was properly expended or whether each dollar of loan funds represents equivalent value in labor, materials, and services used to improve the Company's plant. But the audit report does suggest that if we were to find that the value of the Company's new facilities is equal to the loan principal, we would not err on the conservative side.⁶

In making his income based appraisal Sievers used a 10% vacancy and collection loss factor, rather than the 12½% factor used by Palmer in his appraisal. This judgment was based on unspecified information received from Heppner and Sievers' feeling that since Winton was near an Air Force base, rentals would have a low vacancy factor and collections would be better than average. Sievers did not attempt to obtain actual records that might have been available at the Company with respect to vacancy or collection loss.

⁵ The District introduced this document without a sponsor and without objection. But it made no use of the information contained in the document in the valuation done by Reader.

⁶ A just compensation proceeding is not the proper case in which to litigate the State's claim to a refund of a portion of its SDWBA loan to the Company. If the State believes it is entitled to a refund, it should file suit against the Company in the Superior Court.

Also, in the capitalized income calculation Sievers used a 60% factor for expenses. He did not base this factor upon the Company's actual experience but upon the two 1982 appraisals and upon comparisons with other water companies. It is noteworthy that the ratio of operating and maintenance expenses to gross income adopted by the Commission in D.84-03-060 for the Company is \$193,810 to \$230,590 or 84%.⁷

Regarding the number of connections used by Sievers in his capitalized income calculation, he testified that he was given addresses by Heppner. Sievers counted the addresses on the list given him by Heppner and arrived at the number 1,834. He did not otherwise verify the number either by comparison with Company records or by visiting any of the addresses. In D.84-03-060 the Commission adopted the staff method of estimating customers, which, it stated, was in accord with the Company's tariffs. The staff method resulted in 1,296 customers.

Finally, Sievers adopted a figure of \$200 of gross revenue per connection that he felt was appropriate for the Company based on comparisons with other water companies. He did not review the actual revenues of the Company. Based on gross revenues and numbers of connections adopted in D.84-03-060, the gross revenue per customer is \$178, rather than the \$200 assumed by Sievers.

In testifying on cross-examination regarding his market data approach, Sievers could not explain how he arrived at his estimate of price per connection of \$625. He said that he gave certain factors more weight than others, but he did not do so by any formal method or mathematical computation. He said that dates of sales and numbers of connections carried greater weight than the

⁷ 95% if depreciation and taxes are added to operating and maintenance expenses.

possibility of expansion. However, if this were so, he should have reached a lower estimate of price per connection for this Company than \$625. With one exception (Rio Del) the price per connection is proportional to age of sale; that is, the older the sale the higher the price per connection. Using this criteria alone the Company could have been valued at \$495 per connection or less. Again, there is a strong correlation between the price per connection and the number of connections. As the number of connections increases the price per connection tends to decrease. (We would expect the data to reflect that phenomenon because of economies of scale.) Thus, Sievers' market data shows that the two largest utilities have an average price per connection of \$515.80, while the two smallest average \$665, more than \$150 greater. Using all the data, the three largest utilities have an average price per connection of \$510.50, while the three smallest average \$618.67, more than \$108 greater.

Thus, it appears that while Sievers claimed to have given greater weight to the ages of the sales and the numbers of connections, in fact he gave little or no weight to those factors. Instead of relying on those quantifiable factors he obviously leaned heavily on the factor of room for expansion.

Regarding that factor, he testified that the majority of the companies cited in his market data have no room left for expansion of their facilities, whereas the Company has almost unlimited expansion ahead. He stated that subdivisions on the planning table and ready to build are waiting for the Company to give them the go-ahead.

Nothing in his testimony supports his generalizations about the expandability of the Company versus the six companies he cited. On cross-examination he stated that a "couple" of the comparison companies were not expandable. This contrasts with his appraisal report where he stated that a "majority" were not expandable. Moreover, his conclusion was largely rebutted by the testimony of

Genevieve Ansley, elected member of the Board of Directors of the District and secretary of the board.

