

SEP 15 1988

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ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Petition of)
the CITY OF JACKSON, a Municipal)
Corporation, requesting the Public)
Utilities Commission of the State)
of California to fix just)
compensation for the acquisition)
of the public utility property of)
JACKSON WATER WORKS, INC. known as)
JACKSON WATER WORKS within and)
adjoining the boundaries of said)
CITY OF JACKSON.)

Application 84-04-052
(Filed April 10, 1984)

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Attorney at Law, for City of Jackson,
petitioner.

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Inc., respondent.

I N D E X

<u>Subject</u>	<u>Page</u>
OPINION	2
Property to be Taken	2
Eminent Domain Considerations	2
Condition of the System	3
JWW's View of the Water System	3
City's View of the Water System	6
Value Summaries	8
Marvin Winer - for City	8
Thomas M. Stetson - for JWW	10
Robert A. Meyer, Jr. - for JWW	10
Severance Damages	11
Approaches to Value - Testimony	11
Capitalized Earnings	11
Comparable Sales	13
RCNLD	14
Debt Service Capacity	18
Approaches to Value - Discussion	19
Condition of System	19
City's Capitalization of Earnings	20
JWW's Capitalization of Earnings	21
RCNLD	22
Comparable Sales	23
Debt Service Capacity	24
Finding	25
Comments	25
Increased Award	26
Findings of Fact	26
Conclusion of Law	28
ORDER	28

OPINION

The City of Jackson (City) seeks to have the Commission determine the just compensation for Jackson Water Works, Inc. (JWW).

Duly noticed public hearings were held before Administrative Law Judge Orville I. Wright in San Francisco on September 21-25, 1987. The matter was submitted on January 21, 1988 following the receipt of opening and closing briefs by both parties.

Property to be Taken

The petition declares that the lands, property and rights for which petitioner seeks to have just compensation fixed herein, comprise JWW's water system and are situated within or adjacent to the boundaries of City and the service and planning area of City.

These lands, property, rights, and system sought to be valued are intended to comprise all of the water utility properties of JWW lying within its service area, not including, however, office furniture and equipment, automotive and other transportation equipment, communications equipment, tools, materials and supplies, or cash or accounts receivable.

Eminent Domain Considerations

The parties agree that the proper measure of just compensation is the fair market value of the property to be taken. "Market value" was defined by the California Supreme Court in the case of Sacramento etc. R. R. v Heilbron (1909) 156 Cal 408 at p. 409 as follows:

"...[t]he 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 of the uses and purposes to which it was adapted and for which it was capable."

There is further agreement between the parties that the highest and best use of the property to be taken is its present use - a public water system.

The date of filing of the present application, April 10, 1984, is the valuation date for the property. JWW will have the opportunity in subsequent proceedings to have the value of additions to the water system since April 10, 1984 determined.

Condition of the System

A critical aspect of the evaluation of the JWW system is its condition at the time of taking. There is serious dispute between petitioner and respondent in this case as to whether JWW's system was one of quality or deficiencies in 1984.

All JWW witnesses concur in the opinion that its water distribution system is a well operated and maintained system providing a good quality of water and service to its customers. They contend that since the acquisition of JWW, in August of 1970, the system has been substantially rebuilt to better serve its customers.

City, on the other hand, believes that substantial work remains to be done on the system to bring it up to standard.

JWW's View of the Water System

JWW's view of the history of the Jackson water system and of its condition is well stated by David E. Chardavoyne (Chardavoyne), its Vice President. His testimony follows.

Predecessors of JWW were providing water service in the City area since at least the 1850's and in the Martell area near the City since at least December, 1950. JWW was incorporated on October 30, 1963. By Decision (D.) 67036, April 7, 1964, in Application (A.) 46259, the Commission authorized the transfer of assets from owners McLaughlin and Drandbois dba Jackson Water Works to JWW, a corporation, and the issuance of stock by that corporation. In 1965, JWW acquired Jackson Gate Water Works. In

mid-1970, the stock of JWW was acquired by Citizens Utilities Company (Citizens).

At the time of the 1970 acquisition, all the facilities of JWW were in poor condition. City retained an engineering consultant who estimated in 1969 that a capital improvement program in an amount greater than the then recommended purchase price would have been required immediately to bring the system up to minimum standards.

The consultant's report concluded that the water being supplied was receiving inadequate treatment and constituted a potential hazard to the health of the community. Taste and odor problems also occurred. A hydraulic analysis revealed that the system was incapable of providing adequate fire flow protection. It was recommended that many improvements were required to provide adequate service. The report emphasized that its recommended improvements would upgrade the existing substandard system to a minimum degree of adequacy, and that such improvements must be initiated immediately upon the acquisition of the system should City purchase it. The report also enumerated a number of benefits City would realize by purchasing the water system and effecting the improvements recommended.

When City did not act on the recommendation to purchase JWW, the owner of the corporation approached Citizens and other water companies located in California to see if he could sell his company. On June 30, 1970, Citizens and the then-shareholders entered into an agreement for the purchase and sale of all common stock of JWW.

Citizens was willing to purchase JWW as it was despite its water system problems, and Citizens was ready to make the necessary investment to solve them. Neither City nor anyone else was ready at that time to operate the system and to invest the necessary capital to purchase and substantially upgrade it.

There have been substantial additions to the system since 1970. Since the acquisition, and as of March 31, 1984, approximately \$1,400,000 in water facilities have been installed at the expense of JWW for such purposes as treatment, storage, distribution and fire protection. Additional facilities have been constructed since March 1984. Because of the investments made over the past 17 years, the customers of JWW now have a reliable and safe water supply according to Chardovoyne.

It is not true that JWW performed the necessary improvements to its system only after it was required to do so by order of the Commission, the witness states.

While the Commission did order JWW in D.87609, July 19, 1977, to develop and implement an eight-year capital improvement program, JWW had already been adding facilities to the system each and every year since its acquisitions by Citizens in 1970 and had developed its own extensive construction plan. During the first two years of operation after acquisition by Citizens, from 1971 to 1973, the rate base of JWW more than doubled due to the capital investments made in the system.

In the two years following D.87609, JWW not only complied with, but exceeded the construction program mandated in that decision. In D.90153, April 10, 1979, the Commission had favorable comments concerning the operations of the system: (1) the treatment plant was well maintained; (2) complaints did not indicate inadequate service; and (3) the water quality met all state and federal regulations. Overall, JWW had been transformed into a well-run water supply system since it was acquired in 1970.

The investment represented by improvements included in D.87609 total approximately \$620,000. In addition, however, JWW has also invested about \$804,000 between 1970 and March 31, 1984 for improvements, and \$522,000 since that date. The system has now been improved to a level which will permit further development in the City area.

