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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Petition of the City and County of San Francisco for a Valuation of Certain Pacific Gas & Electric Company Property Pursuant to Public Utilities Code Sections 1401-1421.	Petition 21-07-012

ADMINISTRATIVE LAW JUDGE RULING SOLICITING COMMENTS

On January 17, 2023, the City and County of San Francisco (CCSF) and Pacific Gas and Electric Company (PG&E) filed respective legal briefs addressing the standards for determining just compensation in this proceeding. CCSF and PG&E are the two major parties in this proceeding. Both parties also filed respective reply briefs on January 31, 2023.

Considering the briefs and reply briefs submitted, the Commission presents a draft proposal in Attachment A to this ruling and solicits comments from parties. Parties shall comment on the framework set forth in the draft proposal concerning the standards for just compensation. If parties dispute any portion of the draft proposal, such party shall support its contentions with citations to applicable law and precedent.

Parties shall file their comments within 40 days from the date of this ruling. Reply comments shall be due within 15 days from the last day to file opening comments.

Based on the above**, IT IS RULED** that:

1. Parties shall file comments to the draft proposal in Attachment A of this ruling within 40 days from the date of this ruling. If parties dispute any portion of the draft proposal, such party shall support its contentions with citations to applicable law and precedent or facts.
2. Reply comments shall be due within 15 days from the last day to file opening comments.

This ruling is effective today.

Dated March 27, 2024, at San Francisco, California.

/s/ RAFAEL LIRAG
Rafael Lirag
Administrative Law Judge

ATTACHMENT A

Draft Proposal on Standards for Just Compensation in P.21-07-012

Draft Proposal on Standards for Just Compensation in P.21-07-012

1. Overview

On July 27, 2021, the City and County of San Francisco (CCSF) filed Petition (P.) 21-07-012 for a determination of just compensation for acquisition of public utility property of Pacific Gas & Electric Company (PG&E) within and adjoining the boundaries of San Francisco city and county (San Francisco). The right to receive just compensation for property acquired by eminent domain is guaranteed by the California Constitution.[1]

CCSF and PG&E filed briefs on the standards for just compensation on January 17, 2023 and reply briefs on January 31, 2023. On September 8, 2023, the assigned Administrative Law Judge held a status conference regarding the parties' disputes over discovery. Subsequently, Energy Division held a workshop on October 5, 2023, to develop a plan for parties to reach agreement regarding issues that were necessary to resolve in order to prepare a complete valuation. In their Joint Report regarding the October 5, 2023 workshop, the parties concluded that they would be unable to reach an agreement on the need for workshop or whether CCSF needs to provide additional responses in order to prepare a valuation.

In light of the parties' inability to reach agreement on the information needed to prepare a complete valuation, the Commission proposes these preliminary guiding principles, procedures, and a methodological framework for the determination of just compensation. Adoption of a framework will enable the Commission to resolve disputes regarding the discovery process. Given that this Petition is for a partial taking of PG&E's service area, the valuation needs to take into account the value of the entire (or whole) property before the "taking" and the value of the remaining property after the taking. A summary of the resulting proposals is outlined below:

1.1. Standards for Just Compensation:

a. The policy and legal objectives of the CPUC in determining "just compensation" are to make PG&E's investors and remaining customers whole, meaning: (a) not overcompensate PG&E's investors or lower remaining customer rates; (b) not undercompensate PG&E's investors or increase remaining customer rates; and (c) maintain the same level of safety, reliability, wildfire mitigation, public benefits, etc. for PG&E's remaining customers after the taking.

b. CCSF's condemnation of PG&E's property in and around San Francisco constitutes a partial taking.

c. PG&E, as the property owner with assets dedicated to serving customers as a public utility, is entitled to business and physical severance damages.

1.2. Procedures for Determination of Just Compensation:

a. The before and after rule is the appropriate valuation procedure to be applied in the determination of the just compensation; which is measured as the difference between the value of the "larger" entire property before the taking and the value of the remainder after

[1] California Constitution Article I, Section 19.

the taking. PG&E's Electric Utility System (EUS) refers to PG&E's entire property and is the "larger" property in this particular determination.

b. Determine a separation plan that results in a separation of the part taken from the remainder of the system. A technical meeting should be required with PG&E's engineers, CCSF's engineers and CPUC staff and consultants where access is given to all the necessary information, which could include PG&E's circuit maps, geographic information system (GIS) maps and data, substation load data, etc., to work towards a mutually agreeable separation and reintegration plan. If a mutually agreeable plan cannot be reached, PG&E and CCSF should be compelled to provide all necessary data to one another to allow both parties to complete their own plan. In addition, CCSF should be compelled to identify all of the assets, property and customers that it is taking and complete a separation plan. Separation plans should include details of separation from itemized infrastructure and the timeline for each separation.

