

Special Report of the Receiver

Comments on the Government of Guam's Response to
Receivers Proposed Financing Plan

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Civil Case No. 02-00022

United States of America v. Government of Guam
Guam Solid Waste Management Division

Prepared for:



U.S. District Court of Guam

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This Report is submitted in response to the January 29, 2009 Order of the Court that GBB file its comments on the Government of Guam's response to the financing plan proposed by the Receiver in its Quarterly Report at the January 14, 2009 Status Hearing.

The Government of Guam's response filed on February 2, 2009, can be summarized as follows:

1. A discussion of Guam's financial problems and how they would be exacerbated if the Court orders implementation of the cash financing plan recommended by the Receiver in its January 14, 2009 Report to the Court;
2. The Governor's submission of legislation that would both authorize the Section 30 backed bonds, recommended by the Receiver and other financial experts consulted by the Court, and an option for utilizing lease financing for the Consent Decree projects;
3. An extensive discussion of the use of the *Force Majeure* provision as a potential defense for the Government of Guam's non-compliance with the Consent Decree;
4. A discussion of the impact of the proposed financing on government operations; and
5. A request that the estimates of the Receiver for compliance with the Consent Decree be updated.

Prior to commenting on the specific elements of the Government's response, it is important to emphasize that cash financing of the Consent Decree projects has never been the Receiver's recommendation. ***To avoid all of the negative consequences outlined in the Government of Guam's response, all that is necessary is for the Guam Legislature to pass the bill submitted by the Governor and for the Governor to sign the bill into law and, in good faith, pursue issuing the bonds.***

However, given the urgency of compliance from both a legal and economic perspective, and the Guam Legislature's refusal to authorize the recommended method of paying for the Consent Decree projects, the Receiver reluctantly concluded that a cash payment schedule is required to ensure that the Consent Decree projects are able to be completed within the Court approved schedule and that the new landfill is completed prior to the time the Ordod Dump's capacity is exhausted, a time that is, as of the date of this Report, only 903 days away.

Guam's Financial Problems

A consistent theme of the Government's response is the financial hardship that will occur if the Court orders the Government to comply with the cash deposit plan outlined in our Report of January 14, 2009. As the Government notes, the Receiver has consistently acknowledged the financial difficulties faced by the Government of Guam and has recommended Section 30 backed revenue bonds instead of cash financing. However, these difficulties, no matter how real, are the result of decisions of past Governors

and Legislatures, and cannot justify the Government of Guam's continuing refusal to comply with the Clean Water Act and the Consent Decree. This refusal to comply fails to address a dangerous threat to the health and environment of the people of Guam that has been formally acknowledged by the Legislature itself and ignores the looming economic disaster that will confront the people of Guam should their leaders continue endless debate and once again fail to address this problem. If such logic can effectively excuse non-compliance with federal law then any state or local government can ignore federal law by pleading its own poor management practices.

As we have already said, but it warrants repeating, to avoid all of the negative consequences outlined in the Government of Guam's response, all that is necessary is for the Guam Legislature to pass the bill submitted by the Governor and for the Governor to sign the bill into law and, in good faith, pursue issuing the bonds. Indeed, as we have noted before, the cost of the Section 30 backed bonds will not be paid from Section 30 funds, but instead from tipping and trash collection fees already authorized by the Court. The only part of the Consent Decree projects that must be paid by the Government is the cost of closure of the Ordot Dump and there is nothing in the Consent Decree, the recommendations of the Receiver or the Orders of the Court that prevents the Government from seeking federal funds to pay part or all of this cost.

The Court has clearly and properly stated that the decision of how to pay for the Consent Decree is the responsibility of Guam's elected leaders. The Government of Guam has all the tools available to it that other governments have available to address such issues. In addition, the Government of Guam has been on notice of the urgent need to address this issue for over twenty years, yet it has done little to plan or provide for the required funding. It should not now be allowed to plead economic hardship to once again avoid properly addressing this problem.

Proposed Legislation/Alternative Financing

The principal aspect of the Government's response is the legislation submitted to the Guam Legislature by Governor Camacho on January 29th. The proposed legislation resulted from a meeting that occurred on January 16, 2009, in which the Receiver participated along with members of the Guam Legislature, the Governor's Office, the Office of the Attorney General, Bank of America and the Guam Economic Development Agency. As we have already indicated to the Court, the meeting was a milestone, in that it was the first time the Receiver has been included in a serious discussion of financing alternatives with both the Executive and Legislative Branches of the Government of Guam.

The proposed legislation is essentially a bill that authorizes the Section 30 backed bonds and adds an additional authorization for the use of lease financing for the construction and operation of the new landfill at Layon. The proposal is consistent with the Court's recent orders in this matter in that it requires the landfill to be at Layon, the site selected by the Government of Guam, and requires that any prospective private partner must adhere to the court approved schedule for construction of the landfill.