This significant growth is only possible because the investment by JWW and by Citizens has established a viable water system.

Citizens would not willingly sell any of its California water systems for a purchase price equal to two times rate base. Compensation at that level would not be sufficient to cause Citizens to consider the desirability of entering into a sales agreement, the witness continues.

Citizens is experienced and knowledgeable in the water utility industry. When sales are consummated involving well-operated, well-maintained, growing water systems, the sales prices usually constitute a multiple which substantially exceeds two times rate base. A knowledgeable buyer and seller are aware of the benefits and the reduced risks flowing from a solidly rebuilt, well-organized water system in contrast to one that has either operational or financial problems, or both.

City's View of the Water System

City's view of the condition of the Jackson water system is provided through the testimony of Rudolph C. Metzner (Metzner), who gave his opinion that the JWW system is in immediate need of improvements of an estimated cost of \$3,950,000 to place it in a satisfactory condition.

Metzner is president of Water Resources Associates, a firm specializing in engineering services related to drinking water projects. He is a registered professional engineer in the State of California with more than 20 years of experience in providing consulting engineering services to some 37 water agencies in 15 states.

Metzner was retained by Brown and Caldwell in its evaluation of the JWW water system as of April 10, 1984 with the assignment of preparing a capital improvement program to restore the system to a satisfactory condition.

This witness physically inspected the JWW system, examined respondent's records at JWW and at the Commission's offices, and developed a computer model for test purposes. Metzner concludes that JWW does not have a water system master plan that sets out projections of population and water requirements, analyzes the condition of the system, identifies problem areas, and sets out a comprehensive improvement program to correct problems in the water system.

Metzner developed a list of projects together with preliminary cost estimates, based upon his inspection of the water system, which he considered necessary if the system were to be brought up to standard. Two major elements of the plan recommended by Metzner is a pipe replacement program costing \$2,400,000 and a new 1.3 million gallon treated water reservoir costing \$1,200,000.

This engineer testified that the total amount of pipe in the JWW system increased from 101,000 feet in 1970 to 122,000 feet in 1983, a net increase of 21,000 feet for the period. About 45,000 feet of pipe presently in the system is four inches or less in diameter (36.8% of total pipe). Further, 72% of four inch or less diameter pipe which was in the system in 1970 when it was acquired by Citizens is still in the system in 1983. This small pipe, below today's requirements, should be replaced with six or eight-inch pipe. Too, all unlined steel and cast iron pipe should be replaced with lined steel, ductile iron or asbestos cement pipe.

The pipe replacement project, according to Metzner, would alleviate the many leaks and inadequate fire flow pressures in the JWW system where, for example, unaccounted for water averages 25%. Values for unaccounted for water are usually in the range of 5 to 15%.

Metzner testified that one of the best measures of the adequacy of a distribution system is the ability of the system to produce the fire flows recommended by the Insurance Services Office

(ISO), an organization which conducts investigations and rates the ability of a community to respond to fires.

The engineer did a computer analysis of available fire flows at 17 locations on the JWW system and compared his results with fire flows recommended by ISO. His finding is that the JWW system is significantly deficient in its fire fighting capacity, and additional treated water and pipe capacity would be needed to bring the system up to standard.

Metzner recommends additional treated water storage of 1.3 million gallons for three reasons: to provide a reserve for required fire flows; to provide the difference between the supply capacity and the rates of peak demand; and to provide an overall emergency reserve for the water system to meet unanticipated outages of equipment or facilities.

Other expenditures considered necessary by Metzner are: water system master plan - \$85,000; replacement of fire hydrants - \$100,000; meter repair and replacement - \$55,000; corrosion control facilities - \$100,000; leak detection survey - \$10,000.

Metzner's total cost of needed work is \$3,950,000.

Further, this witness believes that trihalomethanes in JWW water should be lowered at a cost of \$600,000 although this is not included in his capital improvement plan because it is not immediately required.

Value Summaries

Three primary witnesses testified as to the fair market value of subject property as of April 1, 1984. One witness appeared for City and two testified for JWW. Summaries of their testimony follow.

Marvin Winer - for City

Marvin Winer (Winer) testified for petitioner, stating his opinion that the fair market value of subject property was \$1,400,000 as of April 10, 1984, the valuation date.

Winer is chief economist for Brown and Caldwell Consulting Engineers, a company which provides a complete range of engineering and financial services in the fields of solid waste management, utility management, energy conservation, resource recovery, water supply, waste water management, storm drainage and flood control, submarine pipeline engineering and oceanography. Winer has participated as an expert witness in rate proceedings before this Commission and as an expert witness in valuation matters before the California Assessment Appeals Board and California Superior Court.

In May, 1983, Brown and Caldwell was retained by City to study the economic feasibility of its proposed purchase of JWW. The sole criterion considered in this early study was that the revenues, at the then-current water rates, be sufficient in order for City to meet both annual operating and maintenance costs and to meet the projected debt services requirements on obligations issued to both purchase the water system and fund necessary capital improvements.

In valuing JWW facilities as of April 10, 1984, Winer utilized four methods of valuation: book value; adjusted book value, called reproduction cost new less depreciation (RCNLD); capitalization of future earnings; and comparable water utility sales. Winer's indicated values are as follows:

<u>Method</u>	<u>Value</u>
OCLO Rate Base	\$1,265,138
RCNLD	3,455,056
Capitalized Earnings	1,514,000
Comparable Sales	20% to 125% of rate base

In reaching his value opinion of \$1,400,000, Winer relies primarily on capitalized earnings, consideration of original cost less depreciation rate base, and, to some extent, comparable sales.

Thomas M. Stetson - for JWW

Thomas M. Stetson (Stetson) testified for respondent, stating his opinion that the fair market value of subject water system facilities is \$5,100,000.

Stetson is president of Stetson Engineers, Inc., consulting civil engineers. He has 40 years' professional experience and has represented many clients of substance in both the public and private sectors of water enterprise. He is a consultant to the California Department of Justice with respect to water rights on the Colorado River. He has appraised water systems in more than a dozen instances, both for eminent domain purposes and in negotiated sale transactions.

In valuing JWW facilities as of April 10, 1984, Stetson utilized RCNLD and comparable sales. Stetson's indicated values are as follows:

<u>Method</u>	<u>Value</u>
RCNLD	\$4,170,816
Comparable Sales:	
Advances not assumed	7,310,000
Advances assumed	6,365,000

Robert A. Meyer, Jr., - for JWW

Robert A. Meyer, Jr. (Meyer), testifying for JWW, valued the utility's property at \$5,000,000, but also believed that the present value of connection charges he anticipates will be imposed by City in the approximate amount of \$2,000,000 should be added for a total of \$7,000,000.