NB. Working definitions for "assets", "customers" and "properties" are as follows:

- Assets are anything of value: "a useful or valuable thing, person, or quality" and/or "property owned by a person or company, regarded as having value"
- Customers are assets, but they are not property. In this case they are captive customers (there is no competition).
- Property is something that is owned and is usually tangible (poles, wires, transformers, meters, etc.). It can also include intangible property such as customer billing records, construction manuals, maps, drawings, etc.

1.3. Methodologies for Valuation of Just Compensation:

a. Apply and reconcile the income approach and the sales comparison approach to value the PG&E EUS before and after the taking.

b. Apply all applicable approaches to value the CCSF assets, properties and customers in the part taken.

c. Subtract the value of the assets, property and customers from the part taken (difference between the before and after values) to determine business severance damages.

d. Add assets, properties, customers, business severance damages and the physical separation damages to determine just compensation.

2. Valuation of CCSF

2.1. Just Compensation

Principles of just compensation have been established by legal precedent in California, establishing an objective of fairness from a financial point of view:

> "Just compensation seeks to place the property owner in the same economic position the owner would have occupied had the property not been taken."[2]
>
> "While there are statutes and cases defining how to try to determine just compensation, the overriding principle is the notion that the owner is an involuntary seller of property, who is entitled to be made whole."[3]
>
> "The just compensation to which the owner is constitutionally entitled is the full and perfect equivalent of the property taken. This means substantially that the owner shall be put in as good position pecuniarily as he or she would have been if the property had not been taken."[4]
>
> "A landowner is not entitled to be placed in a better position financially than he was before the condemnation; neither is the state required to pay more than land is worth merely because of some theoretical, intangible concept. We cannot ignore rules of evaluation which harmonize with the constitutional requirement of 'just compensation' and which prevent landowners from receiving windfalls at public expense."[5]

The Petition includes two points that should determine the appropriate measurement of just compensation in these proceedings. One point is that the Petition is for a partial taking (PG&E property in San Francisco) as opposed to a total taking (entire PG&E electric utility system). The other point is that CCSF intends to hold PG&E ratepayers harmless.[6]

2.1.1. Partial Taking

In a partial taking, just compensation includes the fair market value of the part taken plus severance damages to the remaining property. Section 1263.410 of California's Code of Civil Procedure states that:

> "(a) Where the property acquired is part of a larger parcel, in addition to the compensation awarded pursuant to Article 4 (commencing with Section 1263.310) for the part taken, compensation shall be awarded for the injury, if any, to the remainder."

Section 1411 of the Public Utilities Code requires that if the CPUC finds that severance damages should be paid, it must separately determine the just compensation for such damages.

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[2] Miller and Starr California Real Estate 4th § 24:21. Principles of just compensation, 7 Cal. Real Est. § 24:21 (4th ed.) (citing *Redevelopment Agency v. Gilmore*, 38 Cal. 3d 790, 796–797 (1985)).

[3] Miller and Starr California Real Estate 4th § 24:21. Principles of just compensation, 7 Cal. Real Est. § 24:21 (4th ed.).

[4] Miller and Starr California Real Estate 4th § 139. Damages, generally, 2 Cal. Real Est. Digest 3d Eminent Domain § 139.

[5] *City of Fresno v. Cloud* (1972) 26 Cal. App.3d 113, 123.

[6] Petition at 1.

> "When the proceeding has been submitted, the commission shall make and file its written finding fixing, in a single sum, the just compensation to be paid by the political subdivision for the lands, property, and rights. If the commission finds that severance damages should be paid, the just compensation for such damages shall be found and stated separately. The just compensation shall be fixed by the commission as of the day on which the petition was filed with the commission."

