

CRRA

Advisory Panel Report

March 19, 2002

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I. Introduction

The transactions among Enron, CRRA and CL&P have been described in detail by others. There is no need to repeat that discussion here.

When Enron declared bankruptcy it stopped making the \$2.2 million monthly “capacity payments” to CRRA. Those payments would have totaled \$26.4 million per year. They stopped in November 2001.

To make up the shortfall, CRRA in February 2002, announced an increase in the tip fees it charges for solid waste deposited at its Mid-Connecticut Project (“**Mid-Conn**”). They are scheduled to rise from \$51.00 per ton to \$ 67.00 per ton for the 2003 Fiscal Year (“**FY03**”), which begins July 1, 2002. This represents more than a 31% increase. Not surprisingly, the Towns which participate in the Mid-Conn project (the “**Towns**”) objected.

Vigorously.

The situation generated significant public controversy. On Friday, March 1, 2002, the Governor announced that he had asked the three undersigned individuals to serve as an informal “**Advisory Panel**” to review the situation as it presently exists and make recommendations. The Governor gave no instructions as to what those recommendations should be.

This Report contains the recommendations of the Advisory Panel.

There are many topics arising out of the Enron/CRRA/CL&P transactions which are appropriate subjects for continued public discussion, further investigation and, inevitably, litigation, but which are not the subject of this Report. Among the many topics **not** covered are:

- Investigation of the past transactions;
- An assessment of responsibility;
- Evaluation of litigation strategies, potential defendants and alternative legal theories;
- Analysis of the proper role for quasi-public authorities in general and CRRA in particular; and
- Review of the mission, structure or governance of CRRA.

This Report takes the world as it finds it – without revisiting how it got there. CRRA is facing an annual revenue shortfall of \$26.4 million. The State of Connecticut is obligated to make payments on more than \$200 million in CRRA bonds if CRRA does not have the money to pay the debt service. The Towns cannot absorb a 31% one-year increase in tip fees, but they need a place to dispose of more than 850,000 tons of garbage every year. In addition, a majority of the Towns have pledged their own full faith and credit to make the payments to CRRA that CRRA needs to pay its bonds.

Looking forward is not a luxury; it is a necessity.

The Advisory Panel recommendations are focused on financial strategies for addressing the immediate crisis. But recommendations for the current year alone, without a long-term plan, would merely defer the crisis, not address it. The Financial Recommendations look out to the next decade and beyond. They take into account events that have not yet occurred, but cannot be ignored, including the projected closing of the Hartford landfill to bulky waste in 2004 and to ash in 2007. That event alone will potentially raise operating costs during the transition phase by approximately \$13 million per year, the equivalent of over \$15 per ton and, when completed, continuing at approximately \$11 million per year or over \$12 per ton.

The Advisory Panel had no budget and did not retain any legal, financial or technical staff or consultants.

CRRA provided financial information. Panel members met with the new Chair designate, the President and with senior staff of CRRA.

The Advisory Panel also sought input and from a variety of other public and private resources. The Panel is extremely grateful for the information, advice and assistance provided by Legislative leaders and their staff, the Legislature's non-partisan offices, many executive branch agencies, the Treasurer and the Attorney General. The Panel is also grateful for the advice, counsel and unpaid assistance provided by many individuals in the private sector including experts in law, finance, accounting and the energy industry.

Most importantly, we are grateful for the candid and constructive input from the municipal officials of the Towns who made a number of suggestions which are incorporated in the Financial Recommendations.

The Advisory Panel is not a governmental entity. It has no legal authority. The views expressed here reflect our collective best judgment, but ultimately, they are ours alone. The Advisory Panel does not speak for the CRRA, the Towns, the Governor or for any other public official or governmental body. The views expressed are our own as individuals, not as representatives of our respective employers.

The remainder of this Report reviews the existing situation at CRRA, makes non-Financial Recommendations, explains the constraints on proposed financial strategies and

makes specific Financial Recommendations for immediate adoption. It also identifies some potential long-term strategies for further relief.

II. CRRA In Brief

As noted above, familiarity with the underlying transaction is assumed and it will not be described again. Much of the public discussion has focused on the loss of the \$220 million that CRRA paid to Enron. This report is focused on the practical consequences of losing the \$26.4 million annually that Enron had committed to pay CRRA. That loss in the context of an over \$90 million annual budget has a devastating impact.

CRRA is a quasi-public authority created to perform the important public function of helping member communities dispose of solid waste. CRRA operates four separate projects¹, each serving a separate group of towns and each separately financed. The Mid-Conn project serves 70 towns. The operating facility was constructed in the mid 1980s using funds raised by the sale of bonds. The bonds were refinanced in 1996.

The financial discussion throughout this report refers to the finances of the Mid-Conn project only, even though for convenience the discussion refers to CRRA.

CRRA's facility burns trash, which generates steam, and the steam in turn is used to produce electricity. It disposes of the ash in landfills. In simplest terms CRRA's revenues are derived from three primary sources: the "tip fee" charged for each ton of solid waste tipped into the trash burner, the sale of electricity and the earnings on reserves.

CRRA's expenses consist primarily of operations, overhead and administration and debt service on the 1996 bonds and other debt.

CRRA is not a for profit entity. It is a quasi-public authority serving a public function. If it were to cease, the consequences would be significant and severe. A functional failure would mean that the Towns would need to find another way to dispose of more than 850,000 tons of solid waste that CRRA processes each year.

A financial failure would also have severe consequences. As discussed below, if CRRA were unable to meet its debt service obligations, the State of Connecticut would be obligated to pay the debt service. The Towns have also pledged their full faith and credit.

Accordingly, the goal of these recommendations is to find feasible financial arrangements to allow CRRA to perform its public function. The recommendations of this report are primarily financial, but there are some important non-Financial Recommendations as well.

¹ The Bridgeport Project, the Wallingford Project, the Southeastern Connecticut Project (in Preston) and the Mid-Connecticut Project.

III. Non Financial Recommendations

1. Create An Oversight Board

Implementation of the Financial Recommendations will require the participation of many different interests. The recommendations may be significantly modified before adoption, but regardless of how they finally evolve, CRRA will play a central role in implementation.

There is an ongoing debate as to whether or not CRRA's Board and management mishandled the current situation. Reasonable people can disagree on that point. Unfortunately, however, the controversy has become so heated that the ultimate answer has become almost irrelevant. As a practical matter, any proposed solution to the present crisis is doomed to failure if the implementation responsibilities of CRRA are to be carried out by the same individuals whose prior conduct is now at issue.

