

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Application of :
Camplands Water LLC for an Increase : PUCO Case No. 13-1690-WW-AIR
in Rates and Charges. :

**HOLIDAY CAMPLANDS ASSOCIATION, INC.'S
REPLY BRIEF**

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Camplands strongly urges the Commission to adopt Staff Witness Mahmud's suggested dividend freeze to ensure Camplands Water's ability to attract capital in the future.

II. LAW AND ARGUMENT.

A. Camplands Revenue Request Seeks Revenue Solely to Permit the Board of Directors to Issue Fixed Dividends.

Camplands Water has provided no basis for its requested \$53,000 revenue increase over the test year operating revenue. There is simply no credible evidence in the record justifying the need for the \$343,306 revenue requirement. Rather, Camplands Water admits that it wants the increased revenue to sustain historically high dividends:

Very simply, the unadjusted/actual test year revenues of \$291,306 were insufficient to sustain the historical dividend payments because of the loan repayment of \$53,000 per year. (Camplands Brief 13).

The results of operation for Camplands over 2011, 2012, and 2013 demonstrate that (given the loan payments of \$53,000 per year) the actual test year revenue was insufficient to pay what was historically a sustainable dividend payment. (*Id.*).

Camplands Water's basis for the increase (issuing historical \$50,000 dividends) is invalidated by Camplands Water's expert witness testimony, who testified that utilities are not entitled to take out fixed dividends each year. (Yankel, Trans. 21:13-23).

Further, Camplands does not need any additional money to meet its obligations to pay the \$53,000 annual loan payment. Holiday Camplands established at the hearing and in its Post-Hearing Brief that Camplands Water's test year revenues are sufficient to pay its annual loan payments *and have \$32,895 of retained earnings.*

(Holiday Camplands Post-Hearing Brief ("HC Brief") 4-5). Even utilizing the Staff's Revised Schedule C-2 with depreciation decreased from \$73,289 to \$19,295, Camplands Water will still be able to make its loan payment. As Holiday Camplands Expert Witness David Monie explained, Camplands Water is not required to pay the debt service with depreciation expense. (Trans. 124:9-23). If depreciation expense is reduced, then the operating revenue is available to pay debt service. (*Id.*). Mr. Yankel confirmed on cross-examination that net income, or operating revenue, could be used to pay the debt service on the loan. (Trans. 25:2-10).

The numbers speak for themselves. The midpoint of Staff's required Operating Income on Schedule A-1 is \$74,758. (Pre-Filed Testimony of Wm. Ross Willis, Schedule A-1). Using operating income alone, Camplands Water would have \$21,581 (\$74,758 – \$53,177) cash on hand for its shareholders and have \$19,295 for depreciation expense. If Camplands Water used the \$19,295 of depreciation expense and \$33,882 of operating income to pay the loan, the utility would have \$40,876 left for its shareholders. Additionally, using Holiday Camplands Schedule DRM 2 and utilizing a 3.28% rate of return, Camplands Water would have sufficient funds to pay the loan and receive an appropriate 10% return on equity. In sum, it is inexplicable that Camplands Water is requesting a total revenue requirement of \$343,306 when the Staff's proposed revenue requirement of \$283,723, utilizing a 10% rate of return, will provide enough revenue to pay its debt service and have a 52% return on equity.

B. The Commission Should Not Accept a Generic Rate of Return for Camplands Water.

The Staff and Camplands Water have failed to demonstrate why a generic rate of return is appropriate in this case other than the Staff's assertion that using a generic

rate of return is a “tradition.” (Staff Brief 18). Without any supporting evidence, the Staff relied on Mr. Mahmud’s conclusory statement that the Staff used the 10% rate of return “[t]o enable Camplands to attract capital.” (*Id.*). As discussed in Holiday Camplands Post-Hearing Brief, Mr. Mahmud stated in his pre-filed direct testimony that he used comparable utilities to determine the appropriate rate of return, but on cross-examination, he could not identify a comparable utility. (HC Brief at 6). Furthermore, when asked about specific comparable utilities, Mr. Mahmud defended the use of the 10% generic rate of return, but in doing so, he incorrectly stated that Piedmont Gas received a 100% return on equity “because they didn’t have any debt.” (Trans. 68:18-19, 21). However, as the tables below demonstrate, and as Mr. Mahmud recognized on cross-examination, a company with a generic 10% rate of return with 100% equity capitalization actually earns a 10% return on equity. (Trans. 70:1-8). Camplands Water argued that Mr. Mahmud knew other utilities with return on equities that “come close” to a 52% return on equity, but Mr. Mahmud could not identify a similar utility at the evidentiary hearing. (Trans. 70:14-16). The Commission should give little weight to that particular statement because the only comparable utility (Piedmont Gas) that Mr. Mahmud identified demonstrated that the witness misapprehended the return on equity calculation.