2.1.2. Parties Briefs on Standards for Just Compensation

In its brief on Standards for Just Compensation, PG&E argues that the valuation must account for the damages that come from the loss of business revenues, together with its lost property assets, when analyzing just compensation. And, in its reply brief, PG&E argues how to account for such damages.[7]

However, CCSF argues against recovery of lost revenues in its brief on Standards for Just Compensation:

> "PG&E makes a separate argument for why it should be able to demand severance damages for lost revenues by pointing to PG&E's remaining customers and the shifting of costs that San Francisco ratepayers had previously paid, such as the Power Charge Indifference Adjustment. It would be inappropriate for the Commission to consider such costs within this valuation proceeding. Such costs go far beyond any notion of severance damages and should be considered, if at all, in a separate proceeding."[8]

Considering that one of the Commission's aims is that the taking will not harm remaining PG&E ratepayers, lost revenues and cost shifting issues should be considered in this petition proceeding to demonstrate the impact of the taking and to minimize harm to remaining PG&E ratepayers as much as possible. In order to arrive at a complete valuation that ensures that no severance damages are either missed or double counted, lost revenues should also be considered damages and should be addressed within this valuation proceeding, using a calculation of just compensation as described below.

2.1.3. Proposed Principles for Just Compensation

Approximately 80 years ago, the CPUC determined just compensation of PG&E's electric distribution system existing within and adjacent to the boundaries of the Sacramento Municipal District in the Petition of the Sacramento Municipal Utility District (SMUD), Application No. 21960. The Commission explained:

> "In addition to compensation for the loss of the property taken, measured in terms of the fair market value of the said property, justice requires that the condemnee be further compensated through an award for (a) the amount of physical damages suffered and (b) for all such loss, if any, as may be sustained by reason of a

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[7] PG&E Reply Brief on Standards for Just Compensation at 13.

[8] CCSF Reply Brief on Standards of Just Compensation at 18.

> diminution in value, due to the severance, of the property remaining after the severance. This doctrine is supported by the great weight of authority."[9]

Severance damages may be comprised of two distinct types of damages: physical severance damages and the diminution in value to the remaining property after the taking. The cost of physically separating the property and reintegrating the system can be thought of as physical severance damages.[10] The diminution in value to the remaining property may be thought of as "business severance damages" (sometimes referred to as "economic severance damages").[11]

> "As a result of actual severance of certain physical properties of the Pacific Gas and. Electric Company's system, in part along the boundary lines of the district area, some particular facilities would require adjustment, through construction, reconstruction, removals and installations, whereby to restore the remaining portion of the system to a proper or normal condition of serviceability. In addition to severance of a physical nature, a further injury or loss is sustained, in the normal case, of a very distinct and different type, namely, that which arises through diminution in value of the property not taken, caused by disturbance to the business activities normally associated with the remaining properties, including the necessity for supporting certain operative facilities which are rendered either permanently or temporarily less useful by the severance. For the purpose of classifying the two indicated types of severance damages, and as a ready means of identification, the former is referred to throughout the record as 'physical severance damages,' whereas the other, which arises from the business attached to the property, is consistently designated as 'business severance damages."[12]

This is further supported by Commissioner Craemer in his Separate Concurring Opinion in the SMUD decision:

> "Since our electric utility rate schedules are designed to respond to the need of a strong agricultural back country in support of our population centers, it becomes obvious that the separation of any population center service area from the whole of a system presents a severance valuation problem.
>
> Binding the wounds, severance, fair market value, and making the remainder of a system an efficient entity is deserving of most serious deliberation and sound judgement. If there is, at any time, error in this judgment it should lean in support of those who risk to suffer the most, through no fault of their own, in potential loss of production and land values because of burdensome higher power costs."[13]

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[9] *Sacramento Mun. Util. Dist.*, D35985 at 20.

[10] Ibid. at 21.

[11] Ibid.

[12] Ibid.

[13] *Sacramento Mun. Util. Dist.*, D35985, Separately Concurring Opinion by Commissioner Craemer at 2.

2.1.4. Proposed Principles for Just Compensation:

a. Establish that the policy and legal objectives of the CPUC in determining "just compensation" are to make PG&E's investors and remaining customers "whole," meaning:

- Not overcompensate PG&E's investors or lower remaining customer rates.
- Not undercompensate PG&E's investors or increase remaining customer rates.
- Maintain the same level of safety, reliability, wildfire mitigation, public benefits, etc. for PG&E's remaining customers after the taking.

b. Establish that CCSF's condemnation of PG&E's property in and around San Francisco constitutes a partial taking.

c. Establish that PG&E, as the property owner, is entitled to business and physical severance damages.