Meyer is a Professor and Associate Dean for Operations and Budget of the School of Business Administration, University of California, Berkeley. He has extensive experience in the fields of finance, economics, statistics, econometrics, operations research, and corporate planning. He has served public agencies, corporate clients, and individuals in areas such as capital budgeting, corporate financial planning, cost of capital, breach of contract,

and antitrust. Meyer has testified before the Commission on numerous occasions and has developed capital budgeting and costing analyses in its behalf.

In valuing JWW facilities as of April 10, 1984, Meyer independently derived a valuation based on cash flow available for debt service and valuations based on the net present value of earnings, or capitalized earnings. While Meyer's own value indicators exceed \$5,000,000 for JWW, this witness offers that value judgment after taking into consideration the results of the comparable sales study and RCNLD study of JWW's other valuation witness, Stetson.

Severance Damages

JWW seeks severance damages of \$132,215 by reason of the taking of its property.

Items of personal property such as furniture, tools, vehicles and the like, claimed to be of no use elsewhere, total \$19,532.

Further, Citizens claims that it should be compensated because it will no longer be able to charge JWW a portion of its foreign plant overhead to be collected in rates from JWW customers.

We take official notice of the several water operations engaged in by Citizens both within and without the State of California. We are not persuaded that personal property used by one water utility cannot be used by another water utility.

Further, we do not believe that the necessity for Citizens to reallocate its overhead burdens to exclude JWW is compensable as severance damages.

Approaches to Value - Testimony

Capitalized Earnings

City's valuation expert Winer relies primarily on capitalized earnings of JWW. His method determines the present value of the cash flow stream produced by JWW, assuming operating and maintenance expenses would increase from 1982 levels by 10% per

year, general and administrative expenses would increase by 8% per year, annual plant additions, net of retirements, would approximate \$60,000, and the Commission would authorize rates which would produce 13% net income on average rate base over the period from 1983 to 1987.

Based on those assumptions, Winer projects net operating income for JWW to increase from \$165,000 in 1983 to about \$174,000 in 1987, and cash flow is projected to increase from about \$201,000 in 1983 to \$215,000 in 1987. This increase in cash flow approximates equal annual increases of \$3,400 which he assumed would persist beyond 1987. The present value of all future cash flows is the sum of the present value of a constant annual cash flow of \$201,253, plus the gradient series, and assumes a discount rate of 15% and a 40 year remaining life for the utility. Capitalization yields a present value of cash flow of \$1,483,844.

Winer notes that his calculation of capitalized earnings is extremely favorable toward JWW since he has assumed that the company will earn the rate of return allowed by the Commission and has assumed that plant additions, exclusive of contributions and advances for construction, would approximate \$60,000 per year. He concludes that those assumptions are extremely favorable to the company in view of its recent earnings history.

On cross-examination, Winer admits that he projects the future cash flow to City as opposed to JWW at \$319,937 which would give him a much larger discounted present value than that which he calculated for JWW. But that, he explains, is because the cash flow to City would be greater than the cash flow to a regulated utility, because City would not have to pay income taxes, property taxes, and certain other fees. Winer's calculations of capitalized earnings did not value cash flow to a municipal utility but rather the present worth of cash flow to JWW as the witness believes that is the correct method of valuation. He explains that it would be improper to value it based upon cash flow to City since a simple

valuation based upon cash flow would not take into consideration capital costs necessary to improve the system.

JWW's valuation expert Meyer also relies, in part, on a capitalization study which indicates the average value for JWW is \$5,400,000 at a 12.04% discount rate, and \$6,900,000 at a 10.15% discount rate. JWW's method utilizes JWW's record of earnings, but assumes that the recipient of these revenues will be City rather than JWW. Using both the authorized and the actual earnings for JWW in 1984, Meyer calculated earnings forward for 35 years. He assumed population growth in City of 2.8% and 3.2%, and inflation rates of 4% and 5%.

Meyer cautioned that his capitalization results were conservative as he assumed that water rates under City's ownership would not be increased and connection fees of City would add another \$1,888,112 to \$2,371,546 to his capitalization values.

Comparable Sales

JWW relies upon the comparable sales approach to value. Its expert reviewed all transactions of which he was aware during the last 10 years in which California water systems were sold. From this universe of transactions, three sales of regulated utilities to public agencies within three years of the valuation date were selected as being comparable. These are: sale of Angora Water Company (Angora) to South Tahoe Public Utility District (South Tahoe) on December 20, 1983; sale of Rowland Water Company (Rowland) to City of Porterville (Porterville) on November 13, 1985; and, sale of Arvin Water Company (Arvin) to Northridge Water District (Northridge) on October 1, 1986.

JWW states that these three public acquisitions were chosen because they occurred reasonably close to the valuation date, some physical elements of the systems being transferred could be compared to JWW, and recent operating results of the systems being sold were to some extent comparable to JWW. We employ qualifying language here as JWW's expert candidly admits that his

selection process was difficult and depended in large degree upon his own extensive experience combined with judgment.

In rounded numbers, the three sales were made at seven, six, and five times net rate base. Applying the weighted average of the three ratios to JWW's net rate base results in an indicated market value for JWW of \$7,310,000, the range being from \$6,567,000 to \$8,865,000.

City's witness Winer placed little reliance on comparable sales, but submitted three recent sales of water systems to public agencies as worthy of some consideration. These were Pacific Gas & Electric Company (PG&E) sales to the Placer County Water District, Tuolumne County, and Amador County Water Agency. They show ratios of sales price to depreciated book value of .392, .149, and .159 for an average ratio for the three sales of .195. Winer admits that the PG&E sales were partially ditch systems requiring substantial improvements.

RCNLD

JWW's witness Stetson presented an analysis of the cost of reproducing its water system and explained the relevance of this approach to a determination of fair market value.

The witness states that RCNLD is a method commonly used to appraise water facilities, as well as other utility properties. When this method is used, an estimate is made of the cost of reproducing the facilities identical to those which are being valued. Current costs, as of the date of valuation, are used to determine the cost of reproducing the facilities. Accrued depreciation is then deducted from the current reproduction cost based on the age of the existing facilities to account for depreciation accruing from the time the facilities were constructed. The value of intangible items such as going concern, organization expense, and water rights, if any, is added to the reproduction cost new less depreciation of the physical facilities

to complete the RCNLD value. The value of land and land rights should also be added.

The RCNLD method reliably estimates the cost of replacing the entire system under consideration. This is significant in and of itself, according to Stetson.

