IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

MOONGATE WATER COMPANY, INC.,

Plaintiff-Appellant/Cross-Appellee,

v. No. 27,889

CITY OF LAS CRUCES,

Defendant -Appellee/Cross-Appellant

Appeal from the Third Judicial District Court
Doña Ana County, New Mexico

Honorable Robert E. Robles, Judge

PLAINTIFF-APPELLANT'S BRIEF IN CHIEF

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SUMMARY OF PROCEEDINGS

A. Introduction.

In this inverse condemnation action the district court ruled that Moongate Water Company had the exclusive right to extend its service to three subdivisions annexed by the City of Las Cruces, and that the City's decision to supply water to the subdivisions was a taking. Nevertheless, the court subsequently decided that Moongate's property was worthless. Moongate appeals the order denying compensation. The City has separately appealed the ruling that there was a taking. [1]

Moongate Water Co., Inc. is a regulated public utility that provides water service in the Las Cruces area. In the early 1980s Moongate pioneered water service to an area referred to as Section 15 on the East Mesa outside the Las Cruces city limits. (Tr. Vol. 12, p. 58-59; *id.* Vol. 16, p. 22; Pl. Ex. 39, p. 9; Def. Ex. 1-F) Moongate extended water lines to Section 15 because the City had refused to provide service to a group of landowners there. (R.P. 1358, 1455-1475, 2139.) Over the next twenty years Moongate met the area's growing demand for service. In 1984, Moongate served about 25 customers in Section 15. (Tr. 1356, 1406, 2137-38; Vol.

[1] By chance Moongate's notice of appeal was filed earlier on the same day as the City's notice of appeal. (R.P. 3775, 3781.) Moongate was designated as appellant and the City as cross-appellant. The awkward procedural result is that the issues on appeal are being briefed in reverse logical and chronological order. Because the principles supporting that there was a taking are intertwined with the issue of how to value what was taken, Moongate sets out those principles in some detail in this brief.

12, p. 58; Pl. Ex. 29, p. 4.) By 2004 or 2005 Moongate served over 250 Section 15 connections. (Tr. Vol. 12, p. 66-67.) Moongate's pipes and meters are widely spread over Section 15. (Pl. Ex. 24, 25.)

As it did when it refused service to Section 15 in the 1980s, the City continues to have a "policy of not providing water service until the density is sufficient to justify service by the City." (Def. Ex. 14, p. 34; R.P. 2139.) The City provided no water to Section 15 until its actions giving rise to this lawsuit. (R.P. 1357, 1449, 2137.)

Between 2004 and 2006, the City annexed and determined that it would provide water to three subdivisions in Section 15 known as Dos Sueños, Los Enamorados and Rincon Mesa.[2] (Pl. Ex. 1, p.2; Pl. Ex. 13; Pl. Ex. 4, p. 2; Pl. Ex. 6, p. 6; Pl. Ex. 7, p. 2; Pl. Ex. 9, p. 6.) The three subdivisions were approved for over 900 lots on approximately 232 acres. (*Id.*; Tr. Vol. 12, p. 123-124, 152,; Pl. Ex. 49, p. 92; Pl. Ex. 50, p. 87.) Prior to annexation these tracts had been zoned for minimum lot sizes of one-half acre to one acre. (Tr. Vol. 14, p. 97-98, 100, 103.)

At the time the City decided to provide water service to the three subdivisions, Moongate's pipes touched or came within a couple of hundred feet of every parcel

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[2] The locations of the three subdivisions within Section 15 are shown in Def. Ex. 1C as tracts 7, 8 and 9. (Tr. Vol. 13, p. 7-8; *id.* Vol. 14, p. 172.)

of land in Section 15. (R.P. 1357, 1407, 2137, 2140.) Its pipes were adjacent to three sides of Dos Sueños, three sides of Los Enamorados and four sides of Rincon Mesa. (R.P. 1358, 1407, 2137, 2140.) In addition, Moongate had constructed production and storage facilities with the intent to serve all of Section 15. (R.P. 1358, 1407, 2137, 2140.)

Moongate brought this action asserting that its certificate of convenience and necessity (CCN) from the Public Regulatory Commission (PRC) gave it the exclusive right to provide water service to the three annexed subdivisions. Moongate asked for a declaration that it had that right unless and until the City either elected to be regulated by the PRC or paid just compensation for the taking of Moongate's property. (R.P. 398.) Moongate further demanded payment of just compensation for the taking the inverse condemnation statute, NMSA 1978 § 42A-1-29 (1981) and under the federal and state constitutions. (R.P. 400-403.)

B. Proceedings on the taking.

The parties filed various motions and cross-motions for summary judgment addressing Moongate's contention that the City's actions amounted to a taking of Moongate's property right to serve the three subdivisions. (R.P. 169, 462, 1279, 1354, 2371.)

Moongate looked to the related legislative policies that a public utility be regulated to insure fair rates, encourage investment and prevent unnecessary duplication of facilities, NMSA 1978 § 62-3-1(B) (1967), and that intrusions by a municipality into the service area of a regulated utility be prohibited until the municipality elects to be regulated under the PUA. *Id.* § 62-3-2.1(C) (1991). These policies, Moongate argued, prevent all municipalities from freely "cherry picking" high density developments out of areas served by regulated utilities. To allow such intrusion without either the regulatory oversight of the PRC or requiring payment of compensation for a taking would destroy any incentive for a utility to invest in facilities near a growing city, thereby preventing people living in those areas from getting utility service. (R.P. 1394.)

Moongate argued that legislature has provided the means to prevent such harm. A municipality may either condemn a utility's service rights pursuant to NMSA 1978 § 3-27-2 (1965) and pay just compensation, or elect "to avail itself of all the benefits of the Public Utility Act and of the regulatory services of the commission" under NMSA 1978 § 62-6-5 (1993). (*See* R.P. 476, 1284.) Moongate asserted that its right to compensation was equal to the fair market value of the income stream derived from providing service to the three subdivisions and the value of contributions in aid of construction (CIAC) it lost from the service areas taken by the City. (R.P. 477-479,

1392.)

The City countered that it has not elected to be regulated by the PRC and is authorized by statute to provide municipal water service both within and without its limits. (R.P. 1283.) It contended that it may freely compete with Moongate to provide water service. (R.P. 1285.) The City further argued that it was unaffected by the policy set out in § 62-3-2.1(C), as that policy declaration was only a preamble to another provision giving the PRC jurisdiction over territorial disputes between regulated utilities and the City of Albuquerque. *See id.* § 62-9-1.1 (1991). (R.P. 235, 1810-11.)

The court granted summary judgment for Moongate (R.P. 2160), concluding that "[u]ntil and unless a municipality elects to come within the terms of the Public Utility Act, it is prohibited from intruding into areas in which a public utility furnishes regulated services." (R.P. 2147.) The court further concluded that "[a]s a consequence of electing not to be regulated by the NMPRC, the City must compensate Moongate for damage or taking of Moongate's property by intruding on its service area." (R.P. 2150.) This Court denied the City's application for an interlocutory appeal of that ruling. (R.P. 2778.) Subsequently, during proceedings on motions preliminary to the trial on compensation, the district court ruled, consistent with its earlier judgment, that Moongate's CCN is a grant of exclusive territorial

rights. (Tr. Vol. 11, p. 26-27.)

