

State of New Jersey
Office of the Inspector General

Mary Jane Cooper, Inspector General



**Meadowlands Remediation and
Redevelopment Project**

February 28, 2008



State of New Jersey
OFFICE OF THE INSPECTOR GENERAL
PO Box 208
TRENTON NJ 08625-0208

JON S. CORZINE
Governor

MARY JANE COOPER
Inspector General

February 28, 2008

The Honorable Jon S. Corzine
Governor
State of New Jersey
Office of the Governor
PO Box 001
Trenton, NJ 08625

Dear Governor Corzine:

Enclosed please find the Office of the Inspector General's report concerning the Meadowlands Remediation and Redevelopment Project.

This review, initiated at your request, details the financial history and other issues that came to our attention during the course of our investigation.

As required by statute, a copy of the report has been sent to Senate President Richard J. Codey, Assembly Speaker Joseph J. Roberts, and EnCap representatives.

We have included for your consideration recommendations for this and further public/private partnerships.

I am available to discuss this report with you at anytime.

Very truly yours,

A handwritten signature in black ink, appearing to read "Mary Jane Cooper", written over a horizontal line.

Mary Jane Cooper
Inspector General

cc: Senate President Richard J. Codey, New Jersey State Senate
Speaker Joseph J. Roberts, Jr., New Jersey State Assembly
Edward McBride, Chief Counsel, Office of the Governor
EnCap Representatives

Office of the Inspector General
Meadowlands Remediation and Redevelopment Project

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APPENDIX A

APPENDIX B

I. INTRODUCTION

A. Scope of Investigation

In October 2000, the New Jersey Meadowlands Commission (NJMC) entered into a Landfill Closure and Development Agreement (hereinafter either “Landfill Closure Agreement” or “Development Agreement”) with EnCap Golf Holdings, LLC (EnCap). As a result of the October 2000 Development Agreement and subsequent amendments, the NJMC transferred ownership and development rights of roughly 1,300 acres to EnCap in return for an agreed upon payment and EnCap’s agreement to close four landfills on the property and to remediate and develop the surrounding property (the Project). EnCap took advantage of State financial incentive programs and used public low interest loan programs available for remediation projects to borrow \$212 million. EnCap obtained additional \$102.8 million from a county government source for other project costs.

EnCap also entered into financial agreements with two municipalities with property within the area subject to the Development Agreement. In return for remediation, development, and incentives, EnCap would share in the revenues anticipated to be received from payments in lieu of taxes (PILOTs) that future property owners within the development area would be required to pay. It was anticipated that the PILOT rate, at least at the outset, would be higher than the property tax rate paid by the rest of the community. In 2006, EnCap applied to the Local Finance Board within the New Jersey Department of Community Affairs for approval to issue up to \$450 million in bonds backed by these future payments. Shortly thereafter, Governor Jon S. Corzine expressed concern that the towns could be at risk of financial detriment as a result

of their agreements with EnCap and requested that the New Jersey Office of the Inspector General conduct an investigation into the history of the Project's financing. This report is the result of that investigation.

At the time OIG began its review of the roughly eight years of the large and multifaceted Project, other State entities were working in real time to ensure that the remediation was completed and to deal with the complex financial and legal issues that were surfacing. In order to understand events that had occurred, OIG of necessity considered evidence revealed during this process and events that went beyond the date of the Governor's request. To the extent that OIG learned information that could be relevant to the ongoing governmental efforts, OIG promptly shared that information with appropriate authorities.

OIG's report does not, however, include a thorough review of actions taken since the Governor's request for OIG's investigation; nor does it include a current update of the Project. Nonetheless, the historical evidence gathered during OIG's review, OIG's analysis of the evidence, and OIG's conclusions reported herein are relevant to the current status of the project since many of the issues have not been resolved and many of the entities involved in the project historically are still involved as of the date of this report.

OIG's report also includes lessons learned from this Project. It includes recommendations for significant procedural and structural reforms to be implemented, to the extent feasible, for this Project going forward and for any future public/private partnerships.

B. Investigative Process

In conducting the investigation, OIG interviewed 75 people, some of them multiple times, and all but a few of the interviews were recorded. Those interviewed included EnCap owners/employees; attorneys from the firm advising EnCap during the Project;¹ EnCap consultants and vendors; past and present elected representatives of and consultants to three municipalities with property in or adjacent to the Meadowlands area: Borough of Rutherford, Township of Lyndhurst, and Borough of North Arlington; State legislators; appointed members of three past and present State administrations, including the former Treasurer, the former Commissioner of the Department of Environmental Protection, and the former Commissioner of the Department of Community Affairs, and their staffs; board members and staffs of State authorities; and advisors to State authorities and departments.

EnCap retained a law firm² to represent it in conjunction with OIG's investigation and requested that all contacts with EnCap employees and consultants be made through that firm. OIG honored EnCap's request, and EnCap owners, employees, and consultants were interviewed by OIG in the presence of at least one attorney from that firm. OIG was also invited to attend several meetings called by the Environmental Infrastructure Trust with Project stakeholders, including representatives of State departments and authorities, and EnCap owners, representatives, financial or potential financial backers, and advisors.

¹ Almost from EnCap's first interest in the Project, EnCap retained the firm currently known as DeCotiis, FitzPatrick, Cole & Wisler, LLP (DeCotiis) to represent EnCap in various matters that are discussed in this report. EnCap and representatives of the DeCotiis firm agreed that members of the firm who were involved in EnCap matters at the time could be interviewed by OIG during its investigation.

² Friedman Kaplan Seiler & Adelman, LLP.

OIG gathered and reviewed over 60,000 pages of documents during the investigation that were logged into a database. These included documents relevant to the selection of EnCap for the project; contracts and amendments; e-mail and other correspondence; engineering reports; invoices; change orders; and information regarding campaign contributions from the Election Law Enforcement Commission and Federal Election Commission.

C. Standards

In determining standards of conduct, OIG was cognizant of State ethics requirements governing the conduct of State employees who are conducting business on behalf of the State or other public entities, and statutes that might be implicated in the conduct of those involved in the Project. OIG does not reach conclusions regarding the conduct but refers this report to appropriate governmental agencies for their review to determine whether further action is warranted.

D. Format of Report

This report contains the result of OIG's investigation into the financial history of the Project. The report is divided into nine sections. Section I contains: this Introduction; Section II contains OIG's Conclusions; Sections III through IX contain an analysis of the evidence gathered during OIG's investigation. The report also has two attached appendices.

II. CONCLUSIONS

A. NJMC Enters Agreement with Private Entity

The New Jersey Meadowlands Commission (NJMC) was created to plan and implement the cohesive remediation and development of 21,000 acres of land known as the Meadowlands located in several contiguous municipalities in northern New Jersey. The land included 2,400 acres of legal and illegal landfills and was otherwise contaminated, fallow, and underused.

Because of changes in the law providing reimbursement of up to 75% of remediation costs to developers of unused and underused contaminated property, in 1998, NJMC was encouraged to seek a private party to remediate and develop some of the Meadowlands property. NJMC issued a request for qualifications to close three landfills on approximately 460 Meadowlands acres. NJMC would retain certain rights, including the right to review the developer's plans for property development and to declare the developer in default if certain conditions were not met within defined time frames. Remediation was required to be completed in accord with requirements prescribed by the New Jersey Department of Environmental Protection (DEP) based on engineering certifications regarding the condition of the property and the developer's intended use. However, the intent was to have the developer pay for and conduct the remediation of the property that would be turned over to the developer; the developer would control the project; receive a 99 year lease on the property at a small annual fee; and would have the right to build a golf course, an office building, and a hotel on the remediated property.

EnCap,³ a subsidiary of a company owned by investors Louis Gonda and William Gauger, was one of several respondents. EnCap represented to NJMC representatives that among its other qualifications for the Project, the eight companies that were members of its team, including environmental engineering firms and a golf course designer, had extensive experience and expertise in landfill-closure-to-golf-course development and that EnCap had the private financial wherewithal to complete the project without public financing. EnCap represented that the team was currently working in Texas on a project similar to the Meadowlands Project. NJMC staff evaluating the responses concluded that EnCap was the only respondent that had previously worked on all phases of a landfill-to-golf-course project and that EnCap's representations about its financial backing were well supported by the wealth of one of its owners, Gonda, who was touted as one of the 400 richest men in the world.

Out of several respondents, NJMC staff found EnCap to be clearly the most qualified to complete the Project. NJMC was formally advised that in accordance with the Local Redevelopment and Housing Law and relevant case law, it was not necessary for NJMC to engage in the Request for Proposal or bidding process. Instead, it would be appropriate for NJMC to engage in a modified procurement process that would take less time to complete and it was anticipated would come to the same result, *i.e.*, that of the interested parties, EnCap was the best choice for the Project. EnCap was given 90 days to determine the condition of the property, including the remedial work necessary, and to decide whether to go forward. The agreement to negotiate a contract was signed in the Spring of 2000; and on October 26, 2000, EnCap

³ EnCap Golf, LLC, was the respondent, but by the time of the agreement, the company had changed its structure and its name to EnCap Golf Holdings, LLC. The changes are described *infra*, but for ease of reading, both the company that responded to the Request for Qualifications and the company that entered into the Development Agreement is referred to as EnCap throughout this report.

representatives and representatives of the NJMC signed the Landfill Closure and Development Agreement, the document that controlled the arrangements between them for the Project.

Gauger told OIG that he was surprised when EnCap was awarded the project. EnCap began its “due diligence” visiting the site for the first time and meeting with DEP representatives. Gauger also told OIG that EnCap representatives learned before signing the Development Agreement that the environmental remediation work, including the landfill closure, was more than the EnCap team had anticipated. He blamed their failure to accurately anticipate the work required on EnCap’s lack of experience and its failure to have sufficiently researched what DEP would require.

The evidence indicates that EnCap was selected based on overstated qualifications regarding its relevant experience. When EnCap responded to the request for qualifications, EnCap and some of its team members *were* in the process of shaping a golf course on property that *had been* a landfill in Texas. (EnCap actually invited NJMC representatives to view the site.) However, EnCap representatives admitted to OIG that the Texas landfill was closed by the prior owner of the landfill, and EnCap’s part in the project was some of the final steps in the closure and shaping of the golf course. The EnCap owner also told OIG that the Texas project had cost EnCap very little to complete since the closure was performed by the prior owner and EnCap did not pay for the top layer of fill used to shape the golf course.

Some of the EnCap principals decided to go ahead with the Meadowlands Project despite what they had learned because it was thought that the Project would return a very good profit for

EnCap's investors. Gauger told OIG that the property was a spectacular location for a golf course. Further, although EnCap's plans had not been shared with NJMC at the time, Gauger also told OIG that EnCap owners had always intended to build residences on the property. He believed that residences would return the most profit for EnCap.

Even more problematic for the Meadowlands Project than the lack of relevant experience of some of EnCap's team members, however, was that just before NJMC and EnCap signed the Development Agreement, the make-up of EnCap changed significantly. The EnCap that ended up working on the Project only superficially resembled the EnCap "team" that had responded in the Statement of Qualifications. In fact, the EnCap that signed the Development Agreement was a newly formed company whose "owners" were chiefly investment managers; had not worked together to close a landfill; did not have a complete understanding of what was required by New Jersey regulators to close the Meadowlands landfills, to remediate the surrounding acres, and to develop the area; and did not have a realistic understanding of how long it would take or what it would cost to complete the Project.

Perhaps the most significant change in EnCap's structure from that represented in its Statement of Qualifications occurred formally shortly before NJMC and EnCap signed the Development Agreement. EnCap had represented to NJMC that the very wealthy Gonda was a member of its team. Gauger told OIG, however, that a decision was made by him and Gonda that Gonda's funds would not be tied up in the long term Project.

Approximately two months before the Development Agreement was signed, Gonda's interests were substantially bought out by a private investment group, Cherokee Investment Partners II (CIP II), allegedly for approximately \$6.1 million in reimbursements for Gonda's expenditure in financing the Project. Significantly, EnCap retained the right to use Gonda's name as an "owner" of the project, and Gonda apparently retained the right to 17.5% of the profits when the project was completed. However, Gonda's interest in the company and the Project had drastically changed to remove any commitment of his funds in support of EnCap and the Project before the Development Agreement was signed.

The then-Executive Director of the NJMC told OIG that Gonda's financial backing was critical to the selection of EnCap for the Project, and EnCap representatives told OIG that they realized at the time that Gonda's involvement in the Project was important to NJMC. Shortly before the Development Agreement was signed, NJMC representatives were told that EnCap had a *new* investor, CIP II, and that CIP II held a majority interest in the project. The Development Agreement also represented that CIP II had a majority ownership in EnCap but that Gonda maintained a 17.5% ownership interest in the partnership.

It would be folly to think that Gonda's name alone without the financial support that his association with the Project implied would be sufficient to meet NJMC's interests. If EnCap representatives wanted to be certain that NJMC understood that only Gonda's name was still associated with the Project but not his financial backing, EnCap could have clearly stated the extent of his connection. On the other hand, given NJMC's expressed reliance on Gonda's financial backing, EnCap's representatives could reasonably fear that knowledge of the

separation of Gonda's financial backing from the Project would threaten EnCap's selection as the Project developer.

EnCap representatives did not take affirmative steps to explain to NJMC representatives that Gonda's interest was limited to 17.5% of *profits* realized after the completion of the Project, he had no capital investment in the Project, and that Gonda was under no obligation to provide financial support to the EnCap project. Indeed, the evidence, including the language of the Development Agreement, indicates that EnCap representatives took steps to keep NJMC representatives from realizing the important change in financial backing. NJMC representatives who had worked on the Project at the time of the original Development Agreement told OIG that they were surprised to learn for the first time in 2007, the true nature of Gonda's involvement in the Project: that from just before the signing of the Development Agreement, Gonda had not been obligated to invest his money in the Project or to financially support it. Moreover, the evidence indicates that from the time of the signing of the Development Agreement, Gonda did not financially support EnCap or the Project.

NJMC representatives were not concerned about the addition of CIP II to the Project, understanding that it was a well capitalized investment company but were not aware of the investment limitations. NJMC representatives were led to believe that CIP II's involvement added to the private financial backing for the Project provided by Gonda. NJMC representatives were not told (as was represented to OIG during its 2007 investigation) that according to investment fund rules, there was a limit on the maximum amount of CIP II funds that could be invested in a single project. OIG was told by EnCap representatives that the maximum was \$25

million, and apparently, that was the amount that CIP II invested in EnCap. They also were not told that \$6.1 million of CIP II's \$25 million had already been disbursed to Gonda, so that only \$18.9 million of CIP II's funds were available to fund EnCap's Project. Again, NJMC learned about the limitation of CIP II's financial support during OIG's investigation.

The replacement of Gonda with CIP II may have driven the replacement of some of the original members of the EnCap team listed in the Statement of Qualifications. Some of them were replaced with companies related to or owned by CIP II. According to the Development Agreement between NJMC and EnCap, NJMC representatives did not have the right to approve or even review the "subcontractors" EnCap hired. NJMC found out about changes in the companies hired by EnCap to work on the Project only by happenstance, and it was not always clear that a replacement was a CIP II related company.

The then-NJMC Executive Director told OIG that NJMC had insisted that EnCap provide NJMC a performance bond in the amount of 125% of the budgeted cost of remediation and the required development elements; but in hindsight, he wished that NJMC had conducted more due diligence that might have revealed EnCap's true make-up. At the time, he was impressed by EnCap's presentation that included a trip to see the ongoing work on the Texas golf course being shaped by EnCap, thrilled at the prospect of having the landfills remediated by a private developer at its own expense; and reliant on Gonda's financial backing since he did not believe that Gonda would lose money or allow the project to fail. However, it is not clear that further due diligence would have disclosed all of the deficiencies in EnCap's qualifications or the

changes in EnCap's make-up, particularly if due diligence was completed before August 2000 when, according to EnCap's attorney, the change in ownership occurred.

After signing the Development Agreement, the newly formed EnCap set about changing and expanding the Project, including the right to build a substantial number of residences, to maximize EnCap's profits. In amendments to the October 26, 2000, Development Agreement, the Project increased to include 1,300 acres, closure of four landfills, significant expansion of development rights to include two golf courses, and hundreds of residences. Instead of leasing the property, EnCap was provided ownership rights to the property in return for a lump sum payment to NJMC, reimbursement of the purchase price of the privately owned property within the Project area, and payment of associated fees.

What began as a landfill closure project with limited development evolved into the largest remediation/development project ever undertaken in the State. However, control of the project was in the hands of a small company with only approximately \$18.9 million in capital run by money managers and a geologist inexperienced in landfill closure. EnCap's inexperience and lack of financial wherewithal have permeated the Project from the beginning through to the present. Neither EnCap nor the Project ever overcame the deficiencies.

Once EnCap had been granted the approval of the Project "owner", staff of other State entities believed that if possible under their own guidelines, it was appropriate to assist the sanctioned beneficial project that was already underway rather than hinder progress. Government entities or representatives involved with the Project either did not verify EnCap's

credentials assuming that EnCap had been chosen by NJMC because EnCap *had* the relevant experience, sufficient financial wherewithal, and whatever else was required to do the job; verified only those EnCap credentials that applied to their area of responsibility; or were aware of EnCap's weaknesses but believed that EnCap was chosen by NJMC for good reason *despite* those weaknesses, and it was government's responsibility to appropriately facilitate the project.

During the next several years, EnCap's efforts proceeded on several fronts but were always aimed at maximizing the Project's profit making ability. Among government entities with whom EnCap worked were:

- NJMC and effected municipalities to further increase EnCap's development rights to include thousands of residential units, thereby increasing, at least from EnCap's perspective, the value of its property.
- The Economic Development Authority (EDA), the Environmental Infrastructure Trust (EIT), and the Department of Environmental Protection (DEP) to obtain low interest financial assistance for the remediation portion of the project. (DEP's portion of the loan was in large part federal funds, but the loan program was administered by DEP.)
- DEP, the department with authority to regulate the remediation, to establish protocols and obtain permits for the landfill closure and remediation of the property; to obtain support for payment of expensive remediation measures with proceeds from loans provided by the EIT and DEP; and to arrange for EnCap to be paid to take and to use difficult to dispose of dredge material to cap the landfills.
- Commissioners and Legislators to gain support for the Project from every corner of government and to bring about changes in legislation to increase EnCap's profits from the Project.
- Municipal representatives to convince them to enter into financial agreements providing for among other things payments in lieu of taxes (PILOTs) and for EnCap to share in the municipalities' future PILOT revenue.
- The Local Finance Board within the Department of Community Affairs to attempt to gain approval for the securitization and immediate release of funds associated with EnCap's "share" of the town's future PILOT revenue.

- The Bergen County Improvement Authority to act as the conduit borrower for loans and to issue additional loans for EnCap as conduit issuer.

State and local government representatives realized the benefits to the area and the State from the success of the Project, and they worked with EnCap as appropriate to make the Project happen. Changes in both State and local administration resulted in newly appointed government officials who also understood that EnCap had been appropriately selected by State representatives to accomplish the “miracle in the Meadowlands.” EnCap reached some degree of success on almost every front it pursued.

The evidence indicates that within its own sphere of responsibility, each government entity acted appropriately, but missing for many years of the Project was a coordinated effort among government entities involved in the Project. For a variety of reasons, the agencies did not communicate about the Project on a regular basis. EnCap encouraged staff of government entities to not communicate and attempted, sometimes with success, to take advantage of the lack of communication between State entities to manipulate the system in an effort to benefit EnCap and maximize its profit.

The lack of communication among government entities and representatives was exacerbated by EnCap’s access to high level government officials. EnCap officials made contributions to political figures and hired well known and respected counsel as well as lobbyists who understood the workings of State government and who had access to elected and high level appointed State representatives. Encouraging government staff to not communicate with each other enabled EnCap to be in control of how and when important information was related to

government officials. Government staffers were frustrated to learn that EnCap had put its spin on information, or worse, had misrepresented it when speaking to higher level officials.

B. Private Entity Seeks Public Financial Assistance

Although EnCap had originally represented in its Statement of Qualifications that it had ample private financing for the Project and would not require public financing, the change in its ownership interests made that statement no longer true. With only approximately \$19 million in private funds and the increase in the size and scope of the Project, EnCap required financial assistance.

Shortly after being awarded the remediation and developments rights to the property, EnCap began efforts to obtain low interest public financing. Because EnCap had indicated from the outset that despite the sufficiency of its private financial backing, it might attempt to obtain low interest public financing if it was available and only if this would not stall the Project, EnCap's efforts in this regard were not a "red flag" to NJMC representatives that EnCap was under funded. Moreover, under the terms of the Development Agreement, NJMC did not have the right to review EnCap's financing.

The first form of financial assistance provided to EnCap was an Economic Development Authority (EDA) conduit bond in 2001 of \$145 million with a variable interest rate that closed at 2.5% with no credit exposure to EDA or the State. Because EDA, as with all of the conduit bonds it issues, required that the collateral for the bonds to be issued was sufficient to protect the bondholders, EnCap obtained a bank letter of credit as backing for the bonds. As a new company with no credit history and no other sources of revenue, this letter of credit was

important. EnCap had represented that it was attempting to negotiate agreements for the transfer of the to-be remediated property to private developers for vertical development and expected to have signed agreements in place in the coming months. The bank issuing the letter of credit required these to be in place before most of the EDA bond funds were released.

While some of the EDA bond funds were used to pay for the property that EnCap purchased and other “administrative” expenses, EnCap had not negotiated the development agreements to the satisfaction of the bank, and most of the EDA bond money remained unspent as of Spring 2004 when EnCap was about to “break ground” on the property. Just before groundbreaking, the terms of the EDA bond were modified, another bank issued EnCap a letter of credit with no requirement that the development agreements be in place before funds were released, and the total amount of the bond was increased to \$150 million (by way of a refunding of the original \$145 million loan and the issuance of another \$5 million).

At the time of the second EDA financing in Spring 2004, EnCap was negotiating another conduit bond with an even lower rate of interest than the first EDA bond. The EDA financing was retired and paid back in full by a 2005 loan from the EIT and DEP for \$212 million (roughly half from EIT bonds and half from a DEP administered revolving fund consisting of federal and other dollars) at a blended interest rate of approximately 2%, as well as by funds obtained from bonds issued by the Bergen County Improvement Authority (BCIA) as a conduit issuer. The funds from the EIT and DEP were to be spent only on the remediation portion of the Project. The amount required was based on a budget EnCap had submitted supporting the cost of remediation plus approximately \$10 million as a cushion.

The loan was unusual because: (1) although these funds were designed for clean water (*i.e.*, waste water) projects and were more typically used for sewer lines and related waste water project elements, the benefit to the groundwater from the proper closure of the landfills and the elimination of leachate qualified the remediation portion of the Project for the funds; (2) it was rare for these funds to be loaned to private developers for purposes of clean water (*i.e.*, waste water); (3) EnCap's loan amount was for much more -- about four times more -- than had ever been loaned from these sources; (4) usually these loans were backed by the taxing power and full faith and credit of the public entity borrowing the funds, but EnCap as a private entity was required to provide collateral from other sources; and (5) the transaction was conducted differently than the other transactions handled by EIT.

EnCap had difficulty providing sufficient collateral for the loan, and EIT representatives worked with EnCap accommodating their lack of collateral with less traditional types of support. After what EIT representatives believed was full disclosure by EnCap, and EIT and DEP staff understood that EnCap had no other resources it could pledge in addition to a bank letter of credit, EIT and DEP staff agreed to accept some collateral that was not likely to materialize for many years. For instance, EnCap pledged its rights to Brownfields reimbursement that would not materialize until after successful completion of the vertical development. At least some EIT and DEP staff were concerned that the federal revolving funds portion of the loan was under collateralized. On the other hand, EIT and DEP understood the benefits of the Project and often loaned with success to projects for the public good that might not otherwise be funded absent the State's assistance.

The terms of the loans had been negotiated and were to close in 2005 when in early 2005 EIT/DEP representatives accidentally (an EnCap lawyer inadvertently made a comment to EIT representatives) became aware that EnCap had failed to disclose to EIT/DEP a potentially significant source of income that could have been used as additional collateral. During the same many months that EnCap's attorneys had been negotiating to obtain the \$212 million loan from EIT/DEP, EnCap's attorneys had also been negotiating financial agreements with the Borough of Rutherford and the Township of Lyndhurst, two towns in the Meadowlands area, for an alternative tax scheme that would provide for payments in lieu of taxes (PILOTs) and permit EnCap to share the PILOT revenue that the towns would receive as a result of development of the remediated area. The financial agreements also laid the groundwork for EnCap to securitize the PILOT revenue that it anticipated receiving, by way of a bond issuance, thus providing EnCap with the potential to obtain upwards of \$450 million in new revenue long before the development was completed.

EnCap convinced the town officials to enter into these financial agreements by representing that the agreements were necessary in order for *remediation* as well as development to occur in the towns. EnCap representatives did not reveal to the towns that EnCap had already obtained funds from an EDA bond issue or that EnCap was in the process of obtaining the \$212 million of EIT/DEP funds plus additional loan funding through the BCIA allegedly to pay the entire cost of the remediation.

EIT/DEP representatives were surprised to discover EnCap's plan to obtain PILOT payments from the towns and securitize this future revenue. They became distrustful of EnCap and its representatives as a result of EnCap's material omission of the potential source of collateral represented by the financial agreements with the towns. EIT/DEP representatives determined to reopen negotiations so that the State could be placed in a better position given the new revenue that EnCap anticipated receiving from the financial agreements and the PILOT-backed bonds.

EnCap's attorneys told OIG that they enlisted the intervention of the State Treasurer to mediate between EIT/DEP and EnCap the terms of the loan. As a result, additional collateral was negotiated for the loan, including a pledge of some of EnCap's anticipated income from EnCap's share of the towns' future taxes.

Despite EnCap's poor behavior, State representatives approved the loan because of the nature and value of the Project that was unlikely to be funded from another private source and because alternate forms of collateral, including a pledged stream of government reimbursements attached to the remediation, development rights sales proceeds, a bank letter of credit, a performance bond, environmental insurance policies, and other pledged possible revenue sources were deemed sufficient for this funding source. The towns' representatives were not made aware that there was another source of funding for the remediation of the area until during OIG's investigation.

C. Private Entity Mismanages Project

With limited EnCap funds at risk but the potential for great profits, EnCap's inexperienced owners went into the Project that was well over their heads. At best, the Project was mismanaged by EnCap, and EnCap representatives have acknowledged its mismanagement. Within a short time of signing the Development Agreement, EnCap's working "team" consisted of two more-often-than-not absentee owners: 17.5% owner Gauger, whose background was investment banking and venture capital investments, and whose management of other projects caused him to be away from the site; and Thomas Darden, the Chief Executive Officer of Cherokee Investment Partners, who made limited appearances in New Jersey. Very often, 2.5% owner Hockensmith, a geologist with little relevant experience, was the only on-site "owner" with few EnCap employees. EnCap hired consultants and project managers with the funds from their public financing.

State representatives were later to learn that EnCap did not put the same time and energy into the remediation/landfill closure aspects of the Project as into the financial side. EnCap promoted a "ground breaking" in Spring 2004 with great flourish. However, EnCap proceeded in a stutter-start, disorganized operation. The evidence indicates a series of failed, broken, mismanaged, or unmanaged contracts. Although NJMC attempted to assist EnCap in the remediation, EnCap rebuffed the offer.

EnCap hired a related company, MACTEC, to manage the Project. However, after some time, EnCap's parent company sold its interest in the sister company, and the loan funds may have been at even greater risk because the Project was in the hands of a "sub-contractor" whose

interests in the project may not have always been the same as EnCap's. Moreover, between contracting with EnCap in 2001 and the May 2004 "ground breaking", EnCap paid MACTEC "premobilization" and "delay" charges because EnCap was not ready to start the Project.

DEP representatives understood that despite idealized drawings of greenways, golf courses, parks, schools, homes, and other structures, EnCap could not state with certainty to what uses property would be put, and it appeared that EnCap considered any area to be open to human habitation. For this reason and because of the fragile Meadowlands environment, including proximity to ground water and waterways and the massive size of the Project, DEP imposed high standards on the Project. EnCap repeatedly attempted to convince DEP to lower the standard, but DEP did not. DEP welcomed the remediation of the Meadowlands, although imposing high standards on EnCap's remediation, DEP staff met frequently with EnCap representatives to help them understand what was required and considered the Project a top priority.

Fill materials were a major component of the Project. Since 2002, after meetings with DEP representatives, EnCap understood the types of fill required and how much was required to close and remediate the Project area. EnCap did not manage the fill issues well. EnCap entered one large contract with a related party, and the evidence indicates that this contract was lucrative for the related party since it was paid by other developers to take the fill it used as the below the barrier fill on this Project. If EnCap had not provided a disposal facility for this fill, the related party might not have been in a position to substantially profit from the acceptance of the large quantity of fill. Because EnCap was not prepared to go forward, EnCap did not honor its

commitments under another fill contract; it was unsuccessful in contracting with one experienced contractor; and settled a law suit with another contractor.

In still another example of mismanagement, on the suggestion of its attorney, EnCap entered a contract for over 2.5 million cubic yards of difficult to find fill with a newly formed small company whose principals had limited experience in brokering fill and had never before engaged in providing this quantity and quality of fill. EnCap was alerted to the lack of experience of the company but claimed that it did not even perform the basic testing to determine whether the small company's stockpiled fill was suitable for the Project. An EnCap attorney's wife went to work for the fill company and at the site preparing bills and doing other paperwork. The fill provider constantly negotiated for more money from EnCap, and only after change orders were not approved by a newly formed working group that included State representatives did this steady increase stop.

EnCap had contemplated having soil prepared for capping and closing the landfills on the Project site but apparently did not understand whether and how this could be accomplished. Apparently EnCap used incorrect fill to prepare roads for trucks hauling fill onto the site, and the roads were not substantial enough to bear the weight of the huge dump trucks laden with fill until one of the fill providers pointed this out to them.

Government representatives, who by this time were engaged in a collaborative effort, were shocked and concerned about the viability of EnCap to complete the project when, in late 2006 and early 2007, although only half of the EIT/DEP funds had been disbursed, EnCap

representatives initially told them that the remediation portion of the Project was projected to be approximately \$95 million over the budgeted amount, but later reduced the projection to \$75 million. The lack of trust that EnCap had earned caused State representatives to demand proof that the remediation project could not be completed with the low income loans and with EnCap's extensive private financial backing. It was at this point that EnCap claimed that it had no access to private funds. Unfortunately, the loss of trust has caused responsible State persons' reluctance to accept even that representation without well documented proof. Indeed, during this period, EnCap represented more than once that they could not make some pending payment without State concessions. However, when State representatives refused to make the concession, private funds materialized.

EnCap representatives told State stakeholders that the only way they could complete the Project was to issue the bonds called for in the financial agreements with the municipalities. EnCap wanted to use those bonds to monetize its share of the future PILOT revenue that it claimed it would use to pay a substantial portion of EnCap's debt, pay for the completion of the Project, and allow EnCap to realize a profit of \$75 million. Indeed, the real value to EnCap of these financial agreements with the towns appears to have been in EnCap's anticipated ability to immediately monetize these agreements rather than to wait perhaps many years for development to begin to produce tax revenue and for twenty more years before such revenue would be completely realized. EnCap later estimated -- whether correctly or not -- that the immediately monetized agreements could be worth as much as \$450 million including a \$75 million profit to EnCap (on what appears to have been a \$25 million investment).

The bond issue required approval by the Local Finance Board in the Department of Community Affairs, and although EnCap had attempted and failed to obtain the approval in the past, EnCap continued to pursue this source of funds. The towns had been represented by counsel in reaching the financial agreements and counsel and the town officials were satisfied with the agreements. (Evidence uncovered later, during OIG's investigation, indicates that relevant information that might have changed the towns' position was not made known to the towns' representatives during the negotiations.)

State representatives, who had not been involved in the negotiations of the financial agreements, were looking for assurances that the two municipalities involved in the financial agreements were not at risk. According to the agreements, each of the towns would share with EnCap, or its successors, variable amounts, from 39.5% to approximately 50%, of the town's PILOT revenue, depending upon specified conditions, for up to 35 years. However, the towns would be responsible for maintaining the infrastructure associated with the housing and other development, such as maintenance of roads, sewers, trash collection, additional schools, and an increase in the number of police and fire services required. The worst scenario was that EnCap might realize \$75 million in profits from the bonds and walk away from the unfinished project leaving other parties to repay the bondholders, with PILOT revenue insufficient to cover municipal costs.

While EnCap was urging the State and local governments to take steps to approve the immediate bond issue, EnCap representatives revisited its estimates and told government officials that even with the securitization of the PILOT payments, EnCap would realize no profit

from the Project since all of its profit would be used to finish the Project. This statement is suspect as the CIP II Fund endeavors to make approximately 30% return on its investments. Despite repeated requests from government representatives, EnCap did not provide evidence to support the increased budget projections other than to multiply allegedly current costs by the number of months EnCap had anticipated it would take to finish the Project. As of the date of this report, EnCap has not provided a detailed budget or proof of the projected cost increases sufficient for the State entities ongoing review of the Project.

D. Summary

The Meadowlands Project was conceived by NJMC as a public/private partnership with the highest and best motivations on the part of the State representatives: at essentially no cost to the public, hundreds of contaminated and underused acres would be remediated, developed, and converted to useful ratables thereby benefiting the citizens of the area as well as the State as a whole. Instead of acres of odorous garbage and putrid wetlands, there would be golf courses, parks, offices, and residences overlooking the river and the New York skyline with relatively easy access to Manhattan, rail lines, and airports by existing highways. Unfortunately, the project is a study in what can go wrong when a public body with high-minded public policy goals and compelled by its status to engage in fair dealing joins forces with a private entity whose primary goal is to maximize its profit and operates in a buyer beware atmosphere.

The Project was mismanaged by EnCap, a company with minimal experience in landfill closure, whose staff was at best learning on-the-job. EnCap hired subcontractors, some of whom

were related parties, some of whom may also have been learning on the job, and who were operating without necessary oversight since EnCap was often an absentee owner.

State policies and procedures, including procurement procedures and ethics requirements and prohibitions, require State employees and representatives to restrict their conduct to open and fair dealing. These same requirements and prohibitions do not always apply to private entities dealing with State employees and consultants. There are many examples described in this report -- including EnCap's conduct in reaching a Development Agreement with NJMC; EnCap's conduct negotiating with the EIT/DEP representatives for the \$212 million low interest public financing; and EnCap's conduct when reaching potentially lucrative financial agreements with the towns -- demonstrating that those requirements did not hinder EnCap in its dealings with State and local entities.

Representatives of some private entities believe they can engage in misleading hyperbole, puffery, and secrecy, and that it is up to the party on the other side of the deal to discover what is true and what is not. This conduct would not be tolerated for State representatives. While public entities are restricted in hiring practices by conflict laws, private parties can hire related parties even to the point of essentially paying themselves. For EnCap representatives, no decision was considered final, and all decisions were open to revisit and change, especially when critical State positions are occupied by public office holders whose identity changes frequently.⁴

⁴It should be understood that the government funds provided to EnCap were loans, including loans provided by way of conduit bonds that involved no public exposure, and there are mechanisms in place to protect public funds. It should not be assumed based on evidence described in this Report that public funds have been lost.

E. Recommendations

Over the course of four administrations and almost ten years, EnCap owners and representatives have had direct contact and/or dealt with numerous public representatives: at least one Governor; five State House staffs; at least five Cabinet level appointees; high level staff of three Departments and four authorities; uncounted legislators; and the changing administrations of several municipalities and counties. Throughout OIG's investigation, it became increasingly evident that government representatives and interests were fractionalized. There was no public central focus for the various aspects of the Project or repository for information. It also became clear that having a central focus point for the Project might have avoided some of the problems that developed.

OIG recommends that in the future, there be a Point entity assigned at the first stages of any public/private joint project, particularly when control of the project is handed over to the private partner. The process of assigning a Point should be institutionalized. Although it will be helpful to have some procedures developed for individual projects, more often than not, procedures for the operation of the point entity should be standardized and in place. The Point need not have decision-making authority, but must be advised of all decisions made impacting the project by all parties. This includes the decision to enter into a contract. The Point must be entitled to demand whatever information it deems necessary to understand the decision and ramifications of the agreements before they are finalized, and should be able to request advice from other public experts.

The Point function should be flexible enough to reside in an appropriate office such as the Office of Economic Growth, the State Comptroller's Office, or, if the project is large enough, to require the appointment of a non-public monitor at the expense of the private entity member of the public/private partnership. The Point should have available to it the expertise and advice of other State agencies as required. The Point role should be institutionalized and processes should be in place to assure that the appropriate appointment and review occurs. Most importantly, the Point entity should report directly to the highest level of government involved in the project: very likely the Governor or the Governor's designee.

At least one major benefit of having a Point entity would be to prevent the fractionalization of government resources that occurred on this Project. EnCap representatives dealt with several public entities, but often one was not aware of what the other was doing, so there was not a cohesive perspective.

This Point entity should also protect against "forum shopping" among State representatives. One tactic that was observed by almost every State employee and consultant involved in this project was that EnCap chose highly skilled well known representatives who sought and were granted access to government representatives at the highest level. These contacts were often with only one governmental group. In fact, EnCap's representatives encouraged isolation of government representatives because it served their interests to have decisions made without input from agencies who might object. Moreover, it provided them the opportunity to go from one agency to another representing, perhaps with a slant, what another State agency had said or decided. Another unfortunate negative consequence of EnCap's access

was that involved government staff did not always have the same access that EnCap representatives did.

Access to high level government representatives is not improper nor does it always result in a detrimental impact on State interests. In fact, for a project of enormous importance, impact, and expense, it is foreseeable that State representatives may view these contacts as informational. However, it obviously has potential for great mischief, particularly when State staffers do not have the same access and the private partner does not communicate fully the relevant facts, including decisions or actions of sister agencies. A central point of information and discussion (Point entity) would lessen the impact of this conduct.

This Point entity can assure that there are procedures in place that level the field between government representatives who engage in open fair dealing, and private representatives who might try to hide relevant information or engage in deceit. Typically, when hiring private firms, public entities utilize established procurement procedures to try to prevent vendor mischief. Many of the usual protective controls were circumvented in this case because the Project was different from previous projects undertaken by the NJMC. The Development Agreement gave EnCap unusual control over the public/private project, and as the project began, with no public funds at risk, that arrangement may have been appropriate. EnCap was becoming the owner of the land and allegedly the “payer” of the cost of remediation. The Point entity can keep a watchful eye on the Project and as it evolves, can make known to all involved that the project has changed and requires further oversight attention.

Further, honest procurement and business practices must be imposed on participants in public/private projects, and it should be the responsibility of the Point entity to implement the procedure. These must include full disclosure of owners and of ownership rights, the amount of private capital behind the project and its source, and information about subcontractors. All participants should receive and sign an ethics form indicating that they agree under an appropriate penalty to abide by the requirements of the policy. These practices should be ongoing, requiring any change of vendors, subcontractors and/or ownership be treated as a new relationship, requiring additional disclosures and certifications.