Moreover, since this witness believes that reproducing the water system is City's only alternative to purchasing it, he believes that RCNLD is a method of appraisal that knowledgeable buyers and sellers would take into account.

RCNLD value is particularly appropriate for newer facilities, and it is therefore appropriate in this case because a substantial portion of the Company's system is recently constructed, according to the testimony.

The valuation of facilities using the reproduction cost new less accrued depreciation method was accomplished in three phases by determining (1) the general overhead percentages, (2) the construction cost as of April 10, 1984, and (3) the accrued depreciation as of April 10, 1984.

The general overhead percentages used in the appraisal total 33%.

The unit costs for construction were determined by reference to Means' Building Construction Cost Data, supplemented, when appropriate, by discussions with contractors and suppliers.

In order to compute accrued depreciation, the ages of the various facilities were taken from JWW records. Salvage values were taken into account for appropriate assets, as in the case of meters. Depreciation was accounted for through April 10, 1984. Average service life varies according to the type of facility and the nature of its use and material. The estimated average service lives for these facilities are within ranges utilized by the Commission's Standard Practice U-4. These were supplemented, as needed, with information from the Commission's office in Los

Angeles. Remaining lives were based either on the appropriate Iowa Survivor Curve or the forecast method, whichever was applicable.

The RCNLD value of JWW facilities, exclusive of going concern value and organization expense, is estimated to be \$4,026,316.

The total value, including the \$144,500 value of JWW's real property interests, as appraised, is \$4,170,816.

To this, the witness adds going concern value, saying that going concern is a value which represents the investment made by Citizens in developing its water system and customers. This was not a viable water system when Citizens acquired it, and going concern value reflects the fact that the water system is now a viable business.

Stetson explains that Marston and Agg, in their book entitled "Engineering Evaluation," state that "going concern values allowed in actual cases frequently equal about 10% of the present value of the fixed-capital physical elements of public utility properties; usually, they are not less than 5, or more than 15 percent." He concluded that the going concern value in this case is 10.0%, which results in a value of \$417,000.

The witness reasons that this was a water system that was in very poor condition under prior ownership. Because of substantial investment in new plant and facilities, the water delivered is of excellent quality, and the system of reservoirs and mains is substantially upgraded. It is a system that has been restored so that it is literally a going concern. These attributes have significant value apart from the physical assets.

Stetson also includes organization expense in the RCNLD appraisal, which he defines as the cost involved in organizing a utility as an operating system. It is included in RCNLD value to reflect such costs as organizing the corporate entity, obtaining operating permits and franchises, the preparation of a prospectus for selling stock, financial studies and reports, and determining

the feasibility of the project. Other costs represented include the recruitment of proper maintenance and office personnel, preparation of meter books, organization of a billing system, setting up proper accounting systems with necessary forms, records, books, depreciation and accrual programs, and establishing pension and welfare programs for the employees.

Relying again on Marston and Agg, in their book entitled "Engineering Valuation," he quotes, "It is not uncommon for valuers to allow, and courts to approve, preliminary expense values of 2.0 percent to 2.5 percent of the present value of the physical property in valuations of public-utility properties." Stetson's own studies indicate that organization expense costs range from less than 1.0% to 3.0% of RCNLD, with the larger percentages applying to the smaller companies. For purposes of his study, a value of 2.0% was utilized, and the witness found that the organization expense value is \$83,000.

Thus, RCNLD of JWW facilities is \$4,026,316. To this is added the value of \$144,500 for the real property interests. Going concern value and organizational expense were calculated as described above as a percentage of RCNLD and found to be \$417,000 and \$83,000, respectively. The full RCNLD appraisal method results in a value of \$4,670,816, summarized by witness Stetson as follows:

RCNLD	\$4,026,316
Land	144,500
Organization Expense	83,000
Going Concern	<u>417,000</u>
	\$4,670,816

City's witness Winer also presented a RCNLD appraisal, but, as he did not have detailed plant records, it was necessary for him to estimate average service life, average age, remaining life, and other factors. We find that Winer's RCNLD value of \$3,283,406 is less reliable than Stetson's value of \$4,026,316, which we adopt for purposes of this proceeding.

We also adopt Stetson's organization expense of \$83,000 as being more reasonable than that of Winer.

Winer agrees with Stetson's land value of \$144,500.

Winer testified that going concern value ranges from 1% to as high as 10% for a system earning a reasonable return and which has a problem-free expectation of future expansion. Winer recommends 1% for going concern value based upon its consistent failure to earn a reasonable return prior to the valuation date and the fact that substantial improvements are required at the present time to bring the utility up to standard.

We agree with Winer's analysis of going concern value and find RCNLD to be \$4,294,079, summarized as follows:

RCNLD	\$4,026,316
Land	144,500
Organization Expense	83,000
Going Concern	<u>40,263</u>
	\$4,294,079

Debt Service Capacity

JWW's witness Meyer suggested the debt service capacity approach as an indicator of minimum value of the system.

In this approach, Meyer commenced with JWW's actual earnings in 1984, 1985 and 1986, added back depreciation because it is a non-cash item, adjusted for income, property and other taxes that City will not pay, and arrived at total cash flow provided by actual levels of return for each of the years.

Meyer next performed the same calculations for each of the years with pro forma earnings - earnings predicated upon JWW's allowed rate of return.

The witness submitted tables tabulating municipal bond interest rates prevailing during the period 1975 through 1986. Based upon average municipal bond interest rates for 1984, 1985 and 1986, Meyer computed the principal amount of debt and interest that the cash flow in each case is sufficient to repay.

The valuations of JWW at current debt cost using actual results of operation as shown on Commission reports and as based on 12.04% allowed return on rate base, were as follows:

	<u>1984</u>	<u>1985</u>	<u>1986</u>
Actual	\$2,598,203	\$3,391,341	\$4,131,177
Pro Forma	3,302,238	3,124,882	4,615,213

Meyer testified that the average valuation for JWW using this method is \$3,527,176. The witness cautioned that too heavy reliance should not be placed upon this approach as it relies only upon a single first year. Meyer predicts that net earnings will increase each year into the future while the cost of debt will remain fixed at the initial bond interest level.

In its brief, JWW, refers to this method as being standard and points out that City itself used this type of analysis to determine that it could afford to finance \$3,400,000 of debt in the purchase of JWW.

JWW asserts that debt service capacity as a measure of value is not just the hypothesis of expert witnesses, but was actually employed by principals in the comparable sales of Angora and Arvin, as testified to in this proceeding.