2.2. The Before and After Rule

The before and after rule is generally required to measure just compensation in partial acquisition cases. Both PG&E and CCSF appear to recognize and endorse the concept of the before and after rule in this case.[14]

The Uniform Appraisal Standards for Federal Land Acquisitions describes the before and after rule as follows:

> **"Before and After Rule (Federal Rule)**. The federal rule—also known as the before and after rule—applies in all appraisals involving partial acquisitions. Under this procedure, the appraiser develops opinions of both the market value before the acquisition and the market value after the acquisition. Requiring this valuation procedure allows acquiring agencies, the Department of Justice, and the courts to calculate a reasonable measure of compensation by deducting the remainder or after value from the larger parcel's before value. The result is a figure that includes the value of the property acquired as well as any compensable damages and/or direct (special) benefits to the remainder property. It should be noted that these are two separate appraisals within the same assignment requiring

[14] CCSF states in its Brief on Standards for Just Compensation: "Under Eminent Domain Law, severance damages are measured by comparing the fair market value of the remainder before and after the taking. (C.C.P. §§ 1263.410, 1263.420; City of Livermore v. Baca (2012) 205 Cal.App.4th 1460, 1466; City of Carlsbad v. Rudvalis (2003) 109 Cal.App.4th 667, 679; In re East Yolo Community Services Dist., 1 CPUC 2d 474, 1979 WL 50263, at *10 [noting that "severance damages represent the decline in value of the property of the owner left after a partial taking…"]; In re Southwest Water Co., 74 CPUC 193, 1972 WL 30110, at *4 [noting that separate from the value of assets to be acquired "the measure of severance damages, if any, would be the loss in market value of the remainder."])."

PG&E states in its Brief on Standards for Just Compensation: "80 In re Sw. Water Co., D.80480, 1972 Cal. PUC LEXIS 120, at *24; see In re E. Yolo Cnty. Servs. Dist., D.90360, 1979 Cal. PUC LEXIS 544, at *31 (Severance damages "represent the decline in value of the property of the owner left after a partial taking by the condemnor.")."

> the appraiser to perform a new analysis and valuation of the remainder after the taking. It should also be noted that it is improper for an appraiser to develop an opinion of the market value of the larger parcel in the before situation and then deduct the opinion of value of the property acquired together with separately calculated damages to arrive at the value of the remainder."[15]

It is also defined in appraisal literature:

> "**Before and After Rule.** In eminent domain valuation, a procedure in which just compensation is measured as the difference between the value of the entire property before the taking and the value of the remainder after the taking."[16]
>
> "Once it is determined that a property owner is entitled to severance damages in an eminent domain proceeding, the damages normally are measured by comparing the fair market value of the remainder before and after the taking."[17]

As discussed above, the before and after rule should be applied to determine the just compensation using a three-step process.

2.2.1. Before and After Rule Steps

Step 1

A **Before** Value of the PG&E EUS, including the Part Taken (CCSF)	**minus**	B **After** Value of the PG&E EUS, excluding the Part Taken (CCSF)	**equals**	C Value of the Part Taken (CCSF), (includes assets, property and business severance

Step 2

[15] Interagency Land Acquisition Conference, Uniform Appraisal Standards for Federal Land Acquisitions 2016 at 37.

[16] The Dictionary of Real Estate Appraisal. 6th ed. Chicago. 2015.

[17] Miller & Starr California Real Estate Digest 3d, § 53. Measure of damages, 2 Cal. Real Est. Digest 3d Eminent Domain § 53.

C Value of the Part Taken (CCSF), (includes assets, property and business severance damages)	**minus**	D Appraised Value of CCSF Property and assets	**equals**	E Business Severance Damages

Step 3

D Appraised Value of CCSF Property and assets	**plus**	E Business Severance Damages	**plus**	F Physical Separation Damages	**equals**	G Total Just Compensation

Step one calculates the total value of the part taken, which inherently includes both the value of the CCSF assets, properties, customers and the business severance damages and is calculated as A minus B equals C where:

A = the value of the larger property, i.e. the entire PG&E EUS, before the taking and therefore includes the part taken, i.e. CCSF (see 2.2.2).