OIG also recommends that the lenders of public funds to EnCap undertake a line item audit to determine if public funds were dispersed properly. This will be beneficial in determining what occurred in this project. The audit function can be performed under the guidance of the Point entity. Consideration should be given to utilizing the expertise of the State Comptroller Office to conduct the forensic audit.

OIG recommends that government entities use the events reported herein as a case study, for lessons learned, and for determination of any changes they deem appropriate to heighten their sensitivity to the conduct described herein.

OIG is referring the matter to the Division of Criminal Justice in the New Jersey Attorney General's Office for its determination of whether any action is warranted by that office.

III. LANDFILL CLOSURE AND DEVELOPMENT AGREEMENT

A. New Jersey Meadowlands Commission

The Hackensack Meadowlands encompasses “21,000 acres of salt water swamps, meadows and marshes,” in and around 14 municipalities in Bergen and Hudson counties⁵ having an “extensive history of environmental degradation,” including approximately 2,400 acres of landfills, a number of former manufacturing facilities and various other sites that “can be considered brownfields.”⁶ The Hackensack Meadowlands Reclamation and Development Act of 1968 (HMRDA) was enacted for the purpose of “comprehensive development” and care of the Hackensack Meadowlands.⁷ The HMRDA described the Hackensack Meadowlands as a “strategic location in the heart of a vast metropolitan area with urgent needs for more space for industrial, commercial, residential, and public recreational and other uses of purpose....” The HMRDA recognized the Hackensack Meadowlands area as “a land resource of incalculable opportunity for new jobs, homes and recreational sites that may be lost to the State through piecemeal reclamation and unplanned development.” The objectives of the HMRDA include:

- The preservation of the delicate balance of nature;
- The provision of special protection from air and water pollution and a special provision for solid waste disposal; and
- The orderly, comprehensive development of the Hackensack Meadowlands in order to provide more space for various uses including, industry, commercial development, residential, and public recreation.

⁵ The Hackensack Meadowlands municipalities are: Carlstadt, East Rutherford, Jersey City, Kearny, Little Ferry, Lyndhurst, Moonachie, North Arlington, North Bergen, Ridgefield, Rutherford, Secaucus, South Hackensack, and Teterboro.

⁶ New Jersey Meadowlands Commission Master Plan, p. 3-15, 2004.

⁷ N.J.S.A. 13:17-1 et seq.

The HMRDA created the New Jersey Meadowlands Commission⁸ (NJMC) and established it in, but not of, the Department of Community Affairs (DCA) as a “a commission transcending municipal boundaries and a committee representing municipal interests which will act in concert to reclaim, plan, develop and redevelop the Hackensack meadowlands . . .” NJMC powers include, but are not limited to, adoption of a master plan for physical development of lands within its jurisdiction, investigation and acquisition of property, development and improvement of district lands, and management of solid waste disposal. NJMC is authorized to establish engineering standards and a building code for the region, thereby regulating: drainage facilities and easements, road improvements, public water and sewer, zoning of housing subdivisions, and providing guarantees and bonds necessary to ensure that the zoning standards are met.⁹

The statute creating NJMC provides for a Board of Commissioners (Board) consisting of the Chairperson, the Commissioner of the DCA, and six Commissioners.¹⁰ At least two Commissioners must be residents of Bergen County and two must be residents of Hudson County, and no more than three Commissioners may be of the same political party. To carry out the day-to-day functions of NJMC, the Board is authorized by statute to hire an executive director, a chief financial officer, and other employees.

⁸ The Hackensack Meadowlands Development Commission was created by the New Jersey Legislature in 1968 and renamed the New Jersey Meadowlands Commission in August 2001. N.J.S.A. 13:17-3.1. For consistency, this document will reference the New Jersey Meadowlands Commission throughout.

⁹ N.J.A.C. 19:5-2.1 et seq.

¹⁰ Commissioners serve five-year terms and are appointed by the Governor with advice and consent of the Senate

The NJMC Board is part of a two-part decision-making system established to balance the rights of the individual towns within the Hackensack Meadowlands area with the needs of the region as a whole. To ensure the rights of the towns are considered, certain actions of the NJMC Board must first be reviewed by the Hackensack Meadowlands Municipal Committee (Committee), which is composed of the mayors or chief executives of the 14 municipalities within the Hackensack meadowlands District. The Committee specifically reviews codes and standards, the district master plan and amendments thereto, development and redevelopment plans, and improvement plans. The Committee elects a liaison committee composed of four members, two from Bergen County and two from Hudson County.

The NJMC has authority to declare any area within its jurisdiction to be a “renewal area,” thereby designating the area as one “whose redevelopment is necessary to effectuate the public purposes declared in this act.” Since 1992, the Local Redevelopment and Housing Law (LRHL)¹¹ has provided the standards governing the declaration of an area in need of renewal. Under the LRHL criteria, declaration of an area as a “redevelopment area” includes assessment of: the discontinued use, or state of disrepair, of any existing structures; the current use of the land, and the length of time it has been unused or underused; and the overall value of the land to “public, health, safety” and the “welfare of the community.”

The LRHL further provides for a separate declaration status, “in need of rehabilitation,” for an area needing “extensive repair, reconstruction or renovation of existing structures . . . to eliminate substandard structural or housing conditions and arrest the deterioration of the area.” The NJMC was granted authority to create and adopt a redevelopment plan when undertaking

¹¹ N.J.S.A. 40A:12A-1, et seq. The Local Redevelopment and Housing Law was passed in 1992 and replaced the 1949 Blighted Areas Act (N.J.S.A. 40:55-21.1(e)) that required determination that an area was “blighted” before it could become subject to purchase or seizure by eminent domain of the NJMC.

rehabilitation of an area under its jurisdiction. A redevelopment plan specifies actions to be taken by the NJMC including, but not limited to the acquisition of real property, clearing areas for development, relocation of residents or business, and creation and adoption of plans for carrying out a program of repair or urban renewal. A redevelopment plan can only be created or changed through an NJMC resolution requiring a public meeting and adoption by Board and Committee.

A proposal to evaluate a site for possible designation as an “area in need of redevelopment” or an “area in need of rehabilitation” can come from NJMC staff, a constituent municipality, a property owner, or a third party. To declare an area in need of redevelopment or rehabilitation the NJMC Board passes a resolution showing the boundaries of properties to be evaluated along with a statement of reasons for the investigation; and the NJMC technical staff uses the LRHL criteria to investigate the property and makes recommendations to the Board. After a public hearing on the property, the Board votes to accept or reject the findings or recommendations of the NJMC technical staff.¹² The Committee does not review, accept, or reject recommendations that a property be declared in need of redevelopment. In 1994, two years after the passage of the LRHL, the NJMC undertook its first redevelopment project.

1. Management of Solid Waste and Landfill Closure

At the time of formation of the NJMC, approximately 940 acres of official landfills were in operation. Prior to 1970 some of the Hackensack Meadowlands towns had leased swamp or marshland that was difficult to develop to garbage collectors who used the land as dumping sites,

¹² N.J.S.A. 13:17-20 et seq. provides for the procedures for declaring a “renewal area” within the NJMC.

while other dumping areas were on property privately owned by entities in the business of receiving solid waste.¹³ In addition illegal dumping occurred along roadways and eventually NJMC designated those areas as landfills as well.

a. Department of Environmental Protection Regulatory Control

Until 1970 “the management of solid waste disposal in New Jersey consist[ed] largely of piecemeal, uncoordinated activities...” with landfills being largely unregulated.¹⁴ At that time, the Solid Waste Management Act (SWMA) was enacted to “establish a statutory framework within which all solid waste collection, disposal and utilization activity in this State may be coordinated...”¹⁵

The SWMA designated each of the 21 New Jersey counties and the Hackensack Meadowlands District, “solid waste management districts,” to “develop and implement” waste management plans to meet the “needs of every municipality” within a county or the Hackensack Meadowlands District. To coordinate waste management statewide and “establish a meaningful and responsible role for the State in the solution of solid waste problems...,”¹⁶ the SWMA

¹³ Entities managing dumping sites collect “tipping fees” for waste accepted at the sites. Tipping fees vary in amount by the type of waste being dumped, and are collected on a per ton basis.

¹⁴ N.J.S.A. 13:1E-1 et seq. The legislative “findings” of the SWMA state that “the collection, disposal and utilization of solid waste is a matter of grave concern to all citizens and is an activity thoroughly affected with the public interest; . . . that the management of solid waste disposal in New Jersey consists largely of piecemeal, uncoordinated activities . . .

¹⁵ N.J.S.A. 13:1E-2(b).

¹⁶ N.J.S.A. 13:1E-2(b)(6). In the event of a violation of any provision of the SWMA the DEP Commissioner is given authority to: issue orders requiring compliance, bring a civil action, levy administrative penalties, or petition the Attorney General to bring criminal actions. N.J.S.A. 13:1E-2(b).

designated the New Jersey Department of Environmental Protection (DEP) as having regulatory and supervisory authority over the 22 solid waste management districts.

In 1981, the SWMA was amended to add the Landfill Closure Act (LCA), providing DEP authority to regulate closure of landfill areas that had ceased to be used for solid waste reception.¹⁷ The LCA defines “closure” as “all activities and costs associated with the design, purchase, construction or maintenance of all measures required by the department, pursuant to law” including, placement of vegetative cover, methane gas or leachate¹⁸ monitoring systems, and insurance.¹⁹ Under authority of the LCA, the DEP promulgated regulations controlling the closure and monitoring of landfills.²⁰

In conjunction with the enactment of the LCA, the Sanitary Landfill Contingency Fund Act²¹ was enacted, establishing a requirement that landfill operators collect \$1 per ton of solid waste deposited at the landfill, to be held to cover the costs of the eventual closure of the landfill. Those landfills in operation subsequent to the enactment of the Sanitary Landfill Contingency Fund Act have closure funds, but those landfills that ceased operations before 1982 are without closure funds and are commonly referred to as “orphaned” landfills.

¹⁷ N.J.S.A. 13:1E-101 et seq., and N.J.S.A. 13:1E-9. The legislative findings for the LCA state that “the proper closure of sanitary landfills is essential to the public health, safety and welfare....”

¹⁸ DEP regulations define “leachate” as any liquid that has been in contact with solid waste. N.J.A.C. 7:14A-1.

¹⁹ N.J.S.A. 13:1E-102.

²⁰ N.J.A.C. 7:26 et seq.

²¹ N.J.S.A. 13:1E-105.

b. NJMC Landfill Closure Methodology

Since its creation in 1968, the NJMC has closed over 500 acres of landfill area in the Hackensack Meadowlands in accordance with DEP approved procedures. To pay for closure of the orphaned landfills, NJMC obtained DEP permits to reopen and temporarily operate landfills at the sites to be closed, allowing acceptance of debris from construction and demolition sites²² that became part of the materials used for closure of the landfills. In operating these reopened landfills, the NJMC collected the tipping fees authorized by the LCA. OIG has been told that it generally took about three years to collect sufficient tipping fees to pay for closure of an orphaned landfill site and post-closure monitoring.²³

NJMC officials explained to OIG that it had used the same methodology when closing all Hackensack Meadowlands landfills. The Hackensack Meadowlands area has a natural impermeable clay floor 35 to 55 feet beneath the ground level. The landfills were contained by digging a three foot wide trench down to the impermeable clay floor and filling the trench with impermeable bentonite clay from Wyoming which bonds with the natural clay floor and creates a “bathtub” of the clay base and clay barrier walls. The “bathtub” prevents groundwater from entering the landfill, and prevents leachate from seeping out to the surrounding area. A drain, similar to a French drain, is placed in the garbage just above the water table to keep water out of the landfill.

²²Per DEP regulations, the construction and demolition debris can have low levels of contaminants but not hazardous materials. This is discussed further elsewhere in this Report.

²³ Post-closure monitoring is the process of examining and maintaining the closed landfill for a period of years.

Once the clay “bathtub” is in place, NJMC opens the landfill and accepts enough demolition and construction debris to create a two-foot layer over the existing garbage. A two foot layer of dredge material²⁴ is then placed over the debris serving as a cap to the “bathtub.” A final two foot layer of top soil and growing material is placed over the dredge. NJMC typically hires contractors and engineers selected through a “Request for Proposal” (RFP) process to do the physical work of closing the landfills. None of the landfills closed by the NJMC have had any vertical development²⁵ on them.

2. Development of the Meadowlands

a. Brownfield Act Encourages Private Development

New Jersey enacted the Brownfield and Contaminated Site Remediation Act²⁶ (the Brownfields Act) in 1998 to encourage cleanup and redevelopment of contaminated sites. A brownfield site is defined as “any former or current commercial or industrial site that is currently vacant or underutilized and on which there has been, or there is suspected to have been, a discharge of a contaminant” thereby posing a health risk to nearby residents. The Brownfields Act additionally provides that “in order to encourage the cleanup of contaminated sites, there must be finality in the process, the provision of financial incentives, liability protection for innocent parties who clean up, and cleanup procedures that are cost effective and regulatory action that is timely and efficient.”

²⁴ Dredge is material that is excavated from harbors and waterways. Its use as fill material for this Project is discussed elsewhere in this Report.

²⁵ Vertical development is the construction of buildings and other structures and is discussed further elsewhere in this Report.

²⁶ N.J.S.A. 58:10B et seq.

To encourage developers to undertake the cleanup and redevelopment of contaminated sites, or brownfields, the statute provides for reimbursement of up to 75% of a developer's remediation costs. To qualify for the reimbursement a developer can not be "in any way responsible," for discharge of a hazardous substance. In exchange for a promise of reimbursement, a developer must enter into a Brownfields Redevelopment Agreement with the State Treasurer and the Chief Executive Officer/Secretary of the Commerce and Economic Growth Commission. The developer agrees to perform any "work" or "undertaking" necessary for the remediation of a contaminated site where a proposed redevelopment project will take place. The reimbursement payments are available when "residential construction is complete, or a place of business is located, in the area subject to the redevelopment agreement that has generated new tax revenues."²⁷

b. Redevelopment Plans for Rutherford and Lyndhurst

In 1996, Borough of Rutherford officials asked the NJMC to investigate whether a 306 acre tract along Berry's Creek in Rutherford was an area "in need of rehabilitation."²⁸ Of the 306 acres, including wetlands and landfill areas, 260 were owned by the Borough of Rutherford and provided no tax revenue to the Borough. The other 45 acres were privately owned but assessed at low value because of the status of the land and its use. The NJMC technical staff evaluated the properties using the LRHL criteria, and recommended the Board declare the area

²⁷A Brownfields Agreement can be executed only if it is determined that the tax revenues to be realized from the redevelopment project exceed the amount necessary to reimburse the developer. N.J.S.A. 58:10B-27(a). The percentage of the reimbursement payment made to the developer is based upon the occupancy rates of the residential or commercial units. N.J.S.A. 58:10B-27(a).

²⁸As described *infra*, an area that has "been determined to be in need of rehabilitation or redevelopment, to eliminate substandard structural or housing conditions and arrest the deterioration of the area." N.J.S.A. 40A:12A-3.

“in need of rehabilitation.” After a public meeting, the Board voted to approve the NJMC staff recommendations but asked the staff to create a redevelopment plan before forwarding the matter to the Committee. The NJMC staff created the Redevelopment Plan for Berry’s Creek (the Berry’s Creek Plan) including details about: the development options examined, area traffic and population, land included, and NJMC Board powers, such as zoning and acquisition of property.

The Berry’s Creek Plan indicated a number of possible uses for the property as suggested by area municipalities, private investors, and NJMC staff, including possible development of: senior citizen housing, an eco-tourist village, office and warehouse buildings, and golf courses. The plan concluded that a golf course combined with possible hotel, retail space and mixed use office/warehouse construction around the golf course was the best use of the land. Residential housing was not among the uses that were considered.

The Committee approved the Berry’s Creek Plan, and on May 28, 1997, the Board voted to accept the Berry’s Creek Plan.

In 1998, the NJMC staff conducted an investigation to determine whether land under its jurisdiction in the Borough of Lyndhurst, adjacent to the land covered by the Berry’s Creek Plan, was in need of rehabilitation. The Lyndhurst property was approximately 240 acres,²⁹ consisting of 12 lots owned by Buckley Broadcasting (24 acres), the Township of Lyndhurst (35 acres), Jersey City Division of Water (14 acres), the State of New Jersey (65 acres) and various private parties (123 acres), and included three orphaned landfills. All of the Lyndhurst property that was

²⁹ The Redevelopment Plan specifies that the acreage numbers are approximate.

investigated was found to be largely unused or underutilized, creating health risks and generating only small amounts of tax revenue for the town.

Rather than draft a separate redevelopment plan for the Lyndhurst area, the NJMC recommended that the plan for the open space in the Berry's Creek Plan should be expanded to include the 240 acres in Lyndhurst, creating a single 460 acre consolidated development. On March 24, 1999, the Board voted to declare the Lyndhurst Recreation Area "in need of rehabilitation" and adopted the consolidated Redevelopment Plan Lyndhurst Recreation Area (Lyndhurst Redevelopment Plan).

B. NJMC Partners with EnCap for Meadowlands Remediation and Redevelopment Project

According to the Lyndhurst Redevelopment Plan, the NJMC could undertake development of the land itself, or contract with a private developer. During interviews, NJMC representatives told OIG that because the incentives in the recently enacted Brownfields Act increased the likelihood of successfully attracting a private developer, they had decided to seek a private developer to undertake the remediation and development.³⁰

1. NJMC Requests Statements of Qualifications

On April 6, 1999 the NJMC issued a "Notice for Request of Statement of Qualifications" (Notice), to identify and gather information about developers interested in taking on the project

³⁰ Redevelopment Plan for the Berry's Creek Tract, Rutherford, New Jersey, May 28, 1997, p. 14; Redevelopment Plan Lyndhurst Recreation Area, February 1, 1999, pp. 10-11, 19.

described in the Lyndhurst Redevelopment Plan, with Statements of Qualifications (SOQs) to be provided by prospective developers by July 29, 1999. The Notice included a list of the properties to be developed by block and lot and stated that there was “evidence of former landfilling activity on the majority of the site.” It described the project as development of an 18-hole golf course to be located on all or part of a 460 acre tract, and specified that the NJMC sought “a multi-disciplinary design team including firms specializing in landfill cap/closure, golf course architecture, property development, and legal aspects of the project.” Specifically, the Notice provided that a developer was to “accomplish the following objectives: gather information (including sampling) about the type, location, and quantity of contaminants on the site, if any; provide for the closure and/or capping of landfills in the study area that will be impacted by the development proposal; provide a comprehensive plan for the development of the site including a public or semi-private golf course and all associated facilities that conforms to the Lyndhurst Redevelopment Plan dated February 1, 1999.”

2. Creation of EnCap

At the time the SOQ was issued, James H. Hockensmith was Senior Vice President of Environmental Engineering at L. Robert Kimball and Associates (Kimball), headquartered in Ebensburg, Pennsylvania.³¹ Hockensmith had been working on a project in Houston, Texas (the Texas Project) for which Kimball had been retained in 1998 or 1999 by EnCap Golf, LLC (EnCap Golf), the developer and manager of the Texas Project, to provide to provide stormwater and infrastructure design. The Texas Project consisted of construction of a golf course on a 450

³¹ According to the information included in their eventual SOQ submission to the NJMC, Kimball was a “45 year old, full service engineering environmental, architectural and mapping firm headquartered in Ebensburg, Pennsylvania.” Kimball employed 500 people in 10 offices.

acre privately owned former landfill. OIG was told that the landfill owner wanted to build a golf course on the landfill, and sought financing to do so through EnCap Golf's parent company, Environmental Capital International (ECI).

ECI was formed in 1998 by a self-described investment banker and venture capitalist William H. Gauger and investor Louis L. Gonda for the purpose of providing financing for remediation of underground storage tanks at gas stations. Gonda had recently been listed in Forbes Magazine as one of the 400 wealthiest people in the world, having made his fortune as a founder of the world's largest lessor of commercial aircraft. In an interview with OIG, Gauger said that he met Gonda through a mutual acquaintance.

In 1999, when ECI decided to undertake the Texas Project, Gauger, Gonda, and their mutual acquaintance formed EnCap Golf and subsequently entered into a contract with the landfill owner, agreeing that EnCap Golf would have a 99-year lease on the property and would create a golf course on the 450 acre site. Gauger told OIG that the private owner had completed the majority of the remediation and infrastructure work on the landfill, leaving EnCap Golf to cap the landfill and add fill³² to shape the golf course.

Gauger told OIG that EnCap Golf had hoped to build houses at the Texas site, as housing sales would provide maximum profit. Gauger said, however, that the EnCap Golf owners learned that the entire area had been used as a landfill, thus making construction of houses on the property "too costly." Gauger explained that he had also researched the possibility of expanding

³² The processes of capping and filling a landfill will be discussed more extensively in subsequent sections of OIG's report.

the Texas Project to include surrounding properties for housing projects, but because the properties were owned by many individual parties, it would have been difficult to obtain ownership of enough contiguous properties to build a housing development. Gauger additionally stated that even without housing, the Texas Project was still profitable for a number of reasons: EnCap did not have to fund most of the closure of the landfill because the private owner had already performed “most of the [landfill] remediation and infrastructure work”; the private owner had paid to have a methane gas collection system installed in the landfill; EnCap did not have to pay to purchase the property but rather had the use of it under a 99 year lease at no cost; and the fill used by EnCap Golf to cap the landfill and form the golf course was provided to EnCap Golf at no cost.

In the Spring of 1999, while working with Kimball on the Texas Project, Hockensmith learned that the NJMC was planning to seek qualified applicants for the Lyndhurst Redevelopment Plan through a “lead service” providing notice to consultants of pending projects. Hockensmith spoke to Gauger about putting together a team to submit an SOQ. At the time, EnCap Golf had not yet begun groundwork on the Texas Project; EnCap Golf had never previously accomplished a landfill to golf course project; and Hockensmith, as a Kimball employee, had only worked with EnCap Golf for a few months.

Gauger told OIG that he, Gonda, their mutual acquaintance, and Hockensmith decided to submit an SOQ for the NJMC project. Gauger told OIG that at that time he thought EnCap Golf’s role would be primarily to “put the financing together,” not to act as the developer. Gauger stated that there was no developer on their team at the time, but a developer could be

selected later if they were successful. Gauger told OIG that he did not put much effort into EnCap Golf's submission because he did not think their team would be selected, saying that he only reviewed the SOQ after Hockensmith prepared it.

3. EnCap Overstates Its Qualifications and Experience

NJMC held a pre-SOQ meeting on June 21, 1999 to provide information to and answer questions raised by entities interested in responding to the Notice. Representatives of 52 companies attended the meeting, including Hockensmith, who attended, planning to submit an SOQ on behalf of Kimball and EnCap Golf as a team.³³

EnCap Golf thereafter submitted an SOQ to be the “developer” of the “Golf Course Development Project,” and provided information about the “world-class team” of companies that would be involved on the project. EnCap Golf's SOQ included resumes and informational literature about its team members and the services they would provide. At the time, EnCap Golf represented that the team included the following entities to provide the described functions:

- Environmental Capital International, environmental cleanup financing;
- L. Robert Kimball & Associates, Inc., engineering;
- ET Environmental Corporation,³⁴ environmental engineering and contracting;
- Amy S. Greene Environmental Consultants, Inc., environmental consulting;
- Roy Case Golf Company, golf course design;
- DeCotiis, FitzPatrick, and Gluck, legal counsel;

³³ OENJ Cherokee Corporation, formed some months earlier, was represented at the meeting but did not submit an SOQ. As far as OIG could determine, Kimball did not submit a separate SOQ and instead joined the EnCap Golf team.

³⁴ ET Environmental was a joint venture between EmCon and Turner Construction Company. EmCon is a solid waste engineering and design company and Turner is a construction company purportedly with experience in large scale construction management in environmentally sensitive areas.

- Environmental Golf, golf course developers and managers; and
- Economics Research Associates, real estate value assessment.

EnCap Golf’s carefully worded submission emphasized the golf course design aspect of the project but also made statements creating the impression that EnCap Golf was experienced in landfill closure. EnCap Golf represented that it was “exceptionally qualified” to be the “developer of the project”, stating that the, “Lyndhurst golf course project is very similar to EnCap’s Wildcat Golf Course project in Houston ... [t]his program dealt with remediation, environmental permitting, and land development issues comparable to what we expect on the Lyndhurst Landfill.” In the section of the SOQ submission in which it described the proposed team, EnCap Golf represented, “EnCap is experienced in developing projects similar to the Meadowlands golf course, as evidenced by the . . . project in Houston,” and,

The concept of building golf courses on landfills has been tried by others. Individual courses have been designed and constructed by a number of different developers. Many of these developers have been discouraged by potential environmental liabilities, increased construction and maintenance costs, and technical uncertainties. EnCap’s unique business strategy, and that of our strategic alliance partners, is to identify, evaluate, and secure closed landfill properties that are suitable for redevelopment as golf courses on a national basis: making us the first true “brownfield” golf course developer. Our strategic vision is confirmed on a regular basis as public and private site owners approach EnCap to convert their properties into golf course developments.

However, it also created the impression that its experience carried over into the remediation portion of the project, and NJMC representatives understood that it did. EnCap Golf described the work done on the Texas Project saying, “[t]his project dealt with remediation, environmental permitting, and land development issues.” As to its proposed methodology for the Lyndhurst Redevelopment Plan, EnCap Golf stated that “EnCap intends to perform all the investigative, permitting, design, and remedial construction required to close and cap the existing

landfills in an environmentally sound manner...,” and the EnCap Golf “management includes senior executives from the banking, accounting, environmental, solid waste, and golf course architecture industries.”

EnCap Golf represented that as a member of the “dynamic team of professional firms that are integral to the successful development of this project...” Kimball “has extensive environmental engineering experience related to remedial investigations, remedial designs (including landfill capping and closure), and remedial construction oversight. Many of these projects have been completed for the DEP and NJDOT ... Kimball recently completed the closure of the Big Hill/BEMS Landfill, Burlington County in the environmentally sensitive Pinelands and is currently closing the Ottilio Landfill in Essex County.” EnCap Golf did not however, say that it had only recently worked with Kimball on one project, the Texas Project, wherein Kimball did not close the landfill.

EnCap Golf also made representations that created an impression that it had the financial resources to undertake the project. EnCap Golf represented that its founder and majority owner, Gonda, was one of the 400 wealthiest people in the world. EnCap Golf additionally stated that Gonda was also the founder and majority owner of ECI, which would provide the financial resources for the remediation project, and that ECI had the “available financial resources to meet the largest of funding needs.” EnCap Golf made repeated representations in its SOQ that it had financial resources sufficient for the project and effectively represented that Gonda and his company ECI could fund the Lyndhurst Redevelopment Project. EnCap Golf also made reference to the presence of Gonda’s father, Leslie Gonda, as being on the Board of Directors for

American International Group (AIG), reportedly furthering the impression in the minds of NJMC representatives of financial strength supporting EnCap Golf.

While EnCap Golf reserved the option of obtaining low interest financing that could be offered by State entities, EnCap Golf stated that public financing would only be sought “if timely and economical.” EnCap Golf’s SOQ clearly represented that seeking such loans would not deter progress on the remediation of the Project. Within the EnCap Golf SOQ is the following statement:

EnCap, independent of other financial support available, will secure private funds to develop the project. This private funds approach will significantly expedite the project. To reduce the project costs, every attempt will be made to use other State and local financial incentives, tax advantages, financial instruments, and economic benefits available to the developer. However, progress of the project will not be subject to the constraints of tax incentives application reviews, bond issuance process, and third party financial assistance.

4. NJMC Selects EnCap

Five NJMC employees, including Professional Engineers and Professional Planner, and a representative designated by each of the mayors and councils of the Boroughs of Rutherford and Lyndhurst were asked to serve on an Evaluation Committee to review the nine SOQ submissions received by the NJMC.

The Evaluation Committee used relevant criteria to assess the SOQ submissions. Numerical scores attributed to each submission by the members of the Evaluation Committee were tallied and the resulting scores ranged from 1090 to 1926. Five of the nine submissions

were eliminated from consideration at this stage. Four remaining lead firms³⁵ with scores of 1553-1926 were asked to make oral presentations to the Evaluation Committee. EnCap Golf's score 1926, the highest of the submissions, was one of the Lead Firms asked to provide a presentation to the Evaluation Committee. The other three Lead Firms were: Matrix, Gale, Wentworth and Dillon, and First Golf Corporation.

When asked by OIG why he thought EnCap Golf was one of the top four Lead Firms selected for the presentations, Hockensmith replied that the EnCap Golf team had "worked very hard" on their SOQ, it "had all the required aspects," and it included a golf course architect on the team, a feature he thought some other presenters may not have had.

Although the NJMC's plan had been to use the RFP process to make the selection, from among the final four, NJMC staff asked the New Jersey Attorney General's Office whether the Evaluation Committee was required to use the RFP process, or if the NJMC had the authority to meet with the top four teams, make a selection, and start negotiating a contract with the entity receiving the highest score. NJMC told OIG that, before the presentations, the Attorney General's office advised the NJMC that, in accord with the LRHL, an RFP was not mandatory, and that NJMC was permitted by statute to contract with redevelopers without using the public procurement process.

The presentations by the top four teams were scheduled for the first week in September 1999. EnCap Golf sent Hockensmith, golf course architect Roy Case, an attorney from the

³⁵ The Evaluation Committee referred to an entity submitting an SOQ to the NJMC as a "Lead Firm" and called the other proposed members of the developer's team the "Project Team."

DeCotiis law firm, and an EnCap Golf Vice President, to make the oral presentation to the Evaluation Committee. During an OIG interview, Hockensmith stated that during the oral presentation, the NJMC Selection Committee had asked questions about: EnCap Golf as an entity, who Lou Gonda was, and EnCap Golf's financial ability to go forward with the project. Hockensmith said that he thought that because of EnCap Golf's representations about the wealth of its founder and majority shareholder, Gonda, NJMC representatives believed that EnCap Golf had ample resources to complete the project without public financing.

After considering the oral presentations made by the top four responders, the Evaluation Committee concluded that based on its representations, EnCap Golf was the clear frontrunner and that it would be preferable to select it outright. Members of the Evaluation Committee told OIG during recent interviews that the EnCap Golf presentation was "far and above" that of the other entities that had submitted SOQs. OIG was also told that because EnCap Golf was the only applicant that represented that it had worked on a landfill-to-golf-course project, EnCap Golf appeared to be much more qualified than any of the other entities that had submitted SOQs and appeared to have only worked on landfill closures or golf course development but not both. Because the NJMC wanted the work done by the most experienced parties not necessarily the lowest bidder, the Evaluation Committee decided that proceeding with an RFP at that time would not be helpful. During the OIG interviews, the Evaluation Committee members also told OIG that the NJMC wanted the work done with private money and EnCap Golf represented that it had the financial ability to do so. Then-Executive Director of the NJMC, Alan J. Steinberg, told OIG in an interview that the NJMC felt confident about the financial resources of EnCap Golf

because of the stated wealth of Gonda as the project's primary investment source. "When EnCap brings Lou Gonda around and tells you he's the principle, it goes a long way."

In a memorandum to Executive Director Steinberg dated September 23, 1999, the Evaluation Committee recommended that the NJMC select EnCap Golf. In the memorandum, the Evaluation Committee stated that the decision to recommend EnCap Golf was based on evidence that EnCap Golf was the most qualified to perform the task. The Evaluation Committee wrote,

EnCap Golf has clearly distinguished itself as the frontrunner. EnCap Golf has demonstrated the ability of their team, an understanding of the interaction between golf course development and landfilled sites, and an understanding of the regional market. Furthermore, they appear to have the financial resources in place to initiate the project with little or no public financing.

The Committee also recommended that EnCap Golf be given a 90 day period for due diligence during which EnCap Golf was to review historical sampling records pertaining to the condition of the property, do its own soil sampling, and present the NJMC with a business plan to ensure acceptability of the proposed project. If by the end of the due diligence period EnCap Golf determined that it was not able to provide the services described in the Notice, NJMC would issue an RFP to the other three top ranked responders with the hope that one of them could do the work. The Evaluation Committee noted that issuance of an RFP at that time instead of offering EnCap Golf the due diligence period was an option, but was not preferable because "many of the aspects involved in this project" were "unquantified" and would "yield incomplete responses" and result in an estimated delay of six months for information gathering by the NJMC.

On October 27, 1999, the NJMC Board passed a resolution authorizing the selection of EnCap Golf as the redeveloper of the Lyndhurst/Berry's Creek redevelopment areas. EnCap Golf was given 90 days from the date of the resolution to perform due diligence.

During this process, EnCap Golf made the decision to proceed with the project. Representations in EnCap Golf's SOQ submission and oral presentation persuaded NJMC to feel confident about the "ability" of the EnCap Golf team. In January or February of 2000, approximately six months after EnCap Golf's SOQ submission, NJMC officials visited the Texas Project site and observed the landfill shaping process then underway in preparation for eventual construction of a golf course.

A decision to enter into contract negotiations was memorialized in an April 14, 2000 letter of intent to negotiate a contract, which was signed by the NJMC and EnCap Golf.

5. EnCap's "Gold Coast" Vision

Gauger told OIG that at the time EnCap Golf submitted its SOQ to the NJMC, he did not know much about landfill remediation. He further stated, however, that he knew that the area to be developed in New Jersey was a "great location" for development and that from the outset, he believed that housing would generate the most profit for EnCap Golf's owners. He told OIG that from a real estate development perspective, the property was one of the "best brownfield sites in the country." Gauger added that the property had several attributes that he considered important to successful real estate development: the close proximity of the property to New York City; the existence of freeway access; the wealth of the area population; and population density. Gauger

told OIG he saw the area as a part of the New York City region's "Gold Coast" similar to towns like Hoboken.

a. EnCap Encourages Expansion of Project Area

When interviewed by OIG, Gauger stated that from the time EnCap Golf representatives first considered possible involvement in the Meadowlands property, EnCap Golf owners believed that housing was the most profitable use of the land. Gauger said that he and the other EnCap Golf owners believed that, because the project area was not entirely used as a landfill as was the land in the Texas Project, there was ample land that was amenable to housing surrounding the landfills/future golf course and they intended to extend the permitted use to include housing.

Gauger told OIG that his first visit to the Lyndhurst Recreation Area site was during the 90-day due diligence period. While at the site, Gauger observed that there were other landfills as well as unused or underutilized areas surrounding the Project site and he thought that additional area could also be redeveloped. Gauger spoke to representatives of the NJMC about the other landfills in the vicinity, stating that it didn't make sense to remediate four landfills while ignoring the others. As the NJMC was interested in having the additional landfill areas closed and developed, and EnCap Golf appeared to be able to and wanted to undertake the additional work, the NJMC Board passed a resolution on May 24, 2000, to examine the possible remediation of 685 additional acres in Lyndhurst, North Arlington and Kearny. The majority of the area studied in this first expansion request included three landfills: Erie, 1-E, and a portion of

the Kingsland landfill. In September of 2000, these areas referred to as the Kingsland Redevelopment Area, were declared by the NJMC to be in need of rehabilitation.

In September and November of 2000 and June of 2001 EnCap Golf made requests for additional acreage in Lyndhurst and North Arlington to be merged into the Lyndhurst Redevelopment Plan. While some areas requested by EnCap Golf were determined to be in need of rehabilitation, others were declared to either be “adequately in use,” or “did not lend themselves to a coordinated development.” By the summer of 2001, the total acreage to be included in the redevelopment project tripled from 460 to 1330 acres, all at the request of EnCap Golf.

b. EnCap Realizes Its Vision Will Increase Costs

Although the NJMC had made available to EnCap Golf historical testing data for the site to be developed, EnCap Golf had not reviewed any of the available information on the content or depth of the landfills or DEP requirements for landfill closure prior to submitting the SOQ. Hockensmith explained that in January of 2000, more than two months after being selected, he and his associates at Kimball began reviewing NJMC historical environmental information on the landfills to be closed, and began actual physical research and sampling on the current conditions of the property. Kimball’s role was to research ground conditions and to determine what types of soil and landfill were present through-out the site. ET Environmental’s role was to apply Kimball’s data to DEP standards and requirements, and determine the plan for, and cost of, remediation.

When interviewed by OIG, Gauger stated that both at the time EnCap Golf submitted the SOQ and when it made the presentation to the NJMC, EnCap Golf had no budget in mind for the project and that it was not until late in 2000 when EnCap Golf developed a budget for the projected costs of the work to be done. Gauger claimed that cost projections were not possible until EnCap Golf had submitted the results of its review about contamination and permit information was received from the DEP. On August 1, 2000, EnCap Golf submitted a plan for closure of the Avon Landfill to the DEP for review and approval. In August of 2000, the DEP rejected EnCap's first closure plan and commenced a series of technical meetings and communications to assist EnCap Golf in preparing an acceptable closure plan. Gauger told OIG that it was during this time that EnCap Golf advisors learned more about what DEP required for landfill closure, and he realized that closure of the landfills would involve more work and expense than EnCap Golf officials and advisors had originally thought.

Gauger told OIG that EnCap Golf's underestimation of what was required to close the landfills was not based on changes in DEP regulations that govern how the landfills were to be closed. Rather, EnCap Golf's assumptions were based on the lack of research about New Jersey's requirements for remediation of landfills, particularly those planned for residential developments, and EnCap Golf's lack of experience in landfill remediation. Gauger began making budget projections and financial models based upon his understanding of DEP requirements. Gauger could not recall specific budget estimates that were produced during this time period but stated that by October of 2000 he had a "range of costs to close" the landfills.

6. Re-Creation of EnCap

In May of 2000, the owners of EnCap Golf formed a new company, called EnCap Golf Holdings, LLC. This is the entity that proceeded with the project and shall be referred to as “EnCap” in OIG’s report.

a. New Ownership

Three or four months later, when EnCap learned more about remediation requirements from the DEP, Gauger told OIG he decided that “institutional capital” from a “committed developer” was needed to provide financial support for the development, and that he believed that it was not in the best interest of Gonda or the project for Gonda to remain invested in the project. Gauger denied that this was because he or Gonda had considered the project “risky.” Rather, it was the amount of funds required to do the work and the length of time the funds would be tied up without realizing any profit that was the basis of this conclusion. Gauger explained that they understood a substantial amount of money would be required and that assembling the capital necessary for the project “wasn’t going to be easy.” He also stated that it would be difficult to obtain such an amount from investors for a brownfields-type project. Gauger told OIG that at that point he contacted Cherokee Investment Partners of Raleigh, North Carolina (Cherokee), a company that had previously reached out to him concerning the project. Gauger stated that he had no previous relationship with Cherokee, but was familiar with its work investing in brownfields sites.