Approaches to Value - Discussion

Condition of System

Both the evidence taken in this proceeding and our own prior decisions in rate cases involving JWW compel us to determine the threshold question of the physical condition of JWW in favor of City. We find the assumption or view of the utility's witnesses that the JWW system is substantially rebuilt, that its water quality is outstanding, that there is no need for further major capital expenditures, that there is demonstrated customer satisfaction, that there is no risk that significant maintenance will be necessary, that fire flows are outstanding, and that the

system is in an essentially new or near new state today to be unsupported by the record.

Our prior decisions with respect to JWW demonstrate a continuing disenchantment with Citizens' management and stated intentions to improve water service in the Jackson area. In D.87609, July 19, 1977, we suspended a JWW rate increase application and ordered the utility to immediately develop and implement a capital improvement program. In D.82-04-017, April 6, 1982, we were able to find JWW's level of water service to be adequate. Adequate service, however, is by no means equated to outstanding service, as alleged by JWW.

We are persuaded that the true condition of JWW's water system is as described by City's witness Metzner, most particularly by his testimony with regard to undersized and steel pipe replacements required if the system is to be brought up to standard.

We find the condition of the JWW system to require a pipe replacement expenditure of \$2,400,000 in the near term and a further expenditure in the longer term of \$1,950,000 for additional storage, fire hydrant replacements, meter repair and replacements, and corrosion control and leak detection work.

Knowledgeable buyers and sellers would be aware of the system's condition and of the cost estimates to bring it up to standard.

City's Capitalization of Earnings

City's capitalization of earnings study yields a indicated market value of \$1,484,000 or \$1,514,000, depending upon the starting point. This method assumes that the market consists only of private purchasers in whose hands JWW would continue to be regulated by the Commission. Public purchasers, such as City, are disregarded as potential purchasers.

Some elements of City's methodology were attacked on cross-examination and shown to be questionable. For example, City

uses a capitalization rate of 15% while JWW was authorized only 12.04% in its last rate case.

On the other hand, City points out several elements of its analysis which are generous toward JWW. For example, the witness assumed that JWW would earn its full rate of return throughout the 40 years of his study even though JWW had done this in only one year from 1970 to 1984.

The utility component of rate base for JWW as of March 31, 1984, was \$1,297,000. If the test year and growth estimates contained in D.82-04-017, our rate case decision dated April 6, 1982, are accurate, and the 12.04% rate of return there found reasonable continued to be fair in 1984, City's capitalization methodology would result in a fair market value approximately equal to net rate base.

As City's earnings study shows a market value which is \$217,000 over net rate base, it is clear that the study favors JWW, all elements being taken together. We note that it is our policy to review Class A water utility rates every three years, and it is unlikely that an overly generous or niggardly rate of return would prevail over any extended period of time.

Informed buyers and sellers would be aware that the market for JWW would include both private entities and public agencies, that net rate base for JWW as of March 31, 1984 was \$1,297,000, and that capitalization of earnings of a regulated utility should approximate net rate base over time.

JWW's Capitalization of Earnings

JWW's capitalization of earnings or discounted cash flow study yields an indicated value of \$5,400,000 at a discount rate of 12.04% and \$6,900,000 at a discount rate of 10.15%. This method assumes that the market consists only of public agencies without the power of eminent domain. Private purchasers, such as Citizens and other owners of multi-district water systems are disregarded as potential purchasers.

Respondent assumes that a public agency, particularly City, would be willing to pay a premium to acquire JWW because its only alternative would be to build its own duplicate system. City would wish to avoid the thorough disruption and disarray that this protracted trenching and other construction would inflict upon the community, JWW argues, and would pay a premium over reproduction cost new to do so.

This capitalization method further assumes that City, upon its acquisition of JWW, would maintain existing rates. Thus, because it pays no income tax and little property tax, City would earn enormous profits from the system throughout its 40 year assumed life. These profits should be paid to Citizens as the fair market value of the water system, according to respondent.

Private buyers would completely reject any methodology used to determine market value which calculated solely the property's value to a public agency, which is the clear result of JWW's discounted cash flow to City.

Public buyers, in our view, would summarily reject the notion that they should convey the present worth of their income and property tax exemptions to JWW as a measure of the value of respondent's water system.

RCNLD

The record in this case persuades us that the maximum amount that informed buyers and sellers would consider as the price of a well maintained and efficient water system would be the cost of reproducing the system less depreciation to date of sale.

We earlier discussed the RCNLD approach to value. We find that willing buyers and sellers would give credence to RCNLD at \$4,294,079 as the maximum value of the water system, but would discount RCNLD to reflect the substantial sums required to bring the system up to standard.

Comparable Sales

As noted in our comments on the comparable sales approach, City submitted three sales of water systems by PG&E to public agencies at an average of less than 20% of net book value.

Both JWW and City agree that the PG&E sales consisted of significant ditch systems, were disposed of by seller in order to curtail operating losses, and largely served untreated water. These elements detract materially from their comparability to JWW.

In the case of the Tuolumne system, the Commission had ordered PG&E to provide treated water for the entire system at an upgrading cost of from \$30 million to \$52 million (D.83-12-064, December 20, 1983.)

While lacking any great physical similarity to JWW, the PG&E systems referenced by City illustrate that informed buyers and sellers will discount rate base as a measure of sales price where improvements are required to bring the utility being sold up to standard.

Commission approval of the three sales offered as comparable by JWW was given as follows: Angora to South Tahoe, D.83-12-052; Rowland to Porterville, D.85-11-050; and Arvin to Northridge, D.86-10-026.

Each of these acquisitions involved a premium paid by a water supplier expanding its service area for the purpose of improving its water supply and integrating an adjacent system into its existing facilities.

South Tahoe has a long-standing policy to acquire the public utility water companies which furnish water service within South Tahoe's boundaries. Its acquisition of Angora stock was the third such transfer approved by the Commission.

South Tahoe, then providing water service to 8,000 customers agreed to acquire the 1,885 customers of Angora in further pursuit of its goal of having a single integrated water system at South Lake Tahoe.

Porterville desired to acquire Rowland's adjacent facilities serving 1,260 customers to interconnect the two systems into a single integrated system, to make improvements and provide improved fire flows within Rowland's service area, and to make it convenient to perform its function of making domestic water available to its inhabitants.

Northridge, at the time of sale, shared a common boundary with Arvin and served approximately 14,000 residential and commercial customers. The transfer was arranged to enable Northridge to conveniently provide water service to its customers and Arvin's 4,145 customers by a single inter-tied water system.

The \$1,750,000 sale price of Angora was 6.855 times net rate base. For Rowland, the \$1,500,000 sale price was 5.998 times net rate base. For Arvin, the \$3,500,000 sale price was 5.063 times net rate base.