C. Proceedings on compensation.

At the trial on compensation Moongate's appraiser, Dr. Vincent Barrett, calculated the value of the rights taken by the City as the present value of the revenue stream that Moongate would have earned from the subdivisions but for the City's taking. (Pl. Ex. 39, p. 1, 5, 18; Tr. Vol. 13, p. 166, 171.) Dr. Barrett's method was to add Moongate's average water bill per connection to the CIAC it was authorized to receive per connection. (Pl. Ex. 39, p. 25.) He multiplied this sum by the number of lots in the three annexed subdivisions (*id.*), and adjusted it by an absorption factor which reflected the rate, based on empirical studies in the Las Cruces area, at which lots would be sold. (Pl. Ex. 39, p. 26: Tr. Vol. 13, p. 179-80.) From this he subtracted the marginal costs Moongate would have incurred to serve the subdivisions. Dr. Barrett based the cost figure upon an analysis by a certified public accountant, which he then verified item by item with Moongate's vice-president Mr. Gariano, as the likely marginal cost to provide service to the three subdivisions. (Tr. Vol. 12, p. 43; *id.* Vol. 13, p. 181, 187-188.) To that result he applied a discount rate of 7 ½ % during the period stabilization period, before all the houses would be sold, which he converted to a capitalization rate of 8 ½ % thereafter. These rates were based on market data. (Pl. Ex. 39, p. 26; Tr. Vol. 13, p. 188-91; Vol. 14, p. 65, 66, 69.)

Dr. Barrett assumed that Moongate would continue providing service in perpetuity. (Tr. Vol. 14, p. 16, 75.) As a practical matter, however, by depreciating the income stream to present value, Dr. Barrett effectively placed a time limit of 100 years on the analysis, a time frame which corresponded with a reasonable estimate of the lifetime of the homes that would be served. (Tr. Vol. 14, p. 83; *id.* Vol. 13, p. 188-189.) Necessarily, this analysis included the assumption that Moongate would have the water rights necessary to provide service during that period of time. (Tr. Vol 14, p. 83-84.)

Dr. Barrett's analysis showed that as a result of the takings Moongate would lose net revenues with a present value of $ 3,048,044. (Tr. Vol 13, p. 195-196, Tr. Vol. 14, p. 5, 26.)

The City attacked Moongate's valuation theory on a broad front. It contended that Moongate had not demonstrated the ability to meet the required service standards, (*infra* p. 15), that it lacked sufficient water rights to serve the subdivisions in the long term (*infra* p. 24), that it was improper to include CIAC as a revenue component (*infra* p. 25), that at most what was taken was Moongate's opportunity to serve the annexed areas at the densities for which they were zoned before annexation (*infra* p. 30), and that utility rate-making principles limited the revenues and expenses Moongate could use in its calculations. (*Infra* p. 31.) The City further contended that

the only applicable valuation method was the "before and after" method employed for partial takings of physical assets. (*Infra* p. 32.) It asserted that under this method, because there was no difference between the value of Moongate's physical facilities and existing business before and after the taking, Moongate was deprived of nothing at all. (*Infra* p. 33-34.) The City also asserted that the limited marketability of the rights taken by the City made them essentially worthless. (*Infra* p. 41.)

The district court generally adopted the City's positions on these matters. It found that Moongate's plan to serve the three subdivisions was inadequate (R.P. 3594-3595, 3597-3598), that it lost only the opportunity to serve the annexed tracts as low density areas (R.P. 3595-3596), that CIAC was not a proper component of valuation of the loss to Moongate (R.P. 3601), and rate making principles required reduction of Moongate's revenue and cost figures. (R.P. 3604, 3606.) Although the court made no specific findings as to quantity of Moongate's water rights, it did find that Moongate mitigated any revenue loss as a result of committing "its limited water rights" to serve other new subdivisions. (R.P. 3607.) Finally, the court fully adopted the City's theory of the valuation. It found that because there was no taking of physical assets used to generate an income stream it was inappropriate to use the income method to determine just compensation (R.P. 3602, 3605-3607, 3610.) It concluded that there was a partial taking which required Moongate to employ the

"before and after" method of valuation. (R.P. 3607, 3612.) Under that method, concluded the district court, "[a]lthough there was a taking, there was no damage." (R.P. 3612.) The court entered its judgment that "there was no proof of damages." (R.P. 3631.)

This appeal presents the question of how to determine just compensation for the taking of Moongate's right to extend water service into areas contiguous to facilities. Moongate contends that its property right and its ability to exercise it must be appraised in light of the comprehensive statutory framework under which it has a monopoly in its service territory in exchange for extensive state regulation. Moongate contends that the district court erred in adopting valuation criteria which are inconsistent with the public policies which give value to its right.

ARGUMENT

MOONGATE'S RIGHT TO SERVE IS AN INTANGIBLE PROPERTY RIGHT. ITS VALUE IS GROUNDED IN ITS NATURE AS AN EXCLUSIVE, STATE-REGULATED RIGHT. A METHOD OF DETERMINING COMPENSATION FOR ITS TAKING WHICH DENIES ITS VALUE *PER SE* IS UNCONSTITUTIONAL.

A. The standard of review.

The district concluded as a matter of law that Moongate's claims of value were speculative, that it could not claim CIAC as an element of compensation, and that it was required to appraise the amount of compensation by the "before and after"

method appropriate to partial takings. (R.P. 3610-3612.) This Court reviews questions of law *de novo*. Smith & Marrs, Inc. v. Osborn, 2008-NMCA-043, ¶ 19, 180 P.3d 1183, 1188.

Normally, findings of fact are reviewed for substantial evidence, while legal conclusions are reviewed de novo. Jicarilla Apache Nation v. Rodarte, 2004-NMSC-035, ¶ 24, 136 N.M. 630, 637, 103 P.3d 554, 561. When a finding listed as a fact is based on a legal conclusion it is reviewed de novo as a matter of law. *See* In the Matter of Locatelli, 2007-NMSC-029, ¶ 11, 141 N.M. 755, 758-59, 161 P.3d 252, 255-56. As will be shown *infra,* most what the court identified as findings of fact were intertwined with the City's legal theories about the character of Moongate's rights and the measure of compensation for their taking. These findings were either legal conclusions or mixed questions of law and fact which must be reviewed de novo. State v. Attaway, 117 N.M. 141, 144-45, 870 P.2d 103, 106-07 (1994) (requiring de novo review of "mixed questions, which require the court to 'exercise judgment about the values that animate legal principles," *quoting* United States v. McConney, 728 F.2d 1195, 1202 (9th Cir.) (en banc), *cert. denied,* 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984).

