

## LEGISLATIVE DIGEST

### FOR LEGISLATION AUTHORIZING A PUBLIC-PRIVATE PARTNERSHIP BY CONCESSION OVER THE WATER AND WASTEWATER SYSTEMS OF THE GUAM WATERWORKS AUTHORITY

(Draft version dated December ~~3~~22, 2004)

Unless the context otherwise requires, capitalized terms used herein shall have the meanings ascribed to them in the Proposed Legislation (defined below).

**Section 1. Legislative Findings and Intent.** This Section describes the background and rationale for legislation that authorizes a public-private partnership by Concession over the water and wastewater systems of the GWA (the “*Proposed Legislation*”). As used in this document and the Proposed Legislation, a Concession means the right conveyed upon a private party to manage, operate, maintain, rehabilitate, design, construct, improve, expand, finance, repair and refurbish the GWA Systems.

#### **Section ~~2~~2. Definition of Terms.**

**Section 3. Public-Private Partnership by Concession.** This Section authorizes GWA to enter a public-private partnership and sets forth a list of the Government of Guam’s key parameters for such partnership. These parameters include the requirement that (i) GWA continue as a public corporation and ~~autonomous instrumentality of the Government of Guam~~ and retain ownership of all real ~~estate~~property assets and fixtures comprising the GWA Systems, and lease the same to the Concessionaire, (ii) the People of Guam continue to own Guam’s water resources, (iii) the Concessionaire offer employment to the GWA employees whose employment by GWA will be terminated as a consequence of the award of the Concession, ~~and~~ (iv) the Concessionaire comply with the requirements of the Stipulated Order, and (v) to the extent required by applicable law, the United States Environmental Protection Agency consents to the terms and conditions for the award of the Concession. The pre-qualification rules, bidding rules and transaction documents for the Concession must reflect these requirements.

**Section 4. Transaction Process.** This Section establishes a transaction process in which the CCU pre-qualifies potential bidders, administers due diligence/negotiations with pre-qualified bidders, prepares and issues the RFP, selects a preferred bidder and monitors closing conditions for turnover by GWA of the GWA Systems to the Concessionaire. Clause (a) (*Management*) designates the CCU as the Government of Guam entity that will manage the entire transaction process. Clause (b) (*Pre-Qualification*) ensures that interested bidders satisfy specific technical and financial criteria, which qualify them to perform the functions of the Concessionaire, and prescribes publication requirements to ensure that the CCU’s announcement of the investment opportunity reaches the widest possible group of potential bidders. Clause (c) (*Request for Proposals*) establishes guidelines for the preparation of the RFP based on the concept that (i) the CCU will negotiate final transaction documents with pre-qualified bidders prior to the issuance of the RFP; and (ii) the ECC must approve the GWA Employee Transfer Terms before the CCU’s issuance of the RFP. During the negotiations with the pre-qualified bidders, the CCU will seek to establish the most favorable non-bid price

terms and conditions for GWA's rate-payers which will cover a wide range of issues, including Stipulated Order compliance, GWA System performance, water and wastewater service targets, the GWA Employee Transfer Terms, environmental liability and changes-in-law, reduction of non-revenue water, performance bond coverage, rate adjustments, customer service levels and many other requirements determined by the CCU. Clause (d) (*Selection of Preferred Bidder*) contemplates that the CCU will select the preferred bidder based ~~solely~~ on criteria determined by the CCU, which will consist of (to the maximum extent possible) financial criteria such as the lowest rate to be ~~developed~~ paid by rate-payers as well as any of the above-described criteria that the CCU, ~~which expedites~~ may deem appropriate through its interactions with the pre-qualified bidders. This approach serves to expedite, and minimizes litigation risk during, the selection process. The CCU currently envisions that it would select as a preferred bidder the investor who proposed to provide water and wastewater services for a rate that represented the greatest percentage of reduction from a public benchmark rate. The CCU would establish this benchmark rate on the assumption that (A) no public-private partnership occurs, (B) GWA continues to operate the GWA Systems, and (C) the rate level should allow GWA to finance the projected costs of a five-year capital improvement program that is at least responsive to the requirements of the Stipulated Order. Clause (e) (~~Legislative~~ Government Approval) gives the ~~Guam Legislature~~ Government the final opportunity to approve the Transaction Documents to be signed by the preferred bidder for the award of the Concession. Clause (f) (*Award*) sets out a procedure for the award of the Concession by GWA.

**Section 5. Role of GWA Employees.** This Section generally follows the approach adopted by the Legislature for the privatization of the Guam Telephone Authority ("GTA") to safeguard the employment of public employees whose employment by GWA will be terminated as a consequence of the privatization. These safeguards principally consist of (i) the formation of the Employee Coordinating Committee who will negotiate the GWA Employee Transfer Terms with the CCU for inclusion in the Transaction Documents, (ii) the appointment of an Employee Financial Advisor who will support the Employee Coordinating Committee during the negotiation of the GWA Employee Transfer Terms with the CCU and otherwise represent the best interests of GWA employees, and (iii) the opportunity to participate in the transaction process through the CCU's Communications Sub-Committee, which provides a forum for all stakeholders, including members of the Employee Coordinating Committee, to express concerns, provide input and otherwise play a meaningful role in the transaction process.