Accordingly, even though the Advisory Panel makes no judgment about the conduct of CRRA or individual members of its Board or management, the Advisory Panel believes it is essential to create a vehicle to provide independent oversight of CRRA.

Although the problems which have generated this Report arise in the context of the Mid-Conn project, it is not practical to limit an Oversight Board to that project alone. Accordingly, the Oversight Board's proposed jurisdiction is oversight of all actions by CRRA.

a. Purpose and Powers of the Oversight Board

The Oversight Board should be statutorily empowered to review and approve all aspects of CRRA's finances and administration, including, but not limited to, tipping fees and adjustments to tipping fees, CRRA's annual budget and any budget transfers, use of reserves, all contracts entered into by or on behalf of CRRA, all financings or restructuring of debt, the sale or other disposition of assets (including sales of electricity and steam), joint ventures and strategic partnerships; and initiation and resolution of litigation, arbitration and other disputes.

The Oversight Board will work with the CRRA board and management without being a component of either. The Oversight Board will have the power to retain independent experts to assist it in the exercise of its powers

The Oversight Board will have access to all information, files and records, including financial and litigation records and documents maintained by CRRA.

b. Structure of the Oversight Board

The current CRRA Board is composed of 13 directors: six appointed by the legislative leaders, four by the Governor and three ex officio agency heads (the Commissioners of DECD and Transportation and the Secretary of OPM).

The Advisory Panel recommends that there be no duplication of agency representation between the CRRA Board and the Oversight Board.

The Advisory Panel recommends that the Oversight Board be composed of five members:

- The Attorney General
- The Treasurer
- Three individuals appointed by the Governor subject to confirmation by the General Assembly.

The Advisory Panel is aware that a number of proposals have been made to restructure the CRRA Board. Even if the CRRA Board is changed, the Advisory Panel believes that the Oversight Board is an essential element of these recommendations.

2. Coordinate Litigation Strategy

There appear to be multiple potential defendants and multiple potential claims that could be brought. The potential plaintiffs include CRRA, the Towns as injured parties and the State, which is ultimately responsible for making up any shortfall in debt service payments to the bondholders.

Unfortunately, some of the legal theories that have been publicly discussed are inconsistent. Specifically, the CRRA and the Attorney General have articulated differing views about the legality of this transaction and about the appropriate legal strategy for obtaining recovery. To date the differences of opinion have been played out in various public statements, not in any formal court proceedings.

The ultimate financial responsibility for the loss will fall on the Towns through increased tip fees and on the State through its obligation on the bonds. Thus the State and the Towns, not the Board or management of the CRRA, are the real parties at interest.

Before CRRA or the State takes a definitive legal position, these differences need to be resolved. In order to have the maximum opportunity for recovery, CRRA and the State – and, to the extent possible, the Towns – need to find a way to speak with a single voice. This means developing an integrated strategy with regard to defendants to be sued, legal theories to be pursued, timing and tactics.

The Advisory Panel is not in a position to determine the issues of litigation strategy. The Panel does recommend that the decisions making on that issue be centralized.

IV. Context and Constraints

Before turning to the specific Financial Recommendations, it is important to understand the context in which they are proposed and the constraints that prevented the Advisory Panel from recommending alternatives that have been suggested by others.

A. Tip Fees In Context

The tip fee for CRRA's Mid-Conn plant is currently \$51.00 for fiscal year 2002 (FY02), the actual level for FY01 as well. Following the Enron bankruptcy, CRRA has proposed a FY03 tip fee of \$67.00.

As shown in Exhibit 1, the Mid-Conn towns have been paying very favorable rates when compared to other CRRA projects for several years. The Mid-Conn project also compares favorably with other tip fees in the state. See Exhibit 2.

The Advisory Panel recognizes that even if an increased tip fee is arguably "fair" when compared to other communities, as a practical matter it is extremely disruptive for Towns to have to make such a large adjustment all at once. In recognition of that, the Financial Recommendations reduce the FY03 increase significantly. Thereafter, they provide for a gradually phased in adjustment.

Not all of the proposed increase is attributable to the Enron transaction. Operations and debt service for the new odor system are now in place. The revenue from sales on recycled materials has declined. Insurance premiums have increased radically. Moreover, although the project had substantial reserves prior to the Enron bankruptcy, the dollar return on the investment of those reserves has fallen significantly as interest rates have fallen.

Even without the loss of Enron income, CRRA estimates the tip fee would have increased nearly \$7.00 per ton, which would still have put the Mid-Conn project towns in a favorable cost position compared to other communities in Connecticut.

Accordingly, the Financial Recommendations are designed to mitigate the Enron increase, but do not completely shield the Towns from increases that would have otherwise occurred.

B. Adverse Adjustments to Adopted Budget

In developing recommendations, the Advisory Panel reviewed CRRA's adopted budget for FY03. That review revealed some assumptions which the Panel believe need to be modified and which made the financial model worse than what is reflected in the adopted budget.

The Panel's recommendations include adding the following additional items of expense to the adopted budget:

- Reserve \$500,000 annually for depreciation on the power block facility equipment.
- Add back in \$1.8 million in savings that CRRA had assumed would be achieved by a reduction in the expense of various MDC contracts. Some savings may be achieved, but at this point they are speculative.²
- Add \$350,000 annually for five years for professional services and other expense of the Oversight Board.

The adopted FY03 budget includes the imposition of a new tip fee on recyclables of \$20 per ton. This fee would generate additional annual revenue of \$1.5 million, or revenue equivalent to an additional \$1.72 per ton of standard waste. When the pro rata cost of the tip fee on recyclables is added to the projected \$16.00 increase on the tip fee for standard waste, the real projected increase is \$17.72 bringing the current \$51.00 fee to **\$68.72**, a nearly **35%** increase.

Although the Advisory Panel recognizes the CRRA's desire to optimize revenue, imposing a fee on recyclables creates a negative incentive for Towns to recycle. That is contrary to long standing public policy in Connecticut. Accordingly the Financial Recommendation is to eliminate the tip fee on recyclables and adjust the budget of CRRA to accommodate that loss of revenue.

C. Problematic Proposals

A number of ideas have been proposed which have the laudable goal of protecting the Towns from the projected increases. Unfortunately a number of these proposals have potential consequences which may not be fully appreciated by their proponents but which are, in the Advisory Panel's judgment, unacceptable. In other cases, the proposals offer a partial, but not complete, solution.

The problematic proposals are discussed here. To the extent that there is a workable aspect to some of these proposals, they are included in the Financial Recommendations, Section VI. below.