B. The policies giving rise to Moongate's exclusive service rights.

Moongate's cause of action is founded upon a comprehensive statutory

framework that gives its service rights value as property. The Public Utility Act declares that the development and expansion of public utilities "affects . . . the general welfare, business and industry of the state," encompassing the interests of consumers, investors and the public at large. § 62-3-1. Consequently, it is in the public interest that public utilities be regulated and supervised to achieve three interrelated goals: to make reasonable utility service available at fair rates, to encourage capital investment and to prevent "unnecessary duplication and economic waste" in the development and expansion of plants and facilities. *Id.*

Public utilities are prohibited from building facilities, operating or expanding without obtaining a certificate of convenience and necessity from the Public Regulatory Commission (PRC). NMSA 1978 § 62-9-1 (2005). They must submit to comprehensive PRC regulation over virtually every aspect of their business, including rate-making, *id.* §§ 62-3-1 and § 62-6-4(A)(2003), service standards and rules, *id.*; § 62-6-19 (1982), and accounting methods. *Id.* § 62-6-16 (1941). Public utilities are required to open their books and premises to PRC inspection. *Id.* § 62-6-23 (1941). They are required to offer adequate, efficient and reasonable service at reasonable rates. *Id.* § 62-8-1 (1941); § 62-8-2 (1941). They must offer non-discriminatory service within classifications and as between localities and classes. *Id.* § 62-8-6 (1993). They are prohibited from abandoning any portions of their facilities without

commission approval. *Id.* § 62-9-5 (2005). In exchange for submitting to extensive public regulation and assuming the continuing duty to offer service, utilities are granted protection from competition. *See* Morningstar Water Users Ass'n v. New Mexico Public Utility Com'n, 120 N.M. 579, 590, 904 P.2d 28, 39 (1995) (monopoly granted to public utility "a quid pro quo for the obligation to render public service and to submit to regulation and control.") A regulated public utility has a property right in its service area. *Id.*, 120 N.M. at 588, 904 P.2d at 37. It may, without seeking PRC approval, extend its lines "into territory contiguous to that already occupied by it and that is not receiving similar service from another utility." § 62-9-1(A) (2005).

The regulatory scheme is complicated by the existence of two classes of unregulated water utilities: mutual domestic water consumer associations (MDWCA), and municipal water utilities. The PRC has jurisdiction to resolve territory disputes between MDWCAs and regulated public utilities. § 62-9-1(A). Municipalities may elect to come under the general jurisdiction of the PRC. *Id.* § 62-6-5. In a special provision applicable only to cities with a population of greater than 200,000 (and thus applicable only to Albuquerque) the legislature has empowered the PRC to resolve territory disputes between regulated utilities and municipalities which have opted not to come under the PRC's general jurisdiction. *Id.* § 62-9-1.1; *see* N.M. Laws 1991, Ch. 143, § 2.

At the time of the passage of this Albuquerque-specific provision, the legislature also enacted a section, applicable to all non-regulated municipal water utilities, to insure that they cannot frustrate the regulatory purposes of the PUA. That section, codified as NMSA 1978 § 62-3-2.1(C) (1991), provides:

> The following are declared to be the objects and purposes of this 1991 act. Experience has proven that the construction, development and extension of proper plants and facilities cannot be accomplished without unnecessary duplication and economic waste within areas certificated to water and sewer utilities without controls against duplicative intrusions into certificated areas by municipal utilities. A rational basis exists to prohibit intrusion of municipal water or sewer facilities or service into areas in which a public utility furnishes regulated services until that municipality elects to come within the terms of the Public Utility Act, in which event both systems will be brought into parity of treatment with respect to the commission's independent jurisdiction and power to prevent unreasonable interference between competing plants, lines and systems. Without such controls as provided by Section 62- 9-1.1 NMSA 1978, the declared policy of the Public Utility Act, the provision of reasonable and proper utility services at fair, just and reasonable rates and the general welfare, business and industry of the state may be frustrated.

See N.M. Laws 1991, Ch. 143, § 1. Sections 62-9-1.1 and 62-3-2.1(C) "shall be liberally construed to carry out their purposes." *Id.* § 62-3-2.1(D) (1991).

Section 62-3-2.1(C) plainly refers to two distinct means of effecting the policy against municipal intrusion. The first, applicable to all municipalities, is to "prohibit intrusion . . . until [a] municipality elects to come within the terms of the Public Utility Act." The second, as a special case pursuant to § 62-9-1.1, is to place

Albuquerque under limited PRC jurisdiction even in the absence of such an election.

Preventing the City's intrusion into Moongate's service area unless it elects to be regulated or pays just compensation squarely serves the policies detailed in § 62-3-2.1(C). For example, the district court found as an uncontested fact that "[w]ithout CIAC from the three subdivisions Moongate and its customers will suffer delays in upgrading the system and the unit cost of upgrading will be higher. (R.P. 1360, 1408, 2140-41.)

The City argued that reading § 62-3-2.1(C) to prohibit it from intruding into Moongate's service area is tantamount to bringing it the under the jurisdiction of the PRC without its election. (R.P. 234-238.) The PUA contains many provisions which affect municipalities without bringing them under general PRC jurisdiction. See e.g. NMSA 1978 § 62-1-3 (1987) (authorizing municipalities to grant franchises to public utilities for the use of city streets); id. § 62-6-15 (1979) (subjecting contract rates and service regulations between public utilities and municipalities to PRC approval); id. § 62-1-4 (1993) (subjecting municipalities to public utilities' power of entry and condemnation of rights of way.) Section 62-3-2.1(C) does not impose PRC jurisdiction upon the City, although it certainly gives the City an incentive to submit to it. This is in keeping with the overall purpose of the PUA as "a comprehensive regulatory scheme granting the PRC the policy-making authority to plan and

coordinate the activities of New Mexico public utilities, in a manner consistent with the Legislature's stated goals." Doña Ana Mut. Domestic Water Consumers Ass'n v. New Mexico Public Regulation Com'n,, 2006-NMSC-032, ¶ 16, 140 N.M. 6, 139 P.3d 166, 172. In that case the Supreme Court upheld an order of the PRC "determining that Moongate . . . has the exclusive right to provide water service in an area east of Interstate 25 . . and north of Las Cruces." *Id.* at ¶¶ 1,29, 139 P.3d at 167, 175. The court further approved the PRC's presumptions "that all contiguous territory lies within a utility's 'service or system," and that "contiguous" means "territory within one-half mile of a public utility's pipes or facilities." *Id.* at ¶¶ 14-18, 139 P.3d at 171-173. These presumptions are reasonable "because utilities have both a right and a duty to extend service to these areas." *Id.* at ¶ 18, 139 P.3d at 173. On this basis, the Court affirmed the PRC's determination that Moongate had the exclusive right to sell water in an area within one-half mile of its facilities.

There is a difference between subjecting a city to regulation and giving it an incentive to be regulated. Section 62-3-2.1(C) plainly encourages municipalities as a matter of policy to"to avail [themselves] of all the benefits of the Public Utility Act and of the regulatory services of the commission." § 3-27-2. As discussed *infra*, those benefits include access to a forum with the expertise to judge competing claims about territory and relative abilities to provide service. The alternative is condemnation of

the protected rights taken.