When contacted about the EnCap project, Cherokee had already been involved in other New Jersey projects since at least May 1999, when Cherokee had purchased an interest in the

OENJ Group and its affiliated entities. The OENJ Group was originally formed by a pair of real estate investors who made use of a technique for capping landfills that involved a mixture of material dredged from waterways, Portland cement and lime. OENJ had completed a project in Elizabeth using this process (the Jersey Gardens Mall site) and was working on a project in Bayonne³⁶ when Cherokee invested in OENJ and formed several OENJ Cherokee entities. As disposal of harbor dredge was a long-standing problem for the New Jersey/New York Port Authority and the Army Corps of Engineers, those companies capable of accepting and disposing of the dredge materials were paid fees for doing so, thereby making dredge acceptance profitable. Gauger stated that Cherokee had originally contacted him and expressed interest in the Hackensack Meadowlands project shortly after EnCap Golf was selected as developer because of Cherokee OENJ's experience with fill materials used for landfill remediation.

In 2000, Cherokee managed two private equity funds, known as Cherokee Investment Partners Funds I and II (CIP I and CIP II). Cherokee subsequently created and undertook management of two additional private equity funds, Cherokee Investment Partners Funds III and IV (CIP III and CIP IV). The shareholders of the investment funds are primarily large pension funds. Through a wholly owned subsidiary, Cherokee Meadowlands, LLC, CIP II offered to buy

³⁶ Cherokee purchased OENJ while OENJ was under contract with the City of Bayonne to close a landfill and build two golf courses. Joseph Doria, who was the Mayor of Bayonne from 1998 to 2007, and is now the Commissioner of the State Department of Community Affairs, was interviewed by OIG about this. He stated that OENJ Cherokee's role in the project ended in approximately late 2004. Commissioner Doria told OIG that, from 2000 until its removal from the site in 2004, OENJ Cherokee had repeatedly violated DEP rules by overfilling the site with dredge materials. Noting that OENJ Cherokee received tipping fees in return for accepting dredge materials, Commissioner Doria told OIG that he understood that OENJ Cherokee had been permitted by the DEP to place dredge materials on the site in amounts that would raise the surface level of the ground by 50 feet; however, OENJ Cherokee exceeded the amount of dredge materials permitted by the DEP, placing fill as high as 90 feet on the site. OIG was advised that DEP accordingly issued fines against OENJ Cherokee for this. Commissioner Doria also told OIG that OENJ Cherokee was unable to properly complete the project and, as such, it was replaced by Empire Golf, the original golf subcontractor on the project. Empire Golf completed the landfill closure and built a golf course on the site. While OENJ Cherokee was to have completed the entire project by 2001, Empire completed it within 18 months of taking over the project and the golf course opened in April 2006.

Gonda's interest in EnCap. OIG was told that, when Cherokee joined EnCap, CIP II invested \$25 million in the project, with \$6.1 million of this investment going to reimburse Gonda for loans and investments he had previously made through subsidiary companies. According to Gauger, Gonda thereafter no longer had any funds invested in the project, he was under no obligation to support the project financially or otherwise, and he had no funds at risk in the project. Gonda's only remaining connection to the project going forward was that EnCap could use his name as an "owner" of EnCap and he would be entitled to 17.5% of any eventual profit.

b. NJMC Not Aware of Full Extent and Significance of Changes

Although according to EnCap representatives, the change in EnCap's ownership had occurred in August or September of 2000, it was not until approximately two weeks before the October 26, 2000 signing of the contract between EnCap and NJMC (the Landfill Closure and Development Agreement (the "2000 Agreement")), that NJMC representatives were informed that there had been a change in the ownership of EnCap Golf. The evidence gathered during OIG's investigation indicates, however, that the effect of the change in ownership was not fully and clearly conveyed to NJMC representatives by EnCap attorneys and representatives. The attorneys for EnCap told NJMC representatives that Cherokee Meadowlands, LLC had invested in the Project, and that Gonda was no longer the majority owner of EnCap. EnCap's attorneys did not tell NJMC representatives, however, that Gonda no longer had any money involved in the venture and he was under no obligation to provide financial support for the project.

The 2000 Agreement consisted of a 98 page agreement and 20 Exhibits.³⁷ A clause in the agreement described the change in EnCap ownership, showing a 51% ownership interest being transferred to CIP II, a subsidiary of Cherokee, with Gonda retaining a 17.5% ownership interest in EnCap, and Gauger retaining a 17.5% ownership interest.³⁸

The 2000 Agreement provided that EnCap had an obligation to disclose name and address information about individuals and businesses with an ownership interest of 10% or more. Disclosures of ownership interest were also made in exhibit 17.1.2 to the 2000 Development Agreement showing Meadowlands Investment Co., LLC (one of Gonda's companies) as having a 17.5% ownership in EnCap.

Then-Executive Director Steinberg told OIG that he had understood at the time of the signing of the 2000 Agreement that Cherokee Meadowlands, LLC, would be a shareholder but that Gonda remained as an owner of EnCap. As recently as spring 2007, the remaining NJMC leadership understood Gonda to be an "investor" in the Project. Steinberg stated that, in hindsight, he wished the NJMC had undertaken a more thorough review of EnCap Golf's financial information; however, because he was aware of Gonda's wealth, the fact that the documents by which EnCap was contracting with NJMC showed Gonda to have a continued

³⁷ The Exhibits were: 1.1 Description of Redevelopment Project Site, 1.2.1 Master Plan, 4.1 Form of Ground Lease, 4.7 Schedule of Waste Reception Contracts, 6.1.4.1 Form of Memorandum of Phase 1 Commencement Date, 6.1.4.2 Form of Memorandum of Phase 2 Commencement Date, 7.2.2 Form of Fill Material Acquisition Contract, 7.6.4 Letter of the NJAG Confirming Payments Terms of O'Brien (Neo) Agreement (regarding a dispute between NJMC and its then current methane gas contractor), 15.1 Default Dates, 16.3.1A-1Form of Post-Completion Security (Term), 16.3.1A-2 Form of Post-Completion Security (Renewable), 16.3.1B-1Form of Post-Completion Security (Term), 16.3.1B-2 Form of Post-Completion Security (Renewable), 16.3.1C-1Form of Post-Closure Security (Term), 16.3.1C-2 Form of Post-Closure Security (Renewable), 16.6.1 Commitment for Performance Security, 17.1.2 EnCap Disclosure Certificate-Officers, Directors, Ownership, 17.1.10A HMDC Section 00428 Affidavit, 17.1.10B HMDC Section 00430 Affidavit, 17.1.10C HMDC Section 00480 Affidavit.

³⁸ Landfill Closure and Development Agreement, Clause 22.4.1(i), pg 84, dated October 26, 2000.

ownership interest, and the fact that EnCap was required to provide performance security,³⁹ he and other NJMC representatives believed that completion of the project was guaranteed.

When told during OIG's investigation that NJMC representatives were not fully aware of the details of the change in Gonda's ownership interest, EnCap's attorney expressed surprise. He pointed out that the change in ownership was spelled out in a document provided as part of the closing documents for the signing of the 2000 Agreement. The only document that OIG is aware of that he could have been referring to was the Amended and Restated Limited Liability Agreement for EnCap Golf Holdings, LLC (the LLC Agreement), which was not a part of the 2000 Agreement but was allegedly provided to the NJMC at or close in time to the signing of the 2000 Agreement. The purpose of the LLC Agreement was to govern the workings of EnCap as an entity and had been provided as one of ten attachments to a certificate by EnCap's attorney (the Certificate).⁴⁰ The Certificate and its attachments, including the LLC Agreement, were provided to demonstrate EnCap's ability to conduct business within the State of New Jersey. The LLC Agreement that was attached to the Certificate was 52 pages long and contained four pages that were redacted almost entirely. The Certificate stated that provisions in the LLC Agreement relating to "contributions of capital, distribution of income, and similar economic terms" had been redacted to preserve confidentiality.

³⁹ "Performance security" refers to a financial instrument that EnCap was obligated to procure, pursuant to the 2000 Agreement, guaranteeing completion of the project in the event of an EnCap default. Specifically, the 2000 Agreement provided that the instrument would "assure the full and timely payment and performance by EnCap...with respect to each component of the ...Project..." and "its post-closure responsibilities...." It is discussed elsewhere in this Report.

⁴⁰ The other documents attached to the certificate were: Certificate of Formation of EnCap, from the State of Delaware, dated May 9, 2000; a Certificate of Good Standing from the State of Delaware; a Certificate of Registration as a Foreign Limited Liability Company, filed in the State of New Jersey; a set of three resolutions adopted by the members of EnCap authorizing execution of the LLC Agreement; and a set of three resolutions adopted by the members of EnCap authorizing execution of the 2000 Development Agreement.

The Certificate and attached LLC Agreement were collateral to the 2000 Agreement and not an integral part of it. Further, the Certificate represented that the redactions were necessary to protect EnCap's privacy. When the LLC Agreement was used in this way, as antecedent to the 2000 Agreement with redactions for privacy, it tended to indicate that information in it was not relevant to the 2000 Agreement. EnCap representatives, including their attorneys, knew that Gonda's involvement, particularly his wealth, were critical to NJMC's willingness to go forward with EnCap. If it had been EnCap's intent to assure that Gonda's interest was made known it would have made the change abundantly clear rather than opine that NJMC officials should have understood that Gonda had no continuing obligations to EnCap based upon an LLC Agreement that was provided as a collateral document to the 2000 Agreement when that agreement clearly represented only that Gonda was a 17.5% owner and was silent as to a cessation of continuing obligations to the project.

Not only were NJMC representatives not fully aware of the changes in Gonda's ownership interest, they were also not advised of the limit on the financial support that the new majority shareholder, CIP II, could provide. In an interview with OIG, EnCap attorneys told OIG that \$25 million was the maximum amount of money CIP II was permitted to invest in any one project under internal rules governing the CIP II fund, thereby making CIP II's maximum equity in the Meadowlands project less than \$19 million (since \$6.1 million had been used to reimburse or otherwise pay money due to Gonda). When interviewed by OIG, Then-Executive

Director Steinberg and other officials for the NJMC stated that they were never informed of this investment limitation.⁴¹

Additional substitutions to the EnCap Golf team as represented by the SOQ took place during this time period as well. ET Environmental, the general contractor for the remediation work on the subject properties in the SOQ, was replaced by MACTEC, Inc. An affiliate of Cherokee Investment Partners called Cherokee Equity Holdings had an ownership interest in MACTEC Inc., from some time in 1999 until February 2002 when it sold this interest to Wachovia Capital Partners and Nautic Partners. In an interview with OIG, Hockensmith alleged that EnCap Golf made the substitution because it was unhappy with ET's work product and schedules.

Based on documentation provided to OIG by EnCap, it appears that EDA funds may have been used to pay "Notice to Proceed Delay Charges" and "Pre-Mobilization Fees" in the years leading up to the time of groundbreaking in May 2004. EDA records provided OIG show payments from EDA funds of approximately \$6.9 million in what was termed "MACTEC-Cost Escalation" payments from the initial contract with MACTEC to May 2004.

Kimball's role in the Project was substantially reduced as another engineering firm, Paulus, Sokolowski & Sartor was brought in. Amy S. Green, the environmental consultant in the SOQ does not appear to have been used beyond the SOQ, and Environmental Capital International, one of Gonda's companies is no longer participating. Whether or not Roy Case

⁴¹ The evidence indicates that NJMC representatives were not aware of the limitation on CIP II investments until Spring of 2007.

Golf Company and Environmental Golf, the golf course designer and developer, respectively, remained a part of the EnCap “team” is unclear as the Project is still in the remediation stage and golf course construction has not yet begun. In general, however, many of those companies who NJMC was impressed by and felt confident about in selecting EnCap as the developer of the Project did not remain a part of the Project as it moved forward through the signing of the 2000 Agreement and into 2001.

At the time of the signing of the 2000 Agreement, EnCap had been formed solely for the purpose of remediation and development of the Project. Gauger and Hockensmith were EnCap’s only employees. Gauger was President and Manager of EnCap and owned a 17.5% share in EnCap, and Hockensmith, who left Kimball to become the Senior Vice President of EnCap, had a 2.5% share in EnCap. While EnCap could technically correctly continue to state that Gonda still had an “interest” in the project, Gonda’s revised “interest” was never clearly represented to NJMC representatives. In fact, Gonda, EnCap’s former majority shareholder, was to invest nothing more in the project, while EnCap’s majority shareholder could only invest a maximum of \$25 million. In addition to these changes, EnCap’s general remediation contractor had been replaced by an entity owned at least in part by a Cherokee company and nearly all of the “team” members on the SOQ had been or were soon to be replaced. NJMC was aware of the changes in terms of percentages of ownership of EnCap, but did not know that EnCap had only two primary employees and a limited investment fund of \$18.9 million.

7. EnCap Takes Control

Once the development Agreement was signed in October 2000, EnCap proceeded along five tracks: (1) working with NJMC and local authorities expanding the area and amount of development in the Meadowlands; (2) obtaining DEP approvals and permits for closing landfills and remediation of the area; (3) obtaining public financial assistance; (4) garnering political and governmental support; and (5) performing physical work on the Project. Work on these efforts often overlapped and continued to some extent and in one form or another up to and even during OIG's investigation:

- Although most of the DEP requirements were established early in the project, EnCap continued efforts to revise DEP standards. It took several years before all permits were obtained.
- EnCap began the Project in 2001 with \$145,000,000 with financial assistance from the EDA; replaced that in 2005 with \$212,000,000 in financial assistance from EIT and DEP; negotiated with vertical developers to sell development rights; received tipping fees for accepting fill; and negotiated with towns in the Meadowlands area from 2003 until the present for financial agreements that EnCap anticipated would enable it to obtain as much as \$450,000,000 in additional financing.
- Between 2001 and 2005, EnCap representatives attempted to benefit the project making contributions to several political entities and meeting with governmental officials.
- EnCap retained consultants, some of whom were related parties, negotiated with fill providers and contractors, and "broke ground" in spring 2004. In early 2007, EnCap representatives estimated that the remediation portion of the Project was at least \$72,000,000 over the budget and acknowledged that they had mismanaged the Project.

The following sections of the report describe the evidence gathered during OIG's investigation regarding many of EnCap's efforts in these areas.

IV. NJMC AND ENCAP WORK TO FULFILL CONTRACT TERMS

The 2000 Agreement between the NJMC and EnCap provided for closure, covering, and subsequent construction on a series of seven landfills and contiguous property to be completed in two independent phases. “Phase 1” consisted of the Avon, Lyndhurst, Rutherford and Kingsland landfills, while the second (“Phase 2”) included landfills called 1-E and Erie, and a solid waste transfer station owned by the Bergen County Utilities Authority (BCUA) (the areas to be remediated and developed as set forth in the 2000 Agreement, and its subsequent amendments, shall be collectively referred to as the Project in OIG’s report). The 2000 Agreement included requirements for both EnCap and NJMC regarding the scope of the project, the required permits, the manner in which the subject properties were to be acquired, minimum requirements for development of golf courses and vertical development, requirements regarding proof of financing, warranties, insurance, limitations of liability, covenants, and warranties for breach.

A. Property Amassed for EnCap Development

Among the main terms of the 2000 Agreement, NJMC agreed to procure, by purchase and sale agreement or eminent domain, the properties subject to the agreement. The NJMC’s costs in obtaining title to the properties were to be reimbursed by funds placed in escrow by EnCap, whereby NJMC could reimburse itself as it closed on individual parcels of land. Title to the property would then be held by the NJMC and EnCap would have the right to lease the property from the NJMC for 99 years.

The Lyndhurst Redevelopment Plan discussed *infra* listed all properties to be included in the Project by block and lot number and granted NJMC staff authority to proceed to purchase the

properties or commence eminent domain proceedings where necessary. NJMC staff was to begin the property acquisition process when EnCap placed the appropriate amount of funds in escrow. The 2000 Agreement also provided that any properties not already under NJMC ownership were to be acquired within 60 days of the completion of the Material Conditions set forth in the Agreement.⁴² From January of 2002, when actual property purchases began to take place, through April of 2007, EnCap reimbursed the NJMC \$19,280,101.80 for property acquisition costs and \$2,778,863.95 for related costs associated with those acquisitions.⁴³ The associated costs consisted primarily of appraisal, planning, engineering, and legal fees.

B. EnCap Obtains Project Insurance and Performance Bond

The 2000 Agreement additionally required EnCap to provide security to ensure the completion of the remediation and required development elements (that by this time had been modified to include, golf course, hotel/resort, timeshare units) sixty days after EnCap had completed the conditions necessary to break ground on the Project. “Performance Security” assuring “full and timely performance by EnCap of its obligations” in the amount of 125% of the costs of those obligations was to be provided to the NJMC by EnCap. The first such Performance Security, a Solid Waste Closure Policy issued by Lexington Insurance Company, was in place December 21, 2001 through December 21, 2006, and covered 125% of the estimated closure costs. An actual performance bond was also to be posted by EnCap, prior to the time of “groundbreaking.” Accordingly, on May 3, 2004, a performance bond in the amount

⁴² The Material Conditions were a series of conditions that were to be met by EnCap and/or NJMC prior to groundbreaking on the Project and will be discussed further in OIG’s report.

⁴³ After signing the 2000 Agreement EnCap management obtained additional financing from the New Jersey Economic Development Authority, obtaining \$145,000,000 in loans, from which these costs could be paid, as discussed infra.

of \$148,824,299 was issued by American Home Assurance Company to accompany the 2001 performance security instrument as groundbreaking was to occur.⁴⁴

C. NJMC Closure Fund Depleted

The 2000 Agreement also contained Material Conditions⁴⁵ for both Phases of the Project. Satisfaction of all Material Conditions was required before groundbreaking could occur.⁴⁶ Further, the failure to satisfy Material Conditions could, at the discretion of either party, result in the termination of the 2000 Agreement without either party being subject to breach of contract penalties. In an interview with OIG, Gauger explained that neither EnCap nor the NJMC was considered “fully committed” to the Project until the Material Conditions were completed and that this allowed EnCap time to complete, among other things, the permitting process and thus determine the financial feasibility of the Project.

One of the Material Conditions required NJMC to arrange for the purchase of a solid waste transfer station that was outside of its jurisdiction. The transfer station was owned by the Bergen County Utilities Authority (BCUA). In an interview, Gauger explained to OIG that after being selected as developer in September of 1999, EnCap Golf expressed interest in purchasing the transfer station property. OIG has been told that officials in Governor Christine Whitman’s

⁴⁴ The Performance Bond is discussed further in subsequent sections of OIG’s report.

⁴⁵ The Phase 1 Material Conditions included: issuance of an Army Corps of Engineers Section 404/10 permit for dredging and filling wetlands; issuance of DEP permits allowing dredging and bridge construction; approval by DEP of Kingsland Closure/Post Closure Plan Amendment; approval by DEP of an MOA and Remedial Action Workplan; final adoption of a Redevelopment Plan; execution by NJMC of purchase and sale agreements or declarations of taking for Phase 1 sites; absence of any title objections; execution of agreements regarding the BCUA Transfer Station and use of portions of the Kingsland Landfill Closure Fund; and all permits, approvals and agreements must remain in full force and effect.

⁴⁶ The Phase 1 Material Conditions were satisfied as of February 12, 2004.

administration, the BCUA, and Bergen County officials were supportive of this proposition, because the BCUA was burdened by \$96 million in bond debt and did not process enough solid waste to generate the fees necessary to pay the debt.⁴⁷ EnCap, the BCUA, NJMC and other state entities developed a plan to defease⁴⁸ the bond debt, whereby NJMC would become the owner of the transfer station. NJMC would then sell the transfer station to EnCap in a later transaction.⁴⁹ Through an amendment to the closure fund statutes, \$42 million of the funds in the NJMC landfill closure accounts was used to help defease the BCUA bond debt in May of 2002.⁵⁰

At the same time, the new administration of Governor James McGreevey was in place and was working to manage a substantial budget shortfall while preparing its first State budget. Susan Bass Levin, who was appointed Commissioner of DCA in January of 2002 and several NJMC officials told OIG that EnCap representatives had approached then-State Treasurer, John McCormac, to propose that the funds remaining in the NJMC landfill closure accounts be used for State general budget purposes, since the NJMC landfill closure funds were no longer required for their stated purpose because EnCap would be closing the landfills. OIG was told that this conversation resulted in the re-appropriation of approximately \$61.5 million of the landfill closure funds from NJMC control that were re-appropriated into the State's General Fund to be used in the 2002-2003 budget, adopted on July 1, 2002. The transfer of funds was effectuated in

⁴⁷ The bond debt had accrued over many years of capital projects necessary to continue to provide proper solid waste disposal for Bergen County.

⁴⁸ "Defease" means that the amount of debt on a bond is paid through cash or issuance of new bonds.

⁴⁹ On February 14, 2002, the "Intergovernmental Agreement by and Among the New Jersey Meadowlands Commission, the County of Bergen and the Bergen County Utilities Authority for Defeasance of BCUA Solid Waste Bonds and Transfer of Solid Waste Facilities," was entered into setting forth the terms by which the sale would take place.

⁵⁰ N.J.S.A. 13:1E-109.1, permitted the withdrawal of \$42 million from the NJMC accounts and will be discussed later in OIG's report.

February 2003. During a recent OIG interview, Treasurer McCormac denied any control or decision-making authority with respect to this transfer of funds.⁵¹

The arrangements for the purchase of the transfer station became problematic for the NJMC because after the landfill closure funds were removed, the NJMC was left without money to close the landfills should EnCap fail to pay to purchase the transfer station from the NJMC, and/or if EnCap should fail to complete the remaining Material Conditions and make a binding obligation for themselves to close the landfills. Ownership of the transfer station shifted from the BCUA to the NJMC in 2002 after the bond debt was defeased. On August 10, 2006, over four years after the NJMC closure funds had been eliminated, EnCap paid NJMC \$13,094,842 for ownership of the BCUA Transfer Station property.

D. NJMC Limited Review and Approval

According to the 2000 Agreement, EnCap is required to seek NJMC review and approval of various actions. NJMC must approve all closure plans, permit schedules and budgets. NJMC could also review all development plans for the golf course, timeshare units, and hotel and resort areas. Additionally, while the 2000 Agreement required EnCap to perform closure and remediation work in accord with the requirements of the DEP and Army Corps of Engineers, NJMC was to review permit applications. EnCap could, however, select fill providers and fill sources without NJMC approval, provided the NJMC was given a copy of any fill materials contracts ten days after its signing. The 2000 Agreement does not provide NJMC with a right or

⁵¹ The Treasurer told OIG that his staff engaged in a review of the budgets of all the State authorities and based on this review a list of budget options including transfers of fund balances was presented by his office to the Governor's office, which made the decisions regarding the necessary transfers that were to take place.

duty to review applications by EnCap for financing, thereby leaving EnCap free to seek financing as it saw fit, and requiring only that EnCap show proof of its financing as one of the Material Conditions. The NJMC also had the right to approve vertical developers to whom development rights and duties could be transferred, but did not have the right to approve sub-contractors used by EnCap. While the NJMC had review or approval rights in many aspects of the Project, the 2000 Agreement did not provide the NJMC authority over the entire project or even make it a central point entity or repository of all information related to the Project.

OIG was told that despite these contractual requirements that NJMC review and approve certain elements of the projects, NJMC had difficulty enforcing the requirements since EnCap would frequently not submit the required documents to NJMC. OIG was told that on many occasions NJMC officials would discover that EnCap had submitted an application or document to another governmental entity without following the requirements of the 2000 Agreement. When NJMC reminded EnCap representatives of their obligation to provide the required materials to the NJMC, EnCap would eventually provide them, but often the processes were underway.

Then-DCA Commissioner Bass Levin, told OIG that there was not one stakeholder “in charge” of the large project, nor a central repository of information, adding that EnCap representatives were free to approach State regulators as they felt necessary. By way of example, Bass Levin stated that neither she nor the NJMC were informed about the DEP requirements and oversight. She told OIG that NJMC did not have jurisdiction over the environmental permitting as this was an area that was under DEP authority.

Thus, EnCap's ongoing relations with DEP, both with respect to permitting and financing, were outside the DCA's and NJMC's scope of review. Consequently, while the 2000 Agreement provided NJMC with some approval authority, which was difficult to enforce, it left open areas in which EnCap could seek to work independently of the NJMC.

E. Agreement Amended to Provide EnCap Ownership of the Property

The 2000 Agreement between the NJMC and EnCap was amended and restated in its entirety three times between 2001 and the issuance of this Report. The first amended agreement, the Amended and Restated Landfill Closure and Development Agreement, was entered into on March 10, 2003, (the "2003 Agreement"), while Governor James E. McGreevey was in office. The Second Amended and Restated Landfill Closure and Development Agreement was signed on September 20, 2005. The current agreement, the Third Amended and Restated Landfill Closure and Development Agreement, was signed August 9, 2006 under the present administration.

The 2000 Agreement was first amended in part, however, on December 19, 2001 when the NJMC and EnCap signed a Memorandum of Agreement (MOA) providing that EnCap would purchase the land to be developed rather than enter into the previously planned 99-year lease with the NJMC. The lease agreement had required EnCap to pay NJMC \$1,000 per year for 99 years for the lease of the Phase 1 properties and \$8,550,000 a year for the Phase 2 properties.⁵²

⁵² Of the Phase 2 payments, \$6,250,000 was to be paid directly to NJMC and the remaining \$2,300,000 would go to the Borough of North Arlington to make up for fees the Borough would no longer collect once the Phase 2 landfills ceased operations.

EnCap representatives told OIG that, in order to be insured by AIG, EnCap was required to have ownership of the property rather than a 99 year lease. Then-DCA Commissioner Bass Levin told OIG that, she was aware of two reasons for the change and both benefited the State.⁵³ First, Bass Levin told OIG that she and the NJMC officials believed that EnCap would pay more money to the NJMC for the rights to remediate and develop the property, through a sale of the property. Bass Levin also told OIG that as owners of the property, EnCap would have direct responsibility for the clean up it was undertaking, and a direct relationship with the DEP rather than an indirect relationship through the NJMC.

While the MOA marked the change from lease to ownership of the property, it was through the 2003 Agreement that Bass Levin and NJMC officials negotiated what they determined was a more financially sound agreement for the State. NJMC officials interviewed by OIG stated that they saw a need to alter the terms of their agreement with EnCap, so as to require EnCap to make payments for the properties earlier than they would in connection with a 99-year lease, to ensure that NJMC be compensated for the properties in the event that EnCap opted not to undertake the Phase 2 development or was otherwise unable to complete the Project.⁵⁴ Because the 2000 Agreement provided that the annual lease payments to NJMC of \$6,250,000, would only be due if EnCap opted to undertake the Phase 2 development, the 2003 Agreement provided for payments totaling approximately \$30 million to be made to NJMC between the signing of the 2003 Agreement and the eventual commencement of Phase 2. These

⁵³ The MOA was entered into on December 19, 2001, during the final days of the administration of Governor Donald DiFrancesco. At the time Bass Levin was appointed DCA Commissioner the change from lease to sale had already taken place, but Bass Levin explained to OIG that many of the financial terms of that change were to be negotiated by her over the next two years, leading up to the 2003 Amended Agreement.

⁵⁴ NJMC officials told OIG that they had been contacted by EnCap officials, who had expressed an interest in eliminating the \$6,250,000 annual payment that it was obligated to make to NJMC in connection with Phase 2 of the Project.

payments did not include payments for the BCUA Transfer Station that was discussed previously in this Report.⁵⁵

F. Expansion of EnCap Vertical Development Rights

While the 2000 Agreement between NJMC and EnCap provided the minimum building requirements expected of EnCap, the NJMC established the maximum limitations on what could be built by way of the Meadowlands Golf Course Redevelopment Plan (the “2001 Redevelopment Plan”), which was adopted by the NJMC on February 28, 2001 and provided for the development of 1,330 acres.⁵⁶ The Redevelopment Plan replaced the earlier Lyndhurst Redevelopment Plan that had been the subject of the SOQ. The 2001 Redevelopment Plan was to be amended in accord with the process set forth by statute whereby EnCap must request a resolution to the plan subject to a public hearing in order to increase its development rights. This process ensured that increases in development be met with public approval before being permitted.

The vertical development proposed in the 2001 Redevelopment Plan consisted of:

- hotel/resort with a minimum of 330 rooms/maximum of 650;
- office space, 750,000 square foot maximum;
- interval occupancy units⁵⁷, maximum of 1,400;
- commercial recreation, maximum of 700,000 square feet;

⁵⁵ The 2003 Agreement contained a number of payments to be made by EnCap, including but not limited to: \$12,800,000 for a solid waste transfer station owned by the BCUA; \$6,750,000 for ownership of Phase 2 properties; temporary host fees to North Arlington; \$8,000,000 to extend the time to exercise the Phase 2 option; and a payment for Phase 1 properties in the amount of \$14,500,000 to be paid after commencement of Phase 2.

⁵⁶ As discussed above, in response to EnCap’s requests, the total acreage was increased to 1330 acres by the Summer of 2001. An amendment to this Redevelopment Plan was later adopted on February 26, 2003, allowing for development of 1,376 acres.

⁵⁷ Interval occupancy units are commonly referred to as timeshares.

- and a golf course with golf clubhouse and retail area.⁵⁸
- The Redevelopment Plan also included a number of zoning requirements that would apply to the development projects including, by way of example, a maximum building height of 25 stories and minimum parking space requirements.

Six months later, in August of 2001, EnCap sought to expand its development rights by seeking amendments to a number of the limitations in the Redevelopment Plan. EnCap requested that in addition to interval occupancy units, an “active adult community” for those 55 years of age and older be permitted. EnCap sought permission to build residential support buildings, a village retail center for the residential community, and an increase in the allowable square footage for office space from 750,000 to 1.2 million. Changes to the Redevelopment Plan were approved through the above-referenced public hearing process and voting by both the NJMC Board and Committee. The changes requested by EnCap in August of 2001 were approved by the Committee and adopted by the NJMC Board in September of 2001.⁵⁹ EnCap’s request to add an “active adult community” to the list of permissible vertical development was EnCap’s first visible action towards fulfillment of Gauger’s original plan of housing developments as part of the Project.

Early in 2002, EnCap requested additional amendments to the Redevelopment Plan which were approved by the NJMC Board and Committee on July 31, 2002.⁶⁰ These

⁵⁸ The Redevelopment Plan largely describes Phase 1 development. Phase 2 was to include a 36-hole golf course and associated amenities.

⁵⁹ OIG was advised, and the evidence indicates, that, in pursuit of its effort to amend and expand the categories of permissible vertical development, EnCap’s representatives had on several occasions, independently approached the impacted towns to explain the need for the vertical development at issue. OIG was advised that EnCap would do this before communicating with the NJMC about its proposal. OIG was further advised that once the town agreed with EnCap’s proposal, it would support EnCap’s application to the NJMC.

⁶⁰ As discussed previously in this Report, in September of 2001, the NJMC Board and Committee had approved EnCap’s request to increase the office space limit from 750,000 to 1,200,000 square feet.

amendments included an expansion of the permitted amount of office space from the 1.2 million square feet that was approved in September of 2001 to 1.3 million square feet. EnCap simultaneously requested an increase in the number of permissible hotel rooms from 650 to 750, and an increase in the number of permissible dwelling units from 1,400 to 1,500, with 750 to be offered at market rate with no age restrictions. This is the first time unrestricted residential housing was authorized by the Redevelopment Plan. NJMC officials told OIG that EnCap officials represented that because the estimated cost of the remediation was over \$100 million, EnCap wanted to be able to incorporate different types of vertical development into the project, and expand the number of permissible units, in order to make the venture profitable.

By December 2002, EnCap sought to return the square footage for office development to the original 750,000 square feet while increasing the number of dwelling units from 1,500 to 1,980, with 1,080 of these units being designated as “Active Adult.” These requests by EnCap were approved by the NJMC Board and Committee on February 26, 2003. EnCap representatives told OIG that the decrease in office space was based in part on a decrease in market conditions as a result of the events of September 11, 2001. OIG was also told that the most important reason for the decrease in office space needs was the then recent approval, by the Sports and Exposition Authority, of an office space development of 2,000,000 square feet as part of the Xanadu development.⁶¹

⁶¹ The Mills Corporation, the developer of Xanadu, was also represented by the law firm of DeCotiis, FitzPatrick, and Gluck at this time.

EnCap did not seek further amendments to the Redevelopment Plan until 2005 when it requested an increase in the number of residences to 2,580 from 1,980,⁶² which was approved on June 22, 2005. This increase permitted EnCap to build 600 units on an area in Rutherford, referred to as the Northern Node, pursuant to a development agreement previously entered into between EnCap and the Borough of Rutherford in December 2004.

G. Attempts by EnCap to Develop Porete Avenue, North Arlington

The majority owner of EnCap is Cherokee Investment Partners (Cherokee) through one of its four investment funds, CIP II. Cherokee has registered at least 27 business entities in New Jersey including Cherokee North Arlington, LLC, Cherokee Porete, LLC, and Cherokee Porete Urban Renewal, LLC. Through these entities Cherokee has sought the rights to remediate and build a 1650 unit housing development on a 91 acre section of Porete Avenue in the Borough of North Arlington (the Borough), that is adjacent to those properties already being developed by EnCap, but is outside the NJMC jurisdiction and not part of the NJMC Redevelopment Plan. In 1990, the North Arlington Planning Board had declared Porete Avenue an area in need of redevelopment under the Local Redevelopment and Housing Law.

The BCUA Transfer Station, owned by EnCap since 2006, is located on 20 of the 91 acres at the Northern end of Porete Avenue.⁶³ On another 46 of the 91 acres was a Bethlehem

⁶² 1,130 of the 2,580 residences were to be “active adult.”

⁶³ As discussed earlier in this report, EnCap, through the NJMC had sought to purchase and remediate the BCUA Transfer Station property shortly after being selected as developer of the Project in early 2000. The NJMC was required to use \$42,000,000 of its landfill closure funds to purchase the Transfer Station from the BCUA in 2002, and in late 2006, EnCap paid NJMC \$13,094,842 for the property.

Steel processing facility that had ceased operations, and was sold to Cherokee North Arlington, LLC by EnCoat-North Arlington, Inc., on February 28, 2003. Twenty-four industrial facilities, some still in use, occupied the remaining 25 acres.

While the Porete Avenue property is separate from the Project property, it is important to understand how Cherokee, through other subsidiaries, was (and still is) seeking to build houses on property that is adjacent to the properties in the Project. With the exception of the BCUA Transfer Station property, Porete Avenue does not contain landfills. EnCap officials have told OIG that from the time they first were selected as the developer of the Project, they intended to seek permission to build houses as a way of making the most profit for their investors.

In late 2002, Cherokee North Arlington, LLC, approached then-Mayor of North Arlington, Leonard Kaiser, to discuss the possibility of a housing development on the property. Mayor Kaiser submitted Cherokee North Arlington, LLC's proposal to the North Arlington Redevelopment Authority for review and approval or rejection. If approved, the proposal would be considered by the Borough Council for adoption or rejection. While the proposal was under review by the Borough Redevelopment Authority, Mayor Kaiser was unsuccessful in a bid for re-election.⁶⁴

Mayor Russell Pittman replaced Kaiser as Mayor. Mayor Pittman rejected the Cherokee North Arlington, LLC proposal that was then being reviewed by the North Arlington Redevelopment Authority. Mayor Pittman told OIG in an interview that although he was

⁶⁴ Not long after ending his 20 years as Mayor in 2002, Mayor Kaiser was appointed to the NJMC Board of Commissioners in January of 2003.

concerned with specific terms of the first plan, he was interested in a housing development as a means to remediate the Porete Avenue properties and bring new tax revenue to the borough. For decades the Borough of North Arlington had relied on landfill tipping fees of up to \$2.3 million a year for acceptance of solid waste at the BCUA Transfer Station, soon to be closed and developed as part of the Project between NJMC and EnCap. Mayor Pittman and the Town Council sought to negotiate a housing development they believed would be better for the town to generate tax revenue to replace the soon-to-be-lost tipping fees.

On October 6, 2005 the Borough entered into a Memorandum of Agreement (MOA) with a pair of Cherokee subsidiaries, Cherokee Porete, LLC and Cherokee Porete Urban Renewal, LLC,⁶⁵ to develop the 91 acres on Porete Avenue. The MOA, unanimously approved by Mayor and Council, acknowledged that Cherokee already owned 66 of the 91 acres, and that the remaining 25 acres would have to be purchased outright or seized by the Borough through its eminent domain authority. The MOA permitted construction of 1,625 residential housing units to be developed as follows: at least 160 units for persons 55 years of age or older, and 90 units would be COAH⁶⁶ units for persons 55 years of age or older. The MOA also allowed for development of recreational facilities, and 50,000 square feet of mixed-use retail space.

A Redevelopment Agreement signed on April 15, 2006, between the Borough of North Arlington and Cherokee Porete, LLC and Cherokee Porete Urban Renewal, LLC provided for

⁶⁵ It is not clear why Cherokee North Arlington, LLC was replaced by Cherokee Porete, LLC and Cherokee Porete Urban Renewal, LLC.

⁶⁶ COAH refers to the Council on Affordable Housing created by the Fair Housing Act of 1985, under the Department of Community Affairs. COAH requires New Jersey municipalities to provide low to moderate income housing, specifying that 20% of a new housing development be low to moderate income housing.

Cherokee Porete, LLC to pay the Borough \$15,000,000 in impact fees over the course of six years to alleviate the impact of the lost revenues from the BCUA Transfer Station while housing was being constructed on Porete Avenue. In consideration for these impact fees, the Borough was to initiate condemnation proceedings for sections of Porete Avenue that Cherokee did not own or was unable to purchase independent of condemnation.

During the 2006 primary election, Mayor Pittman lost to Borough Councilperson Peter Massa, the current Mayor of the Borough.⁶⁷ In interviews OIG has been told that in his Mayoral campaign, Massa was opposed to Cherokee's redevelopment plans for Porete Avenue and the previously agreed upon use of eminent domain proceedings to remove reluctant business operators from Porete Avenue.

Since entering the Redevelopment Agreement Cherokee has paid the Borough \$2,250,000 for the stated purpose of alleviating the impact of lost landfill tipping fees. On August 9, 2006, Cherokee wrote to the Borough requesting that condemnation proceedings be initiated. The Borough responded on August 23, 2006, that it required additional information before it recognized any obligation to initiate condemnation proceedings.

On December 28, 2006, Cherokee Porete, LLC, Cherokee Porete Urban Renewal, LLC, and EnCap Phase 2, LLC, (collectively the Cherokee Porete entities) sued the Borough for breach of

⁶⁷ The Borough of North Arlington holds elections every year, with the 3 year terms of the 6 council-members ending on rotating years.

contract, anticipatory breach of contract and other causes of action.⁶⁸ A payment of \$2,000,000 due to the Borough on December 31, 2006, was withheld by the Cherokee Porete entities. The Borough and EnCap are in conflict over that as well. As of the time of writing this report the matter remains unresolved.

⁶⁸ See Cherokee Porete, LLC, Cherokee Porete Urban Renewal, LLC, and EnCap Phase 2, LLC v. The Borough of North Arlington, Law Div., Bergen County, Docket No. L-Ber-L9580-06.