1. Sue Somebody

The Advisory Panel endorses efforts to obtain all possible damages from any and all parties who have legal responsibility for the losses. However, as a practical matter, the ability to obtain such relief and the amount that will ultimately be recovered is highly uncertain.

² See the discussion of the MDC in Section VI.4. below.

It is certain that any recovery is many months, if not years, in the future. But the problem is immediate. Accordingly, the Financial Recommendations do not assume a recovery. If and when a recovery is obtained, it can be applied at that time. In the meantime, the recommendations are based on a worst-case scenario.³

2. Legislative Moratorium

The proposal is deceptively simple-the legislature would simply make it illegal for CRRA to raise tip fees. The Advisory Panel understands the appeal of this approach. In the absence of another alternative, its appeal seems irresistible.

As shown in the Financial Recommendations below, there are other alternatives. Moreover, a legislative prohibition on rate increases would have significant adverse consequences that may not have been fully understood thus far.

Both the State and the Towns would ultimately be liable for the financial shortfall caused by a moratorium.

The State. When the 1996 bonds were issued CRRA promised to pay the bondholders from the system revenues. As security for that promise, it established a Special Capital Reserve Fund (SCRF) as it was statutorily authorized to do.⁴ CRRA must maintain a balance in the SCRF of one year's principal and interest on the bonds. If CRRA does not pay the debt service on the bonds in any year, the bond Trustee is required to withdraw the shortfall from the SCRF.

If that happens, the State must make it up. Specifically, in that event "the amount necessary to restore" the SCRF is, by operation of law, "deemed appropriated from the State general fund."⁵ No further legislative action is required to make the payment. It is automatic.⁶

In other words, if CRRA cannot pay the debt service, **the State must pay it.**

Moreover, the State has effectively contracted with the bondholders that the State will not limit or alter these rights until the bonds are paid.⁷

³ The Advisory Panel's assumption of no recovery should not be misunderstood as expressing a view on the merits of any claims that may be brought. On the contrary, the Advisory Panel expressly declines to express an opinion on the merits, the likelihood of success or the potential for actually collecting damages. We have neither the data nor the expertise to form such an opinion. We have assumed no recovery only because that is the most conservative assumption and therefore the most prudent at this time.

⁴ CGS sec. 22a-272(b).

⁵ Official Statement, 1996 Series A Bonds, p. 3.

⁶ The Advisory Panel has not looked at the question of whether the amounts "deemed appropriated" would be treated as an appropriation, rather than debt service, for purposes of the state spending cap.

⁷ Official Statement, 1996 Series A bonds, p. 62.

The Towns. Each of the Towns has a Service Contract that requires it to deliver all of its municipal solid waste (MSW) to CRRA. The towns are required to make Service Payments. The Contract requires the Towns' Service Payments to be in an amount that will be sufficient, along with other revenues (e.g. electricity sales) to pay for the net cost of operation and debt service on the bonds. The member Towns' contracts with CRRA contain a pledge of the Town's full faith and credit for the payment of their Service Payments. In other words, the **Towns have promised to pay, have backed that promise with all of their financial resources and have promised to raise municipal taxes if necessary to make payments.**⁸

CRRA in turn has contracted with the bondholders that it will enforce the Service Contracts made by the Towns, including the Towns' promise to make their Service Payments.⁹ CRRA is required to sue Towns who do not pay.

By enacting a legislative moratorium, the State would in effect be trying to breach the existing contract between the Towns and CRRA, the contract between CRRA and the bondholders, and the promise made by the State to the bondholders.

The United States Constitution forbids a State from interfering with an existing contract. Even if CRRA failed to object to the State's action, the bondholders have the right to challenge this action themselves.¹⁰ The Advisory Panel believes the challenge would have a high probability of success.

A legislative moratorium would increase the State's future cost of borrowing.

Regardless of the outcome of any litigation, however, the financial damage to the State even from having enacted the moratorium would be significant. The State borrows money by issuing bonds. The rate of interest the State pays is affected by the creditworthiness of the State. In other words, bondholders want to know if it is safe to loan money to Connecticut. The riskier the loan, the higher the interest rate.

A legislative attempt to breach or avoid the terms of existing bonds would have a devastating impact on the ability to sell bonds in the future. The impact would be felt not only by the State, but every quasi-public authority and by every health facility and educational institution in the state. Future bond sales would likely be significantly more expensive.

⁸ Official Statement, 1996 Series A Bonds, p. 28

⁹ For this reason, if a Town were to unilaterally stop making all or part of the Service Payments, CRRA would be required to sue the town or risk defaulting on the bonds. CRRA is also contractually required to stop accepting solid waste if a Town fails to pay. Official Statement, 1996 Series A Bonds, p. 28.

¹⁰ Official Statement, 1996 Series A Bonds, p. 59.

The Advisory Panel understands why a legislative moratorium seems appealing if there is no other choice. Fortunately, the Financial Recommendations below show there are other choices.

3. CRRA Should Cut Overhead Expenses

Again the concept is deceptively simple – CRRA caused the problem, they should pay for it. The difficulty is that the CRRA budget for General Administration, including the allocation of CRRA salaries and overhead to the Mid-Conn project, is simply not large enough (at only about 1/20th of the total budget), and therefore cannot be cut enough, to have a significant impact on the proposed tip fee increase.

Although cost cutting cannot be the whole solution, it must play a role. CRRA's adopted FY03 budget already reflects some cost cutting. The Financial Recommendations require CRRA to go further.

4. CRRA Should Pay Its Expenses From Reserves Instead of Tip Fees

Admittedly the use of reserves will provide relief for a period of time, but there simply are not sufficient reserves to provide meaningful relief over the life of the problem.

The adopted budget for the current year, FY02, is estimated to have provided for projected total reserves by year-end of \$117 million. However, Enron stopped paying after November resulting in lost revenue for the balance of FY02 of approximately \$ 15.4 million. In order to meet that shortfall without raising tip fees prior July 1, 2002, CRRA has been paying the shortfall from its reserves.

Even if 100% of the reserves now projected to be on hand at the end of FY02, \$101.6 million, were to be applied to debt service to make up the lost revenue, at a rate of \$2.2 million per month, the reserves would be exhausted after 46 months.

Moreover, 100% of the reserves are not available. Certain reserves must be maintained to meet legal requirements (about \$38 million) and to avoid jeopardizing existing operations (about \$20 million). As noted below, the reserves that are actually available for prudent use total only \$43.3 million which would be exhausted in less than 20 months. Given the State's ultimate responsibility for payment of the debt service through 2012, it would be irresponsible to wait until the reserves are exhausted before addressing the changes necessary to effectuate a long-term solution.