She testified that expansion of water connections is limited in the Winton area by the availability of sewer connections. Persons wishing to build must obtain a sewer connection permit from her with the approval of the Board of Directors. Only 20 (single family residence) or 30 (apartment) permits are available because the District is reaching the limits of its sewerage capacity purchased from the City of Atwater, 0.5 million gallons per day (MGD). Thirty apartments or 20 single family residences will use up the remainder of that capacity, according to the District's engineers. Before additional sewage capacity can be handled additional treatment facilities need to be built or capacity purchased from the City of Atwater. Either alternative will cost about \$2 million, but in any event no expansion is foreseen within the next 3 to 4 years. Even if a development project is not within the District's boundaries, but is within the Company's service area, which is larger than the District's area, the County will not issue a building permit without sewer connections in the area covered by the Winton Specific Urban Development Plan. All projects now under construction have sewer permits already. An apartment project of 88 units was covered by a special purchase of sewer capacity from the City of Atwater. Champagne Estates is a development of 104 homes, 40 of which remain to be built. These homes have already used 104 permits. Thus, before very much more expansion occurs, more sewer capacity must be purchased or built.

Sievers' conclusion that the Company had unlimited room for expansion must, therefore, be tempered by the availability of sewer permits, a fact he conceded on cross-examination.

The three factors above-discussed are not entitled to the weight Sievers gave them in his market data approach. It is true, however, that since most of the physical plant was recently (1982)

replaced, it is in excellent condition. But taken all together the factors Sievers mentioned as influencing his determination of value per connection using the market data approach do not support his figure of \$625 per connection in our view. In addition, because he could not state how he used these factors to weight the market data, his approach is not entitled to much credit. Reader's approach, using a ratio of net plant less advances to sales price, is a better method of using market data to value a utility facility, since it screens out the effects of inflation and the passage of time. It also relates the value of the facilities to their recorded costs, which Sievers' approach does not.

Effect of the SDWBA Loan on Market Value

Originally, the District took the position that although the market value of the improved water system was \$1,027,020, the District should only be required to pay \$239,000. Reader testified that:

" . . . Winton Water Company could not expect to sell facilities and reap benefits from property on which the same customers are required to pay principal and interest (on the SDWBA loan) for another 30 years or so. The customers should hardly be expected to pay for the entire water system as well as to assume the mortgage on the property." (Exhibit 1, p. 11.)

The District was concerned that if the Commission found fair market value to be \$1,027,070, and if the Superior Court ordered that amount to be paid to the Company, and if the Company did not pay off the SDWBA loan, the customer would be required both to pay fair market value and to pay off the loan.

This does not happen in private sector real estate transactions and there is no reason to believe that it will occur in forced sales by operation of law. DWR has an interest in the real property of the Company which secures its loan. That interest must be satisfied, either by payment or assumption of the loan, before the property can be transferred. The eminent domain law recognizes this imperative in Code of Civil Procedure (CCP) § 1265.220:

"Where property acquired by eminent domain is encumbered by a lien and the indebtedness secured thereby is not due at the time of the entry of judgment, the amount of such indebtedness may be, at the option of the plaintiff, deducted from the judgment and the lien shall be continued until such indebtedness is paid; but the amount for which, as between the plaintiff and the defendant, the plaintiff is liable under Article 5 (commencing with Section 1268.410) of Chapter 11 may not be deducted from the judgment."⁸

Under this section the plaintiff, or the District in this case, has an absolute right to deduct the amount of indebtedness owed to DWR from the judgment and to pay it off on the same terms enjoyed by the Company. In effect it may assume the DWR loan. This it has already agreed to do and has submitted a copy of its assumption agreement as Exhibit 15. Article 8(d) of the agreement provides:

"The State agrees to provide necessary legal assistance, if requested to do so by District, as a co-plaintiff in any action brought by the CPUC, the District, or its ratepayers, to recover, from Irvin Heppner, the Company, or any other party, missing surcharge account funds of approximately \$80,000, and any improperly spent SDWBA loan funds. The State further agrees that any of these amounts recovered by the State less court costs and sums specifically designated by court order as attorney fees, will be for the benefit of the ratepayers of the Company."