C. Moongate has the ability to serve the taken properties.

Relying on City of Las Cruces v. Rio Grande Gas Co., 78 N.M. 350, 353, 431 P.2d 492 (1967), the City maintained that Moongate's right to compensation was dependent on its showing that it had the ability to serve the areas taken by the City. (R.P. 2472.) In Rio Grande the Court held that the City could not be enjoined by a utility company from unlawfully providing gas service outside its boundaries where the utility made no showing that it was "able to give the service which Las Cruces is furnishing unlawfully." *Id.*, 78 N.M. at 353, 431 P.2d at 495. Moongate's right to an injunction is not at issue here. However, assuming that Moongate's ability to serve is relevant to its right to compensation for the City's takings, the City, by ignoring the policy framework under which Moongate operates, misconstrues the nature of what must be shown.

In Doña Ana Mut. Domestic Water Consumers Ass'n v. New Mexico Public Regulation Com'n,, *supra,* a utility which contested Moongate's exclusive right to extend its lines into contiguous territory contended that Moongate lacked the "capacity and ability to expand service to new customers." *Id.* at ¶ 13-14, 140 N.M. at 10-11, 139 P.3d 166 at 170-171. It argued that Moongate's capacity should be judged only in terms of its "existing customers and facilities," or those "who could

be served without additional improvements," or those "who could be served at a reasonable cost in a reasonable time . . . with additional improvements." *Id.* The Supreme Court affirmed the PRC's determination that Moongate's need to build additional facilities in order to expand service in the disputed territory did not negate its ability to provide that service. *Id.* at ¶ 18, 140 N.M. at 12, 139 P.3d 166 at 172. As the Supreme Court noted, the PRC views challenges to a regulated utility's capacity to expand service in light of its duty to offer service and its right to construct line extensions into contiguous territory without seeking approval from the PRC." *Id.* at ¶ 14, 140 N.M. at 11, 139 P.3d 166 at 171.

1. Moongate's core ability.

The City argued that to be entitled to compensation Moongate was required to show that at the time of the taking it had developed a specific, detailed plan to serve the taken areas. (Tr. Vol. 11, p. 39.) This assertion is inconsistent the realities of how water utility systems, by necessity, expand incrementally to meet growing demand. Under PRC rules, a water utility extends its lines after, not before, applications for new service. (Def. Ex. 3, p. 3.) A utility "shall not under any condition make an extension that would be unprofitable and thereby cause undue financial burden to existing customers . . . ." (*Id.*)

Moongate's ability to serve the three subdivisions at the time they were taken

must be judged on a macro scale. Prior to the annexation of the three subdivisions, Moongate invested in significant excess production and storage capacity sufficient to serve all the land in Section 15. (Tr. Vol. 12, p. 92; R.P. 2141.) That excess capacity was intended to support development in Section 15. (Tr. Vol. 12, p. 83-90.) Moongate had plans for improving facilities to serve Section 15 prior to the City's taking of Dos Sueños. (Tr. Vol. 13, p. 154.)

Historically, Moongate has demonstrated its ability to expand its service to meet every demand within its service area, whether to sparsely settled rural areas or to densely zoned subdivisions. The company began in the early 1980s by supplying about 80 customers. (Tr. Vol. 12, p. 43, 51-53.) At that time its facilities consisted of four wells and about 20,000 gallons of storage. (*Id.*) By the time of trial, Moongate was serving over 4000 customers from its interconnected system of ten production wells, 5 million gallons of storage capacity and 200 miles of pipes. (Tr. Vol. 12, p. 90, 93, 94-95.)

These facilities form Moongate's core ability to serve the demands required of it under its CCN. Given that core, extending service to the three subdivisions at required fire flow rates and pressures is simply a matter of extending and properly sizing and looping pipelines. (Tr. Vol. 13, p. 152; *id.* Vol. 14, p. 180-81; Pl. Ex. 51A, p. 58, 60.)

2. Moongate's preliminary proposal.

Upon learning, during the annexation process for Dos Sueños, that the City was planning to provide water service to the new subdivision, Moongate made a series of service proposals, including a computer model which calculated fire flow and pressure rates. (Tr. Vol. 12, p. 100, 106.) Fire flow refers to a system's capacity to fight a fire while maintaining service to customers. (Tr. Vol. 12, p. 75.) Such models are planning tools which typically serve as a basis for independent analysis by the City, followed by discussion and agreement on changes necessary to meet requirements. (Tr. Vol. 15, p. 53, 59.) Moongate's computer was a starting point for discussions with the City. It was anticipated that Moongate's proposal would change – that a different sizing or grouping of water lines might be required to deliver the necessary fire flow. (Tr. Vol. 15, p. 72-73, 157-158; Pl. Ex. 51B, p. 176, 213-114.) Meeting service standards always requires system adjustments over time as conditions change. "It's a continuous process," Dr. Garcia testified.(Pl. Ex. 51A, p. 112.)

The City made much of the fact the version of the computer modeling program used by Moongate was a demonstration version labeled "not for professional use." (Tr. Vol. 13, p. 117; Vol. 14, p. 205.) The City asserted, and the district court found, that the program was unreliable for that reason. (*Id.*; R.P. 3597.) Whatever the City's opinion of Moongate's edition of the program, its own analysis verified the results

predicated in Moongate's model run. the model. The City's own evidence established that Moongate's proposal would allow it to meet the fire flow requirements of Dos Sueños. (Tr. Vol. 12, p. 110; Def. Ex. 22, p. 35.) This could be accomplished by installing 20,000 feet of 12 inch pipe, as it proposed. (Tr. Vol. 15, p. 65; Pl. Ex. 51A, p. 50-53.) The same pipes would also enable Moongate to provide sufficient commercial fire flow to Los Enamorados. (Tr. Vol. 15, p. 68, 71-72.) The court found that it was undisputed that Moongate could not serve or provide necessary fire flow to Dos Sueños without significant infrastructure improvements. (R.P. 3526.) That finding was irrelevant, as it simply mirrored the equally undisputed evidence that Moongate could serve and provide the necessary fire flow by making the infrastructure improvements it proposed.

The Court found that Moongate could not provide 2500 gallons per minute fire flow to Los Enamorados. (R.P. 3594.) This finding was also irrelevant. In its planning process the City uses a fire flow of 2500 gallons per minute only as "an initial modeling scenario" because, as Dr. Garcia testified, "we have to assume something." (Tr. Vol. 15 p. 72-73.) Some commercial development may require 1,500 gallons per minute. Some may require 2,000. (Pl. Ex. 51A, p. 122.) Actual fire flow requirements are determined by the fire department. .(Tr. Vol. 15 p. 72-73.) The actual rates of flow required for the three subdivisions were less than the City's planning assumption. Dos

Sueños and Rincon Mesa, which are all residential developments, require 1,000 gallons per minute. (Tr. Vol. 12, p. 104, 151.) Los Enamorados, which contains some commercial lots, requires a fire flow of 1,500 gallons per minute. (Tr. Vol. 15, p. 124.) Although the district judge entered a finding that Moongate's model did not demonstrate its ability to provide commercial fire flow of 2,500 gallons per minute (R.P. 3594-3595), there was no such requirement.

The City's analysis showed that Moongate's proposal would not allow it to provide the 50 psi (pounds per square inch) requirement specified in the City's master plan. (Tr. Vol. 12, p. 111; Def. Ex. 22, p. 35.) This criticism ignored that the proposal was for planning and discussion purposes. In addition, there was uncontroverted evidence that Moongate could achieve pressure of 50 psi in Dos Sueños by shifting pressure zones. (Tr. Vol. 12, p. 111.) This could be accomplished in less than a week at a cost of less than $5,000. (Tr. Vol. 12, p. 113-14.)