The Financial Recommendations below include utilizing CRRA reserves to a greater extent than CRRA's adopted FY03 budget, but at a level which the Advisory Panel believes is prudent.

5. CRRA Should Refinance Its Existing Bonds

The proposal is that CRRA should refinance its existing debt to take advantage of lower interest rates and, by stretching out the repayment period, lower its monthly debt service burden. There are several problems with this proposal.

CRRA's long-term debt consists of two outstanding bond issues. CRRA bonds were originally issued in 1985 to finance the construction of the plant. Those bonds were refinanced in 1996. The 1996 Series A bonds had an original face amount of \$209 million and have maturity dates through 2012. By their terms, the 1996 Series A bonds maturing prior to 2008 cannot be "called", i.e. paid off early. Bonds that mature from 2008 forward can be called in 2006 and only then by paying a penalty of 2%. This penalty reduces until 2008 when all bonds can be called without paying a penalty.

The other outstanding bonds are the 2001 Series A bonds issued in early 2001 to finance certain odor control measures. They have a face amount of \$ 13 million and have maturity dates through 2012. They are not callable except under the extraordinary optional redemption provision discussed below.

In certain narrowly limited circumstances, the bonds could be called early without paying the premium.¹¹ There would be a serious dispute as to whether the present circumstances qualified under the applicable language and any attempt to invoke this provision would be likely to have an adverse impact on the credit markets. In addition, the calling of the bonds under this provision requires an opinion of bond counsel that the conditions of the call provision have been met. Suit has already been filed against the original bond counsel on both CRRA bond issues. Under these circumstances, it is unreasonable to assume that any bond counsel would give the required opinion on the CRRA bonds. But even if the bonds could be called, refinancing would be unlikely to be a practical alternative.

The existing bonds are supported by a pledge of the revenue from the Towns. That revenue is assured for the life of the existing bonds because the Towns have long term Service Contracts with CRRA that extend until the maturity of the present bonds in 2012. In order to achieve a significant reduction in debt service payments, the new bonds would need a longer repayment period than the current bonds. However, because the contracts with the towns expire in 2012, there is no assured revenue beyond that point and the new bonds could not be based on revenue after that time.

The only way to issue new bonds with maturity beyond 2012 would be to persuade the Towns to extend their existing contracts. The Advisory Panel does not

¹¹ The "Extraordinary Optional Redemption" provision might be argued to apply here. It can be triggered when excessive Service Payments are charged to the towns, but only if the cause is a change in law or an order of the DPUC. In the present circumstance, it would be difficult to persuade a court that even the new higher tip fees - - which are still lower than other towns in Connecticut - are "excessive" or "extraordinary." But in any event, the cause of the increase was not a change in law or a DPUC order.

believe that persuading the Towns to extend their contracts is a realistic alternative in the current environment. Moreover, as a practical matter it could not be accomplished in time to provide relief from the tip fee increase scheduled for July 1, 2002.

For these reasons, refinancing is not a practical alternative at the present time. However, if the Towns were to decide to extend their contracts, refinancing might be possible at a later time. Moreover, restructuring the debt may provide a significant benefit as discussed in the Financial Recommendations below.

6. CRRA Should Sell Its Assets

This recommendation could not be adequately evaluated, let alone implemented, in the time frame available. It should be considered as a possible long-term strategy. See Section VII below.

7. CRRA Should Restructure Its Operating Arrangements

This could mean many things including renegotiating prices with existing vendors; changing vendors; privatizing functions that CRRA now performs itself or, at the other extreme, transferring some or all of CRRA's functions to a state agency.

None of these alternatives could be adequately evaluated, let alone implemented, in the time frame available. Some of them should be considered as part of a possible long-term strategy. See Section VII below.

8. The Legislature Should Subsidize The Tip Fee From Existing Funds

The State could reduce the tip fee by providing a direct grant of funds to subsidize it if the state chose to do so. Suggestions to the Advisory Panel on where funds for the subsidy could be found included:

- Energy Conservation and Load Management Fund
- Renewable Energy Investment Fund
- Funds for conservation projects in State buildings
- General Obligation bonds

The Advisory Panel does not recommend utilizing any of those funds for grants to CRRA.

V. Financial Recommendations

Enron stopped paying monthly “capacity charges” in November 2001. Notwithstanding the lost revenue, CRRA has not increased tip fees since that time, having chosen to pay for expenditures from reserves. This action has effectively maintained a moratorium on tip fee increases.

1. Eliminate The Recycling Tip Fee

As noted above, the adopted FY03 budget includes the imposition of a new tip fee on recyclables of \$20 per ton. Although increasing revenue, imposing a fee on recyclables creates a negative incentive for Towns to recycle which is contrary to public policy in Connecticut. The tip fee on recyclables should be eliminated.

2. Phase-In The Increase In Tip Fees

If the following Financial Recommendations are adopted, it is anticipated that CRRA will continue to use reserves through the end of the fiscal year as a substitute for tip fee increases. The CRRA adopted FY03 budget (effective July 1, 2002) would raise tip fees from \$51.00 to **\$67.00**, in addition to imposing a tip fee on recyclables of \$20 per ton. Such a fee has a revenue impact of \$1.5 million, comparable to an additional \$1.72 per ton of standard waste. Under the Adopted budget, costs to towns for disposal of waste would accordingly increase by the equivalent of \$17.72 per ton, to an equivalent total of **\$68.72**.

However, as noted above, even without the Enron bankruptcy, the CRRA Board believed that tip fees would have gone up by nearly \$7.00 per ton in FY03 to nearly **\$58.00** as a consequence of increases in costs. Additional increases in the future were also anticipated.

If the Financial Recommendations of the Advisory Panel are adopted, tip fee increases will be limited to \$4.00 per ton in FY03 and by the same amount annually in the next six years.

Tip Fees in FY03 are recommended to be **\$55.00** and not reach \$67.00 per ton until FY06 rather than in FY03.

This gradual, phased-in increase cannot be accomplished by a single “magic bullet” but only by a combination of measures. It will require utilizing reserves to keep tip fees down in the early years and then loaning money from the state to CRRA once the reserves are exhausted. That money will be repaid, with interest, in later years. The amount of borrowing that would otherwise be required is reduced by utilizing some additional revenue sources.

This is not a perfect solution. Some aspects may be troubling to some constituencies. However, as with any budget, any loss of revenue or increase in expense

from what is proposed here will result in higher tip fees unless some other offsetting adjustment is made.

In this context, the Advisory Panel makes the following additional Financial Recommendations.

