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ENVIRONMENTAL PROTECTION

State Water Resources Control Board

TO: PROSECUTION TEAM

FROM: Bryan Elder, MBA, PE
Senior Water Resources Control Engineer
OFFICE OF ENFORCEMENT

DATE: November 8, 2017

SUBJECT: FINANCIAL ANALYSIS – MARBLE MOUNTAIN RANCH, INC., DOUGLAS COLE, HEIDI COLE

This memorandum has been prepared to assess the financial state of Marble Mountain Ranch, Inc. (MMR), Mr. Douglas Cole, and Mrs. Heidi Cole (herein Dischargers), for the purposes of determining their collective ability to fund corrective actions and/or alternative utility expenses. Information utilized in this analysis was provided by the Dischargers or obtained through a public records search.

Information provided by the Dischargers used in this analysis includes the following:

1. 2016 Federal and State Tax Filing
2. 2015 Federal Tax Filing (incomplete)
3. 2014 Federal Tax Filing (incomplete)
4. 2013 Federal Tax Filing (incomplete)
5. Ability to Pay Claim Form dated December 12, 2016
6. Douglas Cole Written Testimony (Exhibit MMR-01)
7. KASL Engineering Proposal (Exhibit MMR-15)
8. Alternative Energy Quotes (Exhibit MMR-19)

Cash Flow Analysis

Cash flow is an important financial analysis to determine an entity's available short-term cash that can be used to finance additional expenditures. Simple cash flow can be determined using annual tax filings. A summary of tax filings from 2013 to 2016 is provided in the table below:

	2013	2014	2015	2016
Gross Income	\$437,330	\$474,949	\$623,213	\$749,250
Total Expenses/Deductions	\$384,234	\$473,754	\$708,217	\$886,503
Total Profit or (Loss)	\$53,035	\$1,195	(\$85,004)	(137,253)

Based on tax filings, gross income has increased over 70% from 2013 to 2016, which averages to approximately 20% year-over-year. MMR has experienced net losses in recent years due to significant increases in allowable businesses expenses. These reported net losses account for allowable non-cash expenses (expenses where no related cash payable was incurred during the year) to reduce the corporation's tax liability, but do not affect actual cash flow. Depreciation and amortization are examples of allowable, non-cash business expenses that do not affect cash flow, but can allow for significant reductions in tax liability. Depreciation expenses are most common, which allocate a portion of the total cost of a business' fixed asset over an appropriate accounting period, thus allowing the business to "spread" the cost out over several years (typically the useful life of the asset) to offset potential tax liability. They are considered non-cash expenses because an actual cash payment is only incurred in the first year, when the asset is purchased. In a simple cash flow analysis, non-cash expenses are excluded from the income analysis. A summary of MMR's depreciation expenses and approximate cash flow is provided in the table below:

	2013	2014	2015	2016
Depreciation	\$40,120	\$57,823	\$186,804	\$314,341
Cash Flow	\$93,155	\$59,018	\$101,800	\$177,088

As shown in the table above, approximate cash flow for MMR was positive for all years reported.

Net Worth Analysis

According to the submitted Ability to Pay Claim Form (ATPCF) signed by Mr. Cole, the Cole's each have a 50% stake in MMR, which was indicated as a for-profit, corporation. Asset information was not provided on the ATPCF, but instead, a reference to prepared tax returns was indicated. Item 16.C – Stockholder's Equity, was also not completed. Mr. Cole listed five loans payable with an estimated present balance of \$111,000 and estimated annual payments of \$28,062. An additional loan was indicated for legal expenses with an estimated present balance of \$37,000, however, no payments were indicated on the ATPCF. One mortgage payable against the MMR property was detailed with an estimated present balance of \$246,802 and an estimated annual payment of \$21,858. Income and expenses related to

MMR were excluded from the ATPCF. Mr. Cole indicated that MMR maintains a checking account with an estimated balance of \$2,000. No other bank accounts were noted. Mr. Cole provided a list of assets valued in excess of \$10,000 in Item 32 of the ATPCF. Approximate values were not listed for all assets, however, the total asset value for those provided was \$143,730.