V. DEP REQUIREMENTS FOR MEADOWLANDS REMEDIATION

A. DEP Permits

DEP regulations set forth the procedures and documentation that must be utilized to investigate contamination and propose a remediation plan for DEP approval.⁶⁹ As part of EnCap's due diligence after it was selected as the developer, it began investigating the environmental conditions at the Project site. EnCap entered into a Memorandum of Agreement with DEP on March 20, 2000,⁷⁰ agreeing to conduct the remediation⁷¹ and the closure of the four landfills at the EnCap site:⁷² Avon, Rutherford,⁷³ Lyndhurst, and Kingsland. EnCap submitted Remedial Investigation Reports, setting forth the data and relevant information regarding its investigation, to DEP from 2000 through May 2001.

To facilitate the permit/application process, frequent meetings occurred between EnCap's attorneys, environmental engineers, and consultants and DEP to guide EnCap's preparation of

⁶⁹ N.J.A.C. 7:26E.

⁷⁰ The Memorandum of Agreement was amended on June 5, 2001.

⁷¹ "Remediation" or "remediate" as defined by DEP regulations means "all necessary actions to investigate and cleanup or respond to any known, suspected, or threatened discharge including, as necessary, the preliminary assessment, site investigation, remedial investigation and remedial action; provided however, that 'remediation' or 'remediate' shall not include the payment of compensation for damage to, or loss of natural resources." N.J.A.C. 7:26E-1.8.

⁷² DEP has the authority to oversee the closure and remediation of the EnCap site pursuant to the Solid Waste Management Act, N.J.S.A. 13:1E-1 et seq., the Spill Compensation and Control Act, N.J.S.A. 58:10-23.11 et seq., and the Water Pollution Control Act, N.J.S.A. 58:10A-1 et seq.

⁷³ The Rutherford Landfill consists of two sections, Rutherford East and Rutherford West. For ease of reference, the two areas of the landfill will be referred to collectively as the Rutherford Landfill.

the Remedial Action Workplans and Closure Plans (RAW/CP)⁷⁴ and related documents/permits. DEP staff explained that meetings regularly occur between applicants and DEP to aid the applicant and facilitate the process. However, because of the massive size of this remediation project, OIG was told by DEP staff that the EnCap Project was given priority status.

The methodology for closing landfills can vary depending on site conditions. As required, EnCap submitted a detailed plan, including data about site conditions; contamination present at the site; methodologies and engineering controls⁷⁵ that would be used to close the landfill; and the intended use of the site post remediation.⁷⁶ The RAW/CPS, all of which were issued by January 2003, state that DEP engaged in expedited reviews of EnCap's applications.⁷⁷

⁷⁴ The detailed plan setting forth the methodology to be utilized to remediate the property, a Remedial Action Workplan (RAW), must be and approved by DEP before remedial activities at the site can begin. Remedial action is defined as:

[T]hose actions taken at a contaminated site as may be required by the Department, including, without limitation, removal, treatment measures, containment, transportation, securing, or other engineering or institutional controls, whether to an unrestricted use or otherwise, designed to ensure that any discharged contaminant is remediated in compliance with the applicable remediation standards....

N.J.A.C. 7:26E-1.8.

⁷⁵ Engineering controls are physical mechanisms to contain or stabilize contamination or to ensure the effectiveness of a remedial action and may include, without limitation, caps, covers, dikes, trenches, leachate collection systems, signs, fences, physical access controls, ground water monitoring systems and ground water containment systems. N.J.A.C. 7:26E-1.8.

⁷⁶ Only some of the remedial and closure activities, or a portion thereof, discussed in this section have been installed. Remedial activities are currently in progress. For ease of the reader the present tense will be used in this section. However, this section only serves as an overview of the proposed remedial and closure activities and/or engineering controls and does not provide a status as to the progress and/or completion of any of the specific activities discussed.

⁷⁷ DEP issued its approval of the RAW/CP for Avon on September 18, 2001, and for the Rutherford and Lyndhurst Landfills on October 29, 2002. DEP initially issued a RAW/CP for Lyndhurst and Rutherford on December 18, 2001, however, EnCap decided to submit a revised design proposal which was approved on October 29, 2002 and superseded the approval issued on December 18, 2001. A Closure Plan and Post Closure Plan Approval was issued on January 27, 2003 for the Kingsland Landfill. EnCap sought a different permit for the Kingsland Landfill as it was not an orphan landfill. Attached as Exhibit A is a schedule, prepared by an independent review engineer hired by EnCap to review the project, provided to EIT, listing all federal, state and local permits sought by EnCap.

Having acquired all permits and approvals necessary to begin remedial activities, EnCap broke ground in May of 2004. According to EnCap's attorneys, remedial activities did not begin until May of 2004 because EnCap did not own the property until that time.⁷⁸ EnCap worked with DEP through May 2005 on the various additional permits that were required.

B. Landfill Closure Methodology

Some, but not all, of the same techniques and engineering controls used by NJMC are being used to close and remediate each of the four landfills at the Project site.⁷⁹ According to DEP approved RAW/CPs, EnCap is not utilizing the "bathtub" effect but is installing vertical hydraulic barrier (VHB) walls around the perimeter of the Rutherford Landfill and in certain areas around the Lyndhurst Landfill⁸⁰ to serve as a barrier between the landfill waste and the surrounding area, and to contain leachate that is generated when surface water or ground water mixes with solid waste.⁸¹ The VHB walls are vinyl sheets 15 feet in height that are driven down

⁷⁸ The deed for all the Phase I properties was executed on June 25, 2004. EnCap told OIG that it could not commence remediation until it possessed all of the property to be remediated.

⁷⁹ Remedial activities have been also been proposed to control soil erosion, control odor and suppress dust, as well as, the operation and maintenance of all engineering controls and long-term performance and compliance monitoring. Institutional controls (mechanisms used to limit human activities at or near a contaminated site or to ensure the effectiveness of a remedial action over time) such as use of a Deed Notice (document that provides notice as to the level of contamination on a property and any restrictions to the property due to engineering controls) and designation of Classification Exception Areas are listed in the RAWs as closure activities. See N.J.A.C. 7:9-6.4, N.J.A.C. 7:26E.

⁸⁰ Natural waterways, including but not limited to Berry's Creek, prevent the installation of the VHB walls around the entire perimeter of the Lyndhurst Landfills. No VHB walls have been proposed for the Avon Landfill.

⁸¹ The VHBs slow down the tidal flushing of ground water from coming into the landfill so that the leachate management system (LMS) will not be overburdened with pumping out ground water and leachate and to prevent ground water from mixing with the solid waste and flowing back out to the surrounding area and bodies of water.

approximately 12 feet into the landfill waste.⁸² The vinyl sheets are connected and sealed to make a continuous barrier around the landfill to prevent leakage.

EnCap and NJMC both install systems to address methane gas (gas created by the decomposition of waste) and leachate (liquid that mixes with solid waste that can seep out of the landfill). Methane gas collection systems⁸³ collect and treat the methane gas or vent it to the atmosphere. Leachate management systems⁸⁴ collect and pump out any leachate to a treatment facility.

1. Cover System

A main component of closing and capping the landfills, used by both NJMC and EnCap, is a cover system placed over the garbage/waste that serves to isolate any contaminants within the landfill and to prevent rainwater from penetrating the solid waste. EnCap is utilizing a three-

⁸² If the natural clay floor is less than 12 below the surface of the landfill materials, the VHB is driven into the landfill to meet the natural clay floor. Thus, the depth of the VHB is either approximately 12 feet or the depth to the natural clay floor, whichever occurs first. The requirements regarding the depth of the VHB walls are set forth in the Lyndhurst/Rutherford RAW/CP Approval.

⁸³ At the Avon, Lyndhurst, and Rutherford landfills, EnCap is installing a passive methane gas system that uses trenches and wells to facilitate directing the gas to vents that release the gas into the atmosphere. The BCUA previously installed an active methane gas collection system at the Kingsland Landfill. It includes a network of underground pipes that convey the landfill gas to a gas recovery system that produces electricity generated by the methane gas. EnCap is installing a gas system at the plateau of the landfill that will supplement the existing active methane gas system. All of the passive gas systems at the site can be converted to active gas systems if warranted by future monitoring or the end use of that area of the property. NJMC typically installs active gas systems at the landfills it closed.

⁸⁴ The LMS consists of leachate collection trenches and pumps that send the collected leachate to a waste water treatment facility operated by the Passaic Valley Sewerage Commissioners (PVSC) for treatment and discharge. The leachate collection trenches are located inside the VHB walls at the Lyndhurst and Rutherford landfills and are around the perimeter of the landfill at Avon. The LMS at the Kingsland Landfill was installed by the Bergen County Utility Authority (BCUA) and consists of a perimeter cut-off wall and piping system located within the perimeter wall that currently pumps leachate to the BCUA Waste water Treatment Plant. The Closure Plan requires EnCap to modify the system to ultimately pump the leachate to PVSC.

layer cover system consisting of below barrier fill which sits directly on the garbage/waste; a cap that sits on top of the below barrier fill and serves as a barrier between the lower and upper layers; and above barrier fill. Fill is an integral part of the Project as it is the main component of the cover system. It is also a source of revenue (EnCap is paid a tipping fee for certain types of fill delivered to the site). However, the fill is also alleged to be a significant aspect of the current cost overruns (EnCap must pay for the above barrier fill).

2. Fill Protocols

After meetings with EnCap representatives DEP issued Fill Protocol Approvals setting forth the types of fill that can be used for each layer and the required procedures for sampling, testing and determining the acceptable quality of fill for the site.

a. Below Barrier

DEP issued the Below Barrier Fill Protocol Approval on April 7, 2004. OIG was told by EnCap's environmental attorney that this Protocol was essentially completed in 2002 but was delayed due to legal issues pending between EnCap and one of its consultants. Pursuant to the Protocol, below barrier fill must satisfy the "non-residential" criteria and may contain low levels of contaminants.⁸⁵ Nonetheless, EnCap is not permitted to accept any fill that is defined by DEP as hazardous.⁸⁶ The thickness of this layer varies across the site depending upon the amount of fill necessary to achieve the required subgrade elevations.

⁸⁵ Acceptable below barrier fill includes PDM, construction and demolition debris, processed sewage sludge, and recycled materials such as masonry, brick, block, concrete, glass and asphalt.

⁸⁶ "Hazardous" is defined at N.J.A.C. 7:26E-1.8, N.J.A.C. 7:26-1.4 and N.J.A.C. 7:26-8.

b. Cap

The cap, or barrier layer, consists of two feet of processed dredge material (PDM) placed on top of the below barrier fill. PDM is dredge material that is excavated from the harbors and waterways and mixed with cement. The placement of PDM at the EnCap site is a significant issue for DEP as upland disposal sites are needed for dredge. PDM is a source of revenue for EnCap and is the subject of various violations recently issued by DEP. PDM is discussed in detail elsewhere in this Report.

The PDM cap must also satisfy the “non-residential” criteria.⁸⁷ PDM is used as the cap because it has a low permeability rate of approximately one foot of water per year.⁸⁸

c. Above the Barrier

DEP issued the Above Barrier Fill Protocol Approval in November 2002 providing that the two feet of fill⁸⁹ placed over the PDM cap must satisfy the “unrestricted” criteria, DEP’s most stringent criteria for fill. EnCap proposed “residential” criteria for the above barrier fill, a

⁸⁷ PDM used as below barrier fill must satisfy the non-residential criteria or the alternate acceptance criteria, which is less stringent than the non-residential criteria for certain contaminants. PDM used for the cap layer must satisfy the non-residential criteria; the alternate acceptance criteria is not applicable.

⁸⁸ The cap at the Avon Landfill consists of a geomembrane liner which allows virtually no permeability of surface waters. VHBs are not proposed for Avon.

⁸⁹ Pursuant to the Above Barrier Fill Protocol Approval the following materials can be used: certified clean material (fill material tested and certified to be clean), processed sewage sludge from PVSC, clean tested soils, masonry fines (brick, concrete and cinderblock crushed into small pieces), and unprocessed dredge material (sediments, clays, rocks, sands, tills, etc., removed from a body of water that do not require treatment). On April 29, 2004, DEP approved EnCap’s amendment to the Above Barrier Fill Protocol which clarified that materials produced by a Class B Recycling Facility can be used as above barrier fill. The Amended Protocol added to the list of acceptable materials: recycled masonry, brick, block, glass, stone, rock, masonry fines, concrete and Class B soils (Class B soils are contaminated soils, *i.e.*, soil that surrounded a leaking underground storage tank that has been treated to remove the contaminants). All materials permitted under the amendment must satisfy the unrestricted criteria.

less stringent criteria, but DEP rejected that criteria. The “unrestricted” criteria requires testing that demonstrates satisfaction of either the criteria that sets forth levels intended to be safe for human contact or the criteria designed to lessen the impact on ground water, whichever of these two criteria is the most stringent. The “unrestricted” criteria also requires EnCap to perform a leachate test for certain inorganic contaminants. DEP explained that the unrestricted criteria was imposed because of the massive size of the project and because of the characteristics of the property (*i.e.*, groundwater, surrounding bodies of water). Also, details regarding the end use of the property (*i.e.*, exact location of buildings, the depth of the foundations) were not available and the end use is subject to change.

EnCap’s environmental attorney told OIG that when the Above Barrier Fill Protocol Approval was issued, EnCap was advised by its engineers that the fill would be difficult to obtain and that the testing would be costly. Before and after the Protocol was approved, EnCap and/or its representatives made several requests, both formal and informal, to change the above barrier fill criteria from the “unrestricted” criteria to “residential”; however, to date, DEP has not changed the requirements for above barrier fill.

C. Fill Acceptance Procedures and Certifications

The Fill Protocol Approvals set forth procedures for review and certification (Fill Acceptance Procedures) to ensure that fill used for the cover system satisfies the applicable criteria: “unrestricted” for above barrier fill and “non-residential” for the PDM cap and below

barrier fill. The procedures for above and below barrier fill were proposed by EnCap, approved by DEP, and are site specific.

Unlike the procedures applicable to below and above barrier fill, the procedures for sampling and analyzing the PDM are standard and were developed by DEP in the late 1990s. Before PDM is brought to a site, DEP analyzes the test results and other applicable data and issues an Alternate Use Determination that states that a site can accept the PDM and where the PDM can be placed on the site, *i.e.*, below barrier, cap or above barrier.

Key components of the Fill Acceptance Procedures are the various certifications executed by professional engineers, consultants and property owners certifying to the quality of the fill. DEP regularly relies on professional engineers and other third parties to certify that environmental remediations and related activities are being performed in a manner consistent with DEP regulations and permits/approvals. In fact, DEP regulations set forth the language that is required in a certification.⁹⁰ DEP generally relies on spot checks, in the form of routine but unannounced inspections, as a form of oversight and an engineer can lose his/her license for false certifications. Some of the certifications are executed by consultants/engineers that are retained by EnCap. Thus, EnCap's consultants/engineers have the responsibility of ensuring that the fill used in the cover system satisfies the applicable criteria.

⁹⁰ N.J.A.C. 7:26C-1.2. DEP has thousands of remediation projects around the State and its staff would have to increase dramatically to have an engineer stationed at each site, thus, the process relies upon third parties certifying to the quality of the fill.

D. Application/Certifications

The review and certification process commences when a fill provider/fill broker locates a potential source of fill. Once a potential source is located, the fill provider must submit an application to EnCap's independent review engineer⁹¹ for a determination that a particular stream of fill from a specific identified source, which will be brought to the site in truckloads and used in the cover system, is acceptable. The application consists of several documents containing certifications from professionals/engineers and source owners attesting to the characteristics and contents of a stream of fill.⁹²

EnCap's independent review engineer is required to review all the documents comprising the fill application submitted by the fill providers and certify that the material described in the

⁹¹ DEP required EnCap to have an independent fill review engineer with "no affiliation with any person or corporate entity with an ownership interest in EnCap, OENJ-Cherokee, Mactec or any associated companies/subsidiaries/joint venture partners." (Below Barrier Fill Protocol Approval dated April 7, 2004)

⁹² The applications for below barrier fill and above barrier fill are essentially the same with some minor differences. The documents listed below demonstrate the types of information and certifications, which must be submitted in an application. The various documents contained within the application are to be completed by the individuals involved in the process of identifying and testing the fill, *i.e.*, property owner, laboratory technician, independent fill review engineer, etc. An application, submitted by a fill provider, for a stream of fill that satisfies the Above Barrier Fill Protocol contains the following:

- Clean Material Certification and Approval Form – Part I – sets forth the location and owner of the source, the amount of material and the samples taken: Certification by the technician who took the samples that the samples were taken in accordance with DEP regulations; certification by the owner of the source stating that the material is clean and has been sampled; and certification by the owner that the samples have been performed in accordance with DEP regulations.
- Independent Sampler Form – Supplement to Part I – lists the laboratory performing the analyses, the DEP certification number of the laboratory, and analytical test results of the samples.
- Form CTS-1 – Site Evaluation to Determine Potential for Clean Soil – sets forth description of the property supplying the source, *i.e.*, history of site, description of adjacent properties, description of the fill (color, consistency, etc.). Certification by individual evaluating the site of the source of the potential fill material stating that the material qualifies to be considered as "clean tested soil" and that he/she has no affiliation with the Review Engineer. Certification by the owner of the site that the material is clean and the history of the site is as described on the form.
- Clean Material Certification and Approval Form – Part II – Review Engineer Findings and Certification – sets forth the quality of the material – the Review Engineer certifies that a particular load is acceptable to use as clean material.

application complies with the appropriate Fill Protocol. EnCap's independent review engineer does not do an independent analysis of the potential stream of fill. After the independent review engineer determines that the proposed load is in compliance, the application is sent to DEP, EnCap and Redevelopment Materials, Inc. (RMI ⁹³).

E. Fill Delivered to the Site

Pursuant to the Fill Acceptance Procedures, after a stream of fill is approved for delivery to the project site the stream is assigned a log number and RMI issues a "bill of lading" for each load of fill from a particular stream to be delivered.⁹⁴ The carrier/truck driver picks up the load of fill, takes it to a scalehouse at the Project site, provides the bill of lading and the truck is weighed. EnCap told OIG that when the truck arrives at the scalehouse, EnCap's fill review engineer visually inspects the load by way of closed circuit cameras stationed above the truck or from a catwalk⁹⁵ to confirm that the load visually matches the description of the approved source. Most loads of fill are not tested upon arrival at the site, and EnCap told OIG that testing at the site is performed only if the load does not appear to match the description set forth in the application for the approved fill.⁹⁶

⁹³ RMI operates the scalehouse at the site and also reviews the application package for completeness only. RMI is owned by CIP II.

⁹⁴ The bill of lading contains the following information: contractor (owner of the site/source), address of the site/source, log number (log number of the stream and a number for that specific load), material type, license plate number of truck delivering load, signature of carrier/truck driver, and location at EnCap site where load is to be delivered.

⁹⁵ OIG viewed the two scalehouses during a site visit. The catwalks were a few feet off the ground and did not appear high enough to allow someone to look into the trailer of a truck.

⁹⁶ EnCap's representative stated that if the load is questionable in appearance or emits an odor, samples of the load are taken and tested, and any delivery from that stream is suspended until the test results are received.

After the load is weighed and tested, MACTEC, EnCap's general contractor for the project, directs the driver to a specific area of the Project site where the fill is unloaded. The driver then returns to the scalehouse where the truck is weighed again, is provided with a copy of a receipt, and leaves the site. The bill of lading and receipt are retained at the scalehouse by RMI.

F. Ground Improvement Program

EnCap has also proposed a Ground Improvement Program (GIP) to be installed in the areas of the Lyndhurst and Rutherford Landfills. The GIP involves three components: dynamic compaction,⁹⁷ which compresses the waste; wick drains,⁹⁸ which provide a supplemental drainage path for excess water that is contained within the natural clay floor; and surcharging,⁹⁹ which improves the strength of the underlying organic material. OIG was advised by DEP that it is in favor of any activity that speeds up the process of remediation.

⁹⁷ Dynamic compaction consists of dropping a heavy weight from a specific height to compress the existing waste in an effort to prevent settlement after closure.

⁹⁸ Excess water from the clay is released by the pressure of the fill. Wick drains are vertical pipes placed through the landfill materials into the underlying clay bottom and drain the water towards the surface thereby enhancing stability.

⁹⁹ Surcharging is the placement of a certain type of fill (surcharge) on top of the landfill materials which is left in place for a specified period of time and then removed. Surcharging is designed to improve the strength of the underlying organic materials and reduce post-construction settlement.

VI. ENCAP OBTAINS PUBLIC FINANCIAL ASSISTANCE FROM EDA

While EnCap was working with DEP on obtaining the necessary permits to begin remedial activities at the site, in 2001 it began its pursuit of low-interest state financing for the remediation portion of the Project, by way of an application to the New Jersey Economic Development Authority (EDA). Despite EnCap's representation in its SOQ to the NJMC that it had financial resources sufficient for the Project, by the time it signed the Development Agreement with the NJMC its financial profile had changed substantially. Unbeknownst to the NJMC, EnCap's source of funding was limited to the \$25 million that Cherokee provided, which had already been diminished by \$6.1 million, the amount required to reimburse Gonda. EnCap, therefore, had less than \$19 million available and obviously required substantial additional financing. Indeed, just the cost of land acquisition, obtaining permits and paying attorneys for their assistance in these and countless other areas would exceed \$19 million. EnCap, through its counsel, therefore sought financial assistance from the Economic Development Authority, which was established to provide loans at favorable rates to private entities performing functions that are beneficial to the State.

A. EDA Financial Assistance for Private Entities

1. Creation and Purpose of the Economic Development Authority

EDA, established in but not of the Department of Treasury, was created in 1974 to provide financial assistance to promote economic growth, address increasing unemployment

rates, protect the environment and encourage business growth in the State.¹⁰⁰ EDA is governed by a Board (the EDA Board) that consists of: the Commissioners of Labor, Education, Banking and Insurance, the State Treasurer, the Chief Executive Officer and Secretary of the New Jersey Commerce and Economic Growth Commission, who serve ex-officio; eight public members appointed by the Governor, one of whom is appointed by the Governor to serve as Chairperson¹⁰¹; and one non-voting, public member of the State Economic Recovery Board who also serves ex-officio. Actions taken by the EDA Board must be reviewed by the Governor who has veto power and may render EDA actions null and void.¹⁰²

EDA financing is available in a number of forms including, grants, direct loans at below-market rates, and guarantees to help credit-worthy entities secure financing from sources other than EDA. EDA has the authority to issue tax-exempt and taxable bonds and utilize those bond proceeds to issue low interest, flexible financing to businesses engaging in projects that further the EDA's purposes.¹⁰³ Tax-exempt financing is available for a variety of entities as defined by criteria set forth in the Internal Revenue Code.¹⁰⁴ Tax-exempt bond proceeds may be used to finance land and building acquisition, new construction or expansion of buildings, purchase of

¹⁰⁰ N.J.S.A. 34:1B-1, et seq., New Jersey Economic Development Authority Act.

¹⁰¹ Four of the eight public appointees cannot be legislators but require legislative input such that two of them must be recommended by the Senate President and the other two must be recommended by the Speaker of the General Assembly. N.J.S.A. 34:1B-4.

¹⁰² N.J.S.A. 34:1B-4(i) provides the Governor 10 days to veto any EDA action, during which time the Governor may choose to approve an EDA action in order to alleviate the need for the 10-day waiting period.

¹⁰³ The EDA acts as a conduit when issuing bonds in that the bonds are either purchased by an underwriter and sold to retail or to institutional investors, or are sold directly to a bank. The EDA does not have a financial stake in the project and does not loan its own money.

¹⁰⁴ Borrowers that qualify: manufacturing facilities, governmentally owned airports, docks and wharves; water, sewage, and solid waste facilities; certain nonprofit 501(c)(3) entities; commercial or industrial projects in designated Empowerment Zones or Enterprise Communities; certain assisted living facilities; and governmental entities.

new equipment and machinery, and up to 2% of the bond proceeds may be used for costs of bond issuance including legal and other professional fees. Those entities or projects that do not qualify for tax-exempt funding may qualify for EDA taxable bond loans that carry a low interest rate.

2. The EDA Funding Process

The following factors are considered when an application is made for EDA financing:

- Economic feasibility of the project;
- The economic and related social distress in the municipality and adjacent area affected by the project;
- The advancement of Statewide and regional strategies and objectives;
- The projects' ability to repay the financing costs;
- The projects' relationship to the local development strategy; and
- Whether the project utilizes, enhances, protects and promotes public transportation systems.¹⁰⁵

The EDA bond funding process usually takes three to five months and is initiated by a meeting between the applicant and an EDA finance officer to discuss the proposed project, types of financing, and potential eligibility. After the initial meeting, an applicant selects bond counsel and submits a completed application package, including application fee of \$500, and copy of relevant sales contracts or site plan approvals. After review by EDA staff, a completed application package that complies with EDA requirements may be granted "preliminary approval", by resolution at a monthly EDA Board meeting. Following preliminary approval, the applicant develops the financing structure for the proposed bond sale and reviews it with EDA. Before granting an applicant "final approval" a financial institution must commit to purchase or underwrite the proposed bonds, and a public hearing on the proposed bond sale must be held.

¹⁰⁵ N.J.S.A. 34:1B-7.5.

The EDA Board then adopts a resolution of “final approval” authorizing the issuance of the bonds. The Governor has 10 days to review the EDA Board minutes and may veto any action taken by the Board. Absent a veto, the Board’s actions become effective after the 10-day period has elapsed. The Governor may make any Board action effective before the 10-day period by approving such action before the 10-day period elapsed. After 10 days has elapsed or the Governor has issued an earlier approval, the bond documents can be executed, the bonds sold, and bond proceeds deposited in a fund for the project.

B. EnCap’s First Application for EDA Financial Assistance

Even though EnCap represented to the NJMC that it had financial resources sufficient for the Project, it in fact did not and, very early in the Project it commenced its pursuit of financial assistance from the State. Indeed, since neither Gonda nor Cherokee were willing to provide collateral, EnCap actually required funding from other sources. On January 31, 2001 EnCap, through its counsel Eric Wisler, submitted an application to the EDA for a \$134.3 million loan to be provided by the EDA as a conduit issuer¹⁰⁶ by way of tax-exempt bonds. EnCap sought the financing to cover the costs of the Project. Wisler represented that EnCap anticipated commencement of the remediation project at or about July 2001 and that the remediation would be completed approximately four years later.

¹⁰⁶ As the conduit issuer, EDA was not obligated to make the debt service payments on the bond or otherwise guarantee that the bonds would be paid. Also, the State is neither obligated to pay EDA-issued bonds nor is the full faith and credit or taxing power of the State pledged to the payment of the bonds.

William Gauger, President of EnCap, represented in the January 2001 application that the cost of remediation was \$78 million. Additional costs¹⁰⁷ were as follows:

- Land acquisition: \$8 million
- Construction of stormwater management improvements: \$2 million
- Engineering and architectural fees: \$6 million
- Finance fees: \$1.5 million
- Financial advisory fees: \$250,000
- Legal fees: \$250,000
- Bond insurance premium: \$2.8 million
- Debt service reserve fund: \$9 million
- Interest during construction: \$24.97 million
- Construction of train stops: \$12 million
- EDA fee: \$300,000
- Other costs of issuance: \$692,000.

Total project cost was, at that time, reported to be \$153.7 million. Gauger represented in the application that EnCap was to make a “capital contribution/equity contribution” to the project of \$10 million and that it was anticipated that there would be investment earnings of \$11.5 million.

On February 13, 2001, the EDA issued a preliminary approval of EnCap’s application for financial assistance in the amount of \$134.3 million. Final agreement to all terms and conditions of the bond issuance and loan by the EDA, EnCap and the bond purchasers was required before the bond and loan could be issued. EnCap was required to advise the EDA of any material changes in the project, in the information and representations provided by EnCap in its application, or if significant expenditures were to be made with respect to the Project before the

¹⁰⁷ For purposes of this Report, the full amount of each remediation cost, as well as revenues and other figures here and elsewhere in the Report, was truncated such that the figures are reported to the hundreds of thousands of dollars.

bonds were to be issued. The EDA also reserved the right to approve any proposals for leasing, subleasing or assignment of the project by EnCap to another party, in whole or in part.

1. EnCap's Amended Application

In November 2001, Wisler advised EDA Executive Director Franzini that the cost of the remediation project had increased substantially. Wisler wrote that since the EDA issued its preliminary approval, EnCap had continued its efforts to obtain required permits and had finalized negotiations with its remediation contractor. EnCap also contracted with AIG Environmental and AIG-related entities for various insurance policies for the remediation project. These events, according to Wisler, caused the cost of the remediation to increase substantially. Although EnCap would pay for a portion of the increased cost by way of an increased equity contribution (Wisler represented that EnCap would contribute \$20 million in equity, rather than the \$10 million it had originally committed), Wisler requested that the EDA increase the amount of its financial assistance to \$145 million to accommodate the new Project costs. The amended application set forth a revised budget that detailed the sources of revenue anticipated by EnCap and the expected Project revenue:

- Bond proceeds: \$141.9 million¹⁰⁸
- Fill revenue: \$12.7 million¹⁰⁹
- Interest earnings: \$11.5 million
- Equity: \$20 million

¹⁰⁸ Wisler represented that, with the increased project cost, the total budget was \$141.9 million but requested EDA provide \$145 million to accommodate any changes.

¹⁰⁹ EnCap anticipated that the use of fill (soil and other materials required for the remediation) would generate revenue for EnCap, as in certain circumstances providers of fill must make a payment for the deposit of the material. This is discussed elsewhere in this Report.

- Landfill closure fund: \$2.3 million¹¹⁰

(November 9, 2001 correspondence Wisler to Franzini, “Sources and Uses”).

The amended application and revised budget identified \$125 million in remediation costs, which included:

- Remediation project: \$86 million
- Permits: \$11 million
- Capping fill: \$8 million
- Remediation management: \$2 million
- Land costs: \$17.4 million
- Capitalized interest on the bonds: \$25.6 million
- Costs of issuance associated with the EDA financing: \$2.8
- Debt service reserve fund: \$14.1 million
- Bond insurance premium: \$2.4 million

The application indicated that total project cost was \$188.4 million.

In the amended application for additional financing, Gauger wrote that it was necessary that the financing be completed before the end of the year in order to facilitate acquisition of insurance products to be provided by AIG.¹¹¹ Gauger represented that AIG had advised EnCap that the insurance coverage, which was for the environmental and closure/remediation portions of the Project, would not be available in the required amount and for the then-current prices after January 1, 2002. As such, Gauger wrote that EnCap intended to procure the insurance policies at the same time the bonds were to be issued and wrote that “...failure to obtain such coverage

¹¹⁰ As discussed elsewhere in this Report, EnCap had access to funds in the Kingsland Landfill Closure Fund for use in this project.

¹¹¹ In subsequent correspondence to Executive Director Franzini, Wisler wrote that AIG Environmental “has advised EnCap that the requisite environmental insurance may not be available if this [bond] issue is not closed and the premium paid by December 31, 2001.” (December 4, 2001 correspondence Wisler to Franzini). The policy was not required by EDA; however, because it protected the bondholders by providing coverage that would lead to the completion of the project, EDA considered it to be an important component of the loan package.

would subject EnCap to being in default under the Development Agreement [between NJMC and EnCap], as well as other agreements executed (or to be executed) in connection with acquisition of the Phase I Redevelopment Project Site.” (Executive Summary to November 8, 2001 amended application to the EDA). As such, Gauger asked the EDA to act on the amended application at its next meeting scheduled for November 13, 2001.

2. EDA Approval of \$145 Million in Bonds for Project

On December 11, 2001, the EDA Board of Directors approved the issuance of bonds for the financing of the Project. The bonds were secured by an irrevocable bank letter of credit issued by Bayerische Landesbank Girozentrale (BLB), a German bank acting through its New York branch. The letter of credit guaranteed that if EnCap defaulted or failed to make required bond payments, BLB would make those payments.¹¹² The letter of credit was effective for one year, through December 21, 2002, and was set to expire then.

EnCap also pledged that it would use several sources of revenue to repay the bonds, including the proceeds from development rights sale agreements (development rights sales proceeds or DRSP) that EnCap intended to enter into with developers of the remediated site (vertical developers)¹¹³; and any brownfield tax reimbursements to which it was entitled.¹¹⁴

¹¹² Accordingly, the bondholders would be protected, as, in the event of a default, payment would still be made to them. OIG was told by EDA representatives that the bondholders were well protected because of the letter of credit and insurance protection, which would ensure the completion of remediation, which was associated with the Project. Insurance policies, including a “performance bond” that guarantees the completion of the remediation, up to \$148 million, are discussed below.

¹¹³ The Offering Statement for the 2001 EDA bonds provides that, at the time of the bond issuance, EnCap expected to enter, within approximately six months, one or more development agreements with developers for the sale of the development rights to the remediated Project site.

EnCap was also required to establish a debt service reserve fund, which would be available for use to make required payments in the event other sources of payment were unavailable. The debt service reserve fund was \$14 million and was initially funded by way of the bond proceeds.

Governor DiFrancesco approved the Board of Director's authorization of the bond issue on December 13, 2001.¹¹⁵

EnCap was not, however, immediately entitled to access all of the proceeds of the EDA loan. As discussed above, OIG was told that the loan was issued before the end of 2001, at EnCap's request, in order to facilitate EnCap's acquisition of the AIG insurance policies. At the time the loan was issued, EnCap was not prepared to commence remediation.¹¹⁶ Nor had it

¹¹⁴ As discussed elsewhere in this Report, the Brownfield and Contaminated Site Remediation Act, N.J.S.A. 58:10(b)-1.1, authorizes qualified private developers to receive up to 75% of the reasonable costs incurred in connection with remediation of a contaminated site. The Offering Statement for the 2001 EDA bonds provides that EnCap believed that it was qualified for reimbursement under the Act and had submitted an application for reimbursement from the State for all qualified costs. At the time of the bond issuance, EnCap was close to finalizing an agreement with then Treasurer Lawrance and the then CEO of the New Jersey Commerce and Economic Growth Commission that would, in fact, eventually entitle EnCap to reimbursement pursuant to the Act.

¹¹⁵ As noted above, the Governor's explicit approval of EDA Board actions is not required except when it is desired that the 10-day period waiting period be waived. Since the Board authorized the bonds on December 11, 2001, the Governor's express approval was required in order to effectuate the Board's action prior to the end of the 10-day waiting period. At this time, the Governor expressly approved two other projects in addition to the Meadowlands Project in order to effectuate closings before the end of the year. OIG was advised by EDA that this often occurs during the December meetings of the EDA Board.

¹¹⁶ As discussed elsewhere in this Report, the process of obtaining the land, by way of purchase and condemnation proceedings, and permitting process, as required by State and federal law, contributed, in part, to the delay in the commencement of remediation. With respect to the land acquisition process, through 2002 EnCap continued to request that the NJMC make determinations about whether or not various pieces of property should be declared in "need of rehabilitation" and thus be included in the Project. Any property that was declared in "need of rehabilitation" must then be purchased or condemned by NJMC to be re-sold to EnCap for development. This process was ongoing from 2002 through 2004. Wisler told OIG that the reason construction didn't start until May 2004 was because EnCap didn't own the land until then.

finalized contracts with vertical developers. As such, the sources of the money that EnCap had pledged to repay both principal and interest on the bonds, including DRSP and brownfield tax reimbursements, was not anticipated for a period of years. OIG was told by, among others, EDA's then bond counsel, and documents obtained by OIG reveal, that this prompted BLB to request that the bond trustee make unavailable the majority of the loan proceeds until EnCap was able to secure the necessary permits and make substantial progress in negotiating development rights sales agreements with vertical developers.

3. 2001 Insurance Coverage

The bond proceeds were held by AIG in connection with an insurance policy that EnCap obtained from AIG/Lexington¹¹⁷ for the Project. Pursuant to the terms of the policy, referred to as the "AIG Closure Insurance Policy", a significant portion of the proceeds of the EDA loan (\$83.8 million) was deposited with AIG and available to be drawn down to pay eligible costs, that is, costs associated with remediation, upon the approval of the EDA trustee. Thus, to the extent EnCap was able to access the EDA loan proceeds, it was obligated to submit requisitions for reimbursement of costs that it had incurred.¹¹⁸

Documents obtained by OIG indicate that approximately \$128 million of the \$145 million in bond proceeds was held in escrow. (April 13, 2004 memorandum from CEO Franzini

¹¹⁷ Lexington is a wholly owned subsidiary of AIG.

¹¹⁸ Typically, the EDA bond trustee is responsible for holding the proceeds and disbursing them to reimburse appropriate expenditures. OIG was told that, in this instance, because AIG was involved in the Project as an insurer, it chose to participate in the requisition and reimbursement process in order to insure that the funds were disbursed appropriately.

to EDA board members). EDA and EnCap records show that EnCap was able to access and spend approximately \$17 million for functions that were required at that time, including but not limited to land acquisition, capitalized interest and costs of issuance of the bonds. EnCap was required, however, to provide an equal amount of cash collateral for the benefit of BLB in order to be permitted to utilize those funds.

OIG was told by bond counsel to the EDA that, at the time of this financing, EnCap represented that this financing was sufficient to cover the costs of the remediation project. While the bond documents provided for the possibility that additional funds and thus bonds might be necessary to cover the cost of the remediation of the Meadowlands Project, State representatives believe that there would not be a future need for substantial additional financing.

As required by the NJMC pursuant to the Landfill closure Agreement between it and EnCap, EnCap also obtained from AIG/Lexington a policy running to EnCap that provides for coverage of up to 125% of the estimated remediation and closure costs. Notwithstanding this, the NJMC also required that EnCap obtain an irrevocable commitment from AIG to issue a “performance bond” at a future date, as required by the Landfill Closure Agreement between NJMC and EnCap.¹¹⁹ The “performance bond” would run to the benefit of NJMC.¹²⁰

¹¹⁹ This is also discussed elsewhere in this Report.

¹²⁰ As discussed elsewhere in this Report, the “performance bond” that was ultimately obtained by EnCap, and for which NJMC was the beneficiary, provided that, in the event of an EnCap default, AIG would be obligated to either: perform and complete EnCap’s obligations under the Landfill Closure Agreement (itself or through its agents or independent contractors) and pay NJMC all damages arising from EnCap’s default; provide for completion of Project by way of a substitute developer; or pay to NJMC the amount owed to it pursuant to the Landfill Closure Agreement (not exceeding \$148.8 million).

C. March 2004 EnCap Application to Restructure Its Loan

On March 31, 2004, Patricia Ryou, an attorney at the DeCotiis firm, on behalf of EnCap, submitted an application for \$5 million in additional bonds and an application for “refunding bonds”¹²¹ in the amount of \$145 million.¹²² Ryou wrote that, although the initial bonds that were issued in 2001 were, in conjunction with investment earnings, EnCap equity and other project-related revenue, believed to be sufficient to pay all Project costs,¹²³ the Project had changed such that additional funds and a restructured collateral package were required.¹²⁴ Ryou wrote that EnCap estimated that no more than an additional \$5 million would be required and that these funds would be used for costs associated with property acquisition, increased remediation and closure expenses (specifically, “implementation of a compaction program for portions of the Project site”), and increased capitalized interest and costs of issuance. (March 31, 2004 correspondence from Ryou to Executive Director Franzini).