3. Cut CRRA Overhead Expenses By 10%

CRRA should make an additional cut of at least 10% in its General Administration budget beyond the FY03 budget already adopted. This produces a saving in FY03 of \$562,112 over the adopted budget. The dollar amount grows in the out years.

It is not the Advisory Panel's role to micromanage CRRA by recommending specific cuts. However in view of the potential shortfall looming in the State's general fund budget, and in view of the rate increases that the Towns will have to absorb in the coming years, it is essential for CRRA itself to share in sacrifices. This is a painful, but obtainable, benchmark.

The 10% cut should be viewed as a floor, not a cap. The Oversight Board should begin immediately to evaluate all operational issues, including consulting contracts, to determine if additional savings can be achieved.

4. Use CRRA Unrestricted Reserves

Prior to the Enron bankruptcy, CRRA had accumulated significant reserve funds. It has already drawn on the reserves since Enron's failure to perform its obligation of making monthly payments of "capacity charges" since November 2001. Even with the use of reserves during this fiscal year, there is sufficient room to draw an additional \$43.3 million from the reserves to finance operations after July 1, 2002. This amount takes into account all of the receipts from the Enron transaction while at the same time maintaining the minimum level of reserves that financial prudence and sound management requires.

The CRRA adopted FY03 budget would have utilized \$8 million in that year with no specific plan for future years. The utilization recommended by the Advisory Panel is front end loaded to help minimize the tip fee increase in the current year and is lower in later years. The recommended utilization schedule is:

Year	Amount (Millions)
FY03	\$ 17.0
FY04	\$ 12.9
FY05	\$ 11.1
FY06	\$ 2.3

5. Secure Savings On Debt Service

Although refinancing the existing bonds is not practical before 2008, it is possible to achieve some debt service savings by utilizing a financial instrument that has the effect of swapping the fixed rate for a variable rate.

Because the interest rate was set in 1996 in excess of 5%, the current lower interest rate environment provides an opportunity for savings through the use of a lower, variable rate on approximately \$118.7 million of 1996 Series A bonds maturing from 2007 to 2012. The savings comes from the difference between the fixed rate and the current variable rate, which is more than 3 percentage points lower. The potential savings could theoretically be as high as \$3 million per year if rates stayed low through 2012. Because it is unrealistic to assume rates will remain as low as they currently are, the recommendations reflect projected savings of between \$11 and \$12 million over the ten-year period. In the first year, the projected effect of the swap is negative by slightly more than \$500,000. However beginning in FY04 the projected savings exceed \$2.8 million, declining until the original bonds are paid in full in 2012.

The two major risks associated with such a swap are that (1) short-term rates increase dramatically and stay at those higher levels, or (2) CRRA would want to terminate the swap in a higher interest rate environment, which would require a payment by CRRA to get out of this arrangement. There are mechanisms available to reduce those risks.

This strategy is based on consultation with experts in this area, but will require further refinement and analysis before being implemented. Nevertheless, we are sufficiently confident in the probability of being able to achieve savings of at least this magnitude that the savings have been reflected in the recommendations.

The Advisory Panel recommends the Oversight Board retain an independent financial advisor that has no previous experience with CRRA to fully analyze all options relative to debt restructuring. As noted below, if the Towns extend their waste contracts beyond the 2012 expiration date, additional restructuring options of the bonds may be considered.

6. Increase Revenue From Electricity Sales

Currently Enron Power Marketing, Inc. has the right to purchase the first 250,000,000 kilowatt hours (“**kWh**”)¹² of CRRA’s production (the “**EMPI**” power) annually beginning July 1 of each fiscal year.¹³ However, Enron has not paid for all of

¹² This is equivalent to 250,000 megawatt hours (MWh)

¹³ The Electricity Generation Agreement between CRRA and Enron Power Marketing, Inc. (EMPI) requires CRRA to deliver electricity to EMPI (sec 3.1(a)). This right applies to the first 250,000 MWh per contract year. (Sec. 3.4). EMPI in turn has a contract to sell it to CL&P.

Footnote continued on next page.

the power delivered during the current fiscal year (FY02) and CRRA can legitimately refuse to deliver additional power when there is no prospect for getting paid. This power is therefore available for resale. Two different strategies are recommended.

FY03 & FY04

The state of Connecticut currently purchases power for all of its agencies and institutions. With the exception of a few individual state educational institutions, the State has no long-term purchase contracts but instead buys its power pursuant to the standard offer. The state is free to purchase power from any supplier it chooses. The State should purchase power from the Mid-Conn project of CRRA.

The State currently purchases power in the CL&P service area at the standard offer rate, ranging from 5.5 cents per kWh to 4.0 cents per kWh.¹⁴ The weighted average purchase price is slightly less than 4.5 cents per kWh. The purchase price set in the Enron transaction is 3.1 cents per kWh in calendar year 2002 and 3.2 cents per kWh in calendar year 2003,¹⁵ a difference of 1.4 cents per kWh in the first six months of FY03. That incremental revenue over 250,000,000 kWh produces an additional \$3,500,000.

In order for CRRA to sell to the State, it should seek and obtain from the DPUC a Certificate of Public Convenience and Necessity (CPCN) to become a “supplier” which would mean CRRA is authorized to sell at the retail level. If CRRA and the DPUC move expeditiously, this could be accomplished before July 1, 2002. Thus the full \$3,500,000 could be obtained in FY03¹⁶ and a similar amount in FY04.

The State will pay the same rate it is paying now. No more, no less. There will be no adverse impact on the state’s budget or the budget of any state agency.

FY05 and beyond

The current standard offer expires at the end of 2003. Beginning on January 1, 2004, electric customers who have not selected a supplier will become part of default service. Standard offer suppliers are not required to include so-called “green” power. Legislation currently pending in Connecticut would require the default suppliers to include a minimum level of green power in the portfolio used to provide default service. Other states in New England, including Maine and Massachusetts (by far the largest power user in New England) appear likely to impose similar requirements.

EMPI will not be able to provide power to CL&P because CRRA will no longer provide power to EMPI. CL&P has the right to ask CRRA to provide the power directly to CL&P, but CRRA has the right to decline to provide it to CL&P and instead sell the power itself.

¹⁴ The standard offer rate for the State and other large users is lower than the residential standard offer rate.

¹⁵ The price goes to 3.3 cents in 2004.

¹⁶ Because Enron power is the first power produced in the fiscal year, any delay in implementing this arrangement beyond July 1, 2002 will reduce the revenue benefits.