This is an appropriate resolution of the problem posed in OII 93 and alluded to here of the allegedly missing surcharge funds and also the problem of the refund allegedly due DWR. Until these matters are litigated or settled, we cannot determine what impact, if any, they should have upon our finding of fair market value. If funds are eventually collected based upon these claims, then the ratepayers can benefit by a reduction of the indebtedness that they would otherwise pay.

⁸ The second independent clause of the section is irrelevant to this case as it deals with the proration and payment of ad valorem taxes, penalties, and costs.

DWR's Position

DWR sponsored no valuation evidence but did offer testimony regarding the history of the SDWBA loan involved here. In brief DWR asked that the Commission find that net value of the new assets (those funded by DWR's loan) to the Company is \$3,812.18.⁹ DWR arrives at this figure by subtracting the unpaid principal of the loan as of July 1, 1983, (\$783,828.13) from the original loan principal (\$787,700). Stated another way DWR believes that the Commission should set the fair market value of the new facilities at a figure equal to the Company's "equity" in the property (loan principal less principal to be paid = equity). This is not what the statutes and case law require of us.

The just compensation for the taking of the land, property, and right of the condemnee is measured by the market value of such land, property, and rights. In Sacramento etc. R.R. Co. v Heilbron (1909) 156 Cal 408, 409, market value was defined as:

"...the highest price estimated in terms of money which the land would bring if exposed for sale in the open market, with reasonable time allowed in which to find a purchaser, buying with knowledge of all the uses and purposes to which it was adapted and for which it was capable."

The Commission has applied a similar definition, which appears to be derived from the Heilbron rule. In City of Riverside (1972) 74 CPUC 193, 202 the Commission stated:

"We have used, as the measure of value of the properties herein, the concept of the highest price, estimated in terms of money, that a willing buyer would pay to a willing seller for the property if exposed for sale on the open market, where each is under no unusual pressures of time or circumstance and each has knowledge of all the uses and purposes to which the property is best adapted and for which it is reasonably capable of being used."

⁹ Mathematically the correct figure is \$3,871.87.

The Heilbron rule has in turn been codified in § 1263.320 of the Code of Civil Procedure, as follows:

- "(a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.
- "(b) The fair market value of property taken for which there is no relevant market is its value on the date of valuation as determined by any method of valuation that is just and equitable."

The Heilbron rule, as variously expressed, constitutes the standard which the Commission should apply when valuing public utility property for just compensation purposes. (1 CPUC 2d 474, 476-477.)

The Commission is required to establish the fair market value. The disposition of the liens encumbering the subject property is the prerogative of the Superior Court, which will be guided by the Code of Civil Procedure. (See § 1265.220 quoted supra.)

Orr Property

In its application the District listed, as one of the parcels of real property owned and operated by the Company, parcel 12, Assessor's Parcel Number 146-182-08. The Company identifies this parcel as Well Site No. 10.

A copy of the application was served upon George Orr as a possible claimant to parcel 12. Orr appeared in this proceeding and testified to his ownership of parcel 12. There is no dispute that Orr is the owner of record of parcel 12.

Orr is a developer. He agreed with Heppner to develop parcel 12 as a well site. He spent \$6,500 to install a well, pump, and storage tank, but was never reimbursed for his investment as Heppner had agreed. Accordingly, Orr did not convey the parcel to Heppner.

However, since the District stipulates that it is not seeking a valuation of parcel 12, it is not necessary to determine whether the parcel has been dedicated to public utility use. Accordingly, our finding of just compensation will not include any recognition of parcel 12 as a part of the utility facilities to be valued in this proceeding. If the District desires to acquire parcel 12, it may do so as part of its eminent domain action in the Superior Court.