B = the value of the larger property, (PG&E EUS) after the taking, and therefore excludes the part taken (CCSF).

C = the value of the part taken (CCSF) (see 2.1.1), which includes assets, property, customers and business severance damages.

In step two, the appraiser is separating the part taken from the business severance damages by subtracting D from C to determine E, where:

D = appraised value of CCSF property, assets and customers but excluding business severance damages, and

E = the business severance damages. See 2.1.3. The diminution in the value of the remaining PG&E EUS after the loss of CCSF assets and customers. Includes any stranded costs to be borne by the remaining ratepayers. Measured as the difference between Just Compensation and the fair market value of the assets taken.

This step is to establish a separate value for the asset valuation and severance damages, even though both of these costs will be added back in to the just compensation, consistent with Public Utilities Code § 1411.

It should be noted that electric systems are designed without regard to city or political boundaries. Hence, when separating the San Francisco area from the rest of PG&E, it will take a physical separation plan (sometimes referred to as

physical severance) to re-integrate the PG&E system, and separate the San Francisco part taken, to create two independent systems. Therefore, in Step 3, the costs related to physically separating and reintegrating PG&E's EUS are added to the value of the part taken and the business severance damages to determine the just compensation. This is done by adding F to D and E to determine G where:
F = the Physical Separation Damages. See 1.2.b. This is separation and reintegration costs. The actual cost of physically separating the CCSF assets and customers from the remaining PG&E EUS into two separate systems. Includes the cost of reintegrating the remaining PG&E EUS along the border. These together are the total severance damages; and
G = the (total) just compensation. Just Compensation plus Physical Severance Damages.

It is important to note that to perform this valuation, it is critical that a separation plan has been determined and all of the property assets that are intended to be acquired are identified. In the event this is not finalized, the parties must recognize there could be significant changes to all values as the future capital expenditures, operating and maintenance costs and customer revenues will rely on the final separation plan. This is discussed in further detail in section 2.4.4.

2.2.2. Determining what Constitutes the Larger Property in the Before and After Rule

An integral part of applying the before and after rule is the determination of the larger property. There are three criteria used to aid in determining the larger property: unity of ownership, contiguity of the parcels and unity of use.[1823] CCSF, in its Standards for Just Compensation brief, cites the same three unities to be considered in determining the larger property: (1) unity of title; (2) contiguity of the parcels; and (3) unity of use. We also recognize that each relevant fact must be analyzed, and all of the facts considered in order to determine unity in a condemnee's claim for severance damages.[19]
The PG&E EUS assets, properties and customers in its San Francisco service territory are an integrated part of the PG&E EUS and are included in its rate base.

1. Unity of title – PG&E is the same owner.
2. Contiguity of the parcels – PG&E's San Francisco transmission and distribution assets are physically integrated with the rest of the PG&E system.
3. Unity of use – PG&E provides the same services billed at the same rates in San Francisco as it does to the remainder of its system.

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[18] *City of San Diego v. Neumann*, 6 Cal. 4th 738, 745 (1993) (California courts "have not always insisted on strict application of the three unities").

[19] *City of Los Angeles v. Wolfe*, 6 Cal. 3d 326, 335 (1971).

Based on the three unities criteria, the larger property would be the PG&E EUS. The Commission recommends valuing the larger property before the loss of PG&E's assets, customers and properties located in the part taken by CCSF and then again after the loss of PG&E's assets, customers and properties located in the part taken by CCSF.
This approach best captures the difference between the before and after values; and using this methodology results in an estimate of the value of the properties taken including severance damages and benefits to the remainder of the system. Separation and reintegration costs of electrically separating the systems are estimated separately. This approach is also similar to what the Parties have suggested.

2.2.3. Proposed Procedures for Determination of Just Compensation:

a. Establish the before and after rule as the appropriate valuation procedure to be applied in the determination of the just compensation and that the PG&E EUS is the larger property.

b. Determine a plan that results in a separation plan. CPUC recommends that PG&E's engineers, CCSF's engineers and CPUC staff, CPUC's engineers and consultants meet at a place with access to all the necessary information, which could include PG&E's circuit maps, GIS maps and data, substation load data, etc., to work toward a mutually agreeable separation and reintegration plan. If a mutually agreeable plan cannot be reached, both parties should be compelled to provide all necessary data to complete their plans and CCSF should be compelled to identify all of the assets, properties and customers that it is taking. Separation plans should include a plan and timeline.