**Section 6. Water and Wastewater Service Franchise.** GWA currently serves as the common water and wastewater service provider for the civilian population of Guam pursuant to its franchise rights set forth in clauses (a), (d), (f) and (k) of Section 14104 of Public Law 26-15:2 (see Exhibit 1 hereto for a copy of Section 14104). Because the Concessionaire replaces GWA as the common water and wastewater service provider upon the award of the Concession, Section 6 of the Proposed Legislation generally establishes, and grants, a similar franchise for the Concessionaire. The Concession differs from the Franchise. While the Franchise confers upon the Concessionaire the right to provide water and wastewater services to Guam's rate-payers within a defined Service Area, the Concession provides the Concessionaire with the means to carry out these services by conveying a right to use GWA's water treatment, transportation and distribution facilities as well as its wastewater collection, treatment and discharge facilities. Clause (b) (*Exclusivity*) ensures that the Concessionaire shall

exercise exclusive franchise rights within the Service Area with the exception of (i) the production, distribution and sale of bottled drinking water, and (ii) the provision of sanitation or plumbing services. Clause (c) (*Transfer and Term*) ensures that the term of the Franchise precisely matches the term of the Concession set forth in Section 3(d) of the Proposed Legislation. Clause (d) (*Suspension*) suspends the operation of GWA's franchise rights during the term of the Concession which addresses investor concerns that GWA may otherwise compete against the Concessionaire. Clause (e) (*No Assignment / Change-in-Control*) imposes standard restrictions on the indirect or direct transfer of the Franchise to third parties. Clause (f) (*Franchise Fee*) waives the payment of any fee in respect of the Franchise by the Concessionaire on the basis that these savings will directly translate into lower rates for water and wastewater services. Clause (g) (*Regulatory Oversight*) makes the Concessionaire a new "public utility" under the PUC's regulatory authority. Clause (h) (*Indemnity*) requires the Concessionaire to hold harmless the Government of Guam from any liability arising out of the exercise of its Franchise rights. Clause (i) (*Restricted Activities*) ensures that the Concessionaire will not distribute and/or sell bottled drinking water produced from Guam water resources without the CCU's prior approval.

**Section 7. Rate Stabilization.** To forecast a return on their investment in the Concession with some accuracy, potential investors will need a clearly defined framework for the review and increase of rates during the Concession period. Clause (a) (*General*) establishes a Rate Stabilization Agreement (the "RSA") between the PUC and the Concessionaire as the vehicle for defining a rate-setting process during the period of the Concession. The RSA, which shall be finalized before the CCU issues the RFP, introduces certainty into the rate-setting process and enhances the Concessionaire's ability to raise financing for new capital improvements. Clause (b) (*Rate-Setting Policy*) defines a rate-setting policy that allows the Concessionaire to (i) recover its expenditures for operation, capital maintenance, debt service and other expenditures so long as the Concessionaire has made such expenditures efficiently and prudently, and (ii) earn a rate of return on equity invested by the Concessionaire's shareholders and the Concessionaire's retained earnings. While regulatory authorities in the US market typically allow a water utility to earn a rate of return that ranges between 9.5 to 10%, this Section intentionally leaves the determination of the appropriate rate of return to the PUC. Clause (c) (*Regulatory Procedure*) confirms the PUC's authority to approve, and the CCU's responsibility to petition the PUC for the approval of, the RSA and the first associated rate plan as part of a regulatory proceeding.

**Section 8. Government Support.** Under this Section, the Government of Guam provides ~~two~~three different types of support for the Concession, which take the form of one or more payment guarantees ~~and~~ tax exemptions and a pledge by the Government of Guam. The need to enhance GWA's credit through a Government payment guarantee stems from the fact that GWA will have payment obligations as the Government counter-party under the Transaction Documents without a balance sheet to support them. Typically, GWA will remit Concession-related payments to reimburse the Concessionaire for (i) the cost to clean-up environmental hazards and other conditions that existed prior to the award of the Concession, (ii) any unrecovered investments that may exist at the end of the Concession period, and (iii) any outstanding indebtedness at the end of the Concession period. These payments form essential elements in the proposed investment opportunity for potential bidders and their lenders/bondholders. This Section also exempts the Concessionaire from all Guam taxes. The