CRRA's power production is Class 2 green power and therefore could be utilized to meet these portfolio requirements. Because of the relatively limited sources of green power, the experts consulted by the Advisory Panel project that green power will command a premium. Although it is impossible to know with certainty what the market price for this power will be in the future, a rate of 6 cents per kilowatt hour appears to be a reasonable assumption.

The recommendations reflect additional electricity sales revenue generated by this higher rate beginning in FY05.¹⁷

7. Utilize The Interest Free Capital That Consumers Give To Beverage Distributors By Escheating Unclaimed Bottle Deposits

Connecticut beverage distributors began collecting a 5-cent deposit on recyclable containers of specified beverages when the Bottle Bill was adopted. Connecticut law requires that when a consumer returns an empty container for recycling, the 5-cent deposit must be refunded to him or her. Not all recyclable containers are returned for refund, however, so a considerable number of deposits are never returned to the consumers who paid them. It is estimated that the total amount of such non-returned deposits totals \$15 million annually. These dollars are effectively an interest free source of working capital for the distributors.

The purpose of the original bottle bill was to encourage recycling by creating a financial incentive to return used bottles and cans. In order to help the Towns avoid paying a recycling tip fee that CRRA proposed to balance its budget – a fee that would provide a disincentive to recycling – the excess funds generated by unclaimed deposits should be utilized.

The distributors would not be required to return the money they have already accumulated. However, in the future any deposit money paid by consumers and not reclaimed by them would escheat to the state for the benefit of Connecticut's cities and towns. The Mid-Conn project of CRRA would not get all of the escheat funds. Rather it would only get the proportion of the total that corresponds to the proportion of the state's population that resides in its Towns (approximately 35.6%). The proportion of the total attributable to the remainder of the towns would be distributed to those towns through their solid waste disposal authorities.

¹⁷ Although the Connecticut green power requirement, if enacted would take effect January 1, 2004, the CRRA power available for sale is the first 250,000,000 kilowatt hours produced in that fiscal year beginning July 1, 2003. Thus, during FY04 most of that power will be sold between July 1 and December 31, 2003 and only a small amount will be available for sale after January 1, 2004. Accordingly, the recommendations assume all of the FY04 power is sold at the State of Connecticut purchase rate and that the green power premium is applicable only to power sold after July 1, 2004, i.e. FY05 and beyond.

This will require legislation. For purposes of the recommendations it is assumed that such legislation will be enacted in the current legislative session but that funds will not actually be available until January 1, 2003. This would produce additional revenue of \$ 2.67 million in the second half of FY 03, or \$ 5.34 million on an annualized basis. The revenue is assumed to inflate at a rate of 2% per year.

This is a critical component of the recommendations. The \$ 5.34 million in annual revenue to CRRA is the equivalent of \$6 per ton in tip fees. As noted above, all towns, not just CRRA, will get the benefit of this enactment.

8. Provide A Cash Flow Loan From The State in Future Years

The recommendations outlined here will enable CRRA to moderate tip fee increases and will also enable it be self-sustaining over the long term. Nothing in these recommendations requires a direct grant by the state to CRRA.

However, the projections show that once the reserves of the Mid-Conn project are exhausted, CRRA will need to borrow to sustain its operations until the existing bonds are paid off in FY12. After that, the money used to pay debt service on the bonds will no longer be required and can be used to pay off the accumulated borrowing. If the recommendations described above are implemented, the annual borrowing would vary from year to year (ranging from approximately \$3 million to \$14 million), but the accumulated balance of principal and accumulated interest is projected to reach a maximum of about \$49.5 million.

There is no practical private sector financing mechanism available to fund CRRA's borrowing during this period.

However, the State of Connecticut maintains several funds from which the legislature could authorize CRRA to borrow in order to sustain operations during the period when other sources of funding are not available. Three such funds may be considered as sources of the recommended borrowing:

1. Energy Conservation And Load Management Fund

Established by the State as part of the electric restructuring legislation, the fund is administered by the Energy Conservation Management Board with the approval of DPUC.¹⁸

¹⁸ See CGS sec. 16-245m.

2. Renewable Energy Investment Fund

Established by the State as part of the electric restructuring legislation, this Fund is available for Connecticut Innovations, Inc., a quasi-public agency, to promote investments in renewable energy technologies.¹⁹

3. General Fund

Following the pattern established for the Connecticut Student Loan Foundation,²⁰ CRRA would be authorized to borrow from the state General Fund.

Under any of these options, CRRA should be authorized to borrow at the rate then currently earned by the State, the so-called STIF (Short Term Investment Fund) rate. Because this is a borrowing, not an appropriation, there would be no net loss to the State.

It is possible to conceive of circumstances under which this borrowing will not be required or could be significantly reduced. The next section briefly describes additional strategies for enhancing revenue or reducing expenses for CRRA. Because these strategies cannot realistically be implemented before July 1, 2002 they are not included in the current recommendations. One or more of these strategies individually or in combination may make borrowing unnecessary or reduce the level of borrowing significantly.

It is the Advisory Panel panel's strong recommendation that the borrowing mechanism be put in place now. If it is never used or if the maximum authority is not required, it will do no harm. If however, the mechanism is not in place and unforeseen circumstances create a short tem cash flow problem before it is enacted, it could precipitate a crisis.

¹⁹ See CGS sec. 16-245n.

²⁰ See CGS sec. 10a-213.

VI. Long Term Strategies

The preceding Financial Recommendations can and should be implemented immediately. They will dramatically decrease the pending tip fee increase and lay the foundation for financial stability into the future.

There are other long-term strategies that CRRA should pursue in order to further reduce the impact of the Enron bankruptcy. They have been excluded from the Financial Recommendations not because they lack merit but because the time line for implementation or their inherent complexity or uncertainty makes it imprudent to include them as a base line recommendation.

The following long-term strategies should be pursued aggressively as soon as possible. In the event one or more of them is successful, it will allow CRRA to eliminate or reduce borrowing from the state and the projected tip fee increases. In other words, if the strategies succeed, the benefits should flow to those who have borne the burden in the meantime.

1. Pursue Law Suit Recovery

As noted above, it is beyond the scope of the Advisory Panel to make recommendations on legal theories, defendants or strategies.

The CRRA, the Attorney General, the State and the Towns must find a way to work cooperatively, not at cross purposes, to maximize the potential for recovery.

2. Pursue Additional Electricity Sales

CRRA should pursue opportunities to sell the balance of its output beyond the 250,000,000 kWh Enron portion. CL&P has the right to buy the next 250,000,000 kWh.

Following Enron's default, if CRRA elects to sell the power itself rather than provide it to CL&P,²¹ CL&P would have the right to terminate its purchase power contract and that power would be available for CRRA to sell. Although it is unlikely that CL&P would unilaterally cancel that contract, there may be an opportunity for CRRA to negotiate with CL&P for a buy out of that contract which could result in additional electricity for sale by CRRA.

If the output of the CRRA facility were ever to exceed the 500,000,000 kWh (the combined Enron and CL&P contracts), that electricity also would be available for sale by CRRA.

²¹ See section V.6. above.

3. Consider Sale of Assets

The Advisory Panel has been asked whether CRRA has assets which could be sold to generate revenue to offset tip fees. We do not have the expertise to make that judgment or the resources to investigate it in the time available.

The Advisory Panel recommends that the Oversight Board retain utility restructuring experts to appraise CRRA assets and consider, as part of a long term capital plan, how the value of both currently productive and unproductive assets can be enhanced.

4. Restructure Operating Arrangements

Significant portions of CRRA operations are performed by other firms on a contract basis. All of these arrangements should be reviewed for possible savings. Two specific situations warrant immediate attention.

The Metropolitan District Commission (MDC) has provided services to CRRA including operation of the transfer stations, the Waste Processing Facility and the landfills. There is presently a dispute between MDC and CRRA. The adopted CRRA budget assumed savings of \$1.8 million even though the dispute has not yet been resolved. It is not prudent to count on savings which have not been achieved; accordingly the projected saving was eliminated when constructing the recommendations.²²

The current relationship between the MDC and CRRA is poor. However, both serve the public. Indeed, they serve many of the same people. Both parties should use the current crisis to reevaluate their relationship. Negotiation is far more likely to produce mutual benefits than arbitration or litigation and can achieve savings in legal expenses.

Covanta has a contract to operate the Power Block Facility. The financial condition of Covanta is reported to be precarious. As that situation evolves, CRRA should be diligent in exploring opportunities to achieve savings through restructured operating arrangements.

5. Evaluate Potential Land Development

CRRA controls real property that it does not utilize for current operations. We understand that CRRA has, in the past, begun to explore development opportunities for some of this property.

²² See section IV.B. above.

Again, the Advisory Panel had neither the expertise nor the resources to evaluate the potential benefits of developing CRRA property. This is another area that needs to be explored in the future.

6. Consider A Replacement Ash Landfill

A critical event facing CRRA in the near future is the projected closure of the Hartford landfill. Although the burning of trash greatly reduces the volume of waste material that requires disposal, the ash produced by burning is currently being deposited in the landfill.

The advisory panel was advised that Connecticut's requirements regarding the disposal of ash are stricter than federal requirements or the requirements of many other states. Consequently, it is currently anticipated that when the Hartford landfill closes, it will be necessary to construct a rail spur and ship the ash to other states. This is projected to increase annual operating costs by as much as \$11 million per year by FY 09. At current tonnage, that annual cost is equivalent to approximately \$12.50 per ton in tip fees.

The recommendations described in section V. assume that this cost will have to be absorbed.

The Advisory Panel has no expertise in environmental matters. Nevertheless, it respectfully suggests that as the time for closure of the Hartford landfill approaches, it may be appropriate for policy makers to review the relationship between costs and benefits of the existing system and to evaluate possible alternatives, such as the siting of a replacement ash landfill in the state.

7. Refinance The Existing Debt

As noted above, the legal restrictions on the existing debt mean it is not callable at all, or is not callable without penalty, until 2008. After that time, the ability to refinance the debt will depend on the willingness of the towns to extend their Service Contracts with CRRA beyond 2012. In order to be able to refinance in 2008, CRRA needs to begin now to work with the Towns and to restore the working relationships and mutual trust that are an essential prerequisite to the Towns considering an extension of their contracts.

VII. Implementation of the Recommendations

Neither the CRRA nor the Towns can solve the current crisis without help. Many of the foregoing recommendations can be done by CRRA acting alone. This section briefly describes the cooperation needed from others.

A. The Legislature

Oversight Board. Whether or not CRRA is responsible for the existing problem is for others to resolve. It is clear, however that the credibility of the existing board and management has been questioned. Legislation is required to create an Oversight Board. The alternative is to leave CRRA without meaningful oversight.

Escheats. Legislation is required to recapture the money that consumers are currently leaving in the hands of beverage distributors. All towns in Connecticut will benefit from the proposed change. Without this revenue, tip fees will need to increase an additional \$6 per ton beyond what the Financial Recommendations project.

Cash Flow Loan From the State. The Financial Recommendations will allow CRRA to continue without any direct payment from the state. But the approach requires CRRA to borrow in some years and repay it later. The State is the only available vehicle for such funding. Legislation is required to authorize this borrowing. The alternative is that CRRA will either have to increase tip fees dramatically in future years or default on its bonds, which will trigger a direct payment by the state and significant collateral consequences.²³ A loan is far preferable.

Abandon the Legislative Moratorium. The Advisory Panel recognizes the reasons that so many public officials have urged a legislative moratorium on raising tip fees. In the absence of any other option, and without the benefit of a full analysis of the potential consequences, the moratorium may have appeared to be the only available alternative to an unbearable increase in tip fees.

The Advisory Panel believes that as a result of these recommendations, the situation has changed. If they are adopted, a legislative moratorium will be unnecessary and the significant adverse consequences to the State and the Towns can be avoided.

The Advisory Panel in the strongest possible terms urges public officials in the Towns and in State government to abandon the legislative moratorium in favor of the recommendations contained in this report or a comparable alternative.

²³ See section IV.C.2. above.

B. The Attorney General

As noted above, litigation regarding the past transactions has already commenced and more is likely. As the Constitutional officer charged with representing the State's legal interests, the Attorney General must, of necessity, play a central role in the development and implementation of the litigation strategies which will be utilized to protect the interests of the State, the Towns and their taxpayers.

C. The Treasurer

The Treasurer's participation will be required in connection with the implementation of the cash flow loan from the State.

With regard to refinancing or restructuring of CRRA's debt, the precise legal requirements for the Treasurer's participation or review may vary with the nature of the transaction finally proposed. In any event, however, the Oversight Board and the CRRA Board should be scrupulous about providing the Treasurer with complete and timely information about any proposed transactions and getting the benefit of the Treasurer's expertise.

D. The DPUC

The only action required by the DPUC will be to review CRRA's application for a Certificate of Public Convenience and Necessity to operate as a supplier of electric power. No change in the applicable standards or the existing process is recommended.