2.3. Appraisal Methodologies

Parties generally agree on the three recognized approaches to valuing property. The sales comparison approach, the income approach, and the cost approach are applicable to measuring just compensation in these proceedings.[20]
The applicability of any of these three approaches depends upon the appraisal problem and the availability of market data. The following sections describe the proposed application of the standard appraisal methodologies to the determination of just compensation in this proceeding.

2.3.1. Sales Comparison Approach

The sales comparison approach to value assumes that an informed purchaser would pay no more for a property than the cost of purchasing an equally desirable substitute. This approach is generally the best approach to valuing properties that are relatively homogeneous and which actively trade. The reliability of the approach depends upon the availability and comparability of the sales data (e.g., the extent of adjustment necessary to make meaningful comparisons).

a) The sales comparison approach is the primary valuation approach used for appraising residential property. In a residential appraisal, market value is estimated by comparing sales of similar properties to the subject property and adjusting for major differences (e.g.,

[20] See generally PG&E's and CCSF's briefs on Standards for Just Compensation.

location, square feet of living area, quality of construction, lot size, garages, swimming pools, out buildings, etc.).

b) The sales comparison approach is applicable in this proceeding. In business valuations application of the sales comparison approach is to derive market multiples from publicly traded peer companies (Comparable Trading Multiples Analysis) and from mergers and acquisitions analysis (Precedents Analysis or Guideline Sales Transactions). These are all valid approaches and are applicable to this proceeding.

2.3.2. Income Approach

The income approach is predicated upon the assumption that the market value of an income producing property is the present worth of future benefits (income) to be derived from owning the property. In general, this approach is the most widely used and relied upon in the appraisal of income producing properties. Typically, this approach involves projecting potential revenue and deducting all operating expenses and capital expenditures to arrive at a projection of free cash flow. Free cash flow may then be discounted over a specified projection period using a market derived weighted average cost of capital to obtain an estimate of value.[21]

a) The income approach is the most common approach used for valuing commercial real estate, such as office buildings, shopping centers, apartments, etc. One common income approach technique is the direct capitalization of income. For example, if an apartment complex is currently generating $500,000 per year in free cash flow and investors are willing to accept a current 6% rate of return, the apartment complex would be valued at $8.3 million ($500,000 ÷ 6% = $8,333,333).[22]

b) The income approach is nearly universally used to value businesses and is applicable to this proceeding. The preferred income approach technique is discounted cash flow analysis (DCF) where revenues, operating expenses, and capital expenditures are projected over several years into the future to arrive at a projection of free cash flows. Projected future free cash flows are then discounted to their present value at a market derived discount rate.

2.3.3. Cost Approach

The cost approach to value is based upon the premise that a purchaser would pay no more for a property than the cost of *producing* an equally desirable substitute (after taking into account timing and convenience issues). This approach is most relevant when the property is new and built using state-of-the-art design and materials, or when the property is unique and there are no comparable properties on the market with which to make a comparison. The procedure involves estimating the replacement cost new (RCN) of the property and deducting all forms of accrued depreciation; physical, functional, and external (RCN less depreciation or RCNLD). Physical depreciation is the loss in value resulting from the wear and tear of the aging process. Functional

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[21] The time period may be a projected holding period or forecast period that is less than the asset's remaining economic life. In such instances, it is necessary to estimate the value of the asset at the end of the projection period (i.e., its "terminal value") and discount it back to its present worth.

[22] The actual return on investment depends on several factors such as: whether cash flows increase or decrease over time; whether the investment goes up or down in value; and how long the investor owns the asset.

obsolescence is the loss in value due to deficiencies within the property usually brought about by changes in technology. External obsolescence is the loss in value due to factors outside the property such as excess supply, competition, or regulation.

a) The cost approach is commonly used in property valuations and is the primary valuation approach in the appraisal of so-called "special purpose properties" such as airports, schools, government buildings, shipyards, etc. For example, if a special purpose property costs $5 million to replace at current construction costs and is mid-way through its economic life (≈ 50% depreciated), the indicated replacement cost new less depreciation is $2.5 million. If the market value of the land as though vacant is $500,000, the cost approach indication of value is $3 million ($2.5 million + $.5 million = $3 million).
b) The cost approach is applicable to this proceeding in estimating the value of the physical assets and property being condemned ("part taken"). RCNLD, alone, will not include business severance damages. If RCNLD is used for the whole and the remaining PG&E system after the taking, then business severance damages would need to be calculated separately.