Using the Westlaw legal research service, I reviewed publically available information on MMR and Mr. and Mrs. Cole. At the time of review (October 9, 2017), no bankruptcies, legal actions, or concerns were linked to the company. Although several tax liens and personal judgements were found against Mr. and Mrs. Cole individually, they are more than 15 years old and are unrelated to MMR. The Cole's have property ownership interest in at least three parcels with Assessor's Parcel Numbers 026-290-200, 026-290-240, and 026-290-290 in Siskiyou County. The combined assessed tax value for 2017 was approximately \$913,000. It is important to note that this value is not considered market value, or the price the property would be acquired for if sold. The assessed tax value also does not typically account for business related-income that the property generates or other property features such as mineral or water rights. For those reasons, the assessed value should be considered conservative for the purpose of determining net worth.

Based on available information in Westlaw, two mortgages have recorded against the parcels for a combined total of \$359,600. Both loans originated in 2007. In addition to Douglas and Heidi Cole, the parcels are held jointly with Norman and Carolyn Cole. No other real estate assets were discovered during the records search. Two secured, five-year loans were identified with Heidi Cole as the debtor originating in 2015 and 2016 from Kubota Credit Corporation. No loan amount information was available, however, Mr. Cole identified two Kubota loans on the ATPCF that also originated in 2015 and 2016, which appear to be the same.

Using information obtained from disclosures in the ATPCF and through the public records search, I calculated a simple net worth for the combined dischargers in the table below:

Assets	\$1,058,730
Liabilities	\$394,802
Net Worth	\$663,928

Notes:

1. The mortgage payable disclosed on the ATPCF was used to calculate the total liabilities for the Dischargers. It is assumed that the mortgage amounts represented in county records available through Westlaw and described above are the original loan amount (2007) and do not accurately reflect the outstanding loan amount.
2. Many assets identified in the ATPCF were not assigned estimated values and therefore, were excluded from the total assets calculated.

Utility Expenses

The Discharger's have argued that the use of a diesel generator has caused significant harm to their income, resulting in observed losses. In addition, in Mr. Cole's written testimony, he indicated that MMR lacks the resources to fund large-scale improvements and has invested considerable resources into efforts to comply with Water Board requirements. The table below highlights several expenses incurred by the Dischargers that should have captured these types of expenditures:

	2013	2014	2015	2016
Repairs/Maintenance	\$22,972	\$69,473	\$58,464	\$63,699
(% of Gross Income)	(5.2%)	(14.6%)	(9.4%)	(8.5%)
Utilities	\$31,296	\$37,522	UNK*	\$32,379**
(% of Gross Income)	(7.2%)	(7.9%)		(4.3%)
Legal/Professional Services	\$18,545	\$21,935	UNK*	\$75,342
(% of Gross Income)	(4.2%)	(4.6%)		(10.0%)
*Expense unknown/not provided.				
**Includes expenses identified on Form 1120S Statement 2 as "RANCH UTILITIES" and "FUEL". "FUEL" expenses are likely related to vehicle and/or equipment (non-power generation) operation, however, are included for conservative purposes.				

As is illustrated in the table, annual utility expenses have remained below \$40,000 and no significant increase has been incurred since 2013. For 2016, an additional utility expense in the amount of \$11,504 was identified in MMR's tax filing as part of the residence apportionment. The expense is not reflected in the total utility expense summarized in the table above as it is not business-related, and would not allow for comparison to those expenses reported for 2013 and 2014.

Repairs and maintenance have increased substantially since 2013, however, MMR has made significant asset acquisitions (new structures, equipment, vehicles, etc.) in 2015 and 2016. For example, over \$165,000 was expended on acquired assets in 2016, including two new structures. Increased repair and maintenance expenses are likely the result of these new acquisitions. Legal and professional services also showed a significant increase in 2016 (2015 unknown), however, no additional details are provided in the 2016 tax filing to determine whether these expenses are legal or professional in nature.

Corrective Actions and Alternative Power

In a proposal for engineering and land surveying services, KASL Consulting Engineers proposed engineering and surveying services to design a piped intake and piped replacement for the open ditch canal currently in use by MMR. The proposal estimated these services at \$44,250. Based on current cash flow, the Dischargers can afford to pay for services in full. Costs to implement the design were not available at the time of preparation, however, average cash flow from 2013 to 2016 was approximately \$107,765 per year.

