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VIA FEDERAL EXPRESS AND EMAIL

April 13, 2006

Nancy C. Miller
Miller, Owen & Trost
428 J Street, Ste 400
Sacramento, CA 95814

Re: Response to PG&E Statements re "Splitting the Difference" Valuation Theory

Dear Ms. Miller:

I am responding to a statement made by Mr. Dan Richard of Pacific Gas and Electric Company ("PG&E") at the April 5, 2006 hearing of the Sacramento Local Agency Formation Commission ("LAFCO") regarding the methodology that LAFCO should utilize in analyzing the valuation evidence presented. The comments by Mr. Richard are also reflected in the letter from Nancy E. McFadden of PG&E to the Sacramento LAFCO, dated April 5, 2006 ("PG&E April Letter").

Specifically, during the April 5 public meeting, Mr. Richard characterized my testimony of earlier that evening as having advocated that a fact finder in a condemnation action seeking the acquisition of utility properties would necessarily engage in a "splitting the difference" valuation approach. Building on this foundation, Mr. Richard suggested that such a "split the difference" approach would restrict the fact finder's derivation of fair market value to a simple mathematical calculation of dividing by two the sum of the highest and lowest values presented for the Yolo County facilities to be condemned by the Sacramento Municipal Utility District ("SMUD"). The PG&E April Letter accordingly refers to the "$320 million difference between PG&E and SMUD on valuation, and [requests that LAFCO] adopt either a range of outcomes or 'split the difference' approach on each of these items for purposes of evaluating the range of possible overall outcomes on SMUD's costs of acquiring PG&E's facilities." April Letter at 6.[1]

[1] PG&E states that "[t]he GES Report at Table C-13 identified $384 million in separate disputes between SMUD and PG&E over valuation, of which $320 millions was not resolved by agreement with PG&E or by 'splitting the

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Mr. Richard's characterization of my testimony is inaccurate and his reliance on it to advance the proposition that the fact finder would value the PG&E facilities based on arbitrary mathematical formulas and without assessing the actual evidence presented is simply wrong. Our memorandum explained that "the courts and the CPUC have purposely not established an absolute one-size-fits-all preference applicable in all instances for the utilization of a particular methodology for the valuation of utility facilities." Memorandum to Peter Brundage from Davis Wright Tremaine LLP, dated March 29, 2006 ("DWT Memo"), at 1.

The obvious point is that the fact finder will likely consider all evidence, "accord differing weight to various valuations, based on the specifics of the condemned facilities and [] exercise its judgment in determining the compensation amount." *Id.* Since Replacement Cost New Less Depreciation ("RCNLD") is often the ceiling for any valuation and Original Cost Less Depreciation is often the floor, it is reasonable to conclude that the fact finder will select a fair market value amount somewhere between these two end points. Nowhere in the DWT Memo or in my testimony did I advocate that the fact finder would simply "split the difference" without any consideration of the credibility or reliability of the valuation evidence.[2] Mr. Richard's theory contravenes established case law and would impermissibly deny the fact finder of the opportunity to set the value based on the evidence presented and the exercise of judgment.

The valuation assessment provided by GES Engineers and Appraisers to LAFCO is consistent with approaches approved by courts. In his valuation analysis, Mr. Walker appears to have "accord[ed] differing weight to various valuations, based on the specifics of the condemned facilities and [] exercise[d] [his] judgment in determining the compensation amount." Thus, based on his experience in the field of public utility valuation, Mr. Walker appears to have exercised his independent judgment and in calculating a total valuation estimate of $110 million, rejected PG&E's RCNLD amount which exceeds the valuation resulting from every other methodology presented by more than $300 million. Under the PG&E mandatory "split the difference" approach, Mr. Walker would have been obligated to accept, without question, PG&E's outlying valuation figure and had his task restricted to simply averaging the PG&E number with the lowest SMUD figure presented.

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difference.'" PG&E April Letter at 6. Table C-13 provides a summary of SMUD's and PG&E's separate RCNLD valuations, plus GES' reconciled figures.