<u>Piedmont</u>		Percent of Capital	Cost Rate	Average Cost of Capital
Long Term Debt	\$0	0%	0%	0%
Capital Equity	\$X	100%	10%	10%
Total Capitalization	\$X	100.00%		10.00%

<u>Camplands</u>		Percent of Capital	Cost Rate	Average Cost of Capital
Long Term Debt	\$705,422	83.96%	2.00%	1.68%
Capital Equity	\$134,717	16.04%	51.90%	8.32%
Total Capitalization	\$840,139	100.00%		10.00%

In addition, neither the Staff nor Camplands Water distinguished Camplands Water from other small utilities based on its 2% taxpayer subsidized loan. In its Post-Hearing Brief, Camplands Water relied on Mr. Mahmud's statement that Christi Water Company is a small utility with a 10% rate of return and a 4.78% cost of debt to make the argument that a 52% return on equity should be permitted in this case. However, documents filed with the Commission in Christi Water Company's last Application for Increase in Rates, Case No. 09-0569-WW-AIR, and in its applicable test year 2008 Annual Report, demonstrate that with a 81.25% debt to 18.75% equity capitalization structure and a 4.78% cost of debt, Christi's return on equity would be 32.60%. Therefore, with only a 2.78% increase in the cost of debt (and a healthier debt to equity ratio), Christi's return on equity was approximately 20% lower than Camplands Water's return on equity, as shown on the table below.

<u>Christi</u>		Percent of Capital	Cost Rate	Average Cost of Capital
Long Term Debt	\$170,505 (Schedule 4, page 10 of 2008 Annual Report)	81.25%	4.78%	3.88%
Capital Equity	\$39,349 (Schedule 4, page 10 of 2008 Annual Report)	18.75%	32.60%	6.11
Total Capitalization	\$209,854	100.00%		10.00%

Moreover, the comparison of Camplands Water's return on equity to Christi's return on equity is not entirely fair because no parties intervened in the rate case and questioned the use of the generic rate of return. (*In the Matter of the Application of Christi Water System, Inc. for an Increase in Rates and Charges*, April 6, 2010 Opinion and Order, Case No. 09-0569-WW-AIR). Camplands Water is truly different than any other "small" utility in Ohio, and the Commission should use a weighted average cost of capital analysis that is unique to Camplands Water's capital structure.

In the alternative, if the Commission finds that a return on equity of 52% is too high to justify using a generic 10% rate of return, but the Commission is not comfortable utilizing a weighted average cost of capital analysis to determine the rate of return, the Commission could use a hypothetical 60/40 weighted average cost of capital analysis as exemplified in Holiday Camplands Exhibit 5 (attached hereto). The 60/40 capitalization structure is an appropriate benchmark based on Mr. Mahmud's suggestion to the Commission that it could order Camplands Water to freeze its dividend payments until it reached a 60/40 debt to equity ratio. The 60/40 structure is a target capitalization ratio, and had the Utility not been so cavalier with its dividend payments, it would be much closer to a 60/40 ratio than it currently is. Basing the rate of return on the 60/40 debt to equity ratio would grant Camplands Water a fair rate of return of 5.20%, which would result in a 21.95% return on equity (Holiday Camplands Ex. 5).

C. The Commission Should Freeze Camplands Water's Dividend Payments Until the Debt to Equity Ratio Reaches 60% Debt to 40% Equity.