Finding of Just Compensation
or Fair Market Value

Estimating fair market value in just compensation or eminent domain proceedings is not an exact science. It is not exact because the only way the fair market value of a property can be determined exactly is to offer the property on the open market. The resulting sale price would by definition constitute the fair market value.

Since that cannot be done where private property is sought to be taken by a public agency, a judicial proceeding is substituted for the open market. Evidence is taken from the adverse parties. This evidence usually presents divergent views of the fair market value of the property. The owner's evidence tends to value the property highly while the public agency's evidence is usually at the low end of the spectrum. Various methods of approaching fair market value are used by the expert appraisers. In this proceeding we have seen RCNLD, capitalized earnings, market data, rate base, original cost, and a hybrid method. Even where the same method is used results may vary from appraiser to appraiser.

The Commission is not required by law to select only one method of appraisal in reaching its finding of fair market value. It may consider all the appraisal evidence and reach an informed judgment based upon a weighing of that evidence.

The spread of the appraisals that the Commission may consider in this proceeding is as follows:

<u>Party</u>	<u>Witness</u>	<u>Method</u>	<u>Result</u>	<u>Opinion of Value</u>
District	Reader	Rate Base	\$ 100,270	
"	"	Capitalized Earnings	100,270	
"	"	Depreciated Orig. Cost	113,000	
"	"	Comparable Sales	239,320	
"	"	Hybrid	1,036,320	
"	"			\$ 100,270
Company	Sievers	Capitalized Earnings	1,145,739	
"	"	Market Data	1,146,000	
"	"	RCNLD	1,600,000	
"	"			\$ 1,400,000

For the reasons stated above in the discussion we have discounted Sievers' appraisal methods and his opinion based upon those methods. Each of his methods was flawed in the ways we have indicated. It would be difficult, if not impossible, to recast his methods to eliminate the problems we mentioned.

In our view, the best evidence of the fair market value of this property is derived using the capitalized earnings approach. As the District so aptly argues, there is no water system in the state which is substantially similar to Winton. This Commission has had to take the extraordinary step of seeking a court-ordered receiver to manage and operate the utility because of its extremely poor management and operational history. Thus, a "comparable sales" approach would erroneously assume that other sales involved comparable utilities. They did not.

We believe that the capitalized earnings approach captures the fair market value of Winton. It certainly represents the reasonable investment value of the utility to Heppner. This approach might even overstate that value given the outstanding claims against the utility. There is certainly no record in this case upon which to adopt any additional increments for the goodwill associated with an ongoing business concern. Therefore, we will adopt Reader's capitalized earnings value of \$100,270 for the old facilities. We will also adopt Reader's value of \$787,700 as the fair market value of the facilities constructed with the SDWBA loan proceeds. To these values, we will add Reader's value to the company of its loss of the new customers shortly to come on the system of \$9,300. Thus, the total fair market value is:

New Facilities	\$ 787,700
Old Facilities	100,270
New Customers	<u>9,300</u>
Fair Market Value	897,270

In reality the District will only pay to Heppner the sum of about \$109,570 or the fair market value less the principal remaining to be paid on the SDWBA loan. The District has an absolute right to assume that loan, which is at a favorable rate of interest (5½% for 35 years). In addition, the District will obligate itself to refund advances for construction of \$135,840, at zero interest, if and when they become due and payable.

Conclusions of Law

1. The District has the absolute right under CCP § 1265.220 to assume the SDWBA loan.
2. The just compensation that the Commission is required to set for the taking of public utility property is equal to the fair market value of that property on the date the application is filed.
3. In finding fair market value the Commission may consider any valuation method likely to shed light on that value.

Findings of Fact

1. The RCNLD, market data, and earnings evidence of the Company is not entitled to great weight.
2. The best evidence of the fair market value of the new facilities is the cost to recently construct them, represented by the principal amount of the SDWBA loan.

