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

REPLY BRIEF OF APPELLANT MOONGATE WATER CO.

Kyle W. Gesswein
P.O. Box 367
Las Cruces, NM 88004
(505) 525-8400

William A. Walker, Jr.
650 E. Montana, Ste. G
Las Cruces, NM 88001
Attorneys for Plaintiff-Appellant
(505) 523-5246

William H. Lazar
P.O. Box 872
Tesuque NM 87574
(505) 988-7100

Attorneys for Plaintiff-Appellant

TABLE OF CONTENTS

TABLE OF AUTHORITIES

New Mexico Cases

Statutes and Rules

The City's assertion that Moongate's brief failed to comply with the requirements of Rule 12-213(A)(3) and (4) to set out the substance of the evidence not supporting challenged findings of fact, or make specific attacks on challenged findings, is puzzling. (Aplee. Ans. Br. at 32.) For citations to the specific findings attacked *see* Aplt. Br. in Chief at 8-9, 19, 20, 22, 24, 26, 30, 31, 32. For detailed discussions of the evidence and the law bearing upon the challenges to each of those findings and conclusions *see* Aplt. Br. in Chief at 6-9, 17-41.

ARGUMENT

THIS APPEAL REQUIRES *DE NOVO* REVIEW OF THE DISTRICT COURT'S LEGAL DETERMINATIONS ABOUT THE NATURE OF MOONGATE'S RIGHT TO SERVE THE SUBDIVISIONS, AND HOW THE NATURE OF THAT RIGHT PRESCRIBES THE METHOD FOR DETERMINING JUST COMPENSATION FOR ITS TAKING.

A. The question of whether the district court erroneously applied the "before and after" method to value Moongate's right to serve the Subdivisions is a question of law.

The evidence presented by each of the parties on the value of Moongate's right to serve the Dos Sueños, Los Enamorados and Rincon Mesa subdivisions ("the Subdivisions") reflects their fundamental disagreement about the legal nature of those rights. The district court's adoption of the City's proposed "findings of fact" incorporated determinations of contested legal issues. As Moongate urged in its Brief in Chief, those findings, in which fact and law are inseparably mixed, require *de novo*

review. (Aplt. Br. in Chief at 9-10.) The City would have this Court view the parties' dispute on the issue of just compensation as a purely factual matter to be reviewed under a substantial evidence standard. (Aplee. Ans. Br. at 28-31.) However, in its answer brief, the City acknowledges that the dispute to be resolved in this appeal is a legal one, arguing, albeit incorrectly, that "[t]he facts of this case made the 'before and after' analysis the only factual sensible and *legally* permissible approach." (Aplee. Ans. Br. at 43, emphasis added.)

Moongate's just compensation claim is based on the statutory presumption that it has the exclusive right to serve the Subdivisions. (Aplt. Br. in Chief at 15,-17, 23-24, 25, 28); Aplt. Ans. Br. Point I.) The presumption applies against the City unless the City (1) opts to be regulated and (2) overcomes the presumption in proceedings before the Public Regulation Commission ("the Commission"). (*Id.*) The district court initially agreed with that proposition as a matter of law, ruling that Moongate enjoys exclusive service rights in the three subdivisions "unless otherwise determined by the PRC." (R.P.2148.) The district court further ruled that the City's extension of water service to the Subdivisions constituted takings of Moongate's property for which the City is required to pay just compensation. (R.P. 2150, 3440-3441; Tr. Vol. 11, p. 26-27.)

From the outset the City's legal theory has been that no such presumption

exists, and that it took nothing from Moongate. (R.P. 682, 691, 1287, 1290.) The City did not change its theory after the district court ruled that it had taken Moongate's property. In the compensation phase, the City continued to argue that Moongate's right to serve the Subdivisions is valueless apart from the physical facilities required to effect it. (Tr. Vol. 17, p. 31-33.) The City asserted, and continues to assert on appeal, that because it took none of Moongate's physical facilities, and because there was no difference between the value of Moongate's physical assets before and after the taking of Moongate's service right, the right has no value. (R.P. 696-699; 1747, 1755, 3159, 3223; Aplee. Ans. Br. at 39-44.) The district court accepted the City's argument that the "before and after" method was the only way to appraise the value of Moongate's right to serve the Subdivisions. (R.P. 3602, 3605-3607, 3610, 3612.) The City's "before and after" approach, however, was based upon the same erroneous theory the district court had originally rejected, that is, that Moongate's service right had no intrinsic value, and that the City took nothing from Moongate.