Camplands Water's arguments against the dividend freeze should be given no weight because the Camplands Water did not have a witness from the company testify regarding the prudence of future dividends. There is no evidence in the record that Camplands Water will make decisions that benefit the company and its customers in the coming years. Rather, the transparent objective of Camplands Water's Brief is finding a way for the utility to continue to issue \$50,000 dividends to the shareholders each year. Despite Camplands Water's claims that the dividends were proper; in 2011 and 2012, Camplands withdrew \$105,000 from retained earnings while simultaneously making approximately \$106,000 in loan payments. These significant withdrawals for a company with a total annual revenue under \$300,000 put Camplands Water in a precarious financial condition that needs to be rectified so that Camplands Water can attract capital in the future.

Camplands Water states that, prior to 2011, the appropriateness of the financial position of the utility is uncontested. This is not true. It was the years of imprudent dividend withdrawals that brought Camplands Water to the brink of financial collapse. Moreover, Camplands Water opines that the dividends issued in 2008, 2009, and 2010 were appropriate because the utility was not making loan payments at the time. However, the Board of Directors of the utility knew, or should have known, that they would eventually have to begin paying the loan in 2011. It should not have come as a surprise to Camplands Water that its withdrawals from retained earnings would eventually negatively impact its capitalization structure when the utility would soon face its annual \$53,177 loan payment.

Camplands Water also relied on its decision to not issue dividends in 2013 as evidence of prudent management. The utility mischaracterizes this decision as an “appropriate” choice. (Camplands Brief at 8). More accurately, it was the Camplands Water’s *only* choice unless Camplands Water was actually contemplating issuing the dividend and leaving the company with \$4,887 cash on hand. (Camplands Post-Hearing Brief 9). Unfortunately, the Commission cannot know for certain because Camplands Water did not present any testimony regarding the decisions to make dividends. Regardless of the lack of testimony, Camplands Water’s decision to not issue a \$50,000 dividend in 2013 is not a signpost of prudent management to come. If Camplands Water was serious about improving its financial condition, it would *agree* to a dividend freeze until the company is in better financial shape.

Finally, Camplands Water’s assertions that “the loan payments are the problem, not the [\$50,000 per year] dividend policy” and “the loan payment is now being paid by depriving the stockholders of a return on their investment,” resonate with such hollowness that it begs the question of whether the ownership can be trusted to maintain the financial stability of the utility. (Camplands Brief at 9). Camplands Water knew, or should have known, that the loan would not increase the rate base *to allow for \$50,000 fixed dividends*. Moreover, a 52% return on equity will never be considered a deprivation of an investment. Consequently, based on the past six years of ignoring the reality of the utility’s finances, Holiday Camplands respectfully requests that the Commission prohibit the issuance of dividends for the security of the utility and its customers until a 60/40 debt to equity ratio is reached.

III. CONCLUSION.

For the foregoing reasons and the reasons provided in the Holiday Camplands' Post-Hearing Brief, the Companies urge the Commission to adopt the proposed findings of fact in Holiday Camplands' Post-Hearing Brief.



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served this 1st day of May, 2013

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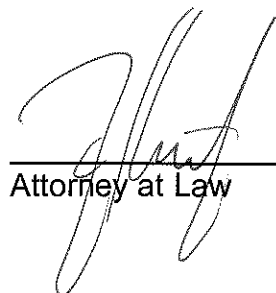
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CAMPLANDS WATER LLC
 CALCULATION OF FAIR RATE OF RETURN
USING HYPOTHETICAL AND ACUTAL CAPITAL STRUCTURES

<u>ITEM</u>		<u>PERCENT OF CAPITAL</u>	<u>COST RATE</u>	<u>AVERAGE COST RATE</u>
<u>Using Hypothetical Capital Structure and 10% ROE</u>				
Long Term Debt		60.00%	2.00%	1.20%
Capital Equity		<u>40.00%</u>	10.00%	<u>4.00%</u>
Total Capitalization	\$0	<u>100.00%</u>		<u>5.20%</u>

Using ROE of 5.2% and Actual Capital Structure

Long Term Debt	\$705,422	83.96%	2.00%	1.68%
Capital Equity	<u>134,717</u>	<u>16.04%</u>	21.95%	<u>3.52%</u>
Total Capitalization	<u>\$840,139</u>	<u>100.00%</u>		<u>5.20%</u>

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