2.4. Application of Valuation Methodologies

As discussed above, there are four components that need to be valued when applying the before and after rule:[23]

(A) Value of the larger property (PG&E EUS) before the taking (includes the part taken (CCSF)),

(B) Value of the larger property (PG&E EUS) after the taking (excludes the part taken (CCSF)),

(D) Value of only the assets, properties and customers in the part taken, excluding business severance damages (from lost CCSF assets, properties and customers); and

(F) Physical Separation Damages.

The three valuation approaches must all be considered, but the applicability of these three approaches depends upon the appraisal problem and the availability of market data. This is discussed more below.

2.4.1. Valuation of the Larger Property Before

The before valuation of the PG&E EUS (larger property) should use the income approach (DCF analysis) and the sales comparison approach (based on market multiples) for PG&E's EUS, including CCSF.

Preparing a cost approach value estimate for the entire PG&E EUS would be a monumental undertaking and as discussed above, would not inform the business severance damage estimate, which is based on lost cash flows. Therefore, as discussed above, if the cost approach is used for the before and after valuation of the larger property, then it would require the appraiser to separately calculate business severance damages.

[23] The other components, such as economic severance damages, are derived through applying addition or subtraction of the valued components and therefore do not rely on a valuation methodology.

2.4.2. Value of the Larger Property After

The value of the remainder after the acquisition is driven by the lost cash flows because of the taking (i.e., the cash flows PG&E EUS will receive after the loss of CCSF assets, properties and customers). The same appraisal approaches that applied in the before valuation of the larger property – i.e., the income and sales comparison approaches – will apply to the valuation of the PG&E EUS, after the taking. The recommended approaches capture both business severance damages and benefits together.

2.4.3. Estimating Lost Cash Flows

This part of the valuation analysis is potentially the most critical part of the entire just compensation determination. It requires quantifying lost revenues and quantifying avoidable and unavoidable costs after the taking.

One approach to quantifying lost revenues and avoidable costs is to use an income statement as a template for PG&E EUS, removing estimated revenues and avoidable costs from the CCSF footprint.[24] By forecasting cash flows into the future, it is possible to distinguish between severance damages that are temporary and those that are permanent.

For example:

[24] This approach provides an internally consistent process for measuring lost cash flows, rather than a piecemeal discounting of individual elements of stranded costs. Furthermore, the recasting of revenues and expenses is consistent with the ratemaking process to establish rates post CCSF acquisition.

	PG&E with CCSF				CCSF	PG&E without CCSF				
Year	**2017**	**2018**	**2019**	**2020**	**2020**	**2020**	**2021**	**2022**	**2023**	**2024**
REVENUES:										
Total Retail Revenues					Lost Revenues					
Total Other Operating Revenue										
Total Electric Operating Revenue										
OPERATING EXPENSES:										
Steam Production					Avoided Costs					
Hydro Production										
Other Power Generation										
Purchased Power										
System Control & Load Dispatch										
Other Power Supply										
Transmission										
Regional Market										
Distribution - Operation										
Distribution - Maintenance										
Customer Accounts										
Customer Service										
Sales										
Administration and General										
Total Operation and Maintenance										
Taxes Other Than Income Taxes										
EBITDA										
Capital Additions					Avoided Capex					
Free Cash Flow					Lost Cash Flow					

Note: The CCSF column represents lost revenues from PG&E and avoided costs that PG&E avoids as a result of the taking. It does not represent CCSF revenues or cost to serve.

2.4.4. Value of the Part Taken (Excluding Business Severance and Physical Separation)

The value of the CCSF property, assets and customers taken may be estimated by all applicable valuation approaches based on the independent judgements of the Parties' valuation experts. Specific applications of each approach may be discussed in workshops.