¹²¹ A refunding involves paying off all of the prior debt. As such, EnCap sought to pay off the 2001 Bonds and replace them with newly issued bonds.

¹²² Prior to this application, on August 7, 2002, EnCap submitted an application to the EDA for an additional \$31.5 million loan. This application was superseded by an April 22, 2003 application for an additional \$63.5 million. Few records concerning these applications have been found; however, it is clear that the EDA did not issue the requested loans. This is nonetheless an indication that EnCap saw the need for substantial additional funds which is subsequently sought and obtained from the New Jersey Environmental Infrastructure Trust (EIT) and Department of Environmental Protection. As discussed elsewhere in this Report, in 2003, while it continued to pursue loans from EDA, EnCap had begun to talk with EIT and DEP about the prospect of their issuing loans to EnCap). Also, on May 27, 2003, EnCap submitted an application for a refunding of the \$145 million EDA loan, which was later replaced by a November 6, 2003 application for a refunding of the bonds. These applications were superseded by the March 31, 2004 application.

¹²³ Wisler wrote that these costs included the costs relating to the permitting and design of the environmental controls required for the remediation, the costs associated with property acquisition, the remediation and closure of the four solid waste landfills, and the purchase of performance security.

¹²⁴ OIG was told that, given that the collateral package was to be restructured, it was efficient to proceed by way of a new bond issuance rather than amend the terms of the 2001 bonds.

The evidence indicates that an amended collateral package was required because BLB did not wish to continue to provide a letter of credit. BLB had increased its fees for the letter of credit and EnCap had not met certain conditions of the collateral package to enable them to access the bond proceeds.¹²⁵ BLB's initial rate for its letter of credit, which was 0.325% per year, increased to 1.00% in March 2003 and then increased again sometime in the third quarter of 2003 to 1.5% per year. OIG was told by bond counsel to EDA that BLB had intended to provide the letter of credit for a limited period of time and it eventually became apparent that the bank intended to remove itself from the financing.

Also important to EnCap's desire to amend the collateral was that EnCap required a financing structure that would enable it to access the bond proceeds, as the proceeds of the 2001 bonds remained largely "locked up" and unavailable for use. EnCap had not entered into a development rights sales agreement. OIG was told by EnCap representatives that EnCap's negotiations with a prospective vertical developer had been terminated, and by the time of the March 2004 application, EnCap was in discussions with a different vertical developer.

According to Ryou's correspondence to Executive Director Franzini, at the time of this application, EnCap had negotiated but not executed a development rights sale agreement with Pulte Homes, Inc.¹²⁶ EnCap anticipated that the agreement would be executed within two weeks of the date of the correspondence. According to EnCap's application to the EDA¹²⁷, it was

¹²⁵ OIG was told that the BLB letter of credit, which originally to expire in 2002 was extended until 2004, at which time it was terminated and a replacement letter of credit was obtained. This is discussed further below in section G.

¹²⁶ Pulte Homes, Inc., was acting through Jersey Meadows, LLC., a single purpose entity created by Pulte Homes, Inc.

¹²⁷ All applications to the EDA by EnCap were signed by Gauger.

anticipated that a letter of credit would be provided by Wachovia Bank, with drawings upon the letter of credit to be reimbursed by the proceeds expected to be received from the DRSA.

The application also provided the following updated sources of revenue and projected expenses:

- Equity: \$25 million (\$20 million equity provided by EnCap in association with the 2001 EDA bonds and an additional \$5 million to be provided by EnCap).
- Fill revenue: \$29.9 million
- Cost of land acquisition: \$35 million
- Cost of remediation project: \$133.2 million
- The application reported that the total Project costs were \$282.6 million.

In the application, EnCap represented that it anticipated that it would refinance the 2004 bonds or seek additional financing when additional DRSA's for other components of the project are entered into by EnCap and vertical developers.¹²⁸

1. EDA Board Approval of Refunding Plus \$5M

On April 13, 2004, the EDA Board approved a refunding of the \$145 million 2001 bonds and the issuance of additional bonds in the amount of \$5 million (\$150 million in total) to fund additional closing costs, land acquisition and remediation costs. At that time, EnCap had negotiated a DRSA with Jersey Meadows, LLC, and the understanding was that EnCap would pledge the proceeds from that DRSA and other DRSA's that EnCap would enter into with vertical developers in the future as security to pay debt service on the \$150 million 2004 EDA bonds.

¹²⁸ OIG was told by then-bond counsel to EDA that the amount of the loan that EnCap could obtain at the time of the March 31, 2004 application was limited to \$150 million, which is the contractual value of the DRSA with Pulte, and which was the only DRSA at that time. Wachovia was prepared to extend a letter of credit only up to the amount of the DRSA. Since EDA would not issue a loan beyond the value of the letter of credit, the EDA loan was limited to an aggregate of \$150 million.

Pursuant to BLB's directive, which was discussed above, the majority of the proceeds of the 2001 bonds (\$128 million) had remained "locked up" in escrow. OIG was told by then bond counsel to EDA that, because EnCap required access to those funds in order to proceed with the Project, EnCap had obtained a commitment for a new letter of credit from Wachovia Bank, which would replace the letter of credit previously provided by BLB.¹²⁹ Documents obtained by OIG indicate that EnCap expected that the execution of a DRSA with Jersey Meadows, LLC, estimated at \$150 million, and the pledge of the proceeds of the DRSA, would enable EnCap to access the bond proceeds.

OIG obtained documents that evidence the care with which EDA endeavored to ensure that the loans and their terms and conditions were appropriate and that EnCap had satisfied all requisite conditions. In addition to requiring that the security for the loan was sufficient and properly protected the bondholders, EDA established a set of conditions precedent to be satisfied by EnCap before the EDA Board could act on its applications.¹³⁰ The documents reveal that EDA aggressively monitored EnCap's progress in meeting these conditions and there was active communication about the status of the Project among the EDA staff and with other involved State entities. EDA representatives told OIG that EDA refrained from issuing the second set of loans until the DRSA was sufficiently established, thus evidencing that the Project was in fact moving forward.

¹²⁹ OIG was told that Wachovia had a strong and ongoing relationship with Cherokee, as Cherokee was a client of the Bank.

¹³⁰ These conditions included, but were not limited to, EnCap providing proof of the status of the Project with respect to construction and development contracts, submission of independent engineers' reports, and reports concerning the completion of engineering due diligence reviews by the vertical developer.

2. EnCap Amends Collateral

On April 16, 2004, despite the action of the EDA Board, Gauger requested that the EDA restructure the security package for the previously approved bonds. Documents obtained by OIG indicate that Gauger asked that the EDA Board remove the pledge of the proceeds of the DRSA's as security for the bonds. In correspondence from Gauger to Executive Director Franzini, Gauger argued that the bonds were fully secured by way of the Wachovia letter of credit and, thus, the pledge of the DRSA proceeds, or any other collateral, as security was not required. He also wrote that it was important to EnCap that it have access to the proceeds from the DRSA's so that EnCap would "retain flexibility and unencumbered capital" in order to facilitate the generation of additional financing for the Project, whether by "attracting additional equity capital" or by way of the issuance of more debt. (April 16, 2004 correspondence from Gauger to Executive Director Franzini).

In support of this request, Gauger noted that the financing structure, through which EnCap will not "recoup its invested capital until the DRSA's are executed and the Development Rights are sold..." creates an incentive for EnCap to complete the Project. Also, "in the event that, for whatever reason, EnCap is unable to effect construction of the various development components programmed for the Project Site", the NJMC had the right to "take the Project Site back from EnCap (or its successors) and contract with a replacement development firm to construct such project development." Consequently, Gauger suggested that the State and the municipalities will still "realize the economic benefits that were expected to be received" in the event of a "delay or EnCap's failure to successfully complete negotiation of one or more DRSA's."

Gauger requested that the EDA Board convene a special meeting to consider and vote favorably on his proposed amendments to the financing that was approved by the EDA Board on April 13.

The EDA Board held a special meeting on April 21, 2004 to evaluate the above proposal. Documents obtained by OIG reveal that the EDA Board consulted with the bank that was to issue the letter of credit for the 2004 bonds about EnCap's proposal and that the bank was willing to proceed with the revised bond issue based on the guarantee of Cherokee Investment Partners. As such, the bank did not require that EnCap pledge the proceeds of its DRSA's as security for the bonds. Rather, documents obtained by OIG indicate that EnCap obtained no security other than the Wachovia letter of credit for the 2004 EDA bonds. While EnCap had a general obligation to repay the bonds from its various sources of revenue, it was the Wachovia letter of credit that constituted the security for the bonds. EnCap was only obligated to reimburse the bank for any draws upon the letter of credit and, as such, was required to provide security to cover this reimbursement obligation. This was provided on EnCap's behalf by Cherokee Investment Partners II and III (CIP II and CIP III), which supplied cash collateral up to \$130 million and an irrevocable letter of credit of up to \$20 million. In exchange, EnCap granted CIP II and III liens on EnCap assets and mortgages on the Project site (CIP III was granted a first mortgage lien on the site; CIP II was granted a second mortgage lien). Bond documents indicate that none of this collateral was pledged to pay the 2004 EDA bonds; it was exclusively pledged to Wachovia by Cherokee on behalf of EnCap. Also, EnCap was required to

deposit \$1.4 million in a collateral account, to which Wachovia was granted a first lien and from which it was authorized to withdraw funds in the event of an EnCap default.

The EDA Board approved the amended application for a refunding of the 2001 bonds and the issuance of an additional \$5 million in bonds. Governor McGreevey approved this action on April 21, 2004 and the bonds were issued May 4, 2004. Remediation subsequently commenced almost immediately with EnCap breaking ground in May 2004. The EDA bonds were paid off in full on or about December 1, 2005.

3. 2004 Insurance Coverage

Upon the commencement of remediation, AIG issued an Amended AIG Closure Policy, which had been issued in conjunction with the 2001 bonds, and issued the performance bond, through its subsidiary American Home Assurance Company, for which the NJMC was the beneficiary. OIG was told that, together, these policies secured the full and timely performance of the remediation up to 125% of the budgeted costs of the Project.

The Amended Closure Policy covered the previously discussed ground improvement program as well as other functions including but not limited to consulting engineering services associated with the ground improvement program and quality control services for fill materials. It also provided the mechanism for the payment of the costs associated for remediation work that had been performed and that was eligible for reimbursement, in the same manner as the original policy did for the 2001 EDA bonds.

D. EDA Financial Assistance Repaid in Full

As discussed below, EnCap proceeded to seek even more money at better terms from other State Entities. Portions of the proceeds it ultimately obtained were used to pay in full the financial assistance EnCap had received from EDA.

VII. ENCAP OBTAINS \$212M IN PUBLIC FINANCIAL ASSISTANCE FROM EIT/DEP

At this time, the Project was showing signs of substantial change, particularly with respect to the cost of remediation, as EnCap pursued more financing. While EnCap representatives were working with EDA representatives to submit its application for a refunding of the \$145 million EDA loan, counsel for EnCap had taken steps to secure even lower interest funds from the Environmental Infrastructure Trust (EIT or Trust) and the Department of Environmental Protection (DEP) in an amount to exceed the EDA loans. Counsel for EnCap approached the Executive Director of EIT and various State officials including the Treasurer to propose that EIT and DEP examine the eligibility criteria for their programs in order to issue loans to EnCap that would be larger than any others previously made by EIT and DEP. Since the NJMC was not a party to the financing program and therefore, did not review EnCap's applications for financial assistance, there was not a State entity with comprehensive knowledge of the Project in a position to critically analyze the representations and assumptions made by EnCap in its applications.

A. Environmental Infrastructure Trust

EIT was created in 1985 and is established in, but not of, DEP. It provides low-cost financing for the construction of eligible environmental infrastructure projects that enhance and protect ground and surface water resources and ensure the safety of drinking water supplies. Typical projects include repairs to or installation of sewage collection, water treatment and storm water management systems. To fund these loans, EIT sells low-interest, tax-exempt bonds that

neither it nor the State secures or guarantees. EIT “pools” its program participants, issuing bonds to provide loans for multiple program participants at the same time. The proceeds of the bonds are lent to the program participants, which are typically local governments and utility authorities that are required to pay back the principal of the loans at a low rate of interest.¹³¹ EIT uses those payments to pay principal and interest to the bondholders. The local government and utility authority borrowers back the principal of an interest on the loans with their taxing and rate setting authority, which constitutes the fundamental component of the collateral structure that secures the EIT’s bonds. Consequently, the loans are routinely well secured and the Trust’s bonds receive high, investment grade ratings (AAA) from the three bond rating agencies, which results in EIT’s bonds (and, therefore, the loans made to the program participants) bearing interest at a very low rate. Because the borrowers are “pooled”, as discussed above, the costs associated with the issuances are lowered, as well.

The Trust is subject to oversight by the State. It is governed by a seven member Board of Directors, composed of the State Treasurer, the Commissioners of the Departments of Community Affairs and Environmental Protection, who serve as ex-officio members; one person appointed by the Governor upon the recommendation of the President of the Senate; one person appointed by the Governor upon the recommendation of the Speaker of the Assembly; and two

¹³¹ OIG was told that, although the majority of eligible projects have typically been undertaken by government entities, EIT, on three occasions prior to the time of the EnCap application, had made loans to government entities as conduit borrowers on behalf of private borrowers for clean water (*i.e.*, waste water) projects in amounts considerably smaller than that sought by EnCap. Government entities served as “conduit borrowers” on behalf of the private borrowers because the controlling law required that the loans for clean water projects must be issued to government entities. The government entities made the loan proceeds available to the private entities and are not necessarily responsible for the repayment of the loans. Also, on numerous occasions prior to EnCap’s application, EIT made loans directly to private borrowers for drinking water projects in an amount considerably smaller than that sought by EnCap.

State residents appointed by the Governor with the advice and consent of the Senate. The Governor, State Treasurer and Legislature have oversight authority: the Governor may reject Trust action by way of a veto of the Trust's minutes; the Governor and the Treasurer must approve Trust debt issues before bonds can be authorized for issuance by the Trust; the Legislature must approve the loans that the Trust proposes to make as well as the Trust's financial plan for each year; and the State Treasurer must approve each loan made by the EIT.

B. Department of Environmental Protection

In providing loans, the EIT partners with the DEP, which provides a matching, zero-interest loan through its State Revolving Fund Program (Fund or Fund Loan Program). This program, which was established in 1987, utilizes federal grants and State funds to provide zero interest loans for water quality improvement projects. The Fund Loan Program is funded by grants from the United States Environmental Protection Agency Capitalization Grant Program (EPA Capitalization Grant), proceeds from State general obligation bonds, repayment from prior Fund loans, State appropriations and certain fees. The majority of the funding is obtained from the EPA Capitalization Grant. The Legislature must approve the DEP's proposed loans. The Fund loans are awarded in conjunction with EIT loans, with each providing 50% of the total loan.¹³² Since the EIT loans are issued at a low interest rate and the Fund loans do not bear interest, the borrowers enjoy a combined interest rate that is exceptionally low.¹³³

¹³² Certain types of program applicants and program projects qualify for funding consisting of 75% from the Fund Loan Program and 25% from the Trust loan program.

¹³³ The combined packages have charged the borrowers rates as low as 2% and 2 1/2%.

Prospective borrowers must comply with an established application schedule, which begins in October and ends with the issuance of loans the following November. Within that 13-month period, applicants must meet numerous deadlines for submission of documents and the procurement of permits and applicable borrower approvals. Borrowers must apply to the Local Finance Board, within the Department of Community Affairs, which must approve the loan structure before loans may be issued to local government units. The DEP must ensure that borrowers have obtained all necessary permits. The Governor and Treasurer must approve all bond issuances and the Legislature must adopt appropriation legislation for each Trust and Fund loan, which is subject to the approval by the Governor.

C. EnCap representatives Identify EIT and DEP Loans as a Source of Financing

McCarter & English, LLP began representing EIT as its bond counsel in 1988¹³⁴ and continues to do so today. Stephen Pearlman was a member of the firm and was the lead bond counsel for EIT from 1989 until he left the firm in March 2002. As such, he was intimately familiar with the EIT program, having worked for EIT since close to its inception and having drafted many of its current procedures.

In March 2002, Pearlman joined the DeCotiis law firm, which had represented EnCap almost from its first involvement in the Project. Pearlman and his law partner Eric Wisler, then-lead counsel for EnCap, told OIG that after Pearlman joined DeCotiis, Wisler asked him whether the EIT program could be used to fund a portion of the EnCap Project that related to waste water.

¹³⁴ As noted above, the EIT was established in 1985.

Pearlman explained to OIG that, although the EIT typically issues loans to public borrowers, such as municipalities and utility authorities, EIT had on three prior occasions issued loans to private borrowers. Pearlman advised Wisler that he believed that not only the waste water portion of the Project would be eligible for EIT funding but that most of the Project could be eligible for this funding. In July 2003, Pearlman provided Wisler with an analysis of the three prior loans to private borrowers that he recalled. He explained that a public entity served as a conduit borrower for each of the private entities. Pearlman told Wisler that under Dirk Hoffman's¹³⁵ tenure, the Trust had always told the relatively few private entities that approached the Trust for waste water projects to find a governmental conduit borrower and enter the program in that fashion.

EIT staff confirmed for OIG that, in fact, on three occasions prior to the EnCap financing, loans had been made for clean water projects by EIT and DEP to local government entities acting as conduit borrowers on behalf of private borrowers. These private borrowers were a homeowner association and two large corporations for which government entities served as conduit borrowers. The government entities had neither secured nor guaranteed the loans and thus were not responsible for paying back the loans. That obligation remained with the private borrowers.¹³⁶

¹³⁵ Hoffman was the Executive Director of EIT until June 30, 2003; he had recently retired at the time of Pearlman and Wisler's discussion concerning the EIT program.

¹³⁶ When a project involves drinking water, rather than clean water, the law permits EIT to issue loans directly to private entities. EIT and DEP regularly make loans for drinking water projects directly to private borrowers (*i.e.*, water companies and homeowner associations) since there is no statutory requirement for a government entity to serve as a conduit borrower in these instances.

1. EnCap Proposes EIT/DEP Financing

At about the same time that Pearlman advised Wisler that EnCap might be eligible for EIT/DEP financing, Pearlman approached State officials about EnCap's eligibility for EIT and DEP funding. As far as OIG was able to determine, the first conversation an EnCap representative had with non-EnCap representatives about the prospect was an informal one possibly to "test the waters" to see if the concept was acceptable. In roughly June 2003, Pearlman broached the subject at a dinner with recently retired EIT Executive Director Dirk Hoffman and Barbara Bisgaier, Managing Director of Public Financial Management, Inc., the company that then served as the financial advisor to the Trust. Pearlman and Bisgaier had worked with Hoffman for years and took him to dinner to celebrate his recent retirement. According to Pearlman and Bisgaier, Pearlman discussed the Meadowlands Project and brought up the possibility of using the Trust and Fund Loan Programs to finance the Project. Bisgaier told OIG that Hoffman did not offer an opinion regarding EnCap's eligibility.

Pearlman, not having been discouraged by Hoffman's non-committal response, continued in his effort to pursue EIT financing. Shortly after the dinner, in July 2003, Pearlman and Wisler sought and obtained a meeting with the Treasurer's Office about the possibility of an EIT/DEP loan to EnCap to finance its Meadowland Project. EIT personnel had not been invited to the meeting; however, upon learning about it at the last minute, the EIT Executive Director, Dennis Hart, directed his Assistant Executive Director to attend the meeting since he was committed to attending another meeting at that time. Thus, the attendees were Treasurer McCormac, Pearlman, Wisler and the EIT Assistant Executive Director. During the meeting Pearlman advocated for EnCap's eligibility for EIT funding and also proposed that the loan be structured

such that EnCap would not have to make a payment back to the State until at the end of a 20 year period. OIG was told by EIT's current bond counsel from McCarter & English, Richard Nolan, and EIT Executive Director Hart that this was the first official contact with State representatives concerning EnCap's desire to substitute EIT/DEP for the EDA as the source of the funding for the Project. According to those present who were interviewed by OIG, at that meeting neither Treasurer McCormac nor the EIT Assistant Executive Director responded or otherwise made a commitment in response to Pearlman's proposal. According to documents obtained by OIG, the Treasurer did conclude that he was unwilling to agree to the issuance of any grants to EnCap but would consider conduit financing options.

Documents obtained by OIG indicate that EIT, the Attorney General's Office, the Governor's Office, and the DEP were made aware that EnCap representatives had met with EIT and DEP personnel and that EnCap's representatives had been advised that substantial review was required and that multiple issues would have to first be resolved before a determination concerning issuance of loans could be made. The correspondence further indicates that EIT Executive Director Hart discussed EnCap's financing proposal with Bradley Campbell, the then-Commissioner of DEP, and an assistant commissioner of DEP, both of whom indicated that extensive review concerning EnCap's eligibility for EIT and DEP loans was required before any decisions regarding financing could be made.

Documents obtained by OIG indicate that EnCap representatives continued in their efforts to obtain the low interest EIT and DEP funding for the Project despite the fact that a decision had not been made concerning EnCap's eligibility for EIT and DEP loans. For instance,

EnCap representatives approached DEP personnel to obtain DEP approval of an “environmental decision document” that would help preserve EnCap’s ability to receive an EIT/DEP loan for approved remediation work. An “environmental decision document” is, pursuant to regulations, a prerequisite to participation in the Fund Loan Program that is issued by DEP if it determines, after a full review of the project, that the project meets specified criteria.

Furthermore, in October 2003, Wisler sent DEP Commissioner Campbell an analysis of the law promoting EnCap’s eligibility for EIT and DEP funding. Acknowledging that the EIT and DEP have traditionally issued clean water loans to public entities, with exceptions in the case of loans to three private borrowers, Wisler argued that the then current law allowed for the issuance of loans to EnCap given the public purpose to be achieved by the Project and because the landfill closure, brownfield redevelopment and water quality improvement would be directly related to government functions.

2. EIT and DEP Review of EnCap Proposal

OIG was told by EIT and DEP representatives that, during this time, EIT and DEP staff and representatives conducted a legal and regulatory analysis of EnCap’s eligibility for Trust and Fund loans. EIT Executive Director Hart and bond counsel Nolan told OIG that although some representatives of the Trust and DEP were unsure at first whether the Project could be eligible, the legal analysis resulted in a conclusion that under the laws governing the Trust and Fund loans the Project could be eligible for this financing. EIT and DEP personnel, EIT’s advisors, including bond and tax counsel, and the Attorney General’s Office conducted a thorough review of the state and federal laws governing the Trust and Fund Loan Program to determine if the

Project could be eligible for funding through these programs. Bond and tax counsel to the EIT determined, however, that only the remediation portion of the Project, and not the vertical development portion, would be eligible for financing and any financing through EIT and DEP would have to be limited to paying for remediation-related functions.

EnCap's eligibility for Trust and Fund loans was bolstered by consideration of the fact that the Project had been initiated by the NJMC; was strongly supported by DEP; was a high priority of the State; the State and the beneficiary towns stood to gain by way of the resultant economic development; EnCap had procured insurance policies that would provide for the completion of the Project;¹³⁷ and the insurer, AIG, had been involved with the Project from an early stage by evaluating the viability of the project and reviewing all requisitions for payment to ensure that any payments made to EnCap were appropriate. In addition, consideration was given to the fact that the EIT and DEP had never denied financing to an applicant for a project when the applicant and project had been determined to be qualified and in compliance with the applicable law. The State parties recognized that, notwithstanding the unprecedented magnitude of a loan of this type, the EIT and DEP loan programs were intended to facilitate projects that would not be viable without the loans offered by these programs. Moreover, the Project's goals also comported with EIT and DEP's desire to see brownfields and landfill sites cleaned and used productively.

Additionally, during OIG's investigation, OIG was told by then-Commissioner Campbell that at the time he had independently contemplated an expansion of the Fund Loan Program to

¹³⁷ The various insurance policies are discussed in detail herein.

include landfill and brownfield remediation projects. Commissioner Campbell told OIG that he supported the Project and that, although DEP and EIT had previously not had much in the way of involvement with projects of this type and magnitude, he had supported a move toward using the Fund Loan Program for projects involving the redevelopment of previously underutilized sites, including brownfield sites. The Commissioner told OIG that he had initiated reforms in order to be able to apply the Fund Loan Program to projects akin to the NJMC's Project (but not just the EnCap Project). OIG also learned that, at the time, it was originally thought by EIT and DEP staff that the loan to EnCap could be used as a template for similar loans in the future and that the Commissioner shared this goal.¹³⁸

Based on the legal research and policy considerations, EIT and DEP representatives determined that the Project was eligible for Trust and Fund loans. Before negotiations concerning the terms of any loans could be discussed in depth, however, DEP was required by federal regulations governing the Fund Loan Program to conduct a regulatory analysis of the entire Project. This analysis continued over a period of several months until July 9, 2004, when DEP advised EnCap that it had satisfied the planning and design requirements for certain enumerated components of the Project and that it was authorized to proceed with those components. As such, the cost of work associated with the approved remediation components would be eligible for payment with funds borrowed from the EIT and DEP.¹³⁹

¹³⁸ This plan was later abandoned and it was determined that the financing structure developed for the EnCap Project would not serve as a template for future transactions.

¹³⁹ DEP also advised EnCap that additional approvals would be required for other elements of the Project. These approvals were issued in June 2005.

On July 14, 2004, the Trust issued a “pre-award approval” which would permit EnCap to obtain an interim loan from the Trust, if it were ultimately determined that EnCap would receive loans from the Trust and Fund. EIT routinely provides interim loans to borrowers, in anticipation of permanent financing at a later date. The interim loan is paid off at closing from the permanent Trust and Fund loans. The issuance of the interim loan to EnCap is discussed below.

3. Negotiations Concerning Terms of the Loans

After the above-referenced approvals were issued, negotiations concerning the terms of the loans resumed in earnest. The evidence indicates that Pearlman negotiated from a position that, if successful, would have greatly benefited his clients and would have been detrimental to the State. The evidence further indicates that, in this regard, Pearlman sought every advantage for his clients, even when his proposals were clearly unwarranted given the circumstances. In August 2004, Pearlman made a presentation to the Treasurer, in which he detailed his vision for the loans, including the terms of repayment to which EnCap would be bound. This was followed by an August 2004 memorandum from Pearlman to the “EnCap Working Group”, which included Treasurer McCormac, members of Treasury staff, EIT Executive Director Hart, Trust Financial Advisor Bisgaier, bond and tax counsels to the EIT from McCarter & English, DEP personnel, representatives of the Attorney General’s Office, Wisler and other DeCotiis attorneys, and EnCap personnel.

a. Interest Rate

In his memorandum, Pearlman reiterated much of the proposal he had already made to the Treasurer: he proposed a \$180 million loan to EnCap, 75% of which would come from the Fund Loan Program (\$135 million), with the Trust loaning the remaining 25% (\$45 million). (August 20, 2004 Pearlman memorandum to “EnCap Working Group”). This distribution, with the majority of the funds coming from the 0% interest Fund Loan Program, would result in a significantly lower interest rate than the typical 50%-50% funding structure.

Pearlman’s proposal was based on an assumption that the Project would be granted a Brownfield Development Area (“BDA”) status by DEP pursuant to its Brownfield Development Area Initiative. This program was established to enable the DEP to provide assistance to communities in remediating and productively using brownfield areas.¹⁴⁰ According to the DEP website, the DEP selects “a limited number of BDA projects annually....” Areas that have been granted BDA status are eligible for financing from EIT and DEP that is divided differently than the financing routinely provided by the Trust and Fund: rather than receiving half of the loan from each source, a BDA project would be eligible to receive 75% of its financing from the 0% Fund loan and the remaining 25% from the Trust loan. Consequently, the vast majority of the loan would be issued at a 0% interest rate, thus substantially reducing the overall interest rate.

Pearlman wrote in his memorandum that EnCap representatives had previously met with DEP staff to request that DEP grant BDA status to the EnCap Project “automatically” because of

¹⁴⁰ The “overall objective of the BDA initiative is to assist ... in developing and implementing comprehensive plans for the coordinated remediation and redevelopment of the brownfield sites within [a] DBA.” (DEP website, http://www.nj.gov/dep/srp/brownfields/bda/bda_synopsis.htm).

the amount of work that had occurred with respect to the Project.¹⁴¹ He acknowledged, however, that it appeared that the DEP was not inclined to grant BDA status to the Project as “the BDA has limited resources and is focused on helping projects get off the ground....” Pearlman recognized that DEP had a “policy that they [DEP] be focused on helping projects get started, and not on projects that are moving regardless of BDA status.” Nonetheless, Pearlman’s proposal, as represented in his memorandum, assumed that BDA status would be obtained and thus, he proposed that the majority of the funding would be issued with a 0% interest rate.

b. Proposal for Bullet Maturity

Pearlman also proposed that the \$45 million Trust loan would have a “20 year bullet maturity”, by which EnCap would not be obligated to repay the loan for 20 years, although he added that EnCap expected that the Trust loan would be paid back in full no later than 2009. The loan would be directly secured by a bank-issued letter of credit¹⁴² and “indirectly secured” by the proceeds from the sale of development rights (“development rights sales proceeds” or “DRSP”) by EnCap to the developers who would construct the various residences, offices and other structures to be built on the remediated site (“vertical developers”). Pearlman wrote that EnCap expected to realize approximately \$200 million in DRSP between 2007 and 2009. Under Pearlman’s proposal, this revenue was not pledged to the EIT as security for the loan. Rather, it would be pledged to “reimburse the [letter of credit] bank, which bank is paying the interest, and ultimately the mandatory redemption price...of the Trust bonds.”

¹⁴¹ August 20, 2004 Pearlman memorandum.

¹⁴² A letter of credit guarantees repayment of the EIT bonds. Here, the EIT Bond Trustee is entitled to draw upon the letter of credit in order to pay the principal and interest of the EIT bonds when due.

c. Brownfield Reimbursements

With respect to the proposed \$135 million Fund loan, which would also have a 20 year bullet maturity, Pearlman proposed that a letter of credit would not be required to back the loan. Rather, he suggested that EnCap would pledge to the DEP the revenue that it anticipated receiving by way of a brownfield tax reimbursement agreement that EnCap entered into with Governor Whitman's Treasurer, and the CEO/Secretary of the New Jersey Commerce and Economic Growth Commission. The agreement provided for reimbursement to EnCap of up to 75% of eligible costs associated with the DEP-approved remediation.¹⁴³ Pearlman represented in his memorandum that EnCap expected to receive \$115 million, through 2023, by way of its reimbursement agreement. These reimbursements would not be realized, in large part, until after vertical development commenced. Pearlman further proposed that the Fund loan would be additionally secured by a pledge of \$20 million of anticipated proceeds from the sale of development rights to vertical developers. Pearlman noted in his memo that he had discussed the proposed Fund loan repayment structure with Treasurer McCormac, who "reserved judgment pending further review and discussion from this working group."

¹⁴³ On December 19, 2001, an "Agreement to Reimburse for Remediation Costs" ("Brownfields Agreement") was executed by Charles Hance, CEO/Secretary of the New Jersey Commerce and Economic Growth Commission, Peter R. Lawrance, Acting Treasurer of the State of New Jersey, and William H. Gauger, on behalf of EnCap Golf Holdings, LLC. Pursuant to the Brownfields Agreement, EnCap is entitled to be reimbursed for 75% of eligible costs associated with the remediation of the site; however, 10% of the reimbursement will be withheld by Treasury and not released until the expiration of all tax refund periods. When the amount of the tax revenues realized from the Project is sufficient to cover the cost of the reimbursement, EnCap would be entitled to begin receiving annual payments. The amount of the annual payment is conditioned upon the percentage of occupancy of the facilities constructed on the site. The brownfield tax reimbursement program is distinct from the BDA program; as is relevant here, the BDA program provides for a different percentage disbursement of State loans than the EIT/DEP loan programs, while the brownfield program provides a mechanism for reimbursement.

d. State Rejects EnCap's Proposed Terms

OIG was told by EIT staff members and advisors that at least some of the State's representatives who reviewed Pearlman's proposal found some of its terms, particularly the 20 year bullet maturity provision for the Fund loan, to be unacceptable and, according to one advisor, "laughable."

There is also evidence that the State representatives were concerned about the security--collateral--for the loans, having found Pearlman's proposal to be insufficient in this regard, and that there was not agreement among the State representatives concerning the proposed 25% and 75% split of the Trust and Fund loan proceeds.

Documents obtained by OIG reveal that during this period of analysis, DEP determined that it would not grant the Project BDA status and thus EnCap would not benefit from a 75% DEP/25% EIT loan that was balanced in favor of a 0% interest rate. Documents obtained by OIG further indicate that it was also determined by EIT and DEP that they desired a letter of credit as backing for the Fund loan, in addition to the letter of credit that Pearlman had offered to provide as backing for the Trust loan. Also, the State would not accept a "bullet maturity" provision for the Fund loan.

Accordingly, EIT and DEP representatives requested a letter of credit for the Fund loan. EnCap's representatives replied that it would be prohibitively expensive to obtain a letter of credit for the life of the Fund loan and requested that the State consider instead a debt service

reserve fund consisting of an amount equal to what EnCap would be obligated to pay back to the DEP over a two year period.

D. EnCap and EIT/DEP Reach Agreement

By the end of 2004, the State and EnCap agreed to the terms of the loans and State officials authorized the issuance of loans to EnCap. On September 9, 2004, the EIT Board adopted a resolution authorizing the Trust to issue to EnCap an interim loan not to exceed \$40 million, with the BCIA serving as a conduit on EnCap's behalf.¹⁴⁴ This interim loan was conditioned upon the execution of a "Participation Agreement" that would set forth the terms and conditions of the permanent Trust and Fund loans that would be issued at a later date. At closing, the amount of the interim loan would be repaid from the permanent Trust and Fund loans.

The Participation Agreement was prepared and signed by Robert A. Briant, Sr., Chairman of the EIT, Commissioner Campbell, Edward H. Hynes, Executive Director of the BCIA, and William H. Gauger, III, on behalf of EnCap. Treasurer McCormac approved and signed the document on December 17, 2004. It was executed simultaneously with the issuance of the interim loan, which was not to exceed \$40 million,¹⁴⁵ and provided that EIT/DEP would issue to

¹⁴⁴ As discussed above, a government entity borrower was required to obtain the loan on behalf of EnCap, as the controlling law prohibited the EIT from issuing loans for clean water (*i.e.*, waste water) directly to a private entity. OIG was told by the then-bond counsel for the EDA that EDA and EIT explored, at an early stage, the possibility of EDA serving as the conduit for this Project as well as others in the future. OIG was told that there was a certain degree of enthusiasm over the prospect of establishing a unified State-run process for financing projects such as this one. It was finally concluded, however, that the controlling law prohibited a State entity (as opposed to a public but non-State entity), such as the EDA, from serving as a conduit in this context.

¹⁴⁵ OIG was told that EIT approved an interim loan of up to \$40 million that was to be paid out; however, as it turned out, EnCap only sought and received \$33.5 million by way of the interim financing program.

EnCap a total permanent loan of \$212 million, again with the BCIA acting as the conduit borrower. The \$212 million loan was comprised of approximately \$107 million from the EIT loan program and approximately \$104.3 million from the DEP loan program. The interest rate for the EIT loan was variable, with an average weekly rate of approximately 3.6%;¹⁴⁶ the DEP loan would be issued at a 0% rate. Taken together, the net interest rate to be paid by EnCap was well below market rates.

The loan amount was based on EnCap's representations about the funding needed to cover the cost of the remediation portion of the Project and, accordingly, EIT and DEP officials believed that the loans would fully fund the remediation.¹⁴⁷ The Participation Agreement stated that this financial assistance was for the

“...filling, remediating and closure (the ‘Remediation’) of four solid waste landfills (the ‘Project Site’) currently owned by EnCap, such Project Site collectively consisting of approximately 815 acres of real property located within [the Township of Lyndhurst, the Borough of Rutherford and the Borough of North Arlington] ... such Remediation to include, without limitation, the construction on the Project Site of leachate collection systems, methane gas collection systems and other engineering controls, as well as drainage, barrier and vegetative layers, all as required by the DEP pursuant to the landfill closure approvals issued by DEP....”

¹⁴⁶ OIG was advised that, ordinarily, the EIT rate is fixed and is approximately 4 – 4 ½ %. OIG was further told that, because of the independent nature of the EIT bond issuance for the EnCap project and the letter of credit that secured the EIT bonds, it was appropriate for the bonds to carry a variable, weekly interest rate. Because the bonds can be tendered by the holders on demand every seven days and are variable rate bonds, their rate is lower than the rate routinely applied to fixed rate EIT bonds.

¹⁴⁷ As discussed herein, EnCap certified that it had funds sufficient to cover the additional costs of the Project. As part of its application for financial assistance that it submitted to the EIT, EnCap certified that it “[w]ill have available sufficient funds to pay that portion of the project costs not covered by the financial assistance being applied for with this application, and shall use these funds to make such payments.” (November 11, 2004 Certification of William Gauger, EnCap Golf Holdings, LLC).

As discussed in full in this Report, the remediation included work that EnCap's representatives called a "Ground Improvement Program" (GIP) consisting of "dynamic compaction", "wick drains" and "surcharging", three functions that EnCap's engineer certified to the DEP are "directly related to the closure and remediation of the Lyndhurst and Rutherford Landfills and the long-term performance of the engineering controls required for water quality improvement."¹⁴⁸ It appears that DEP approved the GIP as eligible for reimbursement from these State funds because of this relationship between the GIP functions and remediation.

- EnCap represented in its application to EIT that the remediation budget included:
- Building costs: \$168.3 million.
- Administrative expenses: \$5.1 million.
- Engineering: \$7.58 million.
- Contingencies: \$8.4 million.
- Planning and design: \$12.5 million.

Total Project costs were approximately \$202 million. At this time, EnCap was obligated to contribute \$25 million of its own equity to the Project.

1. Security for the EIT Loan

The EIT portion of the loan was secured by the pledge of future proceeds from EnCap's sale of development rights to the vertical developers and a letter of credit issued by Wachovia Bank.¹⁴⁹ OIG was told by an EIT representative that EIT does not typically require letters of credit as security for its loans (which are typically backed by the full faith and credit of the

¹⁴⁸ March 17, 2005 letter from John A. Sartor, P.E., P.P. to Stanley Cach, DEP Municipal Finance and Construction Element.

¹⁴⁹ OIG was told by bond counsel to EIT that Wachovia was granted a security interest in the land as collateral for its letter of credit.

government-entity borrower) and that in the case of most EIT loans, such dual security is ordinarily not necessary. In this instance, EIT insisted on both the development rights sales proceeds and the letter of credit as security for its loan to EnCap. EIT's representative told OIG that this was required because there was a high degree of risk associated with this Project, due to the fact that realization of development rights sales proceeds is contingent upon the success of the remediation and completion of the sale to the vertical developers. Consequently, extra protection was required for the bondholders and the State.