3. Line Extension No. 9.

PRC approval is required for a utility to extend its lines more than one-half mile or if the cost of the extension is more than $100,000. (Tr. Vol. 12, p. 55-56.) On July 22, 2007 Moongate filed a plan with the PRC, referred to as Line Extension No. 9 which includes significant improvements in Section 15. (Def. Ex. 11.) Moongate planned Line Extension No. 9 to serve 9,600 connections at a cost of approximately

$15 million, to be financed from CIAC. (Tr. Vol. 12, p. 131.) The filing of Line Extension No. 9 was triggered by the need to serve a subdivision called Vista Chico (Tr. Vol. 12, p. 124) and was designed " build the infrastructure . . . to serve the future needs of the growing area." (Tr. Vol. 12, p. 125.) Line Extension No. 9 is a long term plan. It is being built in segments and could take up to ten years to complete. (Tr. Vol. 12, p. 129-130.)

The City asserted that Line Extension No. 9 wouldn't work, couldn't be financed and was speculative. (Tr. Vol. 12, p. 24; *id.* Vol 16, p. 122-123.) The district court made findings to that effect. (R.P. 35-97-3598.) These findings are unsupported by the evidence. The City's evidence that Moongate would be unable to serve the subdivisions with Line extension No. 9 was inconclusive. Dr. Garcia, the director of the City's utility department testified only that he could not conclude from available information that Line Extension No. 9 would produce sufficient fire flow. (Tr. Vol. 15, p. 208-209.) Another of the City's experts could state only that it was "difficult to assess" Line Extension No. 9. (Tr. Vol. 16, p. 121.) His testimony Line Extension No. 9 would cost twice what Moongate estimated (Tr. Vol. 16, p. 123) was based on nothing more specific than his statement that "[t]here was some problems with it. I had some issues." (Tr. Vol. 16, p. 121.) Moreover, the City's assertions and the court's conclusions that Line Extension No. 9 is "speculative" (R.P. 3597-3598) and

that it "has not . . . and will not be built, to serve the . . . subdivisions" (R.P. 3600) are belied by fact that Moongate was building parts of Line extension No. 9 at the time of trial. (Tr. Vol. 12, p. 115.)

More importantly, the cursory nature of the City's analyses illustrates why any determination as to the adequacy of Line Extension No. 9 is a matter for the PRC, to which it was submitted. Unlike the district court, the PRC is assisted in its determination of technical issues by an expert staff. Unlike the district court, the PRC serves a distinct policy role. The scope of a utility's rights under its CCN is somewhat ambiguous, and its interpretation requires both the PRC's technical expertise and its policy-making authority." Doña Ana, *supra,* at ¶ 19,140 N.M. at 12, 139 P.3d at 172.

Underlying its critique of Moongate's ability to serve was the City's assertion that it was better able to serve the three subdivisions than Moongate. (*See* Tr. Vol. 14, 154-160.) The district judge's findings incorporated the City's case for its having a better ability, including that the City had master planned for the growth of its water system and developed infrastructure and financing to carry out that plan. (R.P. 3590-3591.) This finding brings a central concern of this litigation into sharp relief. The relative abilities of Moongate and the City are not relevant to the issues in this action. The legislature has conferred upon the PRC, not the district court, the jurisdiction to determine such issues as between public utilities and those municipalities which have

availed themselves of the benefits of regulation.

D. The City's attack on Dr. Barrett's quantitative assumptions ignored the nature of Moongate's service rights.

1. Moongate had sufficient water rights for the service areas taken by the City.

Dr. Barrett's analysis of Moongate's lost profits was discounted to a time frame of approximately 100 years. The City contended that Moongate's water rights will be exhausted in 14 years and that it was improper for Dr. Barrett to project future revenues for the three subdivisions for any longer than that. (Tr. Vol. 16, p. 190-192.) The City argued that this rendered Moongate's claim for future lost revenues speculative. (Tr. Vol. 15, p. 30-32.) The district court found that Moongate mitigated any revenue loss as a result of committing "its limited water rights" to serve other new subdivisions. (R.P. 3607.) This finding was erroneous.

It was not disputed that the three subdivisions taken by the City would require approximately 377 acre feet of water per year.(Tr. Vol. 12, p. 136, 151.) Nor was it disputed that the at the time of the takings, Moongate and its owners together had excess water rights of 575 to 675 acre feet per year available to serve the three subdivisions. (Tr. Vol. 12, p. 136-137, *id.* Vol. 16, p. 70.) In addition, Moongate has applied to the State Engineer for the right to extend the use of other water rights it

owns into Section 15 (Tr. Vol. 16, p. 26-27), has applications pending for additional large quantities of water rights (Tr. Vol. 12, p. 134-135) and is in the market for water rights. (Tr. Vol. 12, p. 155.)

Like the evidence of Moongate's ability to meet service standards, this evidence must be viewed within the policy framework which vests Moongate with its service rights. Doña Ana, *supra*. The duty of a regulated utility to serve and its right to expand into contiguous territory are accorded great weight. The PRC is the agency charged with making determinations of a regulate utility's ability to serve in the context of these policy factors. The question of the long term sufficiency of Moongate's water rights, like the City's other challenges to Moongate's ability to serve, is ultimately an issue within the PRC's jurisdiction. The City addresses its challenge to the wrong forum. As Moongate pointed out below, the City has the key to the door of the PRC, but has but has chosen not to open it. (Tr. Vol. 11, p. 18-19.)

2. Contributions in aid of construction were proper revenue components.

A public utility may require its customers to bear the cost of investment in a line extension through the payment of a contribution in aid of construction. (Def. Ex. 3, p. 3.) Moongate is authorized by the PRC to charge CIAC of $1,434.85 per customer for CIAC, exclusive of water rights fees. (Tr. Vol. 12, p. 123; *Id.* Vol. 14, p. 46-47; Pl. Ex. 39, p. 25.) Dr. Barrett included this CIAC charge as a component of

his valuation method. *Id.* The City contended, and the district court agreed, that CIAC was not a proper component of valuation of the loss to Moongate. (R.P. 3601.) This conclusion is erroneous.

A utility uses all of the CIAC it collects to expand and upgrade its facilities. (R.P. 1360, 1408, 2140.) The ability to collect CIAC is inherent in Moongate's right to serve, and by spreading the cost of infrastructure improvements, it serves to benefit all of Moongate's customers. (Tr. Vol. 15, p. 17-20.) In some cases CIAC may exceed the cost of the particular improvement for which it is collected. The utility may invest the excess in other infrastructure and water rights for the benefit of the entire system. (Tr. Vol. 13, p. 153.) This serves the public policy of encouraging public utilities to invest in expanding and improving service.