As those sales were essentially expansions of existing water companies to integrate service areas, it is also instructive to note the cost per customer. South Tahoe paid \$930 ($\$1,750,000 \div 1,882$); Porterville paid \$1,159 ($\$1,500,000 \div 1,294$); Northridge paid \$844 ($\$3,500,000 \div 4,145$.) The average acquisition cost per customer is \$978.

If these three sales are comparable on a per customer basis, the indications are that JWW should yield a market price of \$1,268,466 ($\$978 \times 1,297$ customers).

Debt Service Capacity

The capacity of a public agency to service debt if it adopts JWW's rate structure is a helpful tool in determining market value of the system. As we noted in outlining this approach, the matter of how much the acquiring public entity can afford to pay for JWW has been shown to be a factor in sales negotiations between willing buyers and sellers.

Except for the appraiser's given assumption that JWW's system is up to standard, we find the suggested value of \$3,527,176

minimum to be a reasonable indicator of the worth of JWW to City. Managers of public water agencies might well consider the agency's ability to finance in arriving at their estimates of fair market value. Of course, the amount such managers would pay to seller would decrease to the extent that the sought water system needed structural improvements, as we find in this case.

Finding

We have considered the entire record in this proceeding and find that the just compensation, as April 10, 1984, to which JWW is entitled to be paid for the taking of all its properties set forth in the petition is the sum of \$1,750,000.

JWW shall also be entitled to be paid for additions and betterments from April 10, 1984 forward as provided by law.

Comments

Pursuant to the Commission's Rules of Practice and Procedure, the proposed decision of the assigned administrative law judge for this proceeding was filed with the Commission and distributed to the parties on June 28, 1988. Comments were filed by Jackson Water Works, Inc. on July 25, 1988, in accordance with a granted extension of time.

Respondent asserts that City must be ordered to assume JWW's liability for advances in aid of construction in addition to the just compensation award. It appears that this unsecured JWW obligation stands at \$555,000 as of March 31, 1984.

This issue will be resolved in the further proceedings to value plant additions since the time of filing of City's petition. The amount of advances subject to refund should be determined and, if City assumes them, the \$1,750,000 compensation to be paid by City should be reduced by the present worth of the refund contracts (Vandenberg Village Community Services District, D.87-07-080, July 29, 1987.)

Respondent reminds us that on August 26, 1987, JWW moved to dismiss City's petition on constitutional grounds or,

alternatively, that valuation proceedings be stayed pending action of the Legislature on Assembly Bill 616. JWW's purpose was to receive the benefit of any remedial legislation.

Senate Bill 616, codified in Section 1405.1 of the Public Utilities Code, allows water utilities such as JWW to elect either the Commission or the Superior Court as the forum in which eminent domain compensation is to be determined. However, the amendments noted expressly do not apply to or affect any petition filed before January 1, 1988.

Passage of time since the date of JWW's motion has, in effect, resulted in JWW's alternative motion becoming moot. A ruling is therefore not required.

Increased Award

JWW's comments on the proposed decision, while largely reargument of its positions taken in brief, persuade us that the just compensation award should be increased from \$1,750,000 to \$2,100,000.

While the proposed decision finds that the condition of the JWW system requires a pipe replacement of \$2,400,000 in the near term and a further expenditure in the longer term of \$1,950,000 for additional improvements and replacements, we agree with JWW that City's witness Metzner viewed any improvements eventually effected as necessary would be made only over the next 10 to 20 years. Metzner did not define "near term" or "up to standard."

"Up to standard," in our view, and for the purposes of this proceeding only, does not mean simply meeting the requirements of GO 103; it means meeting the standard of operational excellence testified to by JWW's staff witnesses, and assumed by the utility's valuation witnesses. A willing buyer would, in our view, adjust the asking price downward to reflect anticipated costs of bringing a water system up to operational integrity, as described in the seller's prospectus.

As Metzner testified, how and when required replacements and improvements will be made depends on the future preparation of a master plan. Lacking this tool, and mindful of RCNLD and of the factual matters emphasized in comments, we find that JWW is entitled to just compensation in the amount of \$2,100,000. This award is the value as of the date of condemnation.

We do not intend our finding here to imply that the Commission generally favors discounting valuation awards by proposed necessary improvements. This could result, in some circumstances, in double deductions because ordinarily fair market value reflects (under some valuation methods) the appraised value of the system "as is". It is, however, appropriate to discount the award in this case where the company's own witnesses based their estimates of value on the assumption that this is an outstanding system.

The text under the topic of City's Capitalization of Earnings has been revised to reflect the value change.

Findings of Fact

1. JWW owns and operates a public utility water system within and adjoining the boundaries of City.
2. City is a municipal corporation entitled to exercise the power of eminent domain.
3. On April 10, 1984, City filed with this Commission a petition of the second class under Division 1, Part 1, Chapter 8 of the California Public Utilities Code, to have the Commission fix the just compensation to be paid for its taking by eminent domain of JWW's water system.
4. Evidence of the condition of JWW's water system, net rate base, reproduction cost new less depreciation, capitalization of earnings, comparable sales, and debt service capacity should reasonably be considered in valuing the subject property.
5. The record does not support a finding of severance damage.

Conclusion of Law

JWW is entitled to just compensation of \$2,100,000.

ORDER

IT IS ORDERED that the just compensation to be paid by the City of Jackson for the lands, property and rights of Jackson Water Works, Inc. to be taken is the sum of \$2,100,000 as of April 10, 1984.

This order becomes effective 30 days from today.

Dated September 14, 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. O'HANIAN
Commissioners

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

Victor Weiss

Victor Weiss, Executive Director

as

I N D E X

<u>Subject</u>	<u>Page</u>
OPINION	2
Property to be Taken	2
Eminent Domain Considerations	2
Condition of the System	3
JWW's View of the Water System	3
City's View of the Water System	6
Value Summaries	8
Marvin Winer - for City	8
Thomas M. Stetson - for JWW	10
Robert A. Meyer, Jr. - for JWW	10
Severance Damages	11
Approaches to Value - Testimony	11
Capitalized Earnings	11
Comparable Sales	13
RCNLD	14
Debt Service Capacity	18
Approaches to Value - Discussion	19
Condition of System	19
City's Capitalization of Earnings	20
JWW's Capitalization of Earnings	21
RCNLD	22
Comparable Sales	23
Debt Service Capacity	24
Finding	25
Findings of Fact	25
Conclusion of Law	26
ORDER	26