[2] Mr. Richard's inference that the fact finder's authority to set fair market value is restricted to averaging the highest and lowest valuations presented essentially replicates PG&E's prior assertion that the statutory requirement that the condemnee be paid "the highest price the property would sell for" dictates that the fact finder identify the highest price then per se designate it as the fair market value. In language equally applicable to Mr. Richard's "mandatory split the difference" approach, the DWT Memo explained:

> [Finding] fair market value equal to the "highest price" does not deprive the fact finder of the right to set fair market value at a lesser price based on the exercise of judgment, and in light of the evidence presented.

DWT Memo at 3.

Additionally, I would like to correct one additional point made by Mr. Richard during the April 5 hearing. Mr. Richard advocated that the negotiated sale of PG&E utility facilities to the Modesto Irrigation District ("MID") represents a "comparable sale," that the valuation was based on RCNLD, and thus, that transaction has precedential value for this LAFCO.

The suggestion by Mr. Richard that the MID settlement presents any support for PG&E's RCNLD valuation presently is improper. First, as Mr. Richard acknowledged – the valuation of the PG&E facilities to be sold to MID was in the context of a settlement and thus, the supposed use of RCLND would not even be admissible in a court proceeding.[3] Second, and even more importantly, the PG&E/MID settlement resolved much more than simply the valuation of the PG&E facilities – the total settlement payment to be paid PG&E included additional funds for MID to satisfy certain ratemaking obligations to PG&E and included an offset representing PG&E's payment to MID as compensation for MID's claims that PG&E had violated the antitrust laws.[4] Thus the scope of the PG&E/MID settlement extended beyond simply the amount to be paid by MID to PG&E for facilities.

Contrary to Mr. Richard's statement, the PG&E/MID settlement offers compelling evidence of why courts must reject the results of a settlement as evidence. Mr. Richard's promotion of the intended MID acquisition as a "comparable sale" was intended to suggest that MID was a "willing market-place buyer" who voluntarily agreed that RCNLD would be an appropriate and fair basis to set the price. PG&E's testimony before the CPUC to support the settlement belies Mr. Richard's inference that the selection of RCNLD was a mutual decision. Rather PG&E

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[3] The DWT Memo explains that the various settlements in which PG&E asserts RCNLD was used as the valuation methodology are not even relevant, let alone precedential. See DWT Memo at 12-13. Moreover, as Mr. Richard also acknowledged, the CPUC did not approve the PG&E/MID settlement. *PG&E Co. (MID)*, D.98-06-020, 80 CPUC 2d 435 (1998).

[4] In seeking CPUC approval of its comprehensive settlement with MID, PG&E delineated its multiple components as follows:

> In broad overview, the overall agreement between PG&E and MID: settles litigation and potential litigation between the parties arising from MID's retail power marketing efforts; avoids the immediate construction of wasteful, duplicate distribution systems; allows MID to serve at retail four Central Valley communities with which it has signed "permission agreements;" collects – on a lump-sum basis - the CTC and other nonbypassable charges that are attributable to the former PG&E loads that will be served by MID; avoids the likely stranding of PG&E distribution facilities and associated cost-shifting to other retail customers; replaces a restrictive one-sided service area agreement with a new arrangement that allows for distribution unbundling (except ownership of duplicative wires) and direct access in each entity's service territory [citation omitted]; uses the proceeds from the gain on sale of distribution facilities, rather than ratepayers' dollars, to fund litigation settlement; transfers to MID higher cost rural areas surrounding the four cities as well as the loads within city limits; and reinforces the integrity of the Commission's restructuring implementation plan.

Re PG&E, A.97-07-030, Application at 2.

explained in its testimony that as a condition of PG&E agreeing to sell the facilities to MID, PG&E required that the sale price would be presented as based on the concept of RCNLD.[5]

In conclusion, there is no basis for LAFCO to adopt a "split the difference" approach to analyzing the valuations presented in this case. Further, the MID settlement is simply irrelevant to the issue in front of the Sacramento LAFCO.

Very truly yours,

Davis Wright Tremaine LLP

Steven F. Greenwald

cc: Peter Brundage
Salle E. Yoo

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[5] "The premise *required* by PG&E and not disputed by MID was that the final price [MID was to pay for the facilities] would be supported by the concept of reproduction cost new less depreciation (RCNLD)." *Re PG&E,* A. 97-07-030, PG&E/Moody Testimony at 3-1 (emphasis added).