If Moongate had served Dos Sueños, Los Enamorados and Rincon Mesa the CIAC from those projects would have allowed it to improve service to all of its existing customers at a lower cost than it can now. (Pl. Ex. 51B, p. 226-28.) The infrastructure necessary to serve the three subdivisions would increase the fire flow throughout the system. (Tr. Vol. 13, p. 152.) In addition, CIAC from Rincon Mesa would have generated a surplus of over $250,000 to the benefit of all of Moongate's customers. (Tr. Vol. 12, p. 153.) The loss of CIAC from the three subdivisions has significant consequences for Moongate's customers. They will now suffer delays in

receiving upgraded service, and the cost to each customer for improved service will be greater. (R.P. 1360, 1408,2137, 2140-41.)

The City challenged Dr. Barrett's inclusion of CIAC as a revenue component on two grounds. First, the City claimed that it was not proper to consider CIAC because it is not treated as income for rate-making purposes. (Tr. Vol. 17, p. 28, 35.) This argument is counter to the rules of valuation in condemnation proceedings. The amount of just compensation in eminent domain proceedings cannot be limited by rate-based factors. United Water New Mexico, Inc. v. New Mexico Public Utility Com'n, 1996-NMSC-007, 121 N.M. 272, 279, 910 P.2d 906, 913. In Board of Education v. Thunder Mountain Water Co., 2007-NMSC-031, 141 N.M. 824, 161 P.3d 869 the Court held that a school district which condemned service facilities of a publicly regulated water utility, and to which it had paid CIAC to build of those facilities, cannot deduct that CIAC from the fair market value of the facilities taken. *Id.* ¶ 12, 141 N.M. at 828, 161 P.3d at 873.Quoting a leading treatise, the Court emphasized that rate-making and determining just compensation have different goals: "[A] utility valuation, by whatever approach, that is premised on a regulatory rate base that excludes significant utility assets [such as CIACs] usually results in less-than-just compensation for all property taken." *Id.* ¶ 18, 141 N.M. at 829, 161 P.3d at 874. (Citation and internal quotation marks omitted.)

Exclusion of CIAC in this case would also result in less-than-just compensation, and frustrate the policies under which Moongate's right to serve arises. Public policy encourages development and expansion of public utilities in a way that benefits all the customers on the system. In Adaman Mut. Water Co. v. U.S., 278 F.2d 842, 846 (9th Cir. 1960) the court held that right of an irrigation project to assess members for operation and maintenance charges was compensable under the Fifth Amendment. The court emphasized that members served by the project benefitted from the assessments in the form of lower irrigation costs. *Id.* at 847. Similarly, CIAC, which is used to expand and upgrade a utility's facilities, serves the purpose of spreading the cost of expansion and upgrading for the benefit of the utility's customers.

The City also challenged Dr. Barrett's inclusion of CIAC as a revenue component, claiming that the taking allowed Moongate to avoid the cost of building the infrastructure necessary to serve the three subdivisions. (Tr. Vol. 15, p. 6-10; R.P. 3559-3601.) The City's assertion that Moongate seeks to be paid not to build something (Tr. Vol. 15, p. 33) is simply not true. Whether or not Moongate served the three subdivisions, it would have had to build the same infrastructure, which is part of Line extension No. 9, in order to serve other growth demands. (Tr. Vol. 12. p. 131.) In fact, Moongate had already constructed significant portions of Line

Extension No. 9 at the time of trial. (Tr. Vol. 12, p. 115.) As a result of the takings Moongate has less capital available to build that infrastructure. As more high-density development occurs in and contiguous to Moongate's service area, fire flows equivalent to those required by the three subdivisions will be required. Moongate will incur the same expense to deliver those flows, but without receiving the same contribution. CIAC allows construction costs to be spread out. The taking narrowed the contribution base for the construction of Moongate's facilities. (Tr. Vol. 15, p. 17-20.)

The district court in fact found that "Moongate has a duty to serve the area surrounding and including Dos Sueños, Los Enamorados and Rincon Mesa and must build substantially the same infrastructure whether or not it serves [those subdivisions]" (R.P. 3609), that "[t]he goal of service extension is to divide the costs fairly amongst as many persons . . . and thus to keep the individual costs to a minimum" (R.P. 3609), and that loss of CIAC from the three subdivisions would delay and increase the cost of modernizing Moongate's entire system. (R.P. 3609.) These findings are irreconcilable with the conclusion that CIAC should not be included in determining just compensation.

3. Dr. Barrett properly stated Moongate's future water charges.

The City argued, and the district judge was persuaded, that Moongate's

valuation could only state revenues from the number of connections allowed by the zoning in effect before the City's annexation of the subdivisions. (Tr. Vol. 15, p. 10-13; R.P. 3591-3592, 3595-3596.) The City reasoned that the increase in density occurred only as a result of the City's actions, and that as a result the City took only Moongate's opportunity to serve Section 15 as it was before the City's actions. (Tr. Vol. 11, p. 46-47, 53.) The district judge agreed. (R.P. 3596, 3601.) The City's premise and the court's conclusion are erroneous.

Moongate's CCN gives it, in exchange for state regulation, the "inchoate, but nevertheless essential right to serve." Bear Creek Water Ass'n, Inc. v. Town of Madison, 416 So.2d 399, 402 (Miss. 1982). When that essential right is taken without the taking of physical assets, the valuation of that right is not limited to preexisting population densities. *Id.*

The City's annexation and rezoning of the three subdivisions did not create, but merely confirmed the long-developing urbanization of section 15. A decade before the annexations at issue, the City issued a planning document which recognized the rapid urbanization taking place in "[t]he entire Mesilla Valley and East Mesa Corridor from Las Cruces south to El Paso . . . " (Def. Ex. 14, p. 25.) Moongate facilitated the growth in Section 15 for over 20 years by providing water in areas where the City refused service. (R.P. 1447-1449.) Moongate's experience has been that growth

follows water line extensions. The availability of water service stimulates growth in adjacent areas. (Tr. Vol. 12, p. 64-65.) The development for which the City claimed credit occurred in part because Moongate pioneered water service to Section 15, spurring its highest and best use as an urbanized area. The value of Moongate's service rights to the service areas taken by the City is determined according to that highest and best use. City of Clovis v. Ware, 96 N.M. 479, 480, 632 P.2d 356, 357 (1981).

The City's expert witnesses predicted that the PRC would not permit Moongate to charge for water or state its costs at the rates assumed by Dr. Barrett. (Tr. Vol. 16, p. 170; *id.* Vol. 17, p. 21-23.) The court erroneously adopted this view. (R.P. 3604, 3606.) It is for the PRC to decide how it will regulate Moongate's rates. The City may avail itself of PRC jurisdiction to have that matter determined. However, this action is not governed by rate-making principles. *See supra*, p. 27.

E. The value of Moongate's service rights was properly determined using the lost earnings method.

In its main thrust against Moongate's effort to obtain just compensation for the loss of its service rights, the City argued that Dr. Barrett's entire method of valuation, namely the computation of a lost future income stream, was inappropriate. Relying on the premise that Moongate's business had not been taken in its entirety, the City

contended that compensation for a partial taking must be determined by comparing the market values of Moongate as an ongoing business before and after the takings. (Tr. Vol. 9, p. 72; *id.* Vol. 11, p. 52-53; *id.* Vol. 17, p. 45.) The district judge was persuaded of this and concluded that there was a partial taking (R.P. 3612), that the most appropriate valuation method was the "before and after" method (R.P. 3607), and that Dr. Barrett's valuation testimony was therefore inadmissible. (R.P. 3611.) In addition, the district court found that because of the intangible character of Moongate's lost service rights and the limited market for such rights, their value was only speculative and insubstantial, and that they could not be valued as an income stream. (R.P. 3605-3607.) In all these conclusions the court was in error.