2.4.5. Value of the Physical Separation Costs

CCSF's position on physical severance costs, or separation and reintegration costs is that it "agrees that it will be responsible for certain reasonable separation costs including the costs associated with building the required facilities to ensure that PG&E will be able to continue to

serve its customers outside of the city."[25] CCSF also endeavors to work with PG&E to identify options to effectuate this separation in a manner that is cost effective and allows both PG&E and the CCSF to safely and reliably deliver electricity to their customers.

Nevertheless, CCSF believes that a formal separation plan is not relevant to this proceeding, arguing that:

> "The fundamental flaw in PG&E's argument is that the valuation proceeding is not a "condemnation," and is governed by a different statutory regime that will result in only the valuation of assets. To the extent a separation plan will later be required pursuant to potential future condemnation proceeding has no bearing whatsoever on the instant valuation proceeding. It is revealing that PG&E cannot point to a single prior valuation proceeding before the Commission where a separation plan was "essential," let alone marginally relevant to setting just compensation for a utility's assets. PG&E does not even attempt to argue that the Just Compensation Statute requires such."[26]

CCSF's position is not consistent with the SMUD case, which determined physical severance damages as part of the just compensation awarded. Furthermore, the final separation plan will determine the inventory of assets to be acquired and the post-acquisition operation and maintenance costs for the remaining PG&E EUS.

Notwithstanding the fact that CCSF acknowledges that a separation plan will eventually be required, the Parties are at a stalemate over who is responsible for determining a plan and when the plan should be submitted to the CPUC. PG&E contends that:

> "CCSF suggests that its position on these topics may develop through further communications with PG&E, which are now expected to occur through the ongoing workshop process to be facilitated by the Commission's Energy Division. This process creates a practical solution to the problem: the Commission should compel CCSF to respond to the data requests at issue, but postpone the deadline for CCSF to respond (other than with respect to their valuation expert's workpapers, which should be produced without delay) until after the workshops on the respective data requests topics, and likewise postpone the deadline for PG&E to serve testimony on valuation and severance until after CCSF produces the required information."[27]

As noted above, it is critical that a separation plan has been determined and all of the assets that are intended to be acquired are identified in order to determine the just compensation. However, it is possible that an initial severance plan can serve as a starting point recognizing there could be significant changes in value.

Ultimately, the physical severance costs will be based on actual estimated costs to perform the separation and reintegration.

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[25] *Sacramento Mun. Util. Dist*., D35985 at 23 to 25.

[26] See CCSF Response in opposition to PG&E's Motion to Compel Further Responses to Date Requests.

[27] PG&E Reply in support of Motion to Compel CCSF to Provide Further Responses to Data Requests at 3.

2.4.6. Calculation Using Before and After Rule

The following table outlines the contemplated template for each party to follow in determining the just compensation accounting for the before and after rule and the applicable valuation methodologies discussed above.

2.4.6.1. Just Compensation Calculation Using Before and After Rule

Step 1: Valuation of the CCSF part including Business Severance			
	Before PG&E EUS Enterprise Value with CCSF (A)	**After** PG&E EUS Enterprise Value without CCSF (B)	**Difference** Value of the Part Taken (C)
Valuation of the PG&E EUS Enterprise Values			
Income Approach - PG&E EUS Enterprise Values			
Sales Comparison Approach - PG&E EUS Enterprise Values			
Final Estimate of PG&E EUS Enterprise Values			

Step 2: Valuation of the Part Taken	
	Indicated Value
Value of Part Taken (C)	
Value of CCSF assets, properties and customers	
Replacement Cost Approach	
Sales Comparison Approach	
Income Approach	
Final Estimate of Value of CCSF assets property and customers (D)	
Business Severance Damages to the remainder of PG&E EUS (C – D = E)	

Step 2: Valuation of the Physical Severance Costs
Final Estimate of Value of Part Taken (D)
Business Severance Damages to the Remainder of PG&E EUS (E)
Estimate of Separation and Reintegration Costs (F)
Just Compensation (D+E+F=G)

Proposed Methodologies for Valuation of Just Compensation:

a. Apply the income approach and the sales comparison approach to value the PG&E EUS before and after the taking. The difference is the part taken. This is not the total just compensation because it doesn't include the physical separation damages.
b. Subtract the value of the assets, properties and customers from the part taken (difference between the before and after values) to determine business severance damages.
c. Add Physical Separation Damages (the separation and reintegration costs) to the part taken to determine the total just compensation to the part taken.