At the January 16th meeting mentioned in the Government's response, this concept was discussed at some length and it was agreed that if the Government could secure the services of a private entity that was capable and willing to commit the necessary financial resources, had the necessary experience in the field, was willing to assume the liability for any construction and other contracts already in effect, would accept the project at whatever level of completion the construction work had achieved at the time such an arrangement became effective, would complete the landfill in accordance with the approved design and schedule and was otherwise acceptable to the Court, the Receiver would have no

basis for objecting to such an arrangement. It was further stated by the Receiver in this meeting that until such an arrangement could be successfully put into place, construction activity financed by the Government of Guam's Section 30 backed bonds or cash contributions would have to continue in order to assure that the court approved schedule is not jeopardized.

The legislation proposed by the Governor appears to be consistent with the discussion outlined above. The only concern the Receiver has is the level of commitment by the Governor to issue the bonds in order to continue the project uninterrupted in order to maintain compliance with the Court approved schedule. The Government's response states that the proposed legislation authorizes "the use of lease financing in addition to, in lieu of, or in conjunction with one or more Series of Solid Waste Management System Revenue bonds."

The Receiver concurs in the Government's belief that any bonds issued for the Consent Decree projects should be flexible and sold in a series of issues to both facilitate market acceptance and allow the competitive bid process to continue to work to achieve a lower cost for the projects. In this way, the final amount of the bonds issued could be better matched to the final cost of the projects and if the Government is successful in attracting a private partner as described above, the partner could reimburse the Government's cost to date and these reimbursed bond funds could be used to pay for the closure of the Ordot Dump.

However, to ensure that this is not another in a long series of false starts for the Government of Guam, the Receiver recommends that in any order issued by the Court, it is made clear that the Government is required to make the cash contributions outlined in the Receiver's Report of January 14, 2009 unless:

1. The Legislature authorizes the maximum amount of bonds recommended by the Receiver for full implementation of the Consent Decree projects, with such authorization certified to the Court by the Attorney General and Guam's Bond Counsel; and
2. The Governor and GEDA must, in good faith and to the Court's satisfaction, move to sell the first series of these bonds as soon as possible and such other bonds at a later date as are required to keep the Consent Decree projects funded and on schedule.

At this point it cannot be determined what the Guam Legislature will do in this matter. From the public comments of some members, it is apparent that there remains a mistaken belief that this problem can be solved without a public commitment of resources. If, in fact, the Government is successful in attracting a viable private partner acceptable to the Court, the cost to the customers of the system will likely be higher than they will be if the Government completes the landfill and contracts its management to a qualified firm since the private sector's cost of capital and/or required return on investment will probably be higher than the Government's cost. In our experience in other solid waste financings where private sector capital has been considered, the cost of capital has always been higher than publicly sponsored financing approaches as the Receiver has recommended here. In the final analysis, the Government should be pursuing the lowest possible cost for its people. While the course of action contemplated here may be more palatable for the Government it is likely to result in higher cost for the people of Guam.

In addition, it is unlikely that any private firm will be able to borrow the necessary funds using private activity bonds or otherwise without a binding contractual commitment from the Government that it will be the exclusive source of waste disposal on Guam. Given the long history of litigation in this area that

has helped produce the stalemate that has prevented progress in this matter, it is unlikely that such a contractual commitment will escape similar litigation along with its potential for lengthy delay.

There are also those in the Legislature that are advocating the private development proposed by Guam Resource Recovery Partners (GRRP). This proposal has been pending for over a decade and has resulted in the extensive litigation referred to above. An integral part of the GRRP approach is waste-to-energy, a technology that has been controversial in past debates in Guam and which is likely to be more expensive than the approach required by the Consent Decree. It should also be noted that the Consent Decree itself explicitly notes that this project is not to be considered in the Consent Decree process when it states in section 31:

“The schedule set forth in Paragraph 9 above {paragraph 9 refers to the schedule for building the new landfill} for the construction of a new municipal solid waste landfill is not based on, or dependent upon, the existence of any contractual arrangements the Government of Guam may or may not have, now or in the future, for the construction and operation of a new landfill or incinerator.”

It is apparent from these words in the Consent Decree that the proposed project at Guatali will not satisfy the requirements of the Consent Decree. In addition, it is simply not reasonable to bet Guam’s future on a project that has failed to materialize despite over a decade of effort in the 903 days remaining before Guam’s capacity at the Ordod Dump is exhausted.