1. Dr. Barrett properly avoided using the "before and after" method of valuation.

The "before and after" method of valuation is required when there is a partial taking of property which results in a difference between the value of the property before and after the taking. NMSA 1978 § 42A-1-26 (1981). Dr. Barrett considered, but rejected use of the "before and after" method for two reasons. First, there was not a partial taking. "[E]ach subdivision service area taken represents for all practical purposes a taking of the whole . . . ." (Pl. Ex. 39, p. 18, 24.) Second, Dr. Barrett determined that because the takings caused no change to the remainder of Moongate's

business, the appropriate method of appraisal was to simply determine the value of the part taken. (Tr. Vol. 13, p. 193-94.) A "before and after" valuation would be "a meaningless exercise." (Tr. Vol. 13, p. 193.) What was taken was the right to receive a stream of revenue from each subdivision. (Pl. Ex. 39, p. 24.) Dr. Barrett's method was designed to measure the economic value of those revenue streams. (Pl. Ex. 39, p. 1, 5, 18; Tr. Vol. 13, p. 166, 171.)

The law supports this approach. When a partial taking does not affect the value of the remainder "the 'before and after' rule loses its relevancy and the proper alternative measure of compensation would be the fair market value of the property actually taken." Yates Petroleum Corp. v. Kennedy, 108 N.M. 564, 568, 775 P.2d 1281, 1285 (1989). *See also* City of Albuquerque v. Westland Development Co., Inc., 121 N.M. 144, 147, 909 P.2d 25, 28 (Ct. App. 1995) (just compensation includes both the value of the right taken and any reduction in the value of the remainder of the property.) Dr. Barrett's method is consistent with these rules.

The opinion of the City's expert was that Moongate's compensation should be determined using the "before and after" method, precisely because there was no change in Moongate as a going concern as a result of the takings. (Tr. l. 17, p. 45-47.) It was this opinion, which was in direct conflict with the rule stated Yates and Westland Development, which should have been deemed irrelevant, not that of Dr.

Barrett.

2. Moongate's service right is a valuable intangible asset.

The City took none of Moongate's physical assets. Rather it took Moongate's right to extend the service its service into contiguous territory. The taking resulted in a loss of revenue. The City insisted that the value of Moongate's lost income stream could not be calculated unless there was also a taking of the physical means of production – its pipes and tanks. (Tr. Vol. 14, p.19-23; *id.* Vol. 16, p. 111-114.) The City's expert opined that there was no basis for calculating an income stream unless at the time of the taking Moongate had its pipes and meters in the ground in the subdivisions. (Tr. Vol. 17, p. 32-33.) The law does not support this position. In the context of the Takings Clause, property does not necessarily refer to physical objects, but "to a group of rights granted to the property owner including the right to use and enjoyment of the object." Estate and Heirs of Sanchez v. County of Bernalillo, 120 N.M. 395, 397, 902 P.2d 550, 552 (1995).

The right to compensation is grounded in the "ownership of a recognized property interest in the property taken or damaged ." City of Sunland Park v. Santa Teresa Services Co., 2003-NMCA-106, ¶ 53, 134 N.M. 243, 255, 75 P.3d 843, 855, *cert. denied,* 134 N.M. 179, 74 P.3d 1071 (2003). Intangibles are property under the Takings Clause. Although intangible property has no intrinsic value *per se*, it

nevertheless represents something with value. 2 Julius L. Sackman & Patrick J. Rohan, *Nichols' The Law of Eminent Domain* § 5.01[2][f] (rev. 3d ed. 2003) (hereinafter *Nichols.)*

In Kimball Laundry Co. v. United States, 338 U.S. 1, 6, 69 S.Ct. 1434, 1438, 93 L.Ed. 1765 (1949) the Court held that the Takings Clause protects intangible assets such as trade routes, good will and earning power. This protection extends to many other kinds of intangible property, including trade secrets, Ruckelshaus v. Monsanto Company, 467 U.S. 986, 1003-04, 104 S.Ct. 2862, 2873 (1984); materialman's liens, Armstrong v. United States, 364 U.S. 40, 44, 46, 80 S.Ct. 1563, 1566, 1567, 4 L.Ed.2d 1554 (1960); real estate liens, Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 596-602, 55 S.Ct. 854, 866-869, 79 L.Ed. 1593 (1935); contracts, Lynch v. United States, 292 U.S. 571, 579, 54 S.Ct. 840, 843, 78 L.Ed. 1434 (1934); and franchises. 2 *Nichols',* § 5.03[1].

A franchise is "[t]he right conferred by the government to engage in a specific business or to exercise corporate powers." *Black's Law Dictionary* (8th ed. 2004), franchise. "A franchise is . . . incorporeal property." The West River Bridge Company v. Dix et al., 47 U.S. 507, 534, 12 L.Ed. 535 (1848). It is property "of the most valuable kind." Wilmington Railroad v. Reid, 80 U.S. 264, 268, 20 L.Ed. 568 (1871). New Mexico law recognizes a franchise as property, Equitable Bldg. and

Loan Ass'n v. Davidson, 85 N.M. 621, 625, 515 P.2d 140, 144 (1973), of which an owner may not be deprived without due process. In Mountain States Tel. & Tel. Co. v. Town of Belen, 56 N.M. 415, 429, 244 P.2d 1112, 1121 (1952).

"A certificate of public convenience and necessity, like any other franchise, is valuable property and should not be lightly dealt with, once the certificate holder starts operations, which necessarily involve a considerable investment of funds and create employment." Pan Am. World Airways, Inc. v. Boyd, 207 F.Supp. 152, 156 (D.C.D.C. 1962) (Holzhoff, J.). Many courts concur that certificates of convenience and necessity are property entitled to constitutional protection. *See* Tamiami Trail Tours v. Railroad Com'n of Florida, 120 Fla. 371, 384-85, 163 So. 1, 6 (1935) (valuable rights inhere in certificate of convenience and necessity for bus route in consideration of operator's " investing its money and embarking upon a public venture"); State ex rel. Northeast Transp. Co. v. Schaaf, 198 Wash. 52, 57, 86 P.2d 1112, 1115 (1939) (right to operate busses over the route designated in CCN); Northern Virginia Elec. Co-op. v. Virginia Elec. & Power Co., 265 Va. 363, 369, 576 S.E.2d 741, 744 (2003) (CCN "is a valuable property right entitled to protection by the courts"); Arnold Line Water Ass'n, Inc. v. Mississippi Public Service Com'n, 744 So.2d 246, 250 (Miss. 1999) (CCN "a valuable and exclusive property right"). The intangible nature of Moongate's service rights does not devalue them. "[T]he most

valuable property acquired by condemnation of a utility may be intangible, namely, its franchise or right to do business." City of Oakland v. Oakland Raiders, 32 Cal.3d 60, 68, 646 P.2d 835, 840, 183 Cal.Rptr. 673, 678 (1982).