3. For the old facilities the best evidence of value consists of Reader's capitalized earnings appraisal of \$100,270, augmented by the value to the Company of its loss of the new customers of \$9,300.

4. The just compensation to be paid by the District for the land, property, and rights (excluding the Orr property) of the Company is the sum of \$897,270 as of July 1, 1983, the day on which the application was filed with the Commission.

5. The foregoing finding assumes that District will assume the duty to refund advances for construction of \$135,840.

6. This proceeding is closed.

This opinion becomes effective 20 days from today.

Dated AUG 7 1984 at San Francisco, California.

Commissioner Priscilla C. Grew,
being necessarily absent, did
not participate

LEONARD M. CRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Joseph E. Bodovitch, Executive Director

The Commission is not required by law to select only one method of appraisal in reaching its findings of fair market value. It may consider all the appraisal evidence and reach an informed judgment based upon a weighing of that evidence.

The spread of the appraisals that the Commission may consider in this proceeding is as follows:

<u>Party</u>	<u>Witness</u>	<u>Method</u>	<u>Result</u>	<u>Opinion of Value</u>
District	Reader	Rate Base	\$ 100,270	
"	"	Capitalized Earnings	100,270	
"	"	Depreciated Orig. Cost	113,000	
"	"	Comparable to Sales	239,320	
"	"	Hybrid	1,036,320	
"	"			\$ 239,320
Company	Sievers	Capitalized Earnings	1,145,739	
"	"	Market Data	1,146,000	
"	"	RCNLD	1,600,000	
"	"			\$ 1,400,000

For the reasons stated above in the discussion we have discounted Sievers' appraisal methods and his opinion based upon those methods. Each of his methods was flawed in the ways we have indicated. It would be difficult, if not impossible, to recast his methods to eliminate the problems we mentioned.

In our view, the best evidence of the fair market value of this property is what it cost to build it recently. Accordingly, we adopt Reader's value of \$787,700 as the fair market value of the new facilities. We will also accept his value of \$239,320 for the old facilities, based on the comparable sales method. To these two values we will add Reader's value to the Company of its loss of the new customers shortly to come on the system of \$9,300. Thus, the total fair market value is:

New Facilities	\$ 787,700
Old Facilities	239,320
New Customers	<u>9,300</u>
Fair Market Value	1,036,320

We reject Reader's appraisals ranging between \$100,270 and \$113,000 because they were offered in view of the District's concern for double payment of the SDWBA loan. Since that concern is illusory, it would not be proper to value the Company's systems using accounting data that eliminate SDWBA funded facilities and revenue attributable thereto for ratemaking purposes.

In reality the District will only pay to Heppner the sum of about \$253,491.87 or the fair market value less the principle remaining to be paid on the SDWBA loan. The District has an absolute right to assume that loan, which is at a favorable rate of interest (5½% for 35 years). In addition, the District will obligate itself to refund advances for construction of \$135,840, at zero interest, if and when they become due and payable.

Conclusions of Law

1. The District has the absolute right under CCP § 1265.220 to assume the SDWBA loan.
2. The just compensation that the Commission is required to set for the taking of public utility property is equal to the fair market value of that property on the date the application is filed.
3. In finding fair market value the Commission may consider any valuation method likely to shed light on that value.

Findings of Fact

1. The RCNLD, market data, and earnings evidence of the Company is not entitled to great weight.
2. The best evidence of the fair market value of the new facilities is the cost to recently construct them, represented by the principal amount of the SDWBA loan.

3. For the old facilities the best evidence of value consists of Reader's comparable sales appraisal of \$239,320, augmented by the value to the Company of its loss of the new customers of \$9,300.

4. The just compensation to be paid by the District for the land, property, and rights (excluding the Orr property) of the Company is the sum of \$1,036,320 as of July 1, 1983, the day on which the application was filed with the Commission.