According to the representations of EnCap included in the Participation Agreement, EnCap anticipated that the remediation would be completed and sales of remediated land to vertical developers would be completed by the end of 2009, with EnCap realizing approximately \$200 million from the sale. As such, EnCap projected that the proceeds from the sale of these development rights to vertical developers would be available to pay off the EIT bonds, including interest, by December 31, 2009.

2. Security for the DEP Loan

The Fund loan (approximately \$104 million), which had a twenty year repayment period, was secured by an assignment of the brownfield tax reimbursements (up to 75% of eligible costs associated with the DEP-approved remediation) that EnCap was entitled to pursuant to its 2001 agreement with Treasurer Lawrance. These reimbursements would not be realized, in large part, until after vertical development commences. The Participation Agreement provided that these tax reimbursements would be paid to DEP by EnCap throughout the twenty year repayment period pursuant to a repayment schedule that set forth the amount to be paid by EnCap each year.

The amounts varied from year to year, with EnCap paying the smallest amounts in the first three years, followed by larger, but still varying, amounts in the subsequent years.

The Fund loan was also secured by a \$13 million debt service reserve fund that EnCap would likely use to make required annual payments during the first two years of the repayment period given that brownfield tax reimbursements were not anticipated to be realized by EnCap during those years. The debt service reserve fund was funded by way of a BCIA bond that provided revenue to EnCap.¹⁵⁰

OIG was told that this was the most complicated loan and bond structure ever undertaken until that time by the EIT and the loan to EnCap was substantially larger than any prior loans issued by EIT and DEP (which have typically not exceeded amounts in the tens of millions of dollars). Because of the complexity and size of the transaction and the risk associated with it, the Trust loan was issued outside the routine loan financing process that EIT utilizes for all of its other loans. EIT utilized a different application processing schedule and issued the bonds by way of a separate bond sale rather than including the EnCap bonds in the usual bond pool that EIT uses for all other loans. It was also the first brownfield remediation project with a private sector sponsor to receive a loan of this type. When EIT and DEP issued loans to private entities in the past, the projects did not involve brownfield remediation, were small in scale and loan amount, and the loans were completed as part of the ordinary financing process and schedule. The EIT Board of Directors acknowledged that its loan to EnCap was the largest and most complicated that the EIT had undertaken and that, for its part, DEP assumed a level of project

¹⁵⁰ In addition to serving as a conduit for the EIT and DEP loans, the BCIA issued bonds, the revenue from which was loaned to EnCap to fund Project-related costs that did not qualify for funding from the Trust and Fund loan proceeds. This is discussed below.

risk that it had not previously accepted. EIT officials confirmed this in a discussion with OIG, other State entities and EnCap.

3. Concerns Regarding Insufficient Collateral

Notwithstanding DEP and EIT's support for the Project and the use of the Trust and Fund Loan Programs as financing sources for the Project, there was significant concern about the security for the Fund loan¹⁵¹, particularly on the part of high ranking officials within DEP, including Commissioner Campbell. OIG was told that the security for the Fund loan provided DEP with no avenue for recourse against the borrowers; was secured by a source of repayment that was speculative; and did not fully collateralize the full Fund loan amount. There was substantial concern that, because the security for the Fund loan appeared to be insufficient, there was a risk that DEP would not be paid back in full if EnCap folded or the Project were otherwise not completed as contemplated.¹⁵²

DEP assumed the greatest risk, which could conceivably remain in place for a period of years. The security for the Fund loan was primarily brownfield reimbursement payments that EnCap had negotiated with the State and pledged for future repayment of the loan over its 20 year repayment period. As such, the Fund loan would be repaid only to the extent that the property was remediated, sold, developed and utilized in a manner that would generate tax revenues. This was considerably more speculative than the repayment method for the Trust

¹⁵¹ There was not concern about the security for the EIT loan because the bonds were doubly protected: because the bonds were backed by a bank letter of credit, it was anticipated that the bonds would be repaid, even in the event of a delay or failure of EnCap to sell development rights to vertical developers.

¹⁵² Note, however, that this did not undermine the DEP's support for the Project itself.

portion of the loan, as it was dependant largely upon successful vertical development and the generation of sales tax revenue, none of which can be guaranteed. In contrast, the Trust loan would be repaid much earlier than the Fund loan, as it would be repaid with the proceeds from the sale of development rights, which could be realized once the remediation is completed and, moreover, the Trust loan was backed by a letter of credit.

With respect to EnCap's commitment of \$13 million collateral, which was provided by way of a debt service reserve fund, OIG was told that this additional collateral would be depleted within the first few years, as it would be drawn upon to pay back DEP before sufficient sales tax revenue, and therefore brownfield reimbursement payments, could be generated.

OIG was told that, typically, DEP's loans are fully collateralized: the borrowers are obligated to pay the loans back and they have the ability and are expected to generate revenue (by way of assessing higher rates or taxes) to repay the loan, if necessary. OIG was told, however, that because the Fund loan was non-recourse to EnCap and BCIA, which was the conduit borrower on behalf of EnCap, DEP could not sue to collect any unpaid amounts from EnCap or BCIA in the event of a default. DEP would only be entitled to whatever security interest had been negotiated. This concern was expressed internally by DEP personnel.

OIG learned that, even as late as November 2004 while the Participation Agreement was in the final stages of negotiation, DEP personnel expressed concerns about the security for the Fund loan. High ranking DEP staff reminded the DEP Commissioner that the department originally sought credit enhancement for its loan, in order to secure repayment of the full loan;

this had been considered necessary because of the risk associated with the repayment mechanism for the DEP loan.

On the other hand, counsel for EnCap told OIG that EnCap could not fund a letter of credit as collateral for the DEP loan. Counsel explained that the fees for a letter of credit that would be in place for 20 years (the loan repayment period) would be prohibitively high.¹⁵³ As such, EnCap requested the State accept, in lieu of a letter of credit, a debt service reserve fund consisting of an amount equal to two years of debt service.

4. Resolution of Concerns

Despite these concerns, the Project itself was consistently and strongly supported by the State entities that were involved with it, including DEP. In response to its inquiries, OIG was told that all parties wanted to see the landfills cleaned and used productively and, after years of unproductive use, this Project appeared to be a viable method for achieving this goal. The DEP, therefore, endeavored to facilitate the Project where appropriate.

The evidence indicates that, in analyzing the risks and benefits associated with the Project and the State loans, the DEP considered that the brownfield reimbursement structure created an incentive for EnCap to complete the remediation and its vertical development obligations. Pursuant to the terms of the Fund loan, EnCap would retain all of the brownfield tax

¹⁵³ Note, however, that counsel represented in an August 2004 memo to the “EnCap working group” that a letter of credit was not necessary because market access was not contingent upon having a letter of credit as part of the security package. With respect to the letter of credit for the Trust loan, OIG was told that, because it was projected that the EIT loan would be paid in 2009, its letter of credit would not have to be retained as long as it would have been held for the DEP loan. Accordingly, the costs associated with the EIT letter of credit were not as substantial as those that would have been incurred for the DEP loan.

reimbursements to which it was entitled (up to 75% of its approved costs) after the Fund loan was repaid. It was projected that, once the Fund loan is repaid, EnCap would realize approximately \$45 million in remaining brownfield reimbursements. Therefore, once DEP was paid in full, EnCap would be entitled to these excess funds. Accordingly, there appeared to be a built-in incentive for EnCap to fully satisfy its remediation and development obligations.

Furthermore, OIG was told that there was a belief that, to some degree, there was an imperative to disburse the money in the State Revolving Fund. The Fund Loan Program is funded by way of grants from the federal government, which are to be loaned by DEP to borrowers, usually local government entities, for clean water-related projects. By the time EnCap approached the State about obtaining a DEP Fund loan, the State Revolving Fund had not been adequately disbursed and there was concern within the department about federal sanctions for failure to promptly utilize the funds.¹⁵⁴

The evidence also indicates that part of DEP's analysis included consideration of the fact that the NJMC holds a performance bond that would enable the NJMC to complete the remediation in the event of an EnCap default. Once the remediation is completed, whether by NJMC or EnCap, the land would be readied for uses that would generate tax revenue, which had been pledged as repayment for the DEP loan. OIG was told by EIT representatives, and documents obtained by OIG reveal, that this would allow for DEP to be reimbursed, in the

¹⁵⁴ However, after the DEP loan was issued to EnCap, there was concern that the State Revolving Fund would be depleted in the near future as a result of the size of the Fund loan to EnCap and the proposed repayment schedule. As such, concern was expressed internally within DEP that this could lead the United States Environmental Protection Agency to make adverse findings in an audit of the State Revolving Loan Program and reduce its future grants to the State.

manner originally contemplated, even if EnCap were unable to complete its work. (This presumes, however, that there is no dispute and/or litigation over NJMC's right to call upon the performance bond or that NJMC would be successful in any dispute. Moreover, given the Project's complicated financial structure, other parties, including banks, have an interest in the Project and could attempt to influence its outcome.)

In summary, the evidence indicates that, while the DEP would have preferred additional security for its loan, it determined that the benefit associated with the cleanup and eventual productive use of the site, particularly given that the land had been unused and contaminated for so long, outweighed any disadvantages associated with the inadequate security for the Fund loan.

As such, the State parties agreed to the loans to EnCap, with sorely undervalued security for the Fund loan, which were to be issued in 2005 pursuant to the terms set forth in the Participation Agreement. EnCap wanted the permanent loans to close early in 2005; however, the State parties believed this goal was ambitious given the various deadlines that were required to be met before the loans could be closed. EIT and DEP instead anticipated that the loans would be closed and EnCap would receive its permanent financing later in 2005.

E. Discovery of Material Omission by EnCap

Unbeknownst to EIT and DEP, at the same time EnCap was negotiating the terms of the Trust and Fund loans, EnCap was also negotiating agreements with municipalities that were intended to generate hundreds of millions of dollars of additional revenue for EnCap and to

ensure EnCap's profit. As will be discussed below, EIT/DEP lenders were unaware of these negotiations and the potential for significant revenue to EnCap as a result of them. This development marked a significant change in the relationship between EIT/DEP representatives and EnCap. In at least 2003, EnCap's representatives had proposed to the officials of Lyndhurst, Rutherford and North Arlington¹⁵⁵ that they enter into financial agreements providing for payments in lieu of property taxes (PILOTs) to be paid by the future owners of vertical development that would be built on the remediated site.¹⁵⁶ The agreements would allow EnCap to share in a percentage of the PILOT payment revenue, with the county and towns receiving the remainder. The agreements were also intended to lay the groundwork for the securitization of the PILOTs (sale of bonds with a promise to pay back the bonds with the PILOT payment proceeds), with EnCap to realize up to \$450 million from the securitization.¹⁵⁷

1. The RAB Law

The RAB Law, enacted in October 2000, provided an important new mechanism for the financing of extraordinary costs associated with redevelopment projects. It authorized municipalities to designate areas for redevelopment and issue bonds for the planned

¹⁵⁵ Correspondence obtained by OIG indicates that EnCap approached North Arlington before the Participation Agreement was signed in December 2004, as EnCap was fully engaged in a dialogue with North Arlington by December 2004. OIG was advised that EnCap did not finalize its negotiations with North Arlington in this regard.

¹⁵⁶ The payments would be related only to the improvement on the land and not on the land itself. Taxes would be paid on the land.

¹⁵⁷ EnCap's representatives indicated in the preamble to the financial agreements with the towns that the financial agreements were entered into pursuant to the Redevelopment Areas Bond Financing Law (RAB Law), N.J.S.A. 40A:12A-64 et seq., and the Long Term Tax Exemption Law, N.J.S.A. 40A:20-1, et seq. The RAB Law governs the securitization plan proposed by EnCap. As discussed herein, EnCap's proposal was different from more typical payments in lieu of taxes and PILOT bonds.

redevelopment. The bonds would be secured by PILOTs, special assessments on property benefiting from the improvements, or both.

The RAB Law, however, did not apply to municipalities within the Meadowlands, including Lyndhurst, Rutherford or North Arlington, because its provisions did not apply to redevelopment projects undertaken by the NJMC. The RAB Law was amended on August 4, 2004¹⁵⁸ to include the municipalities that are within the jurisdiction of the NJMC. The amendment thus created parity between the municipalities within the NJMC, including Lyndhurst, Rutherford and North Arlington, and the other municipalities in the State.

It also provided the mechanism for EnCap to pursue lucrative financial agreements with the towns that would involve the use of PILOT-backed bonds. EnCap's representatives conveyed the importance of the change in the law and the attendant opportunity for EnCap to realize profits early in the Project. Wisler told OIG that his firm provided Assemblyman Sarlo, the sponsor of the RAB amendment, with a draft of the bill that proposed the change to the law. Both Pearlman and Wisler told OIG that the Project would have been "uneconomic", from EnCap's perspective, without the proceeds of the PILOT bonds; and, as discussed below, they told this to the towns as well.

¹⁵⁸ The bill that proposed this amendment to the RAB Law was sponsored by Assemblymen Scalera and Sarlo and Senator Sarlo (Senator Sarlo began the 2004-2005 Legislative term as a member of the Assembly and became a member of the Senate during the term). The bill was introduced on May 10, 2004 and was signed into law on August 4, 2004.

2. EnCap's Negotiations with Towns

EnCap's representatives, lead by Wisler, commenced negotiations with the towns for the financial agreements before the bill amending the RAB Law was passed into law. EnCap made representations concerning the financial necessity for the financial agreements and, in conjunction with this, also engaged in a process of negotiating "impact payments" and the provision of services for the towns.

a. EnCap Claims Necessity for Additional Funding

The former Mayor of Lyndhurst, who was in office at the time the financial agreements were negotiated, told OIG that, in 2002 or 2003, EnCap's representatives told him that EnCap was in "trouble" and that bonding was required to finance the Project. The former Mayor told OIG that EnCap's representatives threatened to pull out of the Project if such financing were not made available and asked the town to issue bonds.¹⁵⁹ Although the Mayor strongly supported the Project, both in terms of remediation and vertical development, he rejected the suggestion that the town issue bonds. EnCap countered with the "PILOT" bond proposal.

Lyndhurst's former town counsel, who was in office at the time the financial agreements were negotiated, told OIG that, in mid-2004, EnCap representatives told Lyndhurst officials that the estimated cost of remediation was too low, EnCap was experiencing significant cost overruns, and that no other funding was available. When the town, however, suggested EnCap

¹⁵⁹ The Mayor noted that EnCap's representatives often told the town that the company did not have enough money for the Project.

reach out to the State for assistance, EnCap's representatives replied that the State would not provide funding. Wisler subsequently presented EnCap's prepared financial agreement to the town.

The effect of these representations by EnCap representative on the towns is inestimable at this point in the process. Town representatives reported to OIG that they understood that without the agreements, EnCap could neither remediate nor develop the landfill areas of their towns. EnCap represented to the towns that the remediation and subsequent development would not necessarily be completed without the financial agreements and anticipated securitization of the PILOT payments. EnCap's representations about the potential for failure and the lack of funds for remediation were significant, particularly given the towns' strong support for the Project and desire to remediate the land and increase its value.¹⁶⁰

Lyndhurst's officials told OIG that they reviewed EnCap's proposal in consultation with its experts, including bond counsel, a municipal auditor, engineers and a retired tax court judge who had been retained by the town for this purpose. The former Mayor told OIG that, after the review, he believed that the town could realize substantial financial gains¹⁶¹ from the financial agreement and that there was neither a constitutional¹⁶² impediment to the agreement nor a risk

¹⁶⁰ OIG was told that contaminated land is assessed for tax purposes at \$10,500 per acre. Once remediated, the land would be worth thousands or hundreds of thousands of dollars more, thus producing substantially more in the way of ratables for the towns.

¹⁶¹ The former Mayor told OIG that EnCap's representatives said that the town would get 50% of the PILOT payment revenue. The Mayor told OIG that he understood that the town would receive approximately \$26 million per year, which would have been substantial given that the town's annual budget was approximately \$26 or \$27 million.

¹⁶² The Mayor explained that a legal review was sought and obtained by the town. The then-town counsel advised that the legal review concerned whether the financial agreement violated the equal protection clause.

that the town would be responsible for the debt service on the bonds. The former town counsel, however, told OIG that the town's bond counsel opined that the Local Finance Board¹⁶³ would not approve the bonds and further questioned who would purchase the bonds.

In or about November 2003, EnCap began what officials of the Borough of Rutherford called "tentative negotiations" concerning a financial agreement similar to the one proposed to Lyndhurst.¹⁶⁴ Rutherford's mayor, borough administrator, town counsel and special counsel told OIG that, based on representations made to them by EnCap's representatives, they believed that the PILOT bonds were a necessary piece of EnCap's finance package and that, but for Rutherford's participation in the financial agreement, the Project, including remediation, infrastructure work and vertical development, would not be completed. As with Lyndhurst, Rutherford strongly supported the Project, as it wanted the landfills to be remediated and the resultant ratables that would follow.

b. EnCap Promises Impact Payments and Services to Towns

EnCap provided inducements to convince the towns to enter into the financial agreements by agreeing to provide the towns with "impact payments" of millions of dollars and to provide services to the towns. These commitments, which were beneficial to the towns, were made by EnCap's representatives as part of the consideration for the towns' consent to the financial

¹⁶³ The Local Finance Board, which is within the Department of Community Affairs, is required by statute to approve bond issuances such as the one proposed by EnCap. This is discussed further below.

¹⁶⁴ Rutherford's officials told OIG that in or about June 2004 the negotiations began in "earnest."

agreements. In this context, the towns also sought payments and services, often to offset the impact of the redevelopment Project on the towns.

The former Mayor of Lyndhurst told OIG that there was a “constant exchange”, almost monthly, between EnCap and the town representatives, resulting in what the Mayor considered mutually beneficial terms for the parties. By way of example, OIG was told by the former mayor that after the first financial agreement was entered into by EnCap and Lyndhurst, EnCap approached the municipality, seeking consent to construct up to 1800 additional homes. In exchange for the additional vertical development and consent to the financial agreement, EnCap agreed that it would install Astroturf on the town’s recreation and high school fields and give the town a \$2,000,000 payment. The former mayor told OIG that this was in addition to other payments and services that EnCap had already offered to provide to the town, including but not limited to funds for emergency vehicles, road repairs and an agreement to purchase water from the town for the Project.

Rutherford officials told OIG that they saw opportunities for Rutherford to benefit by way of the financial agreement.¹⁶⁵ They were able to negotiate terms they believed were beneficial to the town, including but not limited to financial payments to be made by EnCap, construction that would satisfy its requirement under COAH, age restrictions on some of the new

¹⁶⁵ Rutherford explained that, by virtue of its position within the Meadowlands District, it does not have independent control over its zoning. It could, however, impose by way of the financial agreement its own conditions upon the new construction that is to be built in the town. For example, the NJMC’s zoning plan does not distinguish between age-restricted housing and housing that is unrestricted. Rutherford was able to include such a restriction by way of the financial agreement, thus reducing the likely impact on its schools. This was an element of the negotiation process that the town engaged in with EnCap and which was incorporated into the financial agreement.

housing to be built in the town, infrastructure improvements and divestment of Rutherford's obligation to pay for busing new resident children to schools.

c. Financial Agreements Between EnCap and Towns

In December 2004¹⁶⁶, EnCap entered into separate financial agreements with Lyndhurst and Rutherford. The consistent factor in each of the agreements was that they both established an alternative tax structure for the future residents and owners of the new construction that was to be built on the remediated land. The residents/owners would make PILOT payments that would be established at a rate that would be higher than the tax rate for the rest of the town. The financial agreements provided that EnCap would receive a percentage of the PILOT revenue (39.5% with respect to Lyndhurst; variable rates, from 39.5% to 51% depending upon specified conditions, in the case of Rutherford). Pursuant to the RAB Law, the county would receive 5% of the PILOT revenue and the towns would receive the remainder, in accord with their percentage shares as set forth in the Agreement. According to EnCap representatives, the county would receive its percentage first, followed by EnCap¹⁶⁷ and then the towns.¹⁶⁸

¹⁶⁶ The financial agreement with Lyndhurst was signed December 14, 2004 and the financial agreement with Rutherford was signed December 29, 2004.

¹⁶⁷ While the financial agreements contemplate the issuance of PILOT-backed bonds, OIG is aware of discussions concerning the potential receipt by EnCap of PILOT payment revenue absent the proposed bond issuance. OIG does not opine in this Report whether the financial agreements permit EnCap to receive and hold PILOT payment revenue without a corresponding bond issuance. For purposes of this report, the payment to EnCap will be referred to as a payment for "debt service" unless specified otherwise.

¹⁶⁸ There appears to be disagreement about the manner in which the towns' payments would be prioritized. EnCap's representatives have suggested that the towns would receive their portion of the payment after all other payments (county and debt service) are made. Indeed, Lyndhurst's financial agreement provides a priority order of payment, with the town receiving the third payment, after the county portion and debt service payments are made. Rutherford's official told OIG that its financial agreement provides for simultaneous for debt service and to the Borough. Nonetheless, he acknowledged that EnCap believes that the town would be paid after the county portion and debt service obligations are satisfied. EnCap's counsel confirmed to OIG his understanding that the town would be paid last. Rutherford's official told OIG, however, that he believes that this issue relates solely to the timing of payments and not the ultimate receipt of funds.

In addition to the verbal representations EnCap reportedly made to the municipal officials about the necessity for the financial agreements and PILOT bonds, the financial agreements explicitly state that there was a substantial likelihood that the Project would not be completed absent the financial agreements and PILOT bonds. Lyndhurst's financial agreement provides:

Whereas, the Township has determined to cooperate with EnCap in implementing a financing program that will enable EnCap to obtain funding for payment of a portion of the costs of constructing and improving the Lyndhurst Portion of Phase I Redevelopment Project, and that, without such cooperation, payment of such construction and improvement costs by EnCap would not be economically feasible and might result in EnCap's determination not to proceed with the Lyndhurst Portion of the Phase I Redevelopment Project....

Rutherford's financial agreement contains substantially similar language. Both towns' financial agreements also provide, "Whereas, such Township acknowledges that ... without the availability of various sources and types of financing (in addition to the contribution of equity capital by EnCap), the costs of remediation and infrastructure construction may become uneconomic...."¹⁶⁹

EnCap intended to securitize its anticipated PILOT revenue by way of bonds issued on its behalf by the BCIA, which would serve as a conduit issuer. EnCap anticipated that up to \$450 million could be securitized.¹⁷⁰ EnCap would get the revenue from the bonds up front and would

¹⁶⁹ EnCap did not enter into a financial agreement with North Arlington. OIG was advised that, although EnCap negotiated with North Arlington for a related agreement, such an agreement with the town was not finalized.

¹⁷⁰ In its application for approval of the PILOT bonds, EnCap represented that the stream of revenue anticipated from the PILOT payments would support \$366 million in bonds and that if interest rates change it could support a larger bond issuance. Thus, it sought approval to issue up to \$450 million in bonds. The application was submitted to the Local Finance Board, within the Department of Community Affairs, in August 2006 and was supplemented in

not bear the risk associated with repayment of the bonds, as future property owners would be required to make the “PILOT” payments that would be used to pay the bonds.

F. Towns Unaware of EnCap’s Negotiations with EIT/DEP

Representatives of both Lyndhurst and Rutherford told OIG that, at the time they signed the financial agreements, their towns were unaware of EnCap’s negotiations with the State and that EnCap was in the process of securing a \$212 million loan from the State for remediation related costs. As discussed above, the towns believed that if they did not enter into the financial agreements with EnCap, EnCap would neither remediate nor develop their land. This created enormous pressure for them to negotiate with EnCap. Given these pressures, the towns did what they could do to improve the terms of the agreements. Moreover, at the time these agreements were negotiated and signed, EnCap had submitted a budget with its application for EIT and DEP loans indicating that the cost of remediation for this area was \$202 million (\$10 million less than the amount of the application) and that other funds were not required for remediation.

The lack of full disclosure to the towns by EnCap’s representatives deprived the towns of a full understanding of the context of the financing. They therefore did not have all of the information that would have aided them in analyzing whether there was in fact an imperative that they agree to the financial agreements at that time and in that manner. The towns have independent authority to enter into these types of agreements and they could have opted to negotiate financial agreements at a later date, with different terms, or with any developers who

October 2006. The LFB is required by law to approve government-issued PILOT bonds. Because the BCIA was the proposed issuer, LFB’s approval was required in this matter. This is discussed at length below.

ultimately purchase the rights to develop the remediated land. Both Rutherford and Lyndhurst indicated that they entered into their agreements because of the representations by EnCap that remediation would not happen without them. Rutherford's officials, in fact, suggested to OIG that they would not have agreed to the financial agreement and PILOT bonds if the agreements would have generated a significant windfall for EnCap or if the financing provided via the financial agreement was intended to be used solely to restructure the Project's financing.

Both towns' representatives, however, told OIG that they could not independently verify EnCap's claims about the financial status of the Project and the other sources of EnCap's financing. Rutherford, for instance, told OIG that it attempted to conduct such a review but it did not have access to all of the necessary records. Lyndhurst's former Mayor told OIG that, at the time EnCap proposed the financial agreement and PILOT bonds, he thought that EnCap was getting money from the State in some other manner but he did not know the terms of the transaction. The former Mayor added that he had a "vague sense" of how the remediation would be completed. Consequently, OIG was told that the town officials sought to do their due diligence by consulting with independent reviewers and consultants who examined the financial agreement as well as the attendant benefits and risks to the town that would likely be associated with the agreement.

Communication and full disclosure was further hampered by the independent nature of EnCap's negotiations with each of the towns. Rather than negotiate jointly with the towns, EnCap negotiated with each town separately. Rutherford officials told OIG that it proposed joint negotiations; however, OIG was told by Lyndhurst's former officials that they declined, as its

negotiations had progressed to a different stage than Rutherford's. North Arlington was also not similarly situated at that time. Accordingly, the towns did not have the benefit of discussing and evaluating the matter together and therefore lost an opportunity to share resources and information.¹⁷¹

G. State Discovery of Agreements with Towns

EIT and DEP personnel who were responsible for the Trust and Fund loans were likewise unaware of the towns' negotiations and agreements with EnCap. EIT/DEP representatives told OIG that neither Pearlman, Wisler nor anyone else acting on behalf of EnCap advised EIT or DEP of the financial agreements and PILOT bond proposal. Indeed, Pearlman and Wisler acknowledged to OIG that they did not apprise EIT and DEP of the financial agreements and the PILOT bond proposal before the Participation Agreement was signed and that this was important and relevant information that the State representatives should have been given.

Pearlman told OIG that he did not know that the financial agreements with the towns had been finalized until December 2004, when Wisler informed him about the agreements. Pearlman told OIG that he was not involved in the negotiation of the financial agreements and that he and Wisler did not advise each other of the status of all of their work on the EnCap matter. Pearlman

¹⁷¹NJMC told OIG that it also sought to facilitate joint negotiations on behalf of the towns. Aware that EnCap had been negotiating with the towns with respect to multiple issues, the Executive Director of the NJMC and the then-Commissioner of the Department of Community Affairs, who served as the Chair of the NJMC, told OIG that NJMC proposed that it would negotiate jointly on behalf of the towns. The Executive Director and Commissioner told OIG that the subject matter of any joint negotiations would have not been exclusively about the financial agreements. The negotiations would have also concerned the type of construction that would be approved and the amounts to be paid by EnCap in relation to this construction. While there was a general consensus that the NJMC made this offer, there were differing reports about the towns' willingness to participate. It is clear, however, that there was not a consensus among the towns concerning joint negotiations and the towns continued to negotiate independently.

told OIG that this is why he did not know to inform EIT and DEP of the financial agreements and PILOT bond proposal until after Wisler mentioned it to him. Pearlman also told OIG that upon learning about the financial agreements, he asked Wisler if EIT and DEP knew about them and Wisler replied that they did not. Pearlman said that he told Wisler that EIT and DEP had to be advised of the agreements.

Pearlman told OIG that he believes that after he learned about the financial agreements he told the State parties about the agreements but he could not recall with certainty whether he conveyed this information to the State. He did not recall details of whatever conversation occurred but did recall that the State representatives were displeased upon learning this information. In fact, EIT and DEP representatives told OIG that they were not advised of the negotiations with the towns, the financial agreements or the proposed PILOT bonds by EnCap or its representatives and that it only learned about this inadvertently.

It was not until February or March 2005, two or three months after EnCap had entered into the financial agreements with the towns and the Participation Agreement with EIT and DEP, that EIT discovered, by way of an inadvertent comment made by an associate counsel of the DeCotiis firm to EIT's bond counsel during the course of an unrelated conversation,¹⁷² EnCap's plan to seek up to \$450 million in additional revenue at an early stage of the Project. The evidence indicates that it was only after EIT representatives had accidentally learned of the

¹⁷² In January or February 2003, an attorney for a bank that is involved with the Project referenced the PILOT deal in passing to EIT representatives. EIT's representatives told OIG that it was not until the February or March comment by the DeCotiis associate that EIT's representatives realized that EnCap had laid the groundwork for an entirely new revenue source at the same time it was negotiating the Fund and Trust Loans with the State. EIT's representatives are confident that the DeCotiis associate did not reveal this information to them at the direction of anyone else, including Pearlman or Wisler.

lucrative financial agreements and PILOT bonds that Pearlman and Wisler talked with EIT's representatives about them.

EIT and DEP were shocked to discover EnCap's plan to obtain PILOT payments from the towns and securitize this future revenue. EIT and DEP considered EnCap's representatives' failure to reveal at any time during their negotiations the plan to generate early in the Project as much as \$450 million by way of its financial agreements with the towns to be a material omission, as all of EnCap's sources of revenue were to have been revealed when negotiating the security package for the loans from the State and because State representatives had accepted EnCap's representations about EnCap's alleged inability to provide additional security for the DEP loan. Moreover, as noted above, EIT and DEP representatives understood, and the Participation Agreement between the State and EnCap provided, that the EIT/DEP loans would be sufficient to cover the cost of remediation. Yet the financial agreements provided that the PILOT revenue was essential to ensuring completion of the remediation. Furthermore, EnCap intended to use those proceeds to, in part, pay off the EIT loan but not provide more security for the Fund loan. This compounded the already existing concern within DEP about the amount of security for the Fund loan, which was not guaranteed by way of a letter of credit, as was the EIT loan, or by a similar form of protection. Accordingly, upon learning about EnCap's plan to securitize the PILOT payments, the State agencies determined to reopen negotiations so that the State would be placed in a better position given the new revenue that EnCap anticipated receiving as a result of the financial agreements. OIG learned that Treasurer McCormac agreed that the new information about the financial agreements and PILOT bonds was material and different from what had been previously disclosed.

OIG learned a determination was made by the State agencies to use the newly identified revenue source, in part, to pay down some of the outstanding balance of the Fund loan.¹⁷³ Accordingly, the State entities initiated a renegotiation of the security for the Fund loan, so as to obtain as much of the PILOT revenue as possible to better secure the loan. The evidence also shows that at least the then-Commissioner of DEP also sought to demand more security because EnCap had not been forthright with the State.¹⁷⁴

It is difficult to overestimate the level of distrust on the part of State representatives that EnCap's representatives' failure to disclose caused. At the time, it had the effect to change the tenor of all future dealings between EIT/DEP representatives and EnCap. Treasurer McCormac told OIG that State representatives believed that EnCap had improperly denied them material information. EIT and DEP representatives, including Commissioner Campbell, told OIG that they believed EnCap's failure to disclose was wholly inappropriate and unfair.

¹⁷³ There was no concern about the EIT loan, which was secured by way of a bank letter of credit and the proceeds from the sale of the development rights by EnCap to the vertical developers.

¹⁷⁴ Some individuals within the State, who were not participants in the negotiations between EnCap, EIT and DEP, and EnCap and the towns may have been aware of the concept of the PILOT bonds but did not know the terms and conditions of the financial agreements or have meaningful notice and understanding of EnCap's PILOT bond proposal. OIG was told by the former Chair of the NJMC that counsel to EnCap proposed the use of PILOT bond revenue for payment of certain obligations by EnCap to the NJMC. The Chair, however, explained that she rejected EnCap's proposal and told EnCap's representatives that she did not believe the PILOT bonds were authorized by the then current law. Other NJMC personnel confirmed this discussion. The evidence indicates that the NJMC did not have notice of the terms, conditions and magnitude of the financial agreements and EnCap's proposed PILOT bonds and that the proposal itself was unlike any that had come before it. In fact, NJMC officials told OIG that they did not know the amount of money that EnCap intended to obtain by way of the PILOT securitization until 2006, when EnCap submitted its bond approval application to the Local Finance Board. Indeed, counsel to EnCap acknowledged that meaningful notice was not given to the State.

Pearlman acknowledged to OIG that the failure of EnCap to provide notice to the EIT and DEP seriously damaged EnCap's credibility within the State. He told OIG that he and EnCap recognized at the time that there must be total transparency going forward in order to reestablish a level of trust and credibility. He further suggested that residual concerns about EnCap's credibility may have influenced the State's response to its subsequent application the EnCap submitted to the LFB for authority to proceed with the PILOT bonds.

Having said that, in an interview with OIG, Pearlman diminished the import of the failure to advise EIT and DEP of the financial agreements and PILOT bond plan. He said that because the loans had not been closed, the delayed notice did not create substantial problems for the State, as there remained time to revise the terms of the loans. Pearlman said that this was so because the Participation Agreement amounted to only a memorandum of understanding and, as such, served as merely a "guide" for the loans.

The EIT and DEP, however, considered the Participation Agreement to be a final document that represented the final, negotiated terms of the loans and provided the structure for the entire transaction. But for the discovery of the financial agreements and PILOT bond proposal, the Participation Agreement would have governed the terms of the loans, which would have been issued earlier than the loans ultimately were issued. Indeed, the language of the Participation Agreement supports the view of EIT and DEP officials. It provided, "This Participation Agreement, dated December 17, 2004 ... sets forth the understanding and agreement of the parties hereto with respect to certain of the terms and conditions pursuant to which (i) the NJEIT shall extend to the BCIA a Trust Loan ..., (ii) the DEP shall extend to the

BCIA a Fund Loan ..., and (iii) the NJEIT shall extend to the BCIA an Interim Loan[.]” The Participation Agreement was signed by all parties: the Chair of the Environmental Infrastructure Trust, DEP Commissioner, Executive Director of the BCIA, Manager of EnCap and State Treasurer. Moreover, as discussed below, it was a “participation agreement”, albeit with revised terms, that governed the loans that were ultimately issued.

To diminish the importance of EnCap’s representatives’ failure to disclose the existence of their agreements with the towns, which EnCap believed would result in tens of millions of dollars profit for it during the early stages of remediation, is to fail to acknowledge the State’s commitment to the Participation Agreement that it had negotiated with EnCap. Dismissal of the Participation Agreement as something other than a document that represented the fundamental terms and conditions that had been negotiated by the parties amounts to a self-imposed absolution by EnCap of what was obviously a very significant part of a year-long negotiation for an unprecedented loan.

H. EIT/DEP Require Renegotiation of Agreement

OIG learned that when EIT initiated the renegotiation of the terms of the State’s loans, and EnCap’s representatives realized that the State entities were significantly disturbed to learn about EnCap’s material omission, EnCap’s representatives promptly sought to independently discuss the matter with Treasurer McCormac. OIG was further told that Treasurer McCormac met with EnCap and the State parties separately and negotiated the new loan terms with EnCap over a period of months. OIG was told by EIT and DEP representatives that the negotiations to revise the collateral were tense and difficult.

It has been suggested to OIG that the Treasurer played a substantial role in the renegotiation because Governor McGreevey wanted the Project to be completed. Treasurer McCormac told OIG that he recalled communications about the loans with neither Governor McGreevey nor Governor Codey and that Governor Codey's office was not involved with the negotiations. Treasurer McCormac, however, said that he would not have gotten involved in this manner unless he was directed to do so by a member of the Governor's staff. He does not recall who told him to participate in this manner and OIG has not been provided with any information that aids in determining who would have issued this directive. OIG has interviewed several Statehouse staff members from both the McGreevey and Codey administrations; none recalled having directed Treasurer McCormac to renegotiate the terms of the Participation Agreement or knew who directed the Treasurer to serve in this capacity.

OIG was told that DEP pursued 20% of the PILOT bond revenue and presented this to Treasurer McCormac during a meeting with the Treasurer, EIT officials and EIT's advisors. In June 2005, Pearlman provided the Treasurer a proposal for a restructured Fund Loan security package that would retain the original security and add new provisions. Pearlman proposed that, if PILOT bonds are ultimately issued, EnCap would commit to using the proceeds from its sale of development rights to vertical developers (DRSPs) to increase the debt service reserve fund (assuming it had been drawn upon to satisfy EnCap's repayment obligation to DEP) so that it would continue to be fully funded at \$13 million.¹⁷⁵ Pearlman also proposed that, if the PILOT bonds are ultimately issued, EnCap would use the DRSPs to fund any projected shortfall in the

¹⁷⁵ Pearlman proposed that the PILOT bond revenue would be used to satisfy the Trust Loan, to which the DRSPs are pledged as collateral. If this were to happen, the DRSPs would be available to EnCap as its profit. Thus, Pearlman proposed using the DRSPs to fund additional security for the Fund Loan.

brownfield reimbursement payments that had already been pledged by EnCap as security for the Fund Loan. Pearlman explained that after any such payments are made the remaining DRSPs would flow to EnCap as its “fair return.” (June 20, 2005 email, Pearlman to Richard T. Nolan, Esq.). Pearlman added that if PILOT bonds are not ultimately issued, nothing would have changed and therefore EnCap should owe no additional security for the Fund Loan.

In July 2005, after conferring with their staffs, the Office of the Attorney General and the professional advisors to EIT, Executive Director Hart and Commissioner Campbell sent a memorandum to Treasurer McCormac in which they offered four potential responses to Pearlman’s proposal. Noting that EIT and DEP had previously agreed to Pearlman’s proposal that the PILOT bond revenue be used to “displace” the DRSP and, thus, satisfy the Trust Loan, they suggested that the DRSP should be made available to reduce the Fund Loan rather than allowing EnCap to keep the entire pool of DRSP without strengthening the collateral for the Fund Loan. Hart and Campbell suggested that Pearlman’s proposal was inappropriate to the extent it would enable EnCap to realize up to an additional \$200 million in revenue, which had not been disclosed to the State, without pledging additional collateral to the Fund Loan.