I N D E X

<u>Subject</u>	<u>Page</u>
OPINION	2
Property to be Taken	2
Eminent Domain Considerations	2
Condition of the System	3
JWW's View of the Water System	3
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Value Summaries	8
Marvin Winer - for City	8
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Severance Damages	11
Approaches to Value - Testimony	11
Capitalized Earnings	11
Comparable Sales	13
RCNLD	14
Debt Service Capacity	18
Approaches to Value - Discussion	19
Condition of System	19
City's Capitalization of Earnings	20
JWW's Capitalization of Earnings	21
RCNLD	22
Comparable Sales	23
Debt Service Capacity	24
Finding	25
Comments	25
Findings of Fact	26
Conclusion of Law	27
ORDER	27

I N D E X

<u>Subject</u>	<u>Page</u>
OPINION	2
Property to be Taken	2
Eminent Domain Considerations	2
Condition of the System	3
JWW's View of the Water System	3
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Severance Damages	11
Approaches to Value - Testimony	11
Capitalized Earnings	11
Comparable Sales	13
RCNLD	14
Debt Service Capacity	18
Approaches to Value - Discussion	19
Condition of System	19
City's Capitalization of Earnings	20
JWW's Capitalization of Earnings	21
RCNLD	22
Comparable Sales	23
Debt Service Capacity	24
Finding	25
Comments	25
Increased Award	26 ✓
Findings of Fact	26
Conclusion of Law	27
ORDER	28 ✓

uses a capitalization rate of 15% while JWW was authorized only 12.04% in its last rate case.

On the other hand, City points out several elements of its analysis which are generous toward JWW. For example, the witness assumed that JWW would earn its full rate of return throughout the 40 years of his study even though JWW had done this in only one year from 1970 to 1984.

The utility component of rate base for JWW as of March 31, 1984, was \$1,297,000. If the test year and growth estimates contained in D.82-04-017, our rate case decision dated April 6, 1982, are accurate, and the 12.04% rate of return there found reasonable continued to be fair in 1984, City's capitalization methodology would result in a fair market value approximately equal to net rate base.

As City's earnings study shows a market value which is \$217,000 over net rate base, it is clear that the study favors JWW, all elements being taken together. We note that it is our policy to review Class A water utility rates every three years, and it is unlikely that an overly generous or niggardly rate of return would prevail over any extended period of time.

Informed buyers and sellers would be aware that the market for JWW would include both private entities and public agencies, that net rate base for JWW as of March 31, 1984 was \$1,297,000, and that capitalization of earnings of a regulated utility should approximate net rate base over time.

Willing buyers and sellers would consider net rate base to be among the lowest market value indicators for a well managed regulated utility in good to excellent condition. A discount from that value would be considered if the utility required substantial improvements to bring it up to standard, as does the JWW system.

JWW's Capitalization of Earnings

JWW's capitalization of earnings or discounted cash flow study yields an indicated value of \$5,400,000 at a discount rate of

12.04% and \$6,900,000 at a discount rate of 10.15%. This method assumes that the market consists only of public agencies without the power of eminent domain. Private purchasers, such as Citizens and other owners of multi-district water systems are disregarded as potential purchasers.

Respondent assumes that a public agency, particularly City, would be willing to pay a premium to acquire JWW because its only alternative would be to build its own duplicate system. City would wish to avoid the thorough disruption and disarray that this protracted trenching and other construction would inflict upon the community, JWW argues, and would pay a premium over reproduction cost new to do so.

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Private buyers would completely reject any methodology used to determine market value which calculated solely the property's value to a public agency, which is the clear result of JWW's discounted cash flow to City.

Public buyers, in our view, would summarily reject the notion that they should convey the present worth of their income and property tax exemptions to JWW as a measure of the value of respondent's water system.

RCNLD

The record in this case persuades us that the maximum amount that informed buyers and sellers would consider as the price of a well maintained and efficient water system would be the cost of reproducing the system less depreciation to date of sale.

We earlier discussed the RCNLD approach to value. We find that willing buyers and sellers would give credence to RCNLD

at \$4,294,079 as the maximum value of the water system, but would discount RCNLD to reflect the substantial sums required to bring the system up to standard.

Comparable Sales

As noted in our comments on the comparable sales approach, City submitted three sales of water systems by PG&E to public agencies at an average of less than 20% of net book value.

Both JWW and City agree that the PG&E sales consisted of significant ditch systems, were disposed of by seller in order to curtail operating losses, and largely served untreated water. These elements detract materially from their comparability to JWW.

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While lacking any great physical similarity to JWW, the PG&E systems referenced by City illustrate that informed buyers and sellers will discount rate base as a measure of sales price where improvements are required to bring the utility being sold up to standard.

Commission approval of the three sales offered as comparable by JWW was given as follows: Angora to South Tahoe, D.83-12-052; Rowland to Porterville, D.85-11-050; and Arvin to Northridge, D.86-10-026.

Each of these acquisitions involved a premium paid by a water supplier expanding its service area for the purpose of improving its water supply and integrating an adjacent system into its existing facilities.

South Tahoe has a long-standing policy to acquire the public utility water companies which furnish water service within South Tahoe's boundaries. Its acquisition of Angora stock was the third such transfer approved by the Commission.

South Tahoe, then providing water service to 8,000 customers agreed to acquire the 1,885 customers of Angora in further pursuit of its goal of having a single integrated water system at South Lake Tahoe.

Porterville desired to acquire Rowland's adjacent facilities serving 1,260 customers to interconnect the two systems into a single integrated system, to make improvements and provide improved fire flows within Rowland's service area, and to make it convenient to perform its function of making domestic water available to its inhabitants.

Northridge, at the time of sale, shared a common boundary with Arvin and served approximately 14,000 residential and commercial customers. The transfer was arranged to enable Northridge to conveniently provide water service to its customers and Arvin's 4,145 customers by a single inter-tied water system.

The \$1,750,000 sale price of Angora was 6.855 times net rate base. For Rowland, the \$1,500,000 sale price was 5.998 times net rate base. For Arvin, the \$3,500,000 sale price was 5.063 times net rate base.

As those sales were essentially expansions of existing water companies to integrate service areas, it is also instructive to note the cost per customer. South Tahoe paid \$930 ($\$1,750,000 \div 1,882$); Porterville paid \$1,159 ($\$1,500,000 \div 1,294$); Northridge paid \$844 ($\$3,500,000 \div 4,145$.) The average acquisition cost per customer is \$978.

If these three sales are comparable on a per customer basis, the indications are that JWW should yield a market price of \$1,268,466 ($\$978 \times 1,297$ customers).

Debt Service Capacity

The capacity of a public agency to service debt if it adopts JWW's rate structure is a helpful tool in determining market value of the system. As we noted in outlining this approach, the matter of how much the acquiring public entity can afford to pay

for JWW has been shown to be a factor in sales negotiations between willing buyers and sellers.

