

Decision 90 10 037 OCT 12 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
SAN JOSE WATER COMPANY, U-168-W,)
a corporation, for an order)
authorizing it to (1) increase)
rates charged for water service,)
and (2) revise and add to its Rules)
on file with the Public Utilities)
Commission.)

ORIGINAL

Application 88-09-029
(Filed September 14, 1988)

FINAL OPINION

In Decision (D.) 89-10-038, the interim decision in this proceeding, the Commission rejected both San Jose Water Company's (SJW) and the Commission Water Branch's (Branch) method for calculating SJW's gain on the sale of utility property no longer in rate base. This property was transferred to an SJW affiliated land company in 1987 in exchange for \$2,242,000 of contributed plant. As a result of this transaction, the Commission ordered SJW to develop a competitive bidding process for disposing of this land and similar transactions in the future. The Commission cited D.86-01-026, Pacific Bell's general rate case decision, as precedent for requiring arm's length dealing of affiliated companies in such sales transactions. Branch was directed to review the Pacific Bell competitive bidding procedure and present any revisions of the procedures and the tax treatment of proceeds applicable to SJW in Phase II in this proceeding.

After review of the Pacific Bell procedures, SJW contends that its bond debenture agreement requires that the proceeds from the sale of the subject land must be applied to the bond debt. Therefore, SJW and Branch recommend that competitive bidding be replaced by a method of appraisal by three MAI-certified appraisers. The parties also agree on the tax treatment for the proceeds of such sales. In petitions for modification of the

interim order, SJW and Branch (petitioners) request that a jointly proposed valuing method be adopted to replace Ordering Paragraph 9 of D.89-10-038 which requires competitive bidding. If the parties' agreement is adopted, no further hearings are necessary and the only matter disputed is the date from which an appraisal of the transferred property should be made.

We will grant the parties' request. Our concern in requiring a competitive bidding process was to enforce the policy of arm's length dealing between affiliated companies. SJW's and Branch's proposed appraisal method satisfies this concern. Therefore, we will adopt it to replace our requirement for competitive bidding in such transactions.

Branch contends that SJW's transfer of property without Commission authorization violates Public Utilities (PU) Code § 851 and is void. Branch uses this argument to support its contention that the valuation should be made as of the date of a final decision in this proceeding.

We reject Branch's argument that a violation of PU § 851 has occurred. This section requires that a utility must obtain prior Commission authorization to transfer utility property which is used and useful. For property which is not used or useful, there is no such requirement. At no time during the proceeding did Branch contest SJW's contention that this property had been removed from rate base. Branch may not do so after all evidence has been submitted. Accordingly, it is more reasonable to assess the value of such property within a reasonable time of the transfer since Commission approval is not required.

Accordingly, we grant petitioners' request for modification of D.89-10-038 and in this final opinion order the transferred property to be appraised according to factors existing in 1987 at the time of the transfer.

Findings of Fact

1. Petitioners request modification of Ordering Paragraph 9 of D.89-10-038 to replace the competitive bidding process with a stipulated appraisal procedure.
2. Petitioners agree to determine the fair market value of land once in rate base to be transferred to an SJW affiliate in the future as follows:
 - a. If the value of the land to be transferred exceeds \$500,000, SJW would obtain three independent appraisals from MAI-certified appraisers. The average of the values set forth in the three appraisals would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.
 - b. If the value of the land to be transferred is \$250,000 or more but less than \$500,000, SJW would obtain two independent appraisals from MAI-certified appraisers. The average of the values set forth in the two appraisals would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.
 - c. If the value of the land to be transferred is more than \$5,000 but less than \$250,000, SJW would obtain one independent appraisal from an MAI-certified appraiser. The value set forth in the appraisal would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.
 - d. If the value of the land to be transferred is \$5,000 or less, SJW could use any reasonable valuation method to determine the value of the land for purposes of determining the amount of any gain or loss. Since an appraisal from an MAI-certified appraiser generally costs between \$5,000 and \$10,000, there is little cost-benefit in requiring an appraisal for such sales.
 - e. If mains, facilities, buildings, or other fixtures are part of the land to be transferred by SJW to an affiliate, the

appraisal shall take into account any value for these items as well.