Accordingly, Hart and Campbell proposed the following alternative security enhancements:

- If PILOT bonds are not successfully issued, the State should require a pledge of 10% of the annual PILOT payment that EnCap receives pursuant to its financial agreements with the towns. Also, because EnCap’s representatives provided DEP with a revised loan amortization schedule for the Fund Loan that projected that the loan would be amortized at a slower rate than originally projected, the State should require a payment from EnCap

in 2011 that would cause DEP to receive the amounts anticipated pursuant to the original repayment projections;

- If PILOT bonds are successfully issued and DRSPs are “displaced” and available to be utilized by EnCap, EnCap shall, if necessary, pay to DEP the amount necessary to replenish the debt service reserve fund so that it is again \$13 million; the amount of any shortfall in EnCap’s annual payments owed to DEP, to the extent the debt service reserve fund was insufficient to satisfy these shortfalls; and the lesser of \$20 million of the total “displaced” DRSP or 10% of the total “displaced” DRSP;
- If some but not all of the PILOT bonds are successfully issued when the Trust and BCIA bonds are fully paid off, EnCap should replenish the debt service reserve fund and address any shortfalls (as described above); pay the lesser of \$20 million of the total “displaced” DRSP or 10% of the total “displaced” DRSP; and pay 10% of the annual PILOT payments (those that are not pledged to pay off the PILOT bonds) to the DEP; or
- A combination of the above requirements.

In response to this proposal, negotiations continued, with the Treasurer acting as the intermediary, and by the end of July 2005 there was an agreement concerning the revised security. The security for the DEP loan was ultimately revised to include the following provisions in addition to the assignment of EnCap’s brownfield tax reimbursements¹⁷⁶ and a \$13 million debt service reserve fund that had been the collateral/security in the original Participation Agreement:

- On a specified “calculation date”,¹⁷⁷ to the extent that PILOT bonds have been issued, EnCap shall pay the DEP an amount equal to 10% of the total amount of

¹⁷⁶ On November 30, 2005, EnCap assigned its rights under the Brownfields Agreement, and directed all payments under the Agreement to Commerce Bank as the trustee for the DEP Fund loan (\$104, 306,814.00). (Assign. Of Brownfields Reimbursement Agreement, 11/30/05). Also on November 30, 2005 the Brownfields Agreement was amended with respect to the withholding of 10% of the reimbursements. The State determined that the withholding of the 10% was not in the State’s best interest and, accordingly, the Brownfields Agreement was amended to provide that the 10% withholding shall not apply during any period that reimbursements are assigned by EnCap to the trustee for any outstanding loan obligations to the DEP.

¹⁷⁷ The “calculation date” means the “later of (i) the date which is 91 days after the date on which no Bonds ... are Outstanding ... under the BCIA Series 2005 A & B Indenture and the BCIA Series C & D Indenture, and (ii) November 1, 2010.” (December 1, 2005 BCIA and EnCap Golf Holdings, LLC Loan Agreement at 9) (BCIA Series B, C and D Bonds are discussed below).

any PILOT bond proceeds, after EnCap makes certain payments it is obligated to make to (i) the vertical developers pursuant to the Development Rights Sales Agreements, (ii) the NJMC pursuant to the Development Agreement, (iii) Lyndhurst and Rutherford pursuant to the financial agreements, and (iv) DEP for the procurement of the surety bond described below, as prepayment to the DEP with respect to the Fund loan (the net amount was estimated to be \$8.8 million).

- On each date on or subsequent to the “calculation date” on which EnCap receives PILOT payments from Lyndhurst, Rutherford or North Arlington¹⁷⁸, to the extent such payments are not pledged to the payment of the PILOT bonds because PILOT bonds have not been issued, and to the extent permitted by law, EnCap shall pay the DEP 10% of any such PILOT payments, after EnCap makes certain payment it is obligated to make (as set forth in the previous bullet point), as a prepayment to DEP with respect to the Fund loan.
- Level debt service payments for the term of the loan (\$5.5 million/year for 20 years, recalculated on the “calculation date” after all required prepayments have been made) rather than a varied repayment schedule, which was originally contemplated.
- A calculation date “look back” and “look forward” analysis: If, at the “calculation date”, EnCap missed any prior payments that were not covered by the \$13 million debt service reserve fund, EnCap would be required to make it up by way of any source of funds available to EnCap including funds, if any, made available as a result of the successful issuance of PILOT bonds. Also, EnCap would be required to submit a fiscal feasibility study, with updated tax revenue projections, updating and analyzing the then-projected flow of brownfield tax reimbursements, and EnCap would be required to prepay any then-predicted shortfall in the repayment of the Fund loan from any source of funds, if any, available to EnCap, including funds made available as a result of the successful issuance of PILOT bonds; and
- \$11 million surety bond, to be paid at the calculation date (at the time of the “look back” and “look forward” analysis), regardless of whether the \$13 million debt service reserve fund had been used to pay DEP, such obligation to be satisfied by EnCap from any sources of funds available to EnCap, including funds made available, if any, as a result of the issuance of PILOT bonds.

The Amended Participation Agreement also provides that, if EnCap is able to sell PILOT bonds within six months after it sells the development rights to the Project, the PILOT bond

¹⁷⁸ The DEP security provision contemplated the possible effectuation of the North Arlington PILOT payment program, even though no such agreement was in place at the time the security was negotiated.

proceeds must be used to pay off the EIT bonds. The BCIA Bond Trustee would hold the proceeds from the sale of the development rights until all EIT bonds are paid.

I. Concerns About Renegotiated Collateral for the DEP Loan

OIG was told that DEP was concerned about the terms that the Treasurer negotiated. There is written evidence of DEP's concern. Although there is evidence that he previously communicated his willingness to defer to the Treasurer with respect to the terms of the revised security, Commissioner Campbell expressed consternation to the Treasurer in an August 10, 2005 email in which he said that he could not vote in favor of the revised Participation Agreement. The Commissioner wrote:

As you know, I have long had concerns about the DEP portion of the loan being under secured, and those concerns were reinforced when the undisclosed PILOT bond revenue was discovered. At the that [sic] time, I felt that at least 50 percent of the PILOT bond proceeds should be devoted to securing DEP's position.

This was whittled away in further negotiations, as one might expect. But when you and I left our email exchanges, I thought you and I had an agreement that we were holding the line at 10 percent of the PILOT bond proceeds, estimated to be about \$200+ million. In the deal now before us, we get less than five percent of those proceeds of \$8.8 million.

So, for a \$105 million loan, our security consists of 1) a \$13 million fund that EnCap is already saying will be consumed in the first few years because it already knows that it will not be able to cover the first few payments; 2) a 2-year surety of \$11 million instead of the replenishment of the \$13 million that had been discussed; and 3) the \$8.8 million of PILOT proceeds. If the Project goes belly-up and the vertical development never happens, we are out at least 70 million with no security and no recourse against BCIA or EnCap – at the same time that EnCap walks away with at least \$90 million of the PILOT proceeds. Even if the vertical development is completed, our ability to get paid back depends on it being consistently successful enough over 15 years to generate sufficient sales tax revenue.

Although OIG has not found a response to this email and Treasurer McCormac does not recall it or having replied to it, correspondence from Treasurer McCormac to Commissioner Campbell indicates that the Treasurer considered level debt service to be a better deal for the State than what had been originally sought. Also, although 10% is a smaller percentage than originally contemplated, it would apply to either the PILOT payments received annually by EnCap or to the funds obtained by way of securitization. Further, the revised security contained the new “look back” and “look forward” provisions. Thus, the EIT/DEP officials whom OIG interviewed advise, and the records reviewed by OIG confirm, that the terms of the final Amended and Restated Participation Agreement were better than those previously negotiated in the original Participation Agreement.

Commissioner Campbell told OIG that, although he believed the amended security package did not adequately collateralize the DEP loan, it had been communicated by Governor Codey’s Chief of Staff that the Governor would rely upon the Treasurer to make the final decision on fiscal issues such as this one and the DEP Commissioner to make substantive decisions about the Project. The Commissioner told OIG that he accepted the Chief of Staff’s decision, as the Treasurer is the Governor’s expert on financial matters. Governor Codey’s Chief of Staff told OIG that, while he does not recall this, by the time Governor Codey took office, the Project was so far along and had progressed to such a point that both the Governor and the Chief of Staff deferred to the commissioners. However, the Chief of Staff told OIG that neither he nor the Governor determined to favor one commissioner’s position over that of another commissioner. The Chief of Staff also told OIG that he was not aware of the above-referenced August 2005 email communication from Commissioner Campbell to Treasurer McCormac and

that he did not recall having a conversation with Commissioner Campbell about this. The Chief of Staff added that if this dissention had been brought to his or the Governor's attention, they would have become involved in order to become apprised of the issue.

There is evidence that the other State parties, including the EIT, were able to separate their disapproval of EnCap's conduct from the terms of the loan. They were pleased with the renegotiated security, finding that it provided more to the State than the original security package, which they accepted, had. Consequently, following the granting of all of the requisite State approvals, the loan was issued on December 1, 2005 with the above-referenced additional collateral.

It should be noted that OIG was told that at the time the Participation Agreement was renegotiated, DEP and EIT representatives and staff that OIG interviewed did not believe that EnCap would be able to securitize the PILOT revenue (as opposed to simply obtaining annual PILOT payment revenue from the towns) due to concerns that the representatives had with respect to the marketability of such PILOT bonds as well as the legal authority to issue the bonds. Thus, even though the security package was amended to provide additional security for the State, the State loans were not contingent upon successful issuance of the PILOT bonds. Therefore, any revenue from PILOT bonds or annual PILOT payments would be a windfall for the State.¹⁷⁹ OIG was advised that the revised terms of the loan would remain in place even if PILOT bonds are ultimately not issued or annual PILOT payments are not made by future property owners. Accordingly, the level debt service payments, the "look back" and "look forward" analysis and the surety requirement would be enforced against EnCap under any

¹⁷⁹ Concerns about the PILOT bond proposal are discussed below.

circumstances and, significantly, from any sources of funds available to EnCap, and, therefore, the State representatives had negotiated a better deal than the previously approved agreement.

The Amended and Restated Participation Agreement was approved by the EIT Board during its November 1, 2005 meeting. Treasurer McCormac attended the meeting and OIG was advised that this is the first EIT Board meeting that he attended as State Treasurer. The Treasurer told OIG that he did not place much importance on his attendance as he sat in the spectator's section of the meeting room and did not vote on the resolution concerning the Amended and Restated Participation Agreement. He told OIG that he attended the meeting in order to answer any questions that might be raised about the amended loan provisions. The Treasurer's designee voted on his behalf in favor of the resolution. Pursuant to his statutory authority to approve specific EIT Board actions, the Governor approved the Board's action the same day.

The EIT Board supported the package, the Governor's Office was not opposed and, in fact, Commissioner Campbell, as an ex officio member of the EIT Board, through his designee, eventually assented to the loan by voting in favor of the Amended and Restated Participation Agreement. The EIT Board had previously approved a loan with less collateral and may have been unaware of the distrust that State representatives were developing for EnCap's representatives. In any event, the reasons for not going forward had more to do with the concern for EnCap's bargaining methods than the terms of the loan. Consequently, although the State was locked into dealing with EnCap, State representatives were aware of the necessity for skepticism in dealing with EnCap's representatives.

Accordingly, the EIT and DEP had approved the issuance of \$212 million in low and zero-interest loans to EnCap.¹⁸⁰ At this time, the loan revenues for the Project were:

- Fund Loan: \$104.3 million
- Trust Loan: \$107 million
- BCIA Series B: \$37.9 million
- BCIA Series C: \$26.7 million
- BCIA Series D: \$38.2 million

The additional anticipated revenues were:

- Fill Operating Income: \$27.2 million
- AIG Policy: \$19.7 million
- Miscellaneous Asset Sales: \$14 million
- Interim Land Sales: \$9.9 million
- Interest Income: \$6.9 million
- Equity: \$25 million¹⁸¹

As such, the total of all EIT, DEP and BCIA financing was approximately \$314.3 million; the total of the additional revenues from sources other than EIT, DEP and BCIA was \$102.9 million; and the total of all of the sources of funding was \$417.2 million. (Sources of Funding for EnCap Meadowlands Project, Schedule 1). EIT and DEP officials understood that these loans were sufficient to allow for the completion of the remediation. Gauger told OIG that at this time EnCap anticipated a profit of between \$70 and \$75 million, including the revenue from the PILOT bonds.

¹⁸⁰ Because of the need to utilize the BCIA as a conduit borrower to facilitate this transaction, the proceeds of the EIT bonds were used by the EIT to make a loan to the BCIA, which in turn used the proceeds of the Trust loan to make a loan to EnCap. The BCIA/EnCap repayment obligation with respect to the Trust loan is evidenced by a bond issued by BCIA to EIT (but non-recourse to BCIA and recourse to EnCap) and referred to as the “BCIA Series 2005A Bonds.” The Fund loan was made by DEP to BCIA, which in turn used the proceeds of the Fund loan to make a loan to EnCap. The BCIA issued a bond to the State, acting by and through the DEP, to evidence the BCIA/EnCap loan repayment obligation with respect to the Fund loan (which is non-recourse to BCIA and recourse to EnCap) This is referred to as the “BCIA Series 2005E Bond.”

¹⁸¹ As noted above, figures have been truncated such that they are reported to the hundreds of thousands of dollars.

J. Use of EIT/DEP Loan Proceeds and Insurance/Performance Bond

The proceeds of the Trust and Fund loans were used, in part, to retire the outstanding EDA debt.¹⁸² As such, the EDA loan was completely paid off and it was no longer a source of financing for the Project. Also, as noted above, the \$33.5 million interim loan, issued to EnCap in anticipation of the permanent Trust and Fund loans, was paid from the proceeds of the permanent Fund loan.

At the time the EIT and DEP loans were issued in 2005, the insurance for the Project was restructured. A portion of the loan proceeds was deposited with AIG, which was to invest the proceeds in guaranteed investment contracts until the time when the proceeds are needed for payment of eligible Project costs. A complex process was established for the submission of payment requisitions and was set forth in the Trust Indenture: EnCap was to submit the requisitions, accompanied by a “Master Invoice Control Sheet”, (MICS) to the EIT, DEP and AIG for their review.¹⁸³ The MICS must be signed by an authorized EnCap representative and, after the representative’s review and approval of each requisition, EIT, DEP and AIG must also sign the MICS to indicate their approval, where appropriate. When a requisition is approved by all three entities, AIG shall release the funds for payment.¹⁸⁴ OIG was told by representatives of EIT that this requisition process had not been used for prior projects; however, given AIG’s role

¹⁸² The EDA debt was satisfied using \$6.97 million from the Fund loan, \$40.3 million from the Trust loan and \$52.4 million from proceeds of the BCIA Series B and C Bonds.

¹⁸³ This process was implemented at the time of the issuance of the 2005 EIT/DEP loans. It was not utilized in conjunction with the interim loan that was previously issued by EIT.

¹⁸⁴ During OIG’s review of the requisitions paid pursuant to this process, it appeared that certain expenditures that were approved for payment from EIT/DEP funds were possibly not in fact eligible for payment. This is discussed below.

as insurer, AIG has an incentive to ensure that the State loan proceeds are not spent inappropriately and only for budgeted and qualifying Project costs. Accordingly, AIG requested that it be included in the requisition review process; its request was accommodated by EIT and DEP. Indeed, EIT and DEP concluded, as did the letter of credit bank, that the role of AIG in the requisition process enhanced oversight and controls with respect to the disbursement of Trust and Fund loan proceeds.

The structure of the insurance for the Project changed upon the issuance of the 2005 Bonds. The Amended AIG Closure Insurance Policy was terminated, and EnCap established three accounts, pursuant to three Deposit and Payment of Claims Agreements executed by EnCap and AIG, which provide for the payment of closure costs eligible for reimbursement from the proceeds of the Trust and Fund loans, ineligible costs, and miscellaneous costs. This arrangement is known as the Replacement AIG Closure Payment Instruments and, includes the Investment Agreement and the Excess Closure Cost Policy, which collectively guarantee that the remediation work will be completed. EnCap obtained from AIG/Lexington a policy that covers excess costs, up to \$35 million, which were previously covered under the Amended AIG Closure Insurance Policy. According to EIT bond documents, these instruments “operate in the same fashion and will provide excess coverage in the same amount as was previously provided under the Amended AIG Closure Insurance Policy. As such, the amount of Remediation and macro-infrastructure cost covered pursuant to the Replacement AIG Closure Payment Instruments will be at least equal to 125% of the estimated cost....” (EIT Official Statement for 2005 BCIA Bonds at 17). The performance bond that runs to the benefit of the NJMC remained unchanged.

K. EnCap Obtains \$102M in Public Financial Assistance (BCIA Bonds)

At the same time that the EIT and DEP loans were issued, EnCap obtained additional loans by way of bonds issued by the Bergen County Improvement Authority (BCIA), as a conduit issuer¹⁸⁵. These bonds, Series B, C and D, produced loans to EnCap of \$37.9, \$26.7 and \$38.2 million, respectively.

These bonds were issued to cover costs that did not qualify for financing from the proceeds of the Trust or Fund loans; to retire a portion of the outstanding 2004 NJEDA Bonds; and to finance the costs associated with the issuance of each of the bonds and capitalized interest on each of the bonds. (Indenture of Trust for BCIA Series 2005A and 2005B Bonds at 6; Indenture of Trust for BCIA Series 2005C and 2005D Bonds at 6-7; Official Statement for BCIA Subordinate Special Purpose Limited Obligation Revenue Bonds, Series 2005C and 2005D at 2, 9). OIG was told that the Series B and C Bonds were issued on a tax exempt basis to finance Project related costs that could not qualify for financing by EIT and DEP. The Series D Bonds were issued in order to finance Project related costs that could not be financed by EIT and DEP and also could not be financed on a tax exempt basis (including but not limited to a portion of the fees owed by EnCap to the State, such as administrative fees to EIT and DEP).¹⁸⁶

¹⁸⁵ As with the other debts for which the BCIA served as the conduit, the BCIA was explicitly not obligated to satisfy these debts and could not be compelled to make these payments. Similarly, neither the State, the County of Bergen nor any municipality within Bergen County is required to satisfy these obligations.

¹⁸⁶ OIG was told that, ordinarily, EIT subsidizes the cost of obtaining loans through the Trust Loan program. However, in this instance, EnCap was required to pay every cost, including the fees of EIT's financial management consultant and bond counsel and administrative fees to reimburse EIT for the cost of issuing the loan. OIG was told that EnCap borrowed, by way of the Series D Bond, to pay these fees and that the State did not finance these costs.

The Series B Bonds, issued in the amount of \$37.9, are secured by the same sources of funds that secure the EIT bonds, on a pro rata basis with the EIT bonds: a letter of credit that was issued by Wachovia Bank (this is the same type of letter of credit that secures the EIT bonds) and the pledge of the proceeds from the sale of development rights. These sources of funds are to be divided between the EIT and BCIA on a pro rata basis; 74% of the proceeds shall be directed to satisfy the Trust Bonds while the remaining 26% shall be directed to satisfy the BCIA Series B Bonds. Taken together, the EIT and Series B Bonds equal \$145 million, which OIG was told is the maximum amount that Wachovia Bank was willing to secure by way of its letters of credit (given the bank's analysis of the value of the land).

\$36 million of the \$37.9 million Series B bond proceeds was used to pay off the outstanding EDA loan (in addition to the proceeds allocated from the Trust and Fund loans for such purposes). The remainder was used to pay costs associated with the issuance of the bonds, capitalized interest and related administrative costs. ("Sources and Uses" analysis of the Series A-E Bonds, Schedule 3).

The Series C Bonds (\$26.7 million) and the Series D Bonds (\$38.2 million) are backed by a pro-rata share (41% for C, 59% to D) of the same collateral as is pledged to the Trust and BCIA Series B Bonds, except that the Series C and D Bonds have a subordinate interest in such collateral. OIG was told that the letters of credit, which were also issued by Wachovia, are separate from the letters of credit that were issued for the EIT and Series B Bonds. OIG was told that, to secure the reimbursement obligations of EnCap to Wachovia with respect to the Series C and D letters of credit, Wachovia required EnCap to post cash collateral that EnCap could use to

pay Wachovia for any unreimbursed draws upon the letters of credit. Also, as noted above, the Series C and D Bonds are subordinate to the Trust and Series B Bonds. As such, any collateral shall be applied to the Series C and D Bonds only after the Trust and Series B Bonds have been fully paid off and, thus, the repayment obligation to the Trust and Series B Bonds must be satisfied before the repayment obligations with respect to the Series C and D Bonds will be satisfied. (Official Statement for Series C and D Bonds). The collateral for the Series C and Series D Bonds is to be divided between them on a pro rata basis; 41% of the proceeds shall be directed to satisfy the BCIA Series C Bonds while the remaining 59% shall be directed to satisfy the BCIA Series D Bonds.

The Official Statement for the Series C and D Bonds provides that the costs that are ineligible for EIT financing “include but are not limited to, the costs associated with the issuance of the Letters of Credit by the Bank and certain costs of issuance of the 2005 NJEIT Bonds and the BCIA Bonds. The [BCIA] is financing the Non-Eligible Project Costs from a portion of the proceeds of the 2005B Bonds, the 2005C Bonds and the 2005D Bonds.” (Official Statement for BCIA Series C and D Bonds at 9).

\$16.3 million of the \$27.7 million Series C Bond proceeds was used to pay off the outstanding EDA Bonds (in addition to the proceeds allocated from the Trust and Fund loans and BCIA Series B Bond proceeds). The remainder was used to pay “new tax exempt eligible costs”, which include land costs and property taxes; costs associated with the issuance of the bonds, capitalized interest and related administrative costs. (“Sources and Uses” analysis of the Series A-E Bonds, Schedule 4).

The proceeds of the \$38.2 million Series D Bond proceeds were used to pay the same categories of costs as the Series C Bonds: costs associated with the issuance of the bonds, capitalized interest and related administrative costs. (“Sources and Uses” analysis of the Series A-E Bonds, Schedule 5). The proceeds were also used to pay a portion of the administrative fee owed by EnCap to the DEP (\$3.3 million), the BCIA issuer fee (\$785,767), the debt service reserve fund for the Fund loan (\$13 million), guarantee fees (\$15.9 million) and various fees owed to Wachovia Bank (totally approximately \$1.8 million). Id.

For all of these bonds, the loan documents provide for the capture of any proceeds obtained by EnCap in the event it issues PILOT bonds. As with the Trust and Fund loans, however, the issuance or repayment of the bonds is not contingent upon the issuance of PILOT bonds, as OIG was told that, at the time the EIT, DEP and BCIA made their loans to EnCap there was not an expectation that EnCap would successfully issue PILOT bonds.

L. Status of Project at the time of the EIT/DEP and BCIA Loans

At the time the Trust, Fund and BCIA loans were made (December 1, 2005), it was understood by all parties that EnCap had entered into three agreements with developers for the purchase of the Project site once remediation was completed, as well as for the sale of development rights to those developers for construction of the vertical development. As represented in the Official Statements for the Series A-D Bonds, EnCap had entered into the following development rights sales agreements:

- September 13, 2005 agreement for the purchase and sale of “Northern Node development rights” for the construction of residential units.
- July 28, 2005 agreement for the purchase and sale of real property and development rights for the construction of the conference hotel and Phase I golf courses.
- October 4, 2004 Agreement (amended November 18, 2004) for the purchase and sale of Phase I residential project rights and retail project rights in the “Rutherford West Area” and “Village Area.”

(Official Statement for Trust Bonds; the same information is contained in the Official Statements for the BCIA Series 2005B-D Bonds in each document).

It was also understood at this time that proceeds from the sale of development rights were expected to be received over a period of approximately two and one-half years, commencing December 31, 2006 and ending March 31, 2009. (Official Statement for Trust Bonds). It was anticipated that the sale proceeds would be \$203 million, which was the estimated revenue to be realized by EnCap after “customary closing costs and adjustments.” As noted above, this revenue was pledged to satisfy the Trust Bonds and BCIA Series B-D Bonds, with the requirement that Trust and Series B Bonds must be paid in full before any sale proceeds can be allocated to the payment of the BCIA Series C and D Bonds.

M. EnCap’s Legislative and Regulatory Efforts in Pursuit of PILOT Bonds

1. PILOT bond legislation

On June 8, 2006, Senators Sarlo and Doria introduced Senate Bill No. 1927 (PILOT bond bill) that EnCap’s representatives have said is an essential component of their plan to issue bonds backed by the PILOT payment revenue that it anticipated receiving. According to EnCap’s representatives, the bill was necessary to ensure that bond counsel would issue a “clean opinion”,

which is a prerequisite to the issuance of any bonds. The bill contained several provisions including amendments to the current law that would have:

- amended the RAB Law authorize county improvement authorities (CIAs) to issue bonds;
- provided that, when bonds are secured by PILOT payments, the bond trustee may, instead of the municipality, conduct land sales in the event of a foreclosure;
- provided protection for the bondholders in the event of a bankruptcy involving the property that is subject to a PILOT payment agreement;
- provided that if a PILOT is established with respect to State-owned land pursuant to a lease agreement with a private entity, any lien shall attach only to the leasehold estate and not the underlying State property; and
- amended the Local Improvements and Assessment Law to provide that municipalities may undertake activities, including remediation, to address environmental contamination.

Wisler told OIG that before the bill was introduced he met with Senator Sarlo, who supported the Project and remediation of the landfills, to provide him with a draft of the bill and discuss its provisions. Wisler said that the bill was intended to address a perceived risk associated with bankruptcy that could adversely impact the PILOT bonds. He said that, in the event of a bankruptcy, there was a risk that the financial agreements could be discharged by a bankruptcy court. The bill therefore contained a provision that was intended to insulate financial agreements from bankruptcy proceedings in order to ensure a continuous stream of PILOT revenue for payment of the bonds.¹⁸⁷

¹⁸⁷ See proposed amendment to N.J.S.A. 40A:12A-68 in S-1927: “Upon recordation of the ordinance and agreement, payments in lieu of taxes shall constitute [a] an automatic, enforceable, and perfected statutory municipal lien [within the meaning, and] for all purposes, [of law] including the federal bankruptcy code, regardless of whether or not the amount of the payments to be made in lieu of taxes has been determined at the time the lien attaches to any interest in the land, leasehold estate or improvements, as applicable.” (Language that is contained in brackets is intended to be omitted from the law; language that is underlined is intended to be added to the law).

On October 16, 2006, Pearlman testified in support of the bill before the Senate Community and Urban Affairs Committee. He testified that the bill was “technical” in nature and that the municipal bond community required its passage in order to allow for the issuance of bonds pursuant to the RAB Law. He added that the bond community needs these “technical fixes” in order to issue RAB bond debt and secure it such that the lowest interest rates will apply to the bonds. Pearlman further testified that the bill does not expand the current powers of county improvement authorities.¹⁸⁸ The Committee did not vote or otherwise act on the bill.

On November 13, 2006, the Senate Community and Urban Affairs Committee revisited S-1927, at which time the bill was amended to remove the provision that would allow a CIA to operate in another county that has its own CIA. Language was also added to the bill to amend the definition of “redevelopment” under the RAB Law to specifically include “remediation of any landfill or other contaminated property” and “the construction, enhancement or mitigation of wetlands impacted by a redevelopment project.” Among the provisions remaining in the bill were those that would authorize a CIA to issue bonds under the RAB Law; allow the bond trustee to conduct land sales in the event of a foreclosure; and address concerns regarding bankruptcies.

During this time, Gauger told OIG that in this time frame he realized that the Project costs were likely to be \$25 million over the projected budget for remediation. In October 2006, he realized that the budget had increased by this amount primarily as a result of the cost of fill materials, the GIP, unanticipated obstructions under a portion of the site to be remediated, and

¹⁸⁸ This testimony is available from the archived proceedings of the October 16, 2006 Senate Community and Urban Affairs Committee, which can be accessed at http://www.njleg.state.nj.us/media/archive_audio2.asp?KEY=SCU&SESSION=2006

costs associated with the Kingsland Gas System and Lyndhurst ballpark complex. Gauger stated that the cost increases associated with the provision of fill materials and the GIP constituted the bulk of the cost overruns.¹⁸⁹ In particular, he told OIG that EnCap's above-barrier fill provider, LIR Fiore, could not obtain fill at the original contract price.¹⁹⁰ OIG was advised that EnCap's most recent purported budget increase for fill materials included in the LIR Fiore contract was over \$17 million.

Concerned that the budget increase was greater than \$25 million, Gauger asked EnCap's engineer, John Sartor, of Paulus, Sokolowski & Sartor (PS&S) to provide an analysis of the current status of the cost overruns. Gauger told OIG that Sartor estimated the Project cost going forward, on a "worst case scenario" basis, in order to avoid an estimate that would be inappropriately low. Sartor completed his first analysis early in the Spring of 2007.¹⁹¹

2. Application to the Local Finance Board

In October 10, 2006, EnCap¹⁹² submitted an application to the Local Finance Board (LFB) within the Department of Community Affairs for authority to issue the PILOT Bonds.¹⁹³

¹⁸⁹ Gauger said that the costs associated with the Kingsland Gas System were approximately \$1 – 1.5 million over budget and the ballpark was approximately \$500,000 - \$1 million over budget.

¹⁹⁰ EnCap's contract with LIR Fiore and subsequent amendments to that contract are discussed elsewhere in this Report.

¹⁹¹ Sartor's report concerning his findings is discussed below.

¹⁹² The application was submitted on EnCap's behalf by the BCIA, in its role as the conduit borrower. BCIA and EnCap enlisted the services of Acacia Financial Group, Inc.; EnCap's representatives told OIG that Acacia Financial Group prepared the application materials.

¹⁹³ As noted above the LFB is required by law to approve government-issued PILOT bonds. Because the BCIA was the proposed issuer, LFB approval was required in this matter.

In its application, EnCap sought authority to issue up to \$450 million¹⁹⁴ in “PILOT Revenue Bonds” and specified that it planned to use the PILOT bond revenue to refinance existing debt, pay interest on bonds and closing costs, fund a debt service reserve fund and fund payments and other expenses for the municipalities.

In the application, EnCap’s representatives wrote that the funding it received from the EIT and BCIA was always intended to be temporary financings:

Other than the 2005 Series E Bonds, which...provided permanent financing for certain remediation costs, the series 2005 A through D bonds were designed as interim financings to provide needed capital to begin the remediation and closing of the landfills. As contemplated, the Project has now advanced to a point of greater certainty which makes a more permanent financing possible. Thus, portions of the proceeds of the [PILOT] Bonds will be used to permanently refinance (i) the \$107,015,000 aggregate principal amount of 2005 Series A Bonds sold by the [BCIA] ... (ii) the \$37,985,000 aggregate principal amount of Series B Bonds sold directly in the public marketplace by the [BCIA], and a significant portion of the \$26,770,000 aggregate principal amount of Series C Bonds sold directly in the public marketplace by the [BCIA].”¹⁹⁵

Both Pearlman and Wisler told OIG that the PILOT bonds are an integral component of EnCap’s financing structure; that the PILOT bonds were contemplated early in the Project and that EnCap’s investors¹⁹⁶ were all apprised of the financial agreements and potential revenue. OIG was told by EnCap representatives that some of EnCap’s investors conditioned their

¹⁹⁴ EnCap’s representatives wrote in the application that, given the then current interest rates, it was anticipated that the PILOT payments would support approximately \$366 million in Bonds. However, if interest rates were to decrease, the payments could support a greater amount of debt. Thus, the application sought approval to issue bonds up to \$450 million. (Executive Summary to October 10, 2006 Application at 3).

¹⁹⁵ Note, however, that EIT and DEP officials believed the Trust and Fund loans fully funded the cost of remediation. Also, EnCap’s representatives have stated to public officials that the cost of the remediation was fully funded. This is discussed below with respect to Pearlman’s subsequent representations to the LFB that the “the remediation is already fully funded and over-insured.” (December 27, 2006 correspondence to LFB).

¹⁹⁶ As discussed in this Report, private parties played a role in the financing by providing certain collateral or other support for the Project. For instance, as noted, Wachovia Bank provided a letter of credit as backing for the EDA loan to EnCap. The evidence indicates that other private financial institutions have also supported the Project in this general manner.

involvement upon the successful issuance of the PILOT bonds or, at least, considered the bond revenue as a factor when determining whether to underwrite the Project. Wisler told OIG that EnCap's private participants anticipated that the PILOT bond revenue would be achieved and considered it to be a significant piece of the Project financing. Pearlman told OIG and State stakeholders that the PILOT revenue would enable EnCap to restructure its financing such that it would be provided an overall level of comfort concerning the eventual completion of the Project and ensure a profit for EnCap. As EnCap planned to use the PILOT bond revenue to pay off, or down, the interest bearing loans it received from the EIT and BCIA, the DRSPs would become available to EnCap because the DRSPs were otherwise pledged to the EIT and BCIA loans. Pearlman explained that this would enable EnCap to eliminate its risk and help ensure profit, as it would be able to eliminate debt and gain access to the DRSP.

On November 22, 2006, Susan Jacobucci, Director of the Division of Local Government Services and Chair, Local Finance Board, sent a letter to Pearlman in which she expressed concern about the PILOT bond application and sought clarification of several issues. Noting that the application presented "a substantial public involvement in the financing of the project[.]" Director Jacobucci wrote that it "is imperative that any publicly assisted financing does not expose the public to undue, unexpected or preventable risk... ." ¹⁹⁷ Director Jacobucci wrote that the LFB had identified "significant concerns about the application" and advised EnCap's representative that these concerns "must be addressed before the application is heard by the Board." Broadly, the LFB was concerned about the use of PILOTs to finance the Project and that the proposal was premature, given the lack of progress of the Project, absence of necessary

¹⁹⁷ November 22, 2006 letter from Susan Director Jacobucci, Director Division of Local Government Services and Chair, Local Finance Board, to Stephan Pearlman, Esq., counsel to EnCap.

permits, and representations by EnCap that the controlling law must first be amended before the bonds could be issued. The LFB's concerns are summarized as follows:

- EnCap advised that issuance of the bonds was contingent upon passage of an amendment to the RAB Law. The amendment would have addressed county improvement authorities' ability to undertake RAB financings; address bankruptcy concerns; and provide for a tax lien procedure to support the bonds. The LFB wrote that it was "troubled" by conflicts in the law on these and other issues.
- The proposal did not provide "sufficient financial protection" for the municipalities. As such, the LFB directed that EnCap's financial agreements with the towns and the towns' authorizing resolutions must expressly protect the municipalities from any liability to repay the bonds under any circumstances; provide for revenue guarantee and Project completion agreements; and provide that the Project agreement will terminate, without penalty to the municipalities, if PILOT payments are not made in a timely manner and the property would be taxed at its assessed value and placed on the tax rolls.
- As new IRS rules appeared to prohibit a fixed schedule of PILOT payments based on projected property tax payments, LFB requested an evaluation of the effect of these rules on the proposed financing plan.
- The Project had not progressed sufficiently. Necessary permits and approvals from the Project had not been issued by regulatory agencies. LFB thus advised that it "will not approve a financing for a theoretical project."
- The amount of financing sought by EnCap, \$450 million, differed from the amount discussed by EnCap during a meeting with the LFB. Moreover, EnCap's application did not provide financial impact analyses of the proposed debt. The LFB wrote that it was "concerned about the impact of the financing on the fiscal health and stability of a municipality" and it had not received a sufficient explanation of this. As such, the LFB sought an explanation of what would happen in the event of a default in the repayment of the bonds and a legal analysis of the impact of a bankruptcy of one or more of the developers on the Project and the municipalities.
- A credit rating had not been assigned to the bond and there was no requirement for bond insurance or any other form of credit enhancement.
- The application did not provide a detailed description and schedule of public improvements and estimated costs as well as a discussion concerning who would be responsible for public improvements and infrastructure.

On December 4, 2006, before Pearlman replied to Director Jacobucci's letter, the Senate voted in favor of S-1927, as amended by the Senate Community and Urban Affairs Committee.

The Senate vote was 21-16. The Legislature has not taken action on the bill since then¹⁹⁸ and Governor Corzine would later indicate his opposition to the bill.

Pearlman responded to Director Jacobucci's letter on December 27, 2006. In addition to explaining how the PILOT bond would function and answering specific questions posed by Director Jacobucci, he wrote that, "the remediation is already fully funded and over-insured" and explained that "through the execution of the Closure Agreement [between EnCap and NJMC, which requires EnCap to complete the remediation,] the issuance of the 2005 Bonds and the purchase of the Closure Policy, the funding for all of the remediation work is already in place." (December 27, 2006 letter, Pearlman to Director Jacobucci). Nonetheless, he explained to the LFB that in entering into the financial agreements with EnCap, "the municipalities of Lyndhurst and Rutherford made a prudent choice to partner with EnCap and enter into PILOT agreements ... because they determined that the site was a blight and an environmental hazard, and that nothing in the foreseeable future was going to change that without some economic incentive such as a TIF¹⁹⁹." (emphasis added).

Pearlman also explained that, as of the date of the letter, EnCap had promised the towns payments, services and other expenditures totaling over \$95 million. These include, but are not limited to construction of a new middle school (\$37.5 million), installation of field turf at soccer and football fields (\$2 million), improvements to municipal pool (\$1 million) and purchase of

¹⁹⁸ A-1493, which contains the same provisions as S-1927, was introduced January 8, 2008.

¹⁹⁹ Pearlman explained in the letter that tax increment financing (TIF) involve a loan of money "today to finance or refinance a project, and that these loans are repaid from the increased tax payments from the value that is created by the project. The core principal of any TIF is that the market simply won't work if left to its own devices." (December 27, 2006 letter Pearlman to Director Jacobucci).

fire equipment (\$300,000). Pearlman wrote that EnCap would be responsible for construction of these public improvements. In addition, EnCap committed to paying impact fees exceeding \$12 million to Lyndhurst and Rutherford and school impact fees exceeding \$5.5 million to Rutherford. Pearlman added that it was projected that Lyndhurst and Rutherford would realize “a combined annual surplus in excess of \$10 million” after the land is remediated and PILOT revenue is received by the towns. He explained that this, combined with the above-referenced benefits promised to the towns by EnCap, “answer the question of why the local governments support this project and the PILOT Bond issuance being proposed.”

Notwithstanding Pearlman’s response, the LFB remained concerned about the proposal. Director Jacobucci told OIG that the financing sought by EnCap was premature and speculative. She said that EnCap’s application assumed completion of the entire remediation and development Project; thus, EnCap was seeking financing based on a revenue stream that would not be realized for a period of years.²⁰⁰ OIG was told that this was of concern to the LFB because at the time the application was pending EnCap was still in the process of remediating the land and it had not obtained any of the necessary permits that are prerequisites to development. Director Jacobucci also told OIG that EnCap did not provide developer agreements or other documents to demonstrate its agreements with the vertical developers.

Furthermore, Director Jacobucci told OIG that the LFB was concerned that the proposal would have diverted tax revenue away from the towns to the developer. Even if the rate for PILOT payments was set higher than the town’s tax rate, the town would only get a percentage

²⁰⁰ As noted above, the PILOT application related solely to the portions of the Project that were located in Lyndhurst and Rutherford. Thus, the application contemplated the value of and revenue anticipated to flow from the fully completed remediation and development in Lyndhurst and Rutherford.

of the PILOT revenue, which would likely be less than under the ordinary tax rate. Also, much of the PILOT revenue would be used for EnCap's debt service payments, as EnCap represented that it intended to use the PILOT bond revenue to pay off the loans issued by EIT and BCIA. Director Jacobucci advised OIG that this was particularly disconcerting given that LFB had been assured that those prior loans would be paid only by way of private funds. Director Jacobucci considered the PILOT revenue to be public funds, as it was supplied by taxpayers and diverted tax revenue away from the towns. As such, if EnCap used these funds to pay off the EIT and BCIA loans, it would effectively be using public money for this purpose.