Except for the appraiser's given assumption that JWW's system is up to standard, we find the suggested value of \$3,527,176 minimum to be a reasonable indicator of the worth of JWW to City. Managers of public water agencies might well consider the agency's ability to finance in arriving at their estimates of fair market value. Of course, the amount such managers would pay to seller would decrease to the extent that the sought water system needed structural improvements, as we find in this case.

Finding

We have considered the entire record in this proceeding and find that the just compensation, as April 10, 1984, to which JWW is entitled to be paid for the taking of all its properties set forth in the petition is the sum of \$1,750,000.

JWW shall also be entitled to be paid for additions and betterments from April 10, 1984 forward as provided by law.

Findings of Fact

1. JWW owns and operates a public utility water system within and adjoining the boundaries of City.
2. City is a municipal corporation entitled to exercise the power of eminent domain.
3. On April 10, 1984, City filed with this Commission a petition of the second class under Division 1, Part 1, Chapter 8 of the California Public Utilities Code, to have the Commission fix the just compensation to be paid for its taking by eminent domain of JWW's water system.
4. Evidence of the condition of JWW's water system, net rate base, reproduction cost new less depreciation, capitalization of earnings, comparable sales, and debt service capacity should reasonably be considered in valuing the subject property.
5. The record does not support a finding of severance damage.

for JWW has been shown to be a factor in sales negotiations between willing buyers and sellers.

Except for the appraiser's given assumption that JWW's system is up to standard, we find the suggested value of \$3,527,176 minimum to be a reasonable indicator of the worth of JWW to City. Managers of public water agencies might well consider the agency's ability to finance in arriving at their estimates of fair market value. Of course, the amount such managers would pay to seller would decrease to the extent that the sought water system needed structural improvements, as we find in this case.

Finding

We have considered the entire record in this proceeding and find that the just compensation, as April 10, 1984, to which JWW is entitled to be paid for the taking of all its properties set forth in the petition is the sum of \$1,750,000.

JWW shall also be entitled to be paid for additions and betterments from April 10, 1984 forward as provided by law.

Comments

Pursuant to the Commission's Rules of Practice and Procedure, the proposed decision of the assigned administrative law judge for this proceeding was filed with the Commission and distributed to the parties on June 28, 1988. Comments were filed by Jackson Water Works, Inc. on July 25, 1988, in accordance with a granted extension of time.

Respondent asserts that City must be ordered to assume JWW's liability for advances in aid of construction in addition to the just compensation award. It appears that this unsecured JWW obligation stands at \$555,000 as of March 31, 1984.

This issue will be resolved in the further proceedings to value plant additions since the time of filing of City's petition. The amount of advances subject to refund should be determined and, if City assumes them, the \$1,750,000 compensation to be paid by City should be reduced by the present worth of the refund contracts

Conclusion of Law

JWW is entitled to just compensation of \$1,750,000.

ORDER

IT IS ORDERED that the just compensation to be paid by the City of Jackson for the lands, property and rights of Jackson Water Works, Inc. to be taken is the sum of \$1,750,000 as of April 10, 1984.

This order becomes effective 30 days from today.

Dated _____, at San Francisco, California.

(Vandenberg Village Community Services District, D.87-07-080, July 29, 1987.)

Respondent reminds us that on August 26, 1987, JWW moved to dismiss City's petition on constitutional grounds or, alternatively, that valuation proceedings be stayed pending action of the Legislature on Assembly Bill 616. JWW's purpose was to receive the benefit of any remedial legislation.

Senate Bill 616, codified in Section 1405.1 of the Public Utilities Code, allows water utilities such as JWW to elect either the Commission or the Superior Court as the forum in which eminent domain compensation is to be determined. However, the amendments noted expressly do not apply to or affect any petition filed before January 1, 1988.

Passage of time since the date of JWW's motion has, in effect, resulted in JWW's alternative motion becoming moot. A ruling is therefore not required.

Our review of the balance of the filed comments does not persuade us that any change in the proposed decision is appropriate.

Findings of Fact

1. JWW owns and operates a public utility water system within and adjoining the boundaries of City.
2. City is a municipal corporation entitled to exercise the power of eminent domain.
3. On April 10, 1984, City filed with this Commission a petition of the second class under Division 1, Part 1, Chapter 8 of the California Public Utilities Code, to have the Commission fix the just compensation to be paid for its taking by eminent domain of JWW's water system.
4. Evidence of the condition of JWW's water system, net rate base, reproduction cost new less depreciation, capitalization of earnings, comparable sales, and debt service capacity should reasonably be considered in valuing the subject property.

5. The record does not support a finding of severance damage.

Conclusion of Law

JWW is entitled to just compensation of \$1,750,000.

ORDER

IT IS ORDERED that the just compensation to be paid by the City of Jackson for the lands, property and rights of Jackson Water Works, Inc. to be taken is the sum of \$1,750,000 as of April 10, 1984.

This order becomes effective 30 days from today.

Dated _____, at San Francisco, California.

As Metzner testified, how and when required replacements and improvements will be made depends on the future preparation of a master plan. Lacking this tool, and mindful of RCNLD and of the factual matters emphasized in comments, we find that JWW is entitled to just compensation in the amount of \$2,100,000. This award is the value as of the date of condemnation.

The text under the topic of City's Capitalization of Earnings has been revised to reflect the value change.

Findings of Fact

1. JWW owns and operates a public utility water system within and adjoining the boundaries of City.
2. City is a municipal corporation entitled to exercise the power of eminent domain.
3. On April 10, 1984, City filed with this Commission a petition of the second class under Division 1, Part 1, Chapter 8 of the California Public Utilities Code, to have the Commission fix the just compensation to be paid for its taking by eminent domain of JWW's water system.
4. Evidence of the condition of JWW's water system, net rate base, reproduction cost new less depreciation, capitalization of earnings, comparable sales, and debt service capacity should reasonably be considered in valuing the subject property.
5. The record does not support a finding of severance damage.

Conclusion of Law

JWW is entitled to just compensation of \$2,100,000. ✓

ORDER

IT IS ORDERED that the just compensation to be paid by the City of Jackson for the lands, property and rights of Jackson Water Works, Inc. to be taken is the sum of \$2,100,000 as of April 10, 1984. ✓

This order becomes effective 30 days from today.

Dated SEP 14 1988, at San Francisco, California.

STANLEY W. HULETT
President

DONALD VIAL
FREDERICK R. DUDA
C. MITCHELL WILK
JOHN B. OHANIAN
Commissioners