

January 27, 2014

To: Missoula City Council

From: John Engen

RE: Offer to purchase Mountain Water

This evening I'm asking the Missoula City Council to authorize me to make a formal offer to purchase the assets of Mountain Water Company for \$50 million.

The offer is the next logical step in a process that began with council's approval of Ordinance 3509, which authorized me to pursue the purchase of the monopoly water utility through negotiation and, if necessary, through condemnation.

The offer here reflects what our team of attorneys and financial advisors deem reasonable for an asset purchase. We think that the Carlyle Group purchased Mountain Water as part of a larger transaction for about \$50 million, though the actual number has never been publicly disclosed. If this were a negotiated stock purchase, with all the associated intangible assets, good will and contractual protections to the City, the City of Missoula believes we could make a reasonable offer on the order of \$60 million or more, but because Carlyle has not come to the table, we're left to offer the investment fund about what it paid.

Your action tonight allows me to push a formal, authorized offer across the table. Attached to your packet this evening is the offer letter.

To date, Carlyle has rejected our informal overtures to come to the table and has suggested that its price on Mountain Water is more than \$120 million, more than double what they paid for it in 2011. It is a price that we can't pay and it is unjustifiable by any commonly accepted method of valuation.

I expect this offer will be rejected as well, at which point we will begin condemnation proceedings in district court. My fervent hope is that Carlyle will then come to the table to begin serious negotiations. And if they don't, our legal team continues to believe we will prevail in court and own our water company at a fair price.

With this action, you agree to nothing but making an offer. Any transaction will require your thorough review and approval.

Condemnation is serious business and I'm not leading us down this path lightly. I believe, in the public interest, I'm required to pursue this method because of what's at stake: rights to Missoula's water and its distribution. And I believe that Carlyle intends to sell Mountain Water and its sister and parent companies in California in the very near future to yet another for-profit, out-of-state enterprise with no stake in our community, our place, our people or our future and without deliberate, swift action, Missoula will continue to be the only major city in the state of Montana beholden to a private company for a glass of water or a hot shower.

If someone tells you Mountain Water is not for sale, it's simply not true. It was for sale the day Carlyle bought it. And Carlyle is making another change in its investment strategy, moving away from public utilities, which can be a tough business, to energy. In fact, its investment philosophy has changed dramatically since it purchased Mountain Water in 2011, another reason for the city to pursue ownership: we have one goal, which is to deliver clean, safe water to our citizens in the most effective and inexpensive way possible.

You won't hear anyone at Carlyle confirming any of this, in no small part because as a private company, they aren't required to do so.

And, while we have a letter agreement that allows us a first right of refusal, our advisors don't believe it gives us enough security in this high-stakes situation.

Because I've been working on thinking about and working toward this acquisition for three years, I sometimes forget that not everyone knows why I, and many others, believe that public ownership of the water system is critical to the future of our community.

Let me review:

Why should the city own the water system?

Fundamentally, access to clean, safe drinking water is critical to the health and welfare of all human beings. Management of that fundamental resource should not be the province of a private corporation beholden to distant investors or stockholders, but rather a public utility. I, and many other City of Missoula elected officials and citizens, strongly believe that a community's water system is a public asset that is best owned and operated by the public, through municipal government.

Why now?

Mountain Water's current owner is a subsidiary of Carlyle Infrastructure Group, a global investment fund that purchases businesses at a fixed price, adds financial leverage to increase their value by growing revenue or cutting expenses or both, then resells the business. Carlyle has owned Mountain Water for two years and is failing to grow revenue or cut expenses based on its financial projections. We believe an asset that's not performing will be on the market in the relatively near future. Further, as the national economy continues its recovery, changes in the bond market suggest that this may be the best time to borrow money to purchase the system. And while we have an agreement that provides some opportunity to make an offer to purchase, we don't believe it provides us enough security moving forward.

What will it cost?

Our analysis suggests the system can be valued between \$40 million and \$60 million. This offer reflects the value based on the structure of the transaction and the assets that would be included. We won't negotiate in public, but we'll bring any agreement we reach to the City Council and the public for a thorough review and decision.

What will it mean to customers?

Our analysis suggests that in the near term, customers would notice very little change. Over the long term, the city would encourage conservation, accelerate systems repairs and maintenance and make plans to ensure the sustainability of the system. Our analysis suggests that we can purchase the system through revenue bonds and manage the debt without an immediate rate increase. I want to emphasize that the city will eventually raise rates, but those decisions are made by the City Council, subject to public hearing. Further, those rates don't support profits, rather, they are reinvested in the system.

What will it mean to taxpayers?

Citizens of the City of Missoula will own the water system but, like the City of Missoula's wastewater treatment system, operations, maintenance and debt will be supported through rates collected by the water utility.

What will it mean to Mountain Water employees?

We believe the employees of Mountain Water are experts in operating the system and our goal will be to preserve their jobs and maintain their wages and benefits. Over time, we may learn that some management and professional positions may not be practical or necessary as part of a municipal operation, but we'll work on agreements that allow for a reasonable, humane transition.

What kind of condition is the system in?

To date, we've relied on public documents that don't provide a clear picture. We do know that the system leaks, but as part of our due diligence, we'll engage a national engineering firm to evaluate all aspects of the system.

What does "condemnation" mean?

There's a common misperception that condemnation or the exercise of eminent domain is simply the government taking over private property. In this case, if the city were to pursue condemnation, a court would decide on a fair market value for the system and the city would be required to compensate Carlyle accordingly. While condemnation is not our preferred option for acquisition, we believe it is a necessary course of action if a negotiated sale is not in the offing.

What's changed since the last time the city pursued condemnation?

Our attorneys have worked diligently on this question and are confident that many of the facts on the ground have changed considerably in the 30 years since Missoula last attempted condemnation. We have detailed arguments supporting the position that the city's acquisition is a matter of public necessity.

How long will this take?

A negotiation, due diligence and council deliberation and a decision could happen in a matter of months. Condemnation could take years.

Why didn't we buy it before?

Another misperception is that Mountain Water Company has been available to the city to purchase in recent history, particularly when Park Water sold it to Carlyle. Park Water was not willing to sell to the city of Missoula.

Who will run it?

The same employees running Mountain Water today will continue to work for the City of Missoula (unless they choose otherwise) and we'll plan a transition over time to manage any pay inequity or staffing concerns.

Do voters need to approve the purchase?

Not directly. The Missoula City Council and the mayor have the authority to make the purchase. Indirectly, through their voted representatives, voters will have approved the purchase. Based on all of the information we have today, there is public support for municipal ownership of the water system.

Is this just another way for the City of Missoula to generate revenue?

No. There is certainly revenue generated by the water system, but it can only be invested in the utility and its management.