The court's adoption of the "before and after" method was erroneous as a matter of law. Moongate is presumed to have the legal right and duty to serve all areas within one-half mile of its distribution facilities and plant. Doña Ana Mutual Domestic Water Consumers Ass'n v. New Mexico Public Regulation Com'n, 2006-NMSC-032, ¶¶ 14, 18, 140 N.M. 6, 139 P.3d 166. Moongate has been granted

"exclusive control of the industry in a particular area, as well as a fair opportunity to secure a reasonable rate of return on approved investments, in exchange for providing reliable, nondiscriminatory service to all ratepayers in that area." State ex rel. Sandel v. New Mexico Public Utility Com'n, 1999-NMSC-019, ¶ 4, 127 N.M. 272, 275, 980 P.2d 55, 58. The right to a return on its investment belongs to Moongate as a matter of public policy, subject only to regulation in the public interest by the Commission. That right is inherently valuable as a matter of law. Moongate has invested substantially in excess capacity to serve the area which includes the Subdivisions. (R.P. 1407, 1455-1475, 2139-2140; Vol. 12, p. 92.) The City's taking has deprived Moongate of its right to secure a return on that investment. A method of valuation that denies value to inherently valuable property is unconstitutional. "The primary condition to the exercise of eminent domain is the constitutional requirement to pay just compensation." City of Sunland Park v. Santa Teresa Servs. Co., 2003-NMCA-106, ¶ 43, 134 N.M. 243, 75 P.3d 843.

In a condemnation case, the "before and after" method is not the exclusive measure of compensation where the property actually taken had value. In 1973 the Legislature amended the statute governing compensation for partial takings to nullify a prior rule "that no damages exist when the fair market value of the remaining property after the taking is equal to or exceeds the fair market value of the entire

property before the taking." Yates Petroleum Corp. v. Kennedy, 108 N.M. 564, 568, 775 P.2d 1281, 1285 (1989). *See* Laws 1973, ch. 384, § 1. Under the amended statute, now codified as NMSA 1978 § 42A-1-26 (1981), when, as in the case at bar, the value of remaining, uncondemned property is not diminished, "the 'before and after' rule loses its relevancy and the proper alternative measure of compensation [is] the fair market value of the property actually taken." Yates, *supra*. Consequently, a "before and after" valuation comes into play only where, "*in addition to compensation for property actually taken,*" the property owner is entitled to payment for a diminution in value to remaining property not condemned. *Id.* at 567, 775 P.2d at 1284 (emphasis added).

Moongate's claim for compensation does not involve a partial taking. Rather, Moongate seeks compensation for the value of the service right actually taken by the City, not for any diminution in the value of its remaining property. (R.P. 2031-2032; Tr. Vol. 13, p. 128, 194.) This precludes the use of the "before and after" method as a matter of law. Moongate's use of the capitalization of earnings method to appraise the value of its right to serve the Subdivisions finds extensive support in the law. (Aplt. Br. in Chief at 37-40.) The district court's rejection of Moongate's method and its application of the "before and after" method, was based on an erroneous legal determination which denied the intrinsic value of Moongate's right to serve the

Subdivisions.

B. Because of the legal character of Moongate's right to serve the Subdivisions, evidence of the City's efforts and investments in its water utility is irrelevant, as a matter of law, to the valuation of the property taken from Moongate.

Over Moongate's objections, the district court admitted evidence of the City's planning process for the limited purpose of allowing the City to support its affirmative defense that Moongate was estopped from claiming just compensation because it was aware of the City's water master plan. (Tr. Vol. 14, p. 156-160.) It should be noted that the City did not make public its plan to exclude other water providers from serving newly annexed areas until 1995, over a decade after Moongate established and began expanding its water service to Section 15. (Def. Ex. 14.) More importantly, the City's efforts and investments in planning, financing and expanding its water system, which the City emphasizes in its brief (Aplee. Ans. Br. at 3-4), are irrelevant to any issue in this case.