Even if all of these issues did not exist, Guam’s problems would not be solved by this uncertain project. In the words of Guam’s Governor at the December 10th Hearing:

“...even if the private sector developers proceeded with their development down in Guatali, that area, in and of itself, is limited in life span. We do need to build another landfill, even if that succeeded, we need a long term landfill that can accommodate the growth of this community in years to come. So that's why I said it's not a matter of choice, but it is incumbent upon this territory to build a new landfill.”

There are also those in the Legislature and elsewhere who argue that Section 10b of the Consent Decree should be interpreted as eliminating the need for the Layon Landfill if another properly licensed and permitted landfill is opened first. The exact language of Section 10b is:

“Notwithstanding any of the time frames set forth in Paragraphs 8 and 9 above, upon the opening of a properly licensed and permitted municipal solid waste landfill prior to the times set forth in Paragraphs 8 and 9 above, no further dumping of any kind will be permitted at the Ordod Dump.”

First, the plain language of the Consent Decree requires the Government to build a landfill. Section 9 of the Consent Decree is replete with explicit and detailed mandates for the planning and construction of a new landfill. The Consent Decree states numerous times that “DPW shall” and then directs a specific activity designed to achieve this result including the following:

“.....DPW shall award a construction contract for the new MSWLF in accordance with the applicable procurement rules and policies of the Government of Guam and provide a notice to proceed to the selected contractor and submit evidence of such award and notice to U.S. EPA.”

This wording is abundantly clear that DPW must build a landfill.

It is also worth noting that in the language of Section 10b, it is clear that the intention of the parties was to close the Ordot Dump earlier than anticipated if the Government were successful in completing a new landfill "prior to the times set forth in Paragraphs 8 and 9". That did not happen; therefore we would submit that section 10b is no longer of any consequence for any purpose in the Consent Decree.

Force Majeure

In the response filed by the Government there is much discussion of the use of the *force majeure* provision of the Consent Decree as a potential defense for its failure to comply with the Consent Decree. While this is primarily a legal argument, we would like to offer a few comments for the Court's consideration.

First, the Consent Decree itself eliminates "economic hardship" as a basis for invoking *force majeure* under the Consent Decree (see the second sentence of Section 32). If it were established that Guam could not access the bond market, this results in a requirement that the Government fund the Consent Decree projects with cash. The resulting problems described at length in the Government's Response can only be characterized as economic hardship. The Government of Guam has all the authority it needs to set priorities within its current spending, collect taxes, and borrow funds. It is only its refusal to use some or all of this authority that presents a barrier to compliance with the Consent Decree.

It is true that market conditions are more challenging now than in recent years, but it is not correct to say the market is not available. Neither the affidavit of Mr. Blaz nor the communications from Guam's Financial Advisor, Bank of America, contend that the market is not available. Both urge a flexible approach to the issuance of bonds, with respect to both structure and timing, comments with which we agree. Bank of America also recommends that "the Government should authorize the appropriate legislation", the precise course of action recommended by the Governor and the Receiver. Bank of America also reinforces the Receiver's recommendation for Section 30 backed bonds, stating:

"We have made it clear in the past that a revenue bond issue would not be viable with a pledge of tipping fee revenue solely. The most viable security available to GovGuam at this time is the pledge of Section 30 revenues with a "lock-box" mechanism."

It is apparent from these statements that the use of bond proceeds to fund the Consent Decree projects is not impossible. Indeed, state and local governments are successfully going to the bond market on a regular basis to address their financing needs. It is also clear that access to the bond market is not just limited to governments with strong credit. Puerto Rico, with a bond rating of BBB-, sold \$1.2 billion in bonds during December and early January with interest rates ranging from 5.5 percent to 6.5 percent for varying maturities.

The use of Section 30 as a backstop, as recommended by the Receiver, Bank of America, GEDA, PFM, the Director of BBMR, Governor Camacho and the financial expert of the United States, will raise any bond issue to investment grade assuring reasonable terms and conditions.

Finally, perhaps the most compelling argument against the use of *force majeure* is the fact that Guam is headed toward economic calamity if it does not implement the Consent Decree without delay. This has

been stated by the Receiver on numerous occasions, but more importantly, it is the assessment of Guam's Governor. In response to the Court's inquiry at the December 10th Hearing, asking the Governor for his assessment of the economic impact of Ordot's running out of space without a new landfill in place to receive waste, the Governor responded:

"...it would be a disaster, it would be catastrophic. We all know that there's limited amount of space remaining at Ordot, we all know that there is a limited amount of time, and those are the realities that we're dealing with. If there is no legal place to dump our waste as a government and as a people, then we will see trash, I believe, disposed of throughout this island illegally. It really is going to be a health hazard, and definitely the economic impact, I believe, will be tremendous."

It is imperative that the Government act now to implement the Consent Decree in order to prevent the catastrophe the Governor so correctly forecasts.