Director Jacobucci also told OIG that the LFB was concerned that, while the EIT and BCIA loans were backed by a bank letter of credit, the PILOT bonds were not similarly secured. Nonetheless, EnCap had indicated its intent to use the PILOT bond revenue as the source of payment for those loans that were secured by letters of credit.

Director Jacobucci added that it was of concern to the LFB that EnCap's agreements with the towns left the towns responsible for work and services for which the developer should be responsible. Director Jacobucci said, by way of example, that Lyndhurst and Rutherford would have to enhance their roads to accommodate the new development, as well as enhance public safety services. She further noted that EnCap had filed tax appeals for the land it was remediating, challenging the assessments. This was intended to reduce the amount to be paid to the towns for the unremediated properties, which compounded the loss of revenue previously received when the landfills were operating and generating revenue.

In addition, Director Jacobucci expressed concern about the proposal to the extent it provided that EnCap would have no obligations once it sells the land, thus leaving the trustee to collect the PILOT payments. OIG was also told that if the PILOT bond proposal were approved, a worst case outcome could be that the towns would receive insufficient revenue from the PILOT bonds, thus causing the towns to be under-funded and potentially in need of additional State aid.

On January 19, 2007, the Executive Director of the BCIA advised the LFB that EnCap intended to continue to address the “legitimate concerns” raised by the LFB and that the “resulting dialogue...will result in a substantially updated application.”²⁰¹ Pearlman told OIG and other State entities²⁰² that he believed the LFB did not act favorably on the application because the Department of Community Affairs was still developing its criteria for RAB bonds and because the Project was so large and not ready to proceed in most areas. He said that EnCap withdrew its application with the intent to resubmit it when more work was completed, such that it would not be considered to be speculative. He also said that EnCap was evaluating the requests and suggestions made by the LFB. The application was thus withdrawn, pending submission of a revised application. To date, a revised application has not been submitted.

Prior to asking for this investigation, Governor Corzine expressed concern about EnCap’s bid for PILOT-backed bonds as well as S-1927, the bill that EnCap represented was an essential prerequisite to the issuance of those bonds. Shortly thereafter, at or about January 31, 2007, the Governor asked the OIG to conduct an investigation into the history of the Project’s financing. In particular, the Governor was concerned whether the towns with which EnCap had contracted

²⁰¹ January 19, 2007 letter, Edward H. Hynes, Executive Director BCIA, to Director Jacobucci.

²⁰² During a subsequent meeting of State stakeholders, convened by EIT on April 17, 2007. This is discussed further below.

for the PILOT payments would be at risk of financial detriment as a result of their agreements with EnCap.

As discussed herein, Lyndhurst and Rutherford's officials who signed the financial agreements believe that, if the PILOT bonds were issued, they would be non-recourse to the towns. As such, the towns would in no way be responsible for the debt service payments on the bonds and their taxing authority would not be pledged as support for the bonds. In the event of a default, the bondholders' recourse would be to the individuals and entities that would be responsible for making the PILOT payments, not to the towns. These individuals and entities would consist of the homeowners and commercial business property owners (including the future hotel and golf course owners)²⁰³ who choose to purchase the homes or businesses constructed as part of the Project. These future owners would be required to make PILOT payments that at least at the outset would be higher than the property tax rate paid by the rest of the community.

Nonetheless, as noted above, there is disagreement about the manner in which the towns' payments, pursuant to the PILOT bond scheme, would be prioritized. EnCap's representatives have suggested that the towns will receive their portion of the payment after all other payments (county and debt service) are made. In fact, Lyndhurst's financial agreement provides a priority order of payment, with the town receiving the third payment, after the county portion and debt service payments are made. Rutherford's representative, however, told OIG that its financial agreement provides for simultaneous payments for debt service and to the borough. Rutherford's

²⁰³ According to EnCap's submission to the LFB, EnCap, and later the vertical developers, would be required to make the PILOT payments until the properties are sold to the new home and business owners. EnCap also represented in its submission that, in the event the PILOT payments are insufficient to satisfy PILOT Bond debt service obligations, only the remaining owners of any undeveloped property, that is, EnCap or subsequent developers, would be responsible to satisfy this obligation.

representative recognizes, though, that EnCap believes that the debt service payments will be made first. EnCap's counsel confirmed to OIG his understanding that the town would be paid after the county portion and debt service obligations are satisfied.

In the event that the towns are to be paid only after all other obligations are satisfied, there is a risk that the towns will receive little or no revenue or at least insufficient revenue to provide for municipal costs associated with the new development and related costs. Without a provision that prioritizes payment to the towns or otherwise guarantees to them certain revenue, the towns are at risk of not realizing sufficient revenue by way of the PILOT bonds.²⁰⁴ Indeed, it should be noted that the development that would be required under this proposal is years from construction, let alone completion, and requires that the properties be sold to purchasers who are willing to pay more than the regular tax rate.

3. Continued Push for PILOT Bonds

Nonetheless, during the April 2007 and subsequent meetings with State stakeholders, Pearlman and Wisler endeavored to convince the State representatives that PILOT bonds would be beneficial to all parties. In conjunction with this effort, they incorrectly asserted that the proposed PILOT bonds were the same as another PILOT bond that had been approved by the LFB. However, other evidence, which is discussed below, indicated that they knew this was not the case. Moreover, in and after April 2007, despite having stated that their proposal was just the same as another that had been approved by the LFB, Pearlman acknowledged to OIG and State stakeholders that the PILOT payments to be made pursuant to the financial agreements are not

²⁰⁴ This is discussed further below.

fully analogous to PILOT payment agreements previously established between towns and developers. The PILOT payment is ordinarily an abatement (reduction) of the normal tax rate; as noted previously, in this instance, it is proposed that the PILOT rate would be higher than the otherwise applicable tax. Also, Pearlman told OIG that EnCap's proposal also differs from prior PILOT bonds because the PILOT revenue will flow, in part, to EnCap, which will then securitize the anticipated revenue. Ordinarily, the developer receives a benefit by way of a reduction in the tax rate and thus does not receive any form of payment. As such, in the typical construct, the developer would not have a source of funds that could be securitized. Pearlman told OIG that, had the proposal been approved, it would be the first time this structure had been utilized.

Wisler told OIG that he believed that the LFB was concerned about the proposal because of its size and complexity and because it was the first of its kind. He added that he believed that it had been unwise for EnCap to seek approval to securitize such a large sum of money so far in advance of the completion of remediation. Rather, the application should have proposed that bonding would have been linked more closely to when the land was remediated and transferred to new owners that would develop it. Wisler said that his firm had reviewed the application but did not draft it and, as such, was not aware that it would seek authority to securitize up to \$450 million, an amount that Wisler thought was inappropriately large.

Pearlman recognized the unique nature of the proposed PILOT bonds in correspondence obtained by OIG. In a June 20, 2005 letter, Pearlman wrote to EIT bond counsel that this is "uncharted territory in New Jersey. The RAB law is still relatively new and we haven't worked

through the details to see if it in fact works....”²⁰⁵ Indeed, in his correspondence to the LFB, Pearlman wrote, “New Jersey’s market for RAB Law bonds is in its infancy.”²⁰⁶ And in correspondence to Director Jacobucci, Pearlman wrote, “we appreciate the magnitude and precedential value of this financing.”²⁰⁷

4. Absence of Precedent

Notwithstanding these representations, and subsequent to the above-referenced statements, in April 2007 Pearlman told OIG²⁰⁸ that the LFB recently approved an application for bonding that is structured in a manner that is identical or nearly identical to EnCap’s proposal. He said that the application involved an arrangement between the Township of West Orange and a private entity redeveloper and that the transaction involved the same allocation of money as is proposed in the financial agreement between EnCap and Rutherford. He added that bonds would be issued to provide a source of income for a redevelopment project and PILOT payments would be used as follows: 5% would go to the county; a portion would be directed to the town to cover any increased municipal services costs associated with the project; a portion would be dedicated to debt service; and the remainder would go to the town.

A review of the West Orange proposal reveals significant differences between it and EnCap’s proposal. First, the financial agreement between West Orange and the private entity

²⁰⁵ June 20, 2005 email, Steven Pearlman to Rich Nolan, cc Eric Wisler.

²⁰⁶ December 27, 2006 letter, Pearlman to Director Jacobucci.

²⁰⁷ November 29, 2006 correspondence, Pearlman to Director Jacobucci, cc Wisler.

²⁰⁸ This discussion took place during the above-referenced group meeting attended by the State entities that are parties to the EnCap transaction, including but not limited to EIT, DEP and NJMC.

redeveloper was entered into at the beginning of the project and the town knew the manner in which the bonding and the revenue fit into the overall project. West Orange was aware of the total cost of the project at the time it filed its application with the LFB and it intended to issue bonds for a discrete portion of the cost. The total estimated cost of the project is over \$200 million and the town proposed that not more than \$41,000,000 would be financed with RAB bonds. The remainder would be financed by the redeveloper by way of debt and equity. In the case of Lyndhurst and Rutherford, the Project was already well under way when EnCap proposed the PILOT bonds and, as discussed above, the towns were unable to fully evaluate the necessity for the bonds and the additional revenue. Moreover, EnCap's proposed bonds were linked to the completion of a vast Project that was still evolving and years from completion and those bonds were for an amount that well exceeded the estimated cost of the entire remediation portion of the Project.

Counsel to Rutherford suggested to OIG that the timing and context of EnCap's proposal hampered the application. He told OIG that, although the town knew the categories of appropriate usage (remediation and infrastructure), it did not know in detail how EnCap would use all of the PILOT revenue. He added that, for instance, had the land already been remediated and EnCap needed financial assistance for vertical development, it would have been easier to determine the cost of construction and thus the amount of additional financing that was needed.

Additionally, West Orange's agreement provided that, after the first 5% of the bond revenue is directed to the county, per statute, the town would get a percentage of the bond revenue to compensate the town for additional municipal service costs associated with the

project.²⁰⁹ The agreements between EnCap and Lyndhurst and EnCap and Rutherford did not contain a provision that would prioritize payments to the towns. Rather, payments to the towns would, at the worst, be made after all other payments (to the county and for debt service) were made or, at the best, at the same time as the debt service payments would be made.²¹⁰ There is not a provision prioritizing payments to the towns for municipal services before other obligatory payments. Furthermore, as noted above, the PILOT rate in the West Orange agreement is less than the ordinarily applicable tax rate.

Also, West Orange would retain \$5.7 million for satisfaction of its COAH obligations and \$6.5 million for costs associated with relocating the department of public works and animal shelter facilities. Thus, the township retained almost half of the bond proceeds, \$19.7 million, and will utilize it for municipal purposes. In addition, counsel to West Orange has advised OIG that approximately \$9.9 million of the proceeds are to be used to pay for costs of issuance of the bonds, payment of capitalized interest and deposits to reserve funds. Thus, the remainder, \$10.7 million, will be available to provide financial assistance to the project. Counsel to West Orange advises that this assistance is necessary to defray extraordinary costs associated with remediation and related construction projects on the site.

In addition, Pearlman told OIG that the controlling law must be amended before the bonds for the Meadowlands Project could be issued. As noted above, S-1927, the bill that would

²⁰⁹ February 21, 2007 application to the LFB on behalf of West Orange.

²¹⁰ As noted above, there appears to be disagreement about the manner in which the towns' payments would be prioritized. EnCap's representatives told OIG that the financial agreements provide that the towns will receive their portion of the payment after all other payments (county and debt service) are made. Rutherford's official told OIG that its financial agreement provides for simultaneous payments for debt service and to the borough. He acknowledged, however, that EnCap believes that the debt service payments will be made first.

make the necessary changes, was stalled in the Legislature since November 2006 and did not pass both houses before the 2006-2007 session ended. Moreover, Pearlman told OIG that this type of PILOT arrangement has not yet been evaluated by the courts and he could not say whether a court would uphold the financial agreement even if bond counsels were to issue clean opinions concerning the bonds.²¹¹

N. Meetings with State Stakeholders

In April 2007, EIT Executive Director Hart initiated a series of meetings of the State stakeholders, including representatives of EIT, DEP, NJMC and the Attorney General's Office, and EnCap in order to learn and review the status of the Project and EnCap's then recent representation that it needed the State to subordinate its interest in one of its loans in order for EnCap to procure new funding.²¹² During these meetings, EnCap's representatives acknowledged EnCap's past failures with respect to its management and communication. EnCap's representatives also advised that State that the Project faced substantial cost overruns.

1. EnCap Acknowledgment of Mismanagement

The first meeting was conducted April 17, 2007. During that meeting, EnCap's newly appointed Senior Project Executive, Jim Dausch, acknowledged that EnCap's prior management had not handled the Project well and that better control over the construction and remediation

²¹¹ LFB Director Jacobucci told OIG it was the opinion of the LFB that the West Orange bond is neither identical nor substantially the same as EnCap's proposal.

²¹² At the start of the first meeting, Executive Director Hart told the group that he was concerned that the status of the Project was not known and that he did not want the EIT and the State to be put in a position where they would be required to make important decisions with insufficient information and/or at the last minute.

operations as well as more discipline, in general, was needed. Dausch said that a new management team that believed in being “open and direct” was brought in to replace the former team. The new team, however, had been involved only approximately two weeks at the time of the meeting.

2. Cost overruns and request for State to subordinate its interest

Also, before the April 17, 2007 meeting officially commenced, EnCap’s counsel²¹³ privately told the State representatives that the cost of remediation had increased by \$95 million and that, based on the new Project budget, DEP had been asked by EnCap to subordinate the collateral for its loan (10% of the PILOT revenues) in order for EnCap to receive an additional \$20 million from a new private lender. EnCap’s counsel told the State stakeholders that the Project would be halted if this did not happen.

Nonetheless, EnCap’s representatives did not discuss the \$95 million new cost during the meeting and did not provide data to support cost overruns. Rather, they said that they were preparing a financial statement that would explain all remediation costs. Pearlman told the group that there were three primary areas in which the Project has changed, thus causing a need for additional lenders. Pearlman said those areas were: incremental costs; the failure to successfully issue the PILOT bonds; and the failure to sell the “Northern Node”, a parcel of property that had been remediated and was ready for development, to a vertical developer.

²¹³ EnCap hired counsel to represent the company for the purposes of the OIG investigation.

Approximately one week later, EnCap's counsel told OIG that there was no longer a need for DEP to subordinate its loan because Cherokee said it would subordinate its loan instead. Despite this, during an April 30, 2007 meeting with State stakeholders, EnCap continued to press for DEP to subordinate its loan. When asked by OIG about the prior statement, that DEP was no longer needed to subordinate, EnCap's counsel told OIG that EnCap would prefer that the State, and not Cherokee, make this concession and that, despite Cherokee's willingness to act, it could "still ask" the State. Ultimately, although EnCap claimed that financial failure lay ahead if the State refused to comply with its request, DEP would not agree to the proposal and EnCap proceeded to obtain from a private source the funding it claimed was necessary, notwithstanding the State's refusal.

Also, EnCap did not have a complete financial statement at the time of the April 30, 2007 meeting; rather, it only had rough projections. It was still unable to substantiate the new costs and did not provide a dollar figure for the cost overruns, notwithstanding its representations, in private, that the cost overruns were \$95 million.

In June 2007, Sartor, EnCap's engineer, advised the State stakeholders that the remediation portion of the Project was approximately \$72 million over budget. He did not, however, provide data sufficient to substantiate the increase. Sartor has only generally explained that the increase is a result of the increased costs associated with the fill and the GIP as well as other factors, including Project delay. In fact, Sartor said that his estimates were obtained by using the then current costs for services and supplies and multiplying those figures by the number of months anticipated to complete the Project. He did not obtain any new price quotes.

Since then, OIG has learned that the State entities have spent considerable time attempting to elicit a complete and accurate budget from EnCap officials. To date, it appears that EnCap has not provided satisfactory data and supporting documents that could support a budget upon which the State can rely. OIG was, however, advised by DEP personnel that, to date, EnCap has incurred \$128,735,037 in remediation related expenses that were eligible for payment with the proceeds of the EIT/DEP loans, as follows: EIT \$64,367,616; DEP \$64,367,421.

Furthermore, during the April 2007 meetings, Pearlman and Wisler reiterated EnCap's continued interest in the issuance of the PILOT bonds. Pearlman and Wisler told OIG that they and EnCap believe that the PILOT bond revenue, which was at one time intended to ensure both the completion of the Project and EnCap's profit, is now required to help ensure that the Project will simply be completed and that amount of the cost overruns will totally consume EnCap's profits, which were at one time anticipated to be \$75 million. However, because of the lack of support for the alleged cost overruns and EnCap's past history of falsely insisting that the State's commitment of funds or rights was essential to the Project going forward, State representatives can not be certain that EnCap's representatives' statements are true or perhaps just a negotiating stance intended to force the State into agreement to remove any roadblocks to the issuance of the PILOT bonds.

O. Requisitions for Payment of Ineligible Expenses

Pursuant to the EIT/DEP loan, EnCap is entitled to be reimbursed for administrative costs related to remediation for the Project. According to the EIT/DEP loan documents, the total

amount of allowable administrative costs is capped at three percent of the allowable building costs, which in the case of the EnCap Project is \$5,175,729. Certain costs that were incurred by EnCap and reimbursed by the State as administrative costs may in fact have been ineligible for reimbursement.

OIG's review of the requisitions submitted by EnCap to the State in support of its requests for reimbursement for administrative expenses²¹⁴ revealed expenses that appear to have been for work that may have not been related to remediation and, as the proceeds of the EIT/DEP loans are to be disbursed as payment for only approved costs related to remediation, such expenses could be deemed ineligible for reimbursement.

OIG's review of the requisitions, which was not exhaustive, revealed requests for reimbursement for work performed on behalf of EnCap by, at a minimum, four separate lobbying and/or public relations firms in the amount of approximately \$360,000.²¹⁵ The invoices for these firms were submitted by EnCap without detailed supporting documentation showing how these services were related to remediation. The evidence reviewed by OIG in conjunction with its examination of multiple aspects of the Project indicated that EnCap retained the services of lobbyists and public relations firms to advocate on behalf of legislative changes that EnCap pursued in furtherance of the Project. The requisitions and invoices, however, are devoid of information explaining the services provided by the lobbying and public relations firms and the

²¹⁴ The requisitions set forth the dollar value and categories of work performed for the Project and for which reimbursement from the proceeds of the EIT and DEP loans is sought. An EnCap official, commonly Hockensmith, would certify that the representations contained in the requisitions are "in accordance with the terms of the project, and that the reimbursement represents the stated share due which has not been previously requested, and that an inspection has been performed and all work is in accordance with the terms of the award."

²¹⁵ This figure represents reimbursements requested by EnCap for work performed by entities that were readily recognizable as lobbying/public relations firms.

extent to which those services were related to remediation, if at all. Indeed, some of the invoices merely sought payment for a “retainer” fee without providing further explanation or documentation. As such, it appears that the costs associated with lobbying and public relations efforts on behalf of EnCap could have been ineligible for reimbursement or, at a minimum, there was insufficient evidence to support the use of State funds to reimburse these costs.

Based upon interviews with a number of DEP personnel, it is evident that in the past the Trust and Fund loans were issued for projects that were less complex and for work that was well established and familiar to the DEP. Specifically, the prior projects did not typically require the pursuit of legislative changes, such that lobbying or public relations firms would be involved. Accordingly, it appears that the DEP had not anticipated that such expenses would be submitted for reimbursement and thus were not prepared to identify such costs when reviewing payment requisitions. Indeed, the regulations governing the payment of administrative costs do not contemplate expenses of this type.²¹⁶ Based upon interviews with DEP personnel, it also appears that there may have been an assumption that the lobbying and public relations firms were employed by EnCap to facilitate required public hearings, which could be a reimbursable expense. Regardless, the invoices did not document the work performed by these firms.

OIG met with the Bureau Chief of the Bureau of Administration and Management in DEP, which was responsible for reviewing EnCap’s requisitions. The Bureau Chief was not personally responsible for the line item review of the requisitions. Upon discovering, during the course of OIG’s investigation, that the above-referenced payments had been made, the Bureau Chief initiated an internal review of the regulations governing the payment of administrative

²¹⁶ N.J.A.C. 7:22-5.11

costs, with an eye toward specifically excluding ineligible lobbying efforts, and revamped the manner in which personnel shall review such costs.

In addition, in support of some of its requisitions, EnCap submitted billing records for its attorneys. This complicated the reimbursement process, as the same attorneys provided services with respect to both the remediation and vertical development stages of the Project.²¹⁷ The invoices, which were voluminous and represented work performed by several attorneys over a period of years, were sufficiently detailed to show that some of the work related directly, and apparently exclusively, to vertical development and other non-remediation matters, including but not limited to work related to the negotiation of vertical development sale contracts.

EnCap did not, however, explicitly distinguish those attorney charges for which it sought reimbursement from those for which it did not seek reimbursement. Neither the requisitions nor their supporting documents provided a method to identify the attorney services for which EnCap sought reimbursement. Similarly, DEP's payment records do not provide evidence that each of the line items included in the invoices was reviewed or that any of the costs associated with vertical development was disallowed. Based upon interviews with DEP personnel, it appears to OIG that DEP was not prepared to document its analysis in this regard or simply did not anticipate this issue. Consequently, it is impossible to determine whether a detailed line item review of the attorney bills was conducted by DEP and whether ineligible work was excluded from payment.

²¹⁷ As noted above, unlike the typical project for which Trust and Fund loans have been issued, the EnCap Project involved both remediation and vertical development and, consequently, EnCap's lawyers handled both remediation and non-remediation related matters,

When Wisler was asked whether work that was related solely to vertical development, and not to remediation, would be eligible for reimbursement with EIT/DEP funds, he said it would not be.²¹⁸ Wisler was not able to provide a satisfactory explanation as to why EnCap sought reimbursement for costs incurred by EnCap for work which, based on his representation, would be ineligible for reimbursement.²¹⁹

EnCap's representatives suggested to OIG that the reimbursement of these expenses is ultimately not problematic to the State, as there is a cap on reimbursement by the State for administrative expenses. They told OIG that, because the cap was reached early in the Project²²⁰, there were millions of dollars of eligible administrative costs incurred by EnCap that could not be reimbursed by way of the State loans. The implication, therefore, is that there was ultimately no harm to the State because the State paid no more than it would have even if only eligible expenses had been reimbursed.²²¹ Nonetheless, the requisitioned costs appear to be ineligible for payment, pursuant to the bond documents, DEP regulations and EIT/DEP policy. Thus, by submitting requisitions for work that appeared on their face to be ineligible for reimbursement or were, at a minimum, commingled with clearly eligible remediation-related

²¹⁸ Notwithstanding this, Wisler contended that because PILOT bond proceeds would be used to pay down bonds that were issued to provide funding for remediation costs, there would be a "reasonable nexus" between the remediation portion of the Project and efforts by lawyers and lobbyists to achieve the PILOT bonds. Wisler added that, because development-related costs are not eligible for payment from the proceeds of the EIT/DEP loans, payment of ineligible costs would be sought from the proceeds of the BCIA Series C and D bonds.

²¹⁹ Wisler was unable to explain this despite having been advised by OIG weeks before the interview that he would be asked questions about this very subject and notwithstanding the fact that EnCap had been submitting such requisitions for a period of years.

²²⁰ The bulk of the administrative line item was expended by June 2005. The total line item, of which the majority of the billed expenses appear to have been appropriately reimbursed, is approximately \$5.17 million.

²²¹ Hockensmith told OIG that EnCap's counsels advised him of the concept that the State suffered no harm despite the submission of requisitions for ineligible expenses.

costs, and to the extent payment was accepted these costs, EnCap apparently disregarded its obligation to seek reimbursement for only these expenses for which it was entitled to reimbursement. Moreover, this effectively circumvented the internal controls established by DEP and EIT to ensure that payment is made for only remediation-related expenses. EnCap's argument that the State suffered no harm is nothing more than a post hoc rationalization.

VIII. MANAGEMENT OF THE PROJECT

A. EnCap Staffing at the Time of Groundbreaking

The Phase 1 Material Conditions were deemed satisfied on February 12, 2004 followed by “groundbreaking” on the site in May of 2004. At this time, EnCap’s staff was limited. Gauger told OIG that the EnCap staff consisted of three or four people, primarily himself and Hockensmith from the time of submission of the SOQ until May 25, 2004 when Gauger formed a new entity called Cherokee Northeast, LLC, to serve as the employer for people working on Cherokee projects through-out New Jersey.²²² Gauger told OIG that he and all the employees of Cherokee Northeast actually worked on all of Cherokee’s projects in New Jersey and that, each employee’s time was apportioned and billed to the appropriate project. During the year 2005, Gauger worked primarily on the Project while during other years his time was more evenly divided between the Project and Cherokee work in other parts of the state. Gauger stated that after Cherokee Northeast was formed, the number of employees working on Cherokee projects in New Jersey rose from the original three to four to as many as 10 to 20.

Gauger told OIG that the majority of work to be done on the Project was contracted to outside vendors stating that his management style is to delegate. Gauger told OIG that as the President and Manger of EnCap, his primary role was to make “most of the important decisions” and that he was involved in hiring the primary contractor to do the remediation work, but was not involved in selection of the subcontractors. He said that most of the work Cherokee Northeast

²²² Cherokee through its affiliates and subsidiaries is involved in redevelopment projects in the State of New Jersey that include, but are not limited to, work in the following areas: Camden, Pennsauken, Asbury Park, Porete Avenue North Arlington, and the Hackensack Meadowlands.

employees were performing on the EnCap project was finance, design, and creation of a master plan. Gauger told OIG that he had relied on the advice of outside consultants particularly engineering and environmental consultants, ET/IT and Paulus, Sokolowski & Sartor (PS&S). Gauger said that the number of outsourced personnel involved was “pretty large” with four or five people from PS&S and three or four people from DeCotiis working on the Project. Gauger said that EnCap had relied on consultants, DeCotiis and PS&S, for communication with the NJMC and DEP, and that looking back he said EnCap employees themselves should have focused more on these communications rather than rely on consultants. Gauger also told OIG that EnCap should have done more “due diligence and underwriting in house.”

B. Landfill Closure Oversight and Management Shortfalls

1. Relationships Between Fill Providers and EnCap

a. OENJ and Procurement of Below Barrier Fill

EnCap has represented that a majority of the cost over-runs are a result of the cost of fill. Accordingly, the various fill contractors and the executed contracts have been examined. OIG’s investigation has revealed that several of EnCap’s fill providers have a relationship with EnCap or its representatives.

On December 1, 2002, EnCap entered into a contract with OENJ whereby OENJ agreed to provide a minimum of 1,400,000 cubic yards of below barrier fill for the project and OENJ would provide the services pertaining to billing, weighing, inspecting and testing all fill. OENJ

(now known as RMI²²³) and EnCap are both owned by subsidiaries of Cherokee Investment Partners II, L.P.²²⁴ EnCap has represented that it always intended to contract with OENJ for the below barrier fill due to OENJ's experience with the Bayonne Project²²⁵ and the Garden State Mall in Elizabeth.

Under its contract with EnCap, OENJ was required to pay EnCap a \$5 per cubic yard tipping fee²²⁶ for first 1 million cubic yards of below barrier fill delivered to the site and \$4 per cubic yard for the remaining fill up to 1.4 million cubic yards. Any additional below barrier fill would be delivered for a tipping fee of \$2.67. OENJ generates its profit by charging fees for collecting and disposing of fill that exceeds the tipping fees paid to EnCap.

According to EnCap, OENJ was unable to consistently supply the contractually required amounts of fill. Despite this, EnCap stated that termination of the agreement was not feasible as OENJ was familiar with the project and the fill requirements and that locating a new supplier would cause delays. Under an amended agreement with EnCap, OENJ was still obligated to provide fill but no longer had the exclusive right to do so. As such, EnCap also obtained below

²²³ RMI is discussed above.

²²⁴ Cherokee Meadowlands, LLC is the majority owner of EnCap. Cherokee OENJ, LLC owns RMI (which was previously called OENJ). CIP II owns both Cherokee Meadowlands, LLC and Cherokee OENJ, LLC.

²²⁵ As discussed earlier in this Report, OIG was told by Bayonne officials that the site was filled too high. OIG understands that more profit is generated by overfilling the site.

²²⁶ Contractors looking to get rid of construction debris or other types of fill are willing to pay a tipping fee to an entity that will accept the fill as opposed to disposing of the materials themselves.

barrier fill from other suppliers. As EnCap and OENJ are owned by CIP II, both entities stand to profit from the Project.²²⁷

b. LIR Fiore and Procurement of Above Barrier Fill

In early 2007, EnCap reported to State representatives²²⁸ that the projected cost of the remediation portion of the Project had increased by approximately \$72,000,000.²²⁹ EnCap indicated that because of the increased costs, EnCap would not be able to continue the Project with only the EIT/DEP loan funds; that for a variety of reasons, no private financing was available to EnCap; and that approval of securitization of bonds related to EnCap's Financial agreements with the municipalities and the related almost immediate release of \$75,000,000 of EnCap profit were essential to the completion of the project.²³⁰ There had been hesitation on the part of responsible State officials in authorizing the securitization of the PILOT bonds. Securitization was viewed by some State officials as clearly beneficial to EnCap but potentially a risk for the municipalities, particularly if EnCap were to realize the profits and then leave the Project. The added pressure to authorize securitizing the PILOT bonds created by the alleged but

²²⁷ As discussed in Section III, after EnCap was awarded the project Cherokee Investment Partners II acquired a 65% ownership. OIG is not aware whether agreements between EnCap and Cherokee Investment Partners or CIP II required EnCap to subcontract with other entities owned by any of the Cherokee entities or any affiliated companies.

²²⁸ By this time, officials of the various State entities involved in the project had recognized the disadvantage of not including all State groups in meetings with EnCap representatives, and all groups were represented. In addition, OIG was invited to attend that meeting.

²²⁹ In April 2007, EnCap informed State officials that the remediation portion of the Project was approximately \$95,000,000 over budget. However, weeks later, EnCap representatives reported that the original estimate of cost increases had included \$13,000,000 that was associated with the cost of development rather than remediation, and thus the alleged projected cost overruns for remediation were decreased.

²³⁰ It was during the ensuing conversations that EnCap finally revealed that Gonda's money was not available to them and that there was a limit of \$25,000,000 on Cherokee's financial support for the Project that had already been reached. During these conversations, EnCap representatives also revealed that agreements with some of the private developers were not finalized.

unsupported need for additional funds to complete the Project was greeted with skepticism by many of the government representatives.²³¹

Although EnCap representatives did not substantiate the basis for the alleged cost overruns, during subsequent meetings, EnCap consultants told State representatives, including OIG, that a major component of the projected cost overruns was an alleged substantial increase of the cost of above barrier fill that was to have been provided under EnCap's contract with LIR Fiore. During the next few months, EnCap consultants represented to State officials that an additional approximately \$17,000,000 was required for the delivery of the fill materials specified in the LIR Fiore contract; and thus, the total projected cost for these fill materials was over \$31,000,000.²³² When reviewing documents, OIG learned that this amount was almost eight times the cost for above barrier fill in a contract initially negotiated by EnCap with a different fill provider; four times as much as the original LIR Fiore contract amount; and more than twice the amount in a budget submitted by EnCap in support of the EIT/DEP financing in December 2005.²³³

To date, EnCap representatives have not provided the State with evidence to substantiate either the originally anticipated fill costs or the purported budget increases. That, plus statements

²³¹ By this time, EnCap had withdrawn its request of the LFB that it consider authorizing the issuance of the PILOT bonds. However, EnCap continued to press the issue.

²³² According to the documents submitted by EnCap to the State on June 12, 2007, \$27,756,000 was the forecast of the cost related to the above barrier fill required to complete the Project. This number, according to Table 6, did not include \$4,065,000 that was reported in the documents as paid to the fill provider prior to November 2005, and thus, it appears that the total projected cost for above barrier fill for completion of the Project is \$27,756,000 + \$4,065,000 = \$31,821,000.

²³³ According to the documents submitted by EnCap to the State on June 12, 2007, the original budget for above barrier fill as of the December 2005 closing was \$10,235,000 and according to Table 6 \$4,065,000 had already been paid to the above barrier fill provider prior to November 2005, totaling \$14,300,000. The LIR Fiore contract price as of October 2005 was \$14,149,850. As of April 9, 2004 the contract price was \$8,000,000.

contained in a report submitted to OIG by a separate law firm retained by EnCap, Friedman, Kaplan, Seiler & Adelman, LLP (Friedman Report)²³⁴ purportedly to review fill issues (and perhaps other matters), the alleged increases in the cost of fill, concerns of State representatives about the legitimacy of the purported but unsupported increased cost projections, historical concerns about the trustworthiness of EnCap representations, and EnCap's connection of the purported cost increases to the release of the PILOT bond funds, led OIG to review evidence regarding the circumstances of EnCap's above barrier fill contract.

In sum, OIG discovered as a result of its review that in early 2004, EnCap entered into a multi-million dollar contract with LIR Fiore, a newly formed company whose principals had never provided fill of the quality and quantity that EnCap required, on the suggestion of EnCap's attorney, Eric Wisler, who had a long-standing personal and business relationship with one of the LIR Fiore principals. The contract was entered without meaningful due diligence on EnCap's part and without a credible basis for EnCap to believe that LIR Fiore could perform under the contract. The evidence gathered during OIG's investigation indicates that EnCap continually agreed to price increases to the contract until the summer of 2007, when a new working group of State and EnCap representatives and financial advisors began to analyze LIR Fiore's invoices and refused to authorize the payment of four LIR Fiore change orders. At that point, LIR Fiore sued EnCap. At best, EnCap's conduct throughout this contract demonstrates that EnCap mismanaged this aspect of the project.

²³⁴ During OIG's review, EnCap retained a separate law firm, Friedman Kaplan Seiler & Adelman, LLP, (Friedman) whose responsibilities purportedly include representing EnCap in the OIG investigation. Friedman represented to the State that it was asked to review fill issues. OIG requested and Friedman provided OIG a report of its conclusions and facts that Friedman determined supported those conclusions (Friedman Report). OIG does not accept the Friedman Report as definitive of any of the issues. Nor does OIG accept the recitation of facts in the report as accurate. To the extent that OIG relies on the Friedman report, it is to address statements attributed to EnCap representatives or facts not at issue.

i. History of Contract to Provide Above Barrier Fill

As discussed elsewhere in this report, the above the barrier fill protocol for the Project was approved on November 7, 2002 after discussions among EnCap's attorney's and engineers and DEP representatives. According to the protocol, the above barrier fill was required to meet the "unrestricted" use standard, the most stringent standard required in New Jersey. It also established the types of fill materials that are acceptable for placement above the barrier cap and sets forth the sampling and testing procedures and criteria to be employed when evaluating potential fill materials for the Project. EnCap's representatives understood at least by November 2002 that fill meeting the unrestricted standard might be difficult to find, that the project would require huge quantities of it, and that the amount of testing required to find and certify to the condition of the fill could be expensive.

According to the Friedman report, as early as April 2002, EnCap began negotiating with fill providers for delivery of above barrier fill.²³⁵ The negotiations were unsuccessful until June 6, 2003, when EnCap entered into an agreement with a contractor (not LIR Fiore, but a company whose prior business had included supplying large amounts of fill) to supply all above barrier fill needed for the Project. According to the Friedman report the contract price was \$3.9 million, but only two months after the contract was signed, the provider requested an increase in the contract price to over \$9,000,000.

²³⁵ According to the Friedman report, from April 2002 until December 1, 2002, officials from EnCap attempted to negotiate an agreement with a fill provider who had leased property from the NJMC with the expectation that it could generate fill material on the site that could be used by EnCap for the Project. However, according to the Friedman report, there were concerns that the material produced by this provider would not meet the specifications of the Above Barrier Fill Protocol and, at one point, the provider lost the required DEP permits for this type of operation, and thus, no agreement between EnCap and this provider was ever reached.

Documents supporting this alleged increase were not provided by EnCap to OIG, but according to the Friedman report the increase was attributable to the fill provider's belief that certain materials that it had available were suitable for use as above the barrier fill on the Project, but, in fact, those materials were not permitted under the fill protocol. The Friedman report stated that once the fill provider realized its error, the fill provider advised EnCap that it would not meet its contractual obligations to provide the above barrier fill at the contract price; and that unable to negotiate an acceptable contract amendment with the fill provider, EnCap declared the provider in default of its contract. The evidence indicates that the contract was terminated in the Winter of 2003 or early Spring of 2004.²³⁶

At least as early as January 2004, at the suggestion of EnCap attorney Eric Wisler, Hockensmith and Gauger spoke to Leroy Robinson, the President of LIR Consulting,²³⁷ and/or Theodore "Ted" Fiore, the President of T. Fiore Recycling, about the possibility of providing above the barrier fill to the Project. On February 4, 2004, EnCap signed a letter of intent for the "Supply of Clean and Miscellaneous Fill" with LIR Fiore, whose principals were Robinson and Fiore.

During the course of OIG's review, OIG learned that LIR Fiore was formed as a Limited Liability Company between LIR Consulting, Inc. (LIR Consulting) and T. Fiore Recycling and

²³⁶ On May 18, 2004, the fill provider sued EnCap charging breach of contract; in February 2005 EnCap settled with the fill provider.

²³⁷ LIR Consulting was formed in July 2000 by Leroy Robinson, who serves as the company's President. According to Robinson, LIR Consulting has represented some municipalities in relation to Affirmative Action needs and consent decrees with the NAACP, and also performs janitorial services, construction services and soil brokerage.

Demolition, Inc. (T. Fiore Recycling). According to the LIR Fiore operating agreement, Leroy Robinson is the Manager of LIR Fiore and the President of LIR Consulting and Ted Fiore is President of T. Fiore Recycling. The operating agreement further indicates that LIR Consulting has a 51% membership interest and T. Fiore Recycling has a 49% interest in LIR Fiore. LIR Fiore's Certificate of Formation filed with the State Treasurer's Office indicates that the Company was formed on February 2, 2004, only two days before EnCap representatives signed the letter of intent to hire LIR Fiore to supply fill to the Project.²³⁸ According to Robinson, LIR Fiore was formed solely for the purpose of entering the contract with EnCap, and thus the Company had no experience as a fill provider.²³⁹

Approximately two months later, on April 9, 2004, EnCap entered into a contract with LIR Fiore to be the sole source provider of clean and miscellaneous fill including approximately 2.5 million cubic yards of various types and quantities of above barrier fill as specified in the November 2002 Above Barrier Fill Protocol for a lump sum price of \$8,000,000. Indicating that EnCap representatives realized that it was dealing with a small start-up company, EnCap agreed to pay LIR Fiore a fixed amount of just over \$163,000 of the contract amount monthly for 49 months regardless of the amount of fill LIR Fiore delivered. According to the Friedman report, EnCap agreed to this arrangement to assure that LIR Fiore could pay the truck drivers it used to

²