The fundamental issue is a legal one – whether the City can intrude into the service area of a regulated utility without either taking its case for intrusion to the Commission or paying just compensation to the utility for taking its service rights. Relevant to that issue is the evidence that after the City refused to provide water service in Section 15, Moongate provided that service, and for the next twenty years

met its obligation to serve the growing area with non-discriminatory service (Tr. 1356-1357, 1406-1407, 2137-2138; Vol. 12, p. 58, 66-67; Pl. Ex. 29, p. 4), and invested substantially in excess capacity in anticipation of future growth. (*Id.*; R.P. 1455-1475, 2139; Vol. 12, p. 92.) That was precisely what it was required to do as a regulated utility. Doña Ana, 2006-NMSC-032, ¶ 14. The City, to the extent that it planned and invested in order to appropriate service territory in which Moongate is presumed by law to have exclusive service rights, acted unwisely. The City could have elected to avail itself of the regulatory services of the Commission, as the Legislature has encouraged it to do. NMSA 1978 § 62-6-5 (1993). It chose instead to act upon an assumption that it could, by remaining unregulated, act to the detriment of Moongate and Moongate's customers with impunity. [1] Public policy as effected by the PUA protects the investments of public utilities and the interests of the people it serves. NMSA § 62-3-1 (1967). As a matter of law Moongate could not be not estopped from asserting its right to serve the Subdivisions by the City's open disregard of the Act and its policies.

C. The district court's conclusion that Moongate lost only a limited

[1] The evidence showed, and the district court concluded, that a result of the City's taking Moongate's service rights to the three subdivisions, Moongate has lost contributions in aid of construction it would have received from the developers. (R.P. 1360, 2140-2141.) This will delay and increase the cost of service upgrades to Moongate's existing customers. (*Id.*)

service opportunity in the Subdivisions is based upon a misunderstanding of the legal character of Moongate's right to serve. Moreover, the court's findings are inconsistent with its conclusion that Moongate's right to serve is worthless.

The City theorized that Moongate's loss of future earnings was limited by the zoned densities of the Subdivisions before they were annexed by the City. (Tr. Vol. 11, p. 46-47, 53.) The City continues to advance that theory on appeal. (Aplee. Ans. Br. at 4-9.) The district court's agreement with that theory (R.P. 3596, 3601) is legally erroneous.

The City's lost opportunity theory is based upon its misunderstanding of the legal nature of Moongate's right to serve the Subdivisions. Moongate enjoys a statutory presumption that it may, and indeed must, serve all territory contiguous to its distribution facilities, at such time that service is required. (Aplt. Br. in Chief, Point I; Cross-Aplee. Ans. Br., Point I.) Moongate's opportunity is defined that presumption, not by state of development in the territory before the City annexed it.[2] The value of Moongate's service rights to the service areas taken by the City is determined according to the highest and best use of the property taken. City of Clovis

[2] The City argued that Moongate's opportunities were so limited in each of the Subdivisions. It should be noted, however, that while Dos Sueños was annexed on March 15, 2004 (R.P. 529), the City did not resolve to provide water service to that subdivision until June 21, 2004. (R.P. 533-534.) The latter date is the effective date of the City's taking of Moongate's right to serve Dos Sueños. Under the City's own erroneous theory, Moongate had the right to serve Dos Sueños as it had been replatted and rezoned prior to the City's taking.

v. Ware, 96 N.M. 479, 480, 632 P.2d 356, 357 (1981). The highest and best use of Moongate's service rights is to provide non-discriminatory service within its service area, including the area in which the Subdivisions are located, as that demand arises.

In addition, the City admitted that Moongate's service right was at least equal to the expected revenues from serving the additional connections which would have been allowed in Section 15 if the land in the Subdivisions not been replatted and rezoned. (Tr. Vol. 15, p. 10-13; Vol. 16, p. 166, Vol. 17, p. 201-203.) Although that admission failed to recognize the legal character of Moongate's right to serve, if the district court had accepted it, the value of the taken service right should have at least been equal to the revenue stream from those limited opportunity connections. Hence, the court's conclusion that the right taken had no value could not have been based on what the City contended was Moongate's limited loss of opportunity, but upon a legal theory that precluded giving any value to the right at all.

D. The district court's findings on Moongate's alleged inability to serve the Subdivisions incorporate an erroneous legal judgment about the nature of Moongate's service rights and obligations.