5. The foregoing finding assumes that District will assume the duty to refund advances for construction of \$135,840.

6. This proceeding is closed.

This opinion becomes effective 20 days from today.

Dated _____ at San Francisco, California.

The prehearing conference was held as ordered; and evidentiary hearings were held on January 9, February 27, and April 6, 1984, before Administrative Law Judge Baer.

Evidence and testimony was offered at hearing by District, Company, Department of Water Resources (DWR), and George Orr, and the matter was submitted after the receipt of late Exhibit 15 and concurrent briefs on June 21, 1984.

District's Evidence of Market Value

The District's expert witness was John D. Reader. He testified to the market value of the Company's property based on the historical cost of the facilities actually installed. He divided the Company's facilities into two parts: (1) facilities installed recently (1982) with Safe Drinking Water Bond Act (SDWBA) funds which are not included in rate base, and (2) old facilities, which are included in rate base.

He valued the new facilities at \$787,700, the total amount of the SDWBA loan. In his opinion the improvements installed with SDWBA funds have depreciated slightly, but their replacement cost has also appreciated due to increasing construction costs. He stated that \$787,700 was a reasonable estimate for the cost new, less depreciation, for the SDWBA funded improvements.

For the old facilities he started with the staff estimate of net plant in Application (A.) 83-03-19 (Company's general rate increase proceeding) of \$247,150. Assuming that the District will agree to refund advances for construction of \$135,840, he then deducted that sum from net plant. ($\$247,150 - \$135,840 = \$111,310$). He then multiplied \$111,310 times a factor of 2.15 to arrive at the value of \$239,320 for the old facilities.

New Facilities (SDWBA funded)	\$ 787,700
Old Facilities ($\$111,310 \times 2.15$)	<u>+239,320</u>
Total Market Value	\$1,027,020

Reader's factor of 2.15 was derived from the average of the ratios between net plant less advances and sale prices of six water companies, as follows:

<u>Company</u>	<u>Ratio</u>
Rio Dell	2.29
Rancho Mirage	1.97
Patterson City	2.02
Tomarisk	2.17
North Los Altos	2.23
Niles-Decoto	2.19
Average of Ratio	2.145
Rounded Average	2.15

In addition, Reader testified that the value to the Company of the addition of 148 customers from two tracts would be about \$9,300 when 2/3 of the lots are developed. When this occurs, the rate base per customer will be about \$63. (1,595 customers¹ times \$63/customer = \$9,300.) Adding \$9,300 to the market value, supra, gives a market value of \$1,036,320.

Reader compared this figure with two appraisals commissioned by Heppner and the District. Municipal Consultants, Inc., for Heppner, suggested two values in its October 7, 1982, letter to the District:

\$1,031,888 (District assumes all company debts,
\$148,365, except two personal loans).

\$1,082,400 (Heppner assumes all debts).

James J. Palmer for the District appraised the Company's facilities at \$975,000.

The various figures are from high to low:

Municipal Consultants - Heppner	\$1,082,400
Reader - District	1,036,320
Municipal Consultants - Heppner	1,031,888
James J. Palmer - District	<u>975,000</u>
Average	\$1,031,402

¹ Staff R/O Report shows 1,497 customers plus (2/3 (148 new lots) = 98 lots) equals 1,595 customers.

multiplied by a cost factor per linear foot. These cost factors were obtained from various sources:

1. Marshall-Swift Valuation Service, a standard publication in the appraisal business.
2. Farrell Back-hoe Service, San Carlos, for contemporary costs of trenching, backfitting and boring.
3. Gross Weldrilling, Galt, for contemporary costs of drilling wells and inserting casings.

After he determined the contemporary cost of each type of component in the system, he also calculated the installation cost of these components. He added the costs of components and installation, and factored this sum by a cost multiplier to bring it up to date. This process produced a replacement cost of \$1,701,000. He calculated depreciation of \$86,000, which he deducted, leaving RCNLD of \$1,615,000.