- f. The reasonable cost of the appraisals shall be deducted from the sale price as one of the costs of the sale.
- g. When SJW uses a particular MAI-certified appraiser to appraise land that was once in rate base and is to be transferred to an affiliate, SJW cannot use the same appraiser again for five years. By limiting ongoing employment, the independence of the MAI-certified appraiser is further assured

3. Petitioners agree to the following procedures for valuation of the land transferred to SJW's affiliated land company in 1987: SJW will obtain three independent appraisals from MAI-certified appraisers of the value of the property. The average of the three appraisals will be the purchase price for purposes of determining the gain on the sale. The reasonable cost of these appraisals will be deducted from the sales price as an authorized cost.

4. Petitioners agree that if the approach above in Finding 3 is adopted, the Commission may use \$2,242,000 as the selling price for the property even if the average appraisal price derived is less than this value.

5. Petitioners agree that the gain from this 1987 transaction will inure to the benefit of its ratepayers only.

6. Petitioners dispute the date from which the property should be appraised. SJW recommends an appraisal valuing the property at the time of the transfer. Branch recommends an appraisal valuing the property at the time of D.89-10-038.

7. Petitioners propose that the deferred taxes arising as a result of the 1987 land sale be treated as a temporary reduction to rate base. If and when these deferred taxes are paid, SJW will eliminate this rate base reduction.

8. No further hearings in this proceeding are necessary.

Conclusion of Law

SJW should be required to use its proposed appraised valuation method for property transferred in 1987 and similar transactions in the future.

FINAL ORDER

IT IS ORDERED that:

1. Ordering Paragraph 9 of D.89-10-038 is rescinded and replaced by the appraisal method below.
2. SJW shall obtain three independent appraisals from MAI-certified appraisers of the value of the property transferred to its affiliated land company in 1987. The appraisal shall evaluate the property as of the date of the transfer. The average of the three appraisals will be the purchase price for purposes of determining the gain on the sale. The reasonable cost of these appraisals may be deducted from the sale price as an authorized cost.
3. The Commission may use \$2,242,000 as the selling price for the property even if the average appraisal price derived is less than this value.
4. The gain from this 1987 transaction will inure to the benefit of SJW ratepayers only.
5. The deferred taxes arising as a result of the 1987 land sale will be treated as a temporary reduction to rate base. If and when these deferred taxes are paid, SJW will eliminate this rate base reduction.
6. For future transfers of property to affiliates which is no longer used and useful in rate base, SJW shall abide by the following procedure:
 - a. If the value of the land to be transferred exceeds \$500,000, SJW would obtain three independent appraisals from MAI-certified

appraisers. The average of the values set forth in the three appraisals would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.

- b. If the value of the land to be transferred is \$250,000 or more but less than \$500,000, SJW would obtain two independent appraisals from MAI-certified appraisers. The average of the values set forth in the two appraisals would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.
- c. If the value of the land to be transferred is more than \$5,000 but less than \$250,000, SJW would obtain one independent appraisal from an MAI-certified appraiser. The value set forth in the appraisal would be deemed to be the value of the land for purposes of determining the amount of any gain or loss.
- d. If the value of the land to be transferred is \$5,000 or less, SJW could use any reasonable valuation method to determine the value of the land for purposes of determining the amount of any gain or loss. Since an appraisal from an MAI-certified appraiser generally costs between \$5,000 and \$10,000, there is little cost-benefit in requiring an appraisal for such sales.

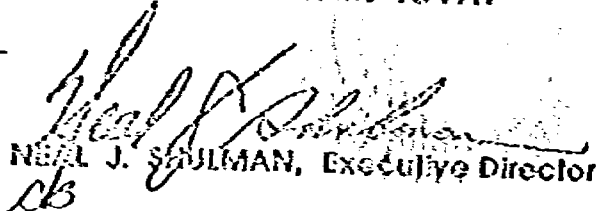
This order is effective today.

Dated OCT 12 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

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

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NEAL J. SCHULMAN, Executive Director