Moongate's Brief in Chief addresses in detail the merits of the City's contentions that Line Extension No. 9 is deficient (Aplt. Br. in Chief at 21-23), and that Moongate's water rights are inadequate. (*Id.* at 24-25.) The City incorrectly argues that these are purely factual questions. (Aplee. Ans. Br. at 9-11, 23-28.) It is

not for a court to determine the adequacy of Line Extension No. 9 or the sufficiency of its water rights, or of any other aspect of Moongate's ability to serve the Subdivisions now or in the future. Only the Commission has the jurisdiction to make such a determination. NMSA 1979 § 62-9-1(A) (2005); Doña Ana, 2006-NMSC-032, ¶ 27. Courts do not substitute their judgment for that of the Commission, which has special expertise in matters relating to utilities. *Id.* ¶ 11, 17. Pursuant to its certificate of convenience and necessity (CCN) from the Commission, Moongate had, at the time of trial, already built portions of Line Extension No. 9. (Tr. Vol. 12, p. 115.) Absent a determination by the Commission that Line Extension No. 9 is not adequate for Moongate to meet its statutory obligations, its adequacy must be presumed. Similarly, absent a determination by the Commission that Moongate's water rights are insufficient to meet those obligations, their sufficiency must be presumed. The City may elect to avail itself of the Commission's regulatory services if it wishes to challenge the adequacy of Line Extension No. 9, the sufficiency of its water rights, or any other aspect of Moongate's ability to serve the Subdivisions. It has chosen not to do so.

E. The district court's findings that CIAC should not be included as an element of compensation was incorrect as a matter of law.

The City asserts that its attacks on Moongate's use of CIAC as an element of

valuation present questions of fact. The City argues that "CIAC is not income to a utility and not part of an investment base upon which a utility is entitled to a return" (Aplee. Ans. Br. at 12); and that the amount of CIAC claimed by Moongate was overstated in violation of the Commission's rules. (*Id.* at 13.) These arguments are legally incorrect because regulatory accounting principles are not relevant to a determination of just compensation for the property taken by the City. Board of Education v. Thunder Mountain Water Co., 2007-NMSC-031, ¶8, 141 N.M. 824, 161 P.3d 869 ("rate-making concepts cannot be likened to eminent domain as a basis for determining fair market value") (citation omitted). The City also asserts that Moongate will not incur any cost to serve the Subdivisions because, as a result of the City's intrusion, Line Extension No. 9 will not be built to serve them. (*Id.* at 14, 45.) This argument rests on the premise, incorrect as a matter of law, that Moongate's right to serve the Subdivisions is unrelated to its right and duty to serve the larger area encompassed by its CCN. The CIAC included in Moongate's valuation is revenue which Moongate would have received specifically to build infrastructure. Because Moongate has the statutory duty to serve a large and growing area both inside and outside of Section 15, *see infra* at 3-4, it must build the same core infrastructure regardless of whether it serves the Subdivisions. (R.P. 3609.) The loss of CIAC from the Subdivisions necessarily reduced the total revenues available to

Moongate for infrastructure construction, and increases the unit cost of infrastructure expansion and improvement. (*See* Aplt. Br. In Chief at 29 and citations therein.)

CONCLUSION

The district court's findings and conclusions that Moongate's right to serve the Subdivisions had no value was essentially a legal determination top be reviewed *de novo*. The court's determination was based upon the City's erroneous legal theory which would deny the statutory presumption that Moongate has an exclusive right to serve, and would further deny the character of that right as compensable property. The determination that the measure of just compensation for Moongate's right to serve is zero should be reversed with instructions to enter judgment for Moongate in the amount of $ 3,048,044.

Respectfully submitted,

William H. Lazar
P.O. Box 872
Tesuque NM 87574
(505) 988-7100

Kyle W. Gesswein
P.O. Box 367
Las Cruces, NM 88004
(505) 525-8400

William A. Walker, Jr.
650 E. Montana, Ste. G
Las Cruces, NM 88001
(505) 523-5246

Attorneys for Plaintiff-Appellant

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served upon the following by first class mail this 14th day of October, 2008.

Thomas C. Bird
P.O. Box AA
Albuquerque NM 87103-1626
Fax: 505-346-1370

Marcia B. Driggers
P.O. Box 20000
Las Cruces, NM 88004-9002
Fax: 575-541-2017

William H. Lazar