For the income approach Sievers assumed 1,834 connections, which he multiplied times assumed income of \$200 per connection per customer, arriving at \$366,000. He deducted a 10% vacancy and collection loss factor of \$36,600 to arrive at effective gross income of \$329,400. He then assumed that expenses would be 60% of gross effective revenue, or \$197,640.

Subtracting those expenses from gross effective income, he arrived at net operating income of \$131,760. He then capitalized this income at 11.5% to reach the indicated value of \$1,158,000⁴ by the income approach.

For his market data approach Sievers obtained data on six privately owned water companies sold in California between 1968 and 1981. From the sales prices and number of connections he derived prices per connection as follows:

⁴ The indicated value by Siever's income approach should be \$1,145,739 ($\$131,760 \div .115$).

DWR's Position

DWR sponsored no valuation evidence but did offer testimony regarding the history of the SDWBA loan involved here. In brief DWR asked that the Commission find that net value of the new assets (those funded by DWR's loan) to the Company is \$3,812.18.⁹ DWR arrives at this figure by subtracting the unpaid principal of the loan as of July 1, 1983, (\$783,828.13) from the original loan principal (\$787,700). Stated another way DWR believes that the Commission should set the fair market value of the new facilities at a figure equal to the Company "equity" in the property (loan principal less principal to be paid = equity). This is not what the statutes and case law require of us.

The just compensation for the taking of the land, property, and right of the condemnee is measured by the market value of such land, property, and rights. In Sacramento etc. R.R. Co. v Heilbron (1909) 156 Cal 408, 409, market value was defined as:

"...the highest price estimated in terms of money which the land would bring if exposed for sale in the open market, with reasonable time allowed in which to find a purchaser, buying with knowledge of all the uses and purposes to which it was adapted and for which it was capable."

The Commission has applied a similar definition, which appears to be derived from the Heilbron rule. In City of Riverside (1972) 74 CPUC 193, 202 the Commission stated:

"We have used, as the measure of value of the properties herein, the concept of the highest price, estimated in terms of money, that a willing buyer would pay to a willing seller for the property if exposed for sale on the open market, where each is under no unusual pressures of time or circumstance and each has knowledge of all the uses and purposes to which the property is best adapted and for which it is reasonably capable of being used."

⁹ Mathematically the correct figure is \$3,871.87.

The Commission is not required by law to select only one method of appraisal in reaching its findings of fair market value. It may consider all the appraisal evidence and reach an informed judgment based upon a weighing of that evidence.

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"	"			\$ 100,270
Company	Sievers	Capitalized Earnings	1,145,739	
"	"	Market Data	1,146,000	
"	"	RCNLD	1,600,000	
"	"			\$ 1,400,000

For the reasons stated above in the discussion we have discounted Sievers' appraisal methods and his opinion based upon those methods. Each of his methods was flawed in the ways we have indicated. It would be difficult, if not impossible, to recast his methods to eliminate the problems we mentioned.

In our view, the best evidence of the fair market value of this property is derived using the capitalized earnings approach. As the District so aptly argues, there is no water system in the state which is substantially similar to Winton. This Commission has had to take the extraordinary step of seeking a court-ordered receiver to manage and operate the utility because of its extremely poor management and operational history. Thus, a "comparable sales" approach would erroneously assume that other sales involved comparable utilities. They did not.

New Facilities	\$ 787,700
Old Facilities	100,270
New Customers	<u>9,300</u>
Fair Market Value	897,270

In reality the District will only pay to Heppner the sum of about \$109,570 or the fair market value less the principle remaining to be paid on the SDWBA loan. The District has an absolute right to assume that loan, which is at a favorable rate of interest (5½% for 35 years). In addition, the District will obligate itself to refund advances for construction of \$135,840, at zero interest, if and when they become due and payable.

Conclusions of Law

1. The District has the absolute right under CCP § 1265-220 to assume the SDWBA loan.
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