Debt Ceiling

In its response, the Government provides an overview of the debt ceiling and its calculations of the debt capacity that is available under the current debt ceiling. The implication of this portion of the Government's response suggests that there is insufficient debt capacity to allow for the Section 30 backed bonds recommended for funding the Consent Decree projects.

The debt capacity issue is important but well within the authority of the Government of Guam to manage. First, as the Legislature has done previously, it can simply take legislative action to increase the limit. Secondly, the Governor can give priority to the Consent Decree projects in actually issuing debt. The Governor has previously indicated that the Consent Decree Projects were to be given such priority. Accordingly, the Government has the tools available to it to assure that the debt ceiling does not present a barrier to financing the Consent Decree projects, should the Legislature approve the Governor's recommended debt financing for these projects.

Impact of Proposed Financing on Government Operations

The Government has submitted several documents to support its contention that the cash funding plan will seriously impact government operations. The Receiver agrees that this is not the best way to fund these projects. In fact, we have consistently said this, stating in our October 22, 2008 Report that "Funding these projects without debt financing would appear to place an unacceptable and unnecessary additional financial burden on the Government of Guam."

The Receiver strongly recommends that the Legislature adopt the legislation submitted by Governor Camacho. In doing so the Legislature eliminates the problems described in the BBMR analysis. Failure to adopt the legislation is a decision of the Legislature to impose whatever problems result on its Government and the people of Guam. ***In other words, if the problems described by the BBMR analysis come to pass, responsibility will rest squarely on the Legislature of Guam for refusing to accept the recommendation of numerous financial experts and the Governor of Guam.***

Updated Estimates

The Government's response also indicates that it has asked the Receiver for a revised estimate of the cost of the Consent Decree projects to reflect what appears to be a lower cost structure based on this first bid. We have consistently said that the actual cost would be based on competitive bidding and would likely be lower given the economic slowdown and the dramatic drop in energy cost. Indeed, the projects could be significantly less costly.

While the first bid does validate what we have expected and it is encouraging, there are many more bids to come. Prior to revising the estimates, we need to get more experience with the actual bids as they come in. In this way we can better assist the Government in properly sizing any bond issue or, should the Legislature persist in refusing to authorize bonds, we can adjust the cash requirements that otherwise will be necessary. Revising the estimates for a complex project like this is not a quick process nor one without cost itself, so it should be done only when there is sufficient information available to justify the time and expense involved.

Military Participation

The Government also expresses the view that it wishes to be more involved in the discussions with the Military and its hope that the Military will become a customer of the new landfill. The Receiver concurs in both of these areas. It remains our hope that ongoing discussions with the Military will produce an agreement the Military can approve and that will also be acceptable to the Government of Guam.

One of the most significant barriers to Military participation, however, is clearly the continuing opposition to implementation of the Consent Decree by some in Guam's Legislature. It is clear to us that the Military wants to participate and that such participation would be in the best interests of all parties. For this to occur, we believe Guam's elected leaders need to come together, as the Court has repeatedly requested, and support the expeditious implementation of the Consent Decree.

Conclusion

The Receiver continues to believe, for all of the reasons stated at the January 14, 2009 Hearing, in prior hearings and in this Report, that certainty of capital funding is a fundamental and essential requirement of compliance with the Consent Decree. We stand by our recommendations to the Court for a cash payment plan. However, we have always preferred and clearly stated our belief that a financing plan based on Section 30 backed revenue bonds is the best approach and the approach that is least disruptive to the Government of Guam and in the best interests of the people of Guam. We have also consistently stated our willingness to explore other alternatives with the Government of Guam as long as such alternatives do not detrimentally affect the construction schedule already adopted by the Court.

We recommend that the Court accept the recommendations contained in the Government's Response for proposed legislation. However, the Receiver further recommends that in any order issued by the Court, it is made clear that the Government is required to make the cash contributions outlined in the Receiver's Report of January 14, 2009 unless:

1. The Legislature authorizes the maximum amount of bonds recommended by the Receiver for full implementation of the Consent Decree projects, with such authorization certified to the Court by the Attorney General and Guam's Bond Counsel; and

2. The Governor and GEDA must, in good faith and to the Court's satisfaction, move to sell the first series of these bonds as soon as possible and such other bonds at a later date as are required to keep the Consent Decree projects funded and on schedule.

If these conditions are not met by March 1, 2009, the cash payments should begin. The cash payments should end when all of the conditions outlined above have been met to the Court's satisfaction or when the full amount of funding is available to assure compliance with the Consent Decree has been deposited to the Trustee Account.

Finally we note that the Government asks the Court to allow it two weeks to respond to any orders requested by the Receiver. We have no objection to whatever reasonable amount of time the Court determines should be afforded the Government for a further response.

We appreciate the Court's consideration of our comments in this important matter.