



CONDEMNATION CASE STUDY: APPLE VALLEY, CALIFORNIA

For more than 70 years, the community water system in Apple Valley, California, has been successfully owned and operated by a water company. But, in January 2016, the Town filed an eminent domain lawsuit to take the infrastructure from the system's owner, Liberty Utilities, through condemnation.

The condemnation fight was spurred on by local activists and politicians who claimed that increasing water rates – approved by the California Public Utilities Commission (CPUC) to fund tens of millions in necessary maintenance and repairs – were cause for the local government to seize the system.



The California Superior Court of San Bernardino County disagreed. After a 67-day trial in late 2019 and early 2020, the Court found that Apple Valley residents would be better served if Liberty continued to own and operate the system, calling a takeover by the Town a risky proposition that would hurt local taxpayers.

The Court's decision was based on three fundamental conclusions supported by the evidence:

1. Liberty has "operated a safe and reliable water system, while the Town has no experience, but only a hope, of doing so";
2. "The regulatory oversight provided by the CPUC is more stringent than the oversight that would apply to Town ownership of the system"; and
3. "There is a substantial risk that the water system will be imperiled and the ratepayers will be harmed if the Town were permitted to take the system."

In addition, in a direct rejection of the Town's premise for trying to take the system, the Court found that Apple Valley residents were in fact paying less for water service than the customers of neighboring municipal water systems.

As a result, the Town wasted millions of dollars over more than five years of legal battles just to be told by the Court that their desired takeover "would constitute an experiment posing a risk to public health, safety, and continued effective system operation by a long-term work force" of skilled water professionals. Furthermore, as part of its final ruling, the Court ordered the Town to reimburse Liberty for more than \$13 million in legal fees and expenses caused by the erroneous takeover attempt. The ruling is further evidence of how the town's failed takeover will ultimately place an even steeper financial burden on taxpayers.

The experience in Apple Valley should serve as a cautionary tale for other communities considering condemnation efforts.

Issued in October 2021, the final decision of the Superior Court of California denying Apple Valley's condemnation claim emphasized seven key findings:

1. Liberty Utilities has operated the Apple Valley water system effectively; the Town has no experience doing so.

The Court noted that the Apple Valley water system has had zero water quality violations over the past 30 years under private ownership and operation. Meanwhile, neighboring municipal systems have struggled with water quality. Given the perfect record, the Court reasoned that "Liberty has proven that the Town could not possibly operate the system with a better record on water quality."

Furthermore, the Court stated that "the evidence has revealed no substantial problems with Liberty's operation or maintenance of the Apple Valley water system," pointing out how operating expenses have decreased 12.81% on a per-connection basis since the company acquired the system. Even the Apple Valley Town Manager testified that he "can't imagine" that anyone could run the system better than the Liberty employees who operate it.

In comparison, the Apple Valley Public Works Department acknowledged in testimony that the Town did not employ anyone with the skills and knowledge necessary to operate a water system. Town officials testified that it was "undetermined" who would run the system if the Town were to acquire it via eminent domain. In addition, under a successful condemnation, the Town's proposed budget would have cut the salary of the average Apple Valley water system employee by about \$25,000.

Given these facts, the Court concluded: "Liberty has proven that the [condemnation] is not required in order to remedy ineffective operations or maintenance of the system ... Acquisition by the Town would constitute an experiment posing a risk to public health, safety, and the continued effective system operation by a long-term work force."

2. Liberty has properly invested in the Apple Valley water system; the Town's record of capital investments in wastewater infrastructure is weak.

Between 2010 and 2018, the Apple Valley water system received an average of \$6.4 million per year in capital investments. As a result of these investments, the number of leaks in the infrastructure was reduced by 90%.

In its assessment of Liberty's investment record, the Court stated that "a water system must spend more on capital improvements than the system is depreciating in order to keep the system functioning properly." The evidence showed that Liberty's capital investment in the Apple Valley system was twice (202%) the system's depreciation.

Between 2010 and 2018, Liberty Utilities invested an average of \$6.4 million per year, which reduced infrastructure leaks by 90 percent.

In comparison, nearby municipal systems made capital investments of just 20% to 48% of the systems' depreciation. The Court called the figures from neighboring towns "the hallmark of an aging system."

While the Court recognized that the Town "has no track record of capital expenditure levels on a water system" it did note how the Town's record with its own sewer system "shows the same pattern of investment below the rate at which the assets are depreciating."

3. Water companies are well-regulated under the CPUC; the regulatory framework for a Town-owned system would be lacking in comparison.

The Court emphasized how water companies are “subject to thorough regulation by the California Public Utilities Commission” but municipal utilities are overseen by local politicians.