In two alternative energy quotes included in Exhibit MMR-19, estimated costs for converting to solar power ranged from \$425,000 to \$526,000. In a quote from Golden West Energy, the equipment can be leased for six years at annual payments of \$55,130 with a buyout price of \$142,000. As illustrated above, annual utility expenses average approximately \$34,000. Therefore, this option would increase utility expenses by approximately \$21,000, until the equipment is paid in full. At that point, the utility expenses related to electricity generation should be dramatically reduced. Furthermore, by implementing an alternative power source, costs associated with the diversion upgrades may be reduced, as the larger diversion conduit for hydropower generation may not be necessary. Based on current cash flow, the Discharger can afford the annual payment associated with the solar power alternative and eventual buyout based on average annual cash flow. Alternatively financing would also be possible based on MMR's strong financials and positive net worth.

Summary and Opinion

Based on review of available information, MMR has positive cash flow from business operations, and continues to improve annual revenues indicating strong future earnings. Even taking into account increased repair/maintenance and increased legal/professional service expenses, cash flows for 2016 exceeded 2015 by over 75%. Based on my review, I believe the Dischargers have the ability to fund any of the alternatives proposed in the previous section.

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EDUCATION

Master of Science, Civil Engineering (Hydrology/Water Resources), 2012
University of California, Los Angeles

Master of Business Administration, 2010
Pepperdine University

Bachelor of Science, Chemical Engineering, 2006
University of California, Santa Barbara

PROFESSIONAL LICENSES/CERTIFICATES

Registered Civil Engineer, C81253 (California)

PROFESSIONAL EXPERIENCE

State Water Resources Control Board – Office of Enforcement, *June 2017 - Present*
Senior Water Resources Control Engineer – Special Investigations Unit

Supervise and oversee the work of five fulltime, permanent positions (four water resource control engineers and one environmental scientist) and one part-time scientific aid. Engage with State and Regional Water Board staff to determine enforcement priorities and provide technical support. Maintain personal case load including complicated technical assistance in construction/industrial storm water, wastewater, and drinking water. Perform financial analyses for enforcement cases statewide. Organize and provide training for State and Regional Water Board staff.

State Water Resources Control Board – Office of Enforcement, *April 2014 – June 2017*
Water Resource Control Engineer – Special Investigations Unit

Provided technical expertise to various programs statewide. Assisted Regional Boards in case investigations and inspections involving waste water collection and treatment, industrial and construction storm water, and industrial contamination that may impact waters of the state and US. Particularly experienced in site assessment evaluation (soil, groundwater, etc), discharge estimate calculations and verifications, remediation design

and strategy review, and construction/implementation costing for computing economic benefit of noncompliance. Provided expert testimony for economic benefit and ability to pay analysis for cases statewide.

AECOM Environment, *September 2007 – April 2014*

Project Engineer/Manager

Provided technical expertise for over 50 Chevron leaking underground storage tank program sites, many with active remediation in progress. Managed two active remediation sites with annual operating budgets in excess of \$100,000, and provided project scoping, cost estimation, and budgeting for dozens of projects nationwide. Technical lead for all Southern California remediation projects within the Chevron program. Prepared storm water pollution prevention plans and hazardous materials business plans for major oil, gas and industrial clients. Evaluated project data for remediation/strategy optimization and work with regulatory agencies towards site closure - including remedial action and site assessment workplans.

Work with contractors, suppliers, and regulators to ensure projects are completed in a timely, cost-effective, and appropriate manner. Responsible for design and implementation of remediation technology including wastewater treatment, vapor extraction, air injection, chemical injection, and biological treatment, based on extensive project research and team collaboration. Responsible for permitting and permit compliance for waste water and air treatment systems. Regularly oversaw equipment and remediation well installation in the field. Managed routine operation and maintenance of remediation equipment by field technicians and subcontractors.

Catalytic Solutions, Inc., *April 2006 – September 2007*

Product Development Engineer

In a laboratory setting, developed catalytic products for use in automotive and stationary exhaust applications. Worked closely with suppliers, testing agencies, and clients (automotive manufacturers). Aided in the successful development of several technically capable products. Produced bill of materials for all new designs. Develop new internal test procedures to meet customer/internal product specifications. Extensive experience using and analyzing data from particle size analyzers, X-Ray Florescence, X-Ray Diffraction, Gas Chromatography, Mass Spectrometry, and catalyst-aging. Studied slurry processing and slurry rheological behavior.