The revenue stream foreclosed by the City's action was not, as the City suggested (R.P. 1290) merely a unilateral expectation falling short of a property interest. There is a difference between a property owner's mere hopes and "uses for which the property is adaptable by reason of location, its state of improvement, or other special elements of value." State ex rel. State Highway Dept. v. Kistler-Collister Co., Inc., 88 N.M. 221, 223-224, 539 P.2d 611, 613-614 (1975). The right to serve created by certificate of convenience and necessity is not merely a "unilateral expectation." *See* Ruckelshaus, 467 U.S. at 1005, 104 S.Ct. at 2873. It is both a right and an obligation conferred by the state to serve the public interest.

3. Because Moongate's service rights are intangible, the capitalization of earnings was the most appropriate method for determining their value.

"There is no a priori formula to apply in determining what factors should be considered in awarding compensation for a taking of private property. As the very term "just compensation" suggests, the touchstone is justice, or fairness." Westland Development, 121 N.M. at 149, 909 P.2d at 30.

The excess earnings method is generally applicable to the valuation of

intangibles. 8A *Nichols* § 29.07[2][b]. The method employed by Dr. Barrett is similar to that approved in Matter of Annexation of a Portion of the Service Territory of People's Co-op. Power Ass'n by City of Rochester (North Park Additions), 470 N.W.2d 525 (Minn. App. 1991). In that case a municipality annexed and began providing electrical service to two subdivisions which were previously in the service area of an electrical cooperative, but in which the cooperative had no customers at the time of the annexation. The cooperative brought an action seeking compensation for the taking. The court affirmed an administrative ruling "furnishing electric service in the area was synonymous with a utility assigned to the area having developed facilities making it capable of providing service in the area." *Id.* 470 N.W.2d at 527. (Citation and internal quotation marks omitted.) In making this determination the court reasoned that "compensation is needed to protect member customers, lenders and investors whose prior investments are rendered less usable and more expensive because of the loss of an opportunity to expand services in an annexed area." *Id.* 470 N.W.2d at 528. The court rejected the city's argument "that there can be no lost revenues where there are no present customers." *Id.* 470 N.W.2d at 529.

> What is material is . . . the justness of compensation awarded to the rural cooperative. Should a cooperative such as respondent be given no compensation, it suffers a waste of investments. Moreover, . . . a bright line rule prohibiting compensation where no customers are found invites gerrymandered annexation which that is designed to avoid costs and

may cause a severe loss of rural cooperative investments.

Id. 470 N.W.2d at 528-29.

In determining the amount of compensation to be awarded, the court approved the use of the value of lost revenues, less expenses and the savings resulting from not having to serve the area. *Id.* 470 N.W.2d at 530. The method employed by Dr. Barrett was consistent with this approach. The revenues Moongate would have received from servicing the three subdivisions were reduced by the marginal expenses associated with that service and by the amount of water rights fees not incurred as a result of not serving the annexed areas. (Tr. Vol. 14, p. 45.) By using this method Dr. Barrett achieved the objective of putting Moongate "in the same position it would have occupied but for the loss of service rights to the area for which compensation is being determined." In re Grand Rapids Public Utilities Com'n, 731 N.W.2d 866, 869 (Minn. App. 2007).

The principles which guided this Court's recent opinion in Primetime Hospitality, Inc. v. City of Albuquerque, 2007-NMCA-129, 142 N.M. 663, 168 P.3d 1087, *cert. granted*, 2007-NMCERT-9, 142 N.M. 716, 169 P.3d 409, are relevant to the choice of a valuation method here. In Primetime a long construction delay because of the City's unanticipated relocation of a water main resulted in the temporary taking of the property of a hotel developer. The City argued that the valuation of the

developer's loss was restricted to the "before and after" method for temporary takings. Rejecting that approach, this Court held that just compensation included consequential damages in the form of excess construction costs, *id.* at ¶ 23, 168 P.3d at 1094, and an amount that an objective property owner would accept to delay construction of a similar project for the same length of time. *Id.* at ¶ 41, 168 P.3d at 1098. This Court concluded that lost profits could be taken into account in calculating this second category of consequential damages. *Id.* at ¶ 40.

Moongate has suffered such consequential damages. To Moongate Section 15 was a territory sown with the seeds of potential development. It watered those seeds by pioneering service to the area. Like a farmer who is entitled to consequential damages for crops made unharvestable by a taking, *see* El Paso Elec. Co. v. Pinkerton, 96 N.M. 473, 474, 632 P.2d 350, 351 (1981), Moongate is entitled to the value it would derive from the service rights taken by the City.

4. The limited marketability of Moongate's service rights does not destroy their value.

The City's expert was of the opinion that Moongate's service rights have a "very low value" because of their limited marketability. (Tr. Vol. 17, p. 21.) The court adopted this view. (R.P. 3605.) This was error. Courts approve the use of the income method of valuation to determine just compensation when "profits derived from the

property's use are the chief source of its value . . . and . . . the property is so unique that comparable sales data is not available." Vivid, Inc. v. Fiedler, 219 Wis.2d 764, 792, 580 N.W.2d 644, 655 (1998). While in many condemnation cases "market value" may be a sound basis of valuation, "when the property is of a kind seldom exchanged, it has no 'market price,' and then recourse must be had to other means of ascertaining value . . ." Kimball Laundry, *supra,* 338 U.S. at 6, 69 S.Ct. at 1438. The capitalization of income method is preferred when other methods fail. 1 Dan B. Dobbs, *Law of Remedies*, § 3.5, p. 329-330 (2d ed. 1993). *See*, Great Atlantic & Pac. Tea Co., Inc. v. Kiernan, 42 N.Y.2d 236, 240, 366 N.E.2d 808, 811 (1977) (capitalization of income method appropriate to valuation of unique properties and intangibles.)

The City argued for the use of the "before and after" method precisely because it did fail and yielded a result of zero. As Dr. Barrett noted, that approach was nonsensical. (Tr. Vol. 14, p. 27-29.) Its application in this case denied Moongate the just compensation to which it is entitled.

Conclusion

The City took Moongate's valuable service rights. Their value was properly determined using the income method employed by Dr. Barrett. The district court's judgment that Moongate's rights were worthless should be reversed with instructions to enter judgment for Moongate in the amount of $ 3,048,044.

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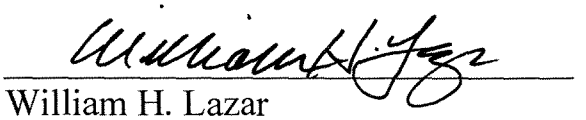

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Statement of Compliance

The body of this brief complies with the length limitations of Rule 12-213(F) NMRA (2007). It was prepared in Times Roman type using WordPerfect X3 and contains 9,920 words.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served upon the following by first class mail this 29th day of May, 2008.

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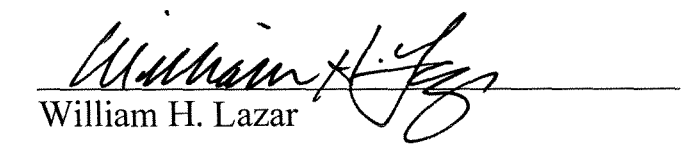

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