The Court stated:

“Liberty must furnish to the PUC whatever reports the PUC requests and must answer all questions propounded by the PUC. The PUC has a plenary right to inspect Liberty’s books, records, and facilities, including those of any parent or affiliate of Liberty ... Liberty bears the burden of justifying its expenses to the PUC before any such expenses may be included in rates.

Control by the Town Council leaves the water system vulnerable to political pressure to keep rates low, regardless of whether it is prudent in the short run or the long run ... Naturally, voters want to pay less for water service, not more; and Town Council regulation is focused more on the short-term interest of voters than the long-term interest of water infrastructure. The pressure to keep rates low increases the likelihood that the water system’s buried capital assets will be run to failure, thereby creating risks to water reliability, water quality, and public safety.

PUC regulation takes the politics out of rate setting, focusing instead on prudent investments in the system.”

4. Town ownership of the system would not lower water rates; a fair analysis of Liberty’s rates found customer costs in Apple Valley were lower than neighboring municipal systems.

The Town’s own evidence acknowledged that a takeover would not lower water rates, with one report stating clearly: “The Town does not expect to be able to decrease rates.” This is due to what the Court called the “sizeable debt service payments the Town would pay for the money it would need to borrow to buy the system.”

Regarding rate comparisons between Apple Valley and neighboring municipal systems – the entire premise on which the Town based its condemnation claim – the Court found that Liberty’s rates expert provided a “more thorough and accurate economic analysis” than the Town.

The Superior Court of San Bernardino concluded that Apple Valley residents would end up paying higher water rates if the Town seized control of the water system.

While the Liberty analysis controlled for the rate of spending on capital investments and subsidies provided to municipal systems by other local government funds, the Town’s analysis ignored these relevant differences between systems. In addition, the Liberty analysis demonstrated how the benefit of economies of scale under Liberty’s multi-system operation would be lost if the Town were to operate it as a standalone 20,000-connection system.

The Court accepted the Liberty analysis and its conclusion that Apple Valley residents were in fact paying lower water rates than their neighbors and would be forced to pay higher water rates if the Town seized the system.

5. Condemnation would result in an immediate and significant tax revenue shortfall for the Town that would harm local schools.

As a private enterprise, Liberty pays taxes to various governments, including the Town of Apple Valley. In 2019, Liberty paid more than \$764,000 in property taxes alone to the Town.

The Court rejected the Town's argument that a takeover would provide residents a "savings" because a municipal water system would not pay taxes: "The Town's tax avoidance is not a savings at all, but a shifting of the tax burden from Liberty to other taxpayers."

Noting that Liberty is the third largest property taxpayer in the Town, the Court concluded that the condemnation would result in "private injury to those who currently rely on tax revenues that would be lost if the Town were to acquire the system ... like the Apple Valley Unified School District and the County of San Bernardino."

6. Low-income customers would lose water bill assistance under Town ownership.

Through a program approved by the CPUC, Liberty provides a 14% reduction in water bills to low-income households in Apple Valley, funded by a \$0.69 monthly surcharge on customer bills.

The Court noted that "the evidence established no intent by the Town to continue low-income discounts if it were to acquire the water system." As such, the Court found that "low-income customers will suffer significant private injury" under a takeover.

7. Town ownership would block opportunities for water system consolidation.

The Court found that a government takeover of the Apple Valley system would hurt surrounding communities by taking away opportunities for water system consolidation.

The Court stated:

"The CPUC recognizes that many smaller water systems lack the resources and skill to continue to provide healthy water to their customers, and encourages Class A water companies like Liberty to take them over ... There are five smaller systems, each serving less than 1,500 connections, that are adjacent to Liberty Apple Valley, and each of the smaller systems have had multiple water quality violations.

The public good inherent in the opportunity for consolidation of such nearby smaller systems with an experienced operator like Liberty would be lost if the [condemnation] were to proceed."

Sources

1. Superior Court of California, County of San Bernardino "Final Statement of Decision: Town of Apple Valley v. Apple Valley Ranchos Water Company" 8 October 2021
2. San Bernardino County Sentinel, "Judge Rules Against Apple Valley in Its H2O Eminent Domain Takeover Attempt" 14 May 2021
3. Victorville Daily Press, "A closer look: Why Liberty Utilities' arguments were favored in Apple Valley's eminent domain lawsuit" 17 May 2021
4. Victorville Daily Press, "Judge makes preliminary ruling against Apple Valley taking over water system" 11 May 2021
5. Superior Court of California, County of San Bernardino "Ruling on Defendant Motion for Award of Litigation Expenses" 2 August 2022