The Advisory Panel respectfully suggests that it is in the interest of all concerned for CRRA to apply promptly, and for the DPUC to act as promptly as possible, in order for CRRA to be able to achieve the enhanced revenue from electricity sales beginning July 1, 2002.

E. OPM and DAS

The customer for CRRA's sale of what was previously Enron's 250,000,000 kWh is the state of Connecticut. For the same reason it is important for the DPUC to act quickly, the Office of Policy and Management and the Department of Administrative Services should act as promptly as possible to arrange to purchase electricity from CRRA so that the enhanced revenue from electricity sales can be achieved.

F. The Towns

No formal action is required by the member Towns to implement the Advisory Panel recommendations. The Advisory Panel recognizes that although we believe the recommendations are the best available solution at this time, they still present significant challenges for the Towns.

Nevertheless, the Advisory Panel respectfully suggests that the Towns

- Drop their support for the legislative moratorium;
- Refrain from initiating litigation against CRRA; and
- Refrain from initiating any other litigation until the Oversight Board and others have an opportunity to develop a cooperative and coordinated approach to maximize the potential benefits for the State and CRRA, which will ultimately benefit the Towns.

VIII. CONCLUSION

We recognize that implementation of the foregoing recommendations will require compromise and pain by all involved. They are not the only possible solution, but we believe they are a workable one.

The Advisory Panel has looked critically at information provided but has not had the time or resources to do a full blown due diligence investigation of financial data, to review all the technical information, or do a complete legal analysis of all the relevant issues. Out of necessity, we have had to depend on information provided by others and our own experience.

Ultimately, however, the recommendations contained in this Report are our own, and we are solely responsible for them.

Respectfully submitted,

William J. Cibes, Jr.

Richard D. Gray

Richard F. Orr

CRRRA HISTORIC TIP FEE COMPARISON

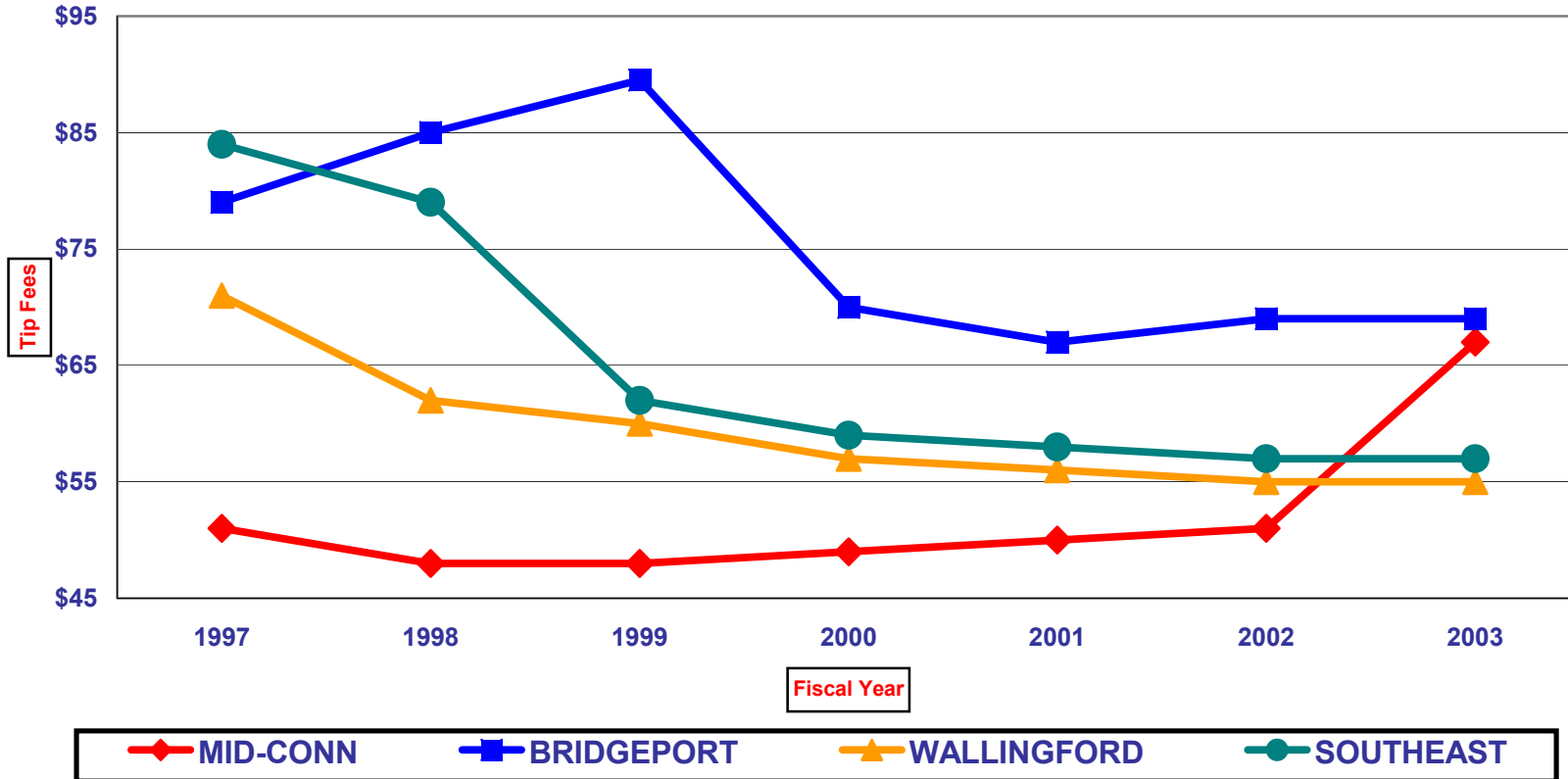


EXHIBIT 2

State of Connecticut MSW Tipping Fees by Affiliation

	2002	2003	
80			80
79			79
78	HRRR \$78	HRRR \$78	78
77			77
76			76
75			75
74			74
73			73
72			72
71			71
70			70
69		Bridgeport \$69	69
68			68
67	Bridgeport \$67	Mid-Conn Adopted \$67	67
66	Preston I \$66	Preston I \$66	66
65			65
64			64
63			63
62			62
61	Bristol \$61	Bristol \$61	61
60			60
59			59
58			58
57	Preston II \$57	Preston II \$57	57
56			56
55	Wallingford \$55	Wallingford \$55 Mid-Conn Proposed \$55	55
54			54
53			53
52			52
51	Mid-Conn \$51		51
50			50

NOTE: Tip Fees for the Southeastern Connecticut Project in Preston vary among towns. They have been grouped for simplicity. This table represents the vast majority of, but not all, Connecticut towns.