rationale behind this form of the Government of Guam support stems from the need to keep the Concessionaire on a level playing field with GWA in terms of operating expenses. Rather than solicit the highest price in respect of the Concession, the CCU's proposed bidding procedure will require each potential investor to bid on the basis of the lowest rate below a public benchmark rate, which the CCU believes will allow GWA to operate and improve the GWA Systems itself. Taxes represent an operating expense. Since the public benchmark rate reflects GWA's tax exemption, the private sector needs the same benefit for the CCU to properly evaluate private bid rates. Further, this Section provides a pledge and agreement by the Government that it will not take any action that would limit or impair the powers given to the Concessionaire under the Proposed Legislation or materially impair the powers, duties or effectiveness of the PUC in relation to the Concessionaire and its rights. Given the Legislature's past interference with the PUC's rate setting ability, this pledge and agreement provides security to potential bidders and their lenders/bondholders that future Legislatures will not interfere with the rights given to the Concessionaire or the PUC's ability to set rates. This pledge and agreement includes aspects of previous pledges given by the Government for the Guam Power Authority's 1999 bond issuance and in the Government's 2004 legislation authorizing the Guam Airport Authority's bond issuance.

**Section 9. Security Interests.** This Section describes the scope of security interests that the Concessionaire may grant in favor of bondholders and other lenders. To ensure the financeability of the transaction, lenders will require at a minimum a security interest in amounts owed by rate-payers, payments owed by GWA in the event of an early termination of the Concession, ownership interests held by the winning bidder in the Concessionaire, and any new assets contributed to the GWA Systems by the Concessionaire.

**Section 10. Enforcement and Amendments of Transaction Documents.** The Government of Guam will want to exercise control over any material changes to the terms of the Concession that the Concessionaire and GWA may agree after the award date. This Section gives the Legislature approval authority over material amendments and therefore the ability to manage the level of Guam's exposure under the payment guarantee to be issued by the Government of Guam as part of the transaction.

**Section 11. Protest Provisions.** This Section defines the procedure for unsuccessful bidders to protest the selection of the preferred bidder by the CCU for the award of the Concession. All parties with an interest in the Concession (including the Government of Guam, bidders and lenders) normally want to see finality in the award. This provision requires potential claimants to file claims of protest within a fixed period of time after the selection date after which these same claimants will lose their standing to oppose the CCU's selection.

**Section 12. Amendments.** This Section amends or repeals legislation that will impact the Concessionaire. Clause (a) (*Priority of Water Uses*) ensures that the Concessionaire receives the same priority of groundwater use as GWA. Clause (b) (*Well Drilling Activities*) ensures that the Concessionaire receives the same well drilling privileges as GWA. Clause (c) (*PUC's Rate-Setting Policy*) redefines the PUC's rate-setting policy to conform with Section 7(b) (*Rate-Setting Policy*). Clause (d) (*Charges for Water Use*) ensures that the Concessionaire shall not pay monetary charges for water drawn from wells. Clause (e) (*Bond Issuance*) removes the legislature approval requirement for the issuance of qualified private activity bonds on the basis

that the Concessionaire will be responsible for the repayment of such indebtedness. Clause (f) (Certification of Sewer Lines) ensures that the Concessionaire receives the same powers as GWA regarding certification of the sewer lines during the Concession period. Clause (g) (GWA's Rule-Making Powers) grants rule-making powers jointly to GWA and the Concessionaire, through a joint rule-making committee, during the period of the Concession, and Clause (h) (Guam Administrative Rules) recognizes such joint rule-making power. Clause (i) (Frank D. Perez Economic Revitalization and Enhancement Zone Act) applies the rights currently afforded to private water contractors to the Concessionaire. Clause (j) (Contractor Licenses) includes the Concessionaire amongst the entities operating public utilities. Clause (k) (Deep Well A-32) grants an easement to GWA to access Deep Well A-32, and provides GWA with the right to lease its rights arising out of such easement to the Concessionaire.

**Section 13. Conflict of Interest.** This Section largely tracks the language of the GTA legislation and precludes parties with a relationship to the Government of Guam from participating in the Concession. While this Section generally precludes the Concessionaire from employing certain individuals involved in the procurement process for two years after the award to avoid conflicts of interest and maintain the process' integrity, this restriction only applies to (i) GWA employees, and persons under contract with the CCU, who have directly participated in the transaction process as a member of the CCU's Transaction Sub-Committee, (ii) advisors and consultants who worked with the CCU or GWA to develop the RFP, (iii) advisors, consultants and employees of the Legislature who advised or worked with the Legislature on matters related to the Concession, (iv) any escrow agent (including its directors, officers and interested persons) that holds funds on deposit related to the Concession, (v) any offeror (including its directors, officers and interested persons) who is (x) a spouse or family member of that spouse or (y) a family member or spouse of a family member of any person described in (i), (ii), (iii) or (iv) above, and (vi) any offeror and any of its affiliated entities, who has paid or agreed to pay any person described in (i), (ii) or (iii) above, to assist it in its efforts to acquire the Concession.

**Section 14. Procurement by Concessionaire.** This Section exempts the Concessionaire from the procurement rules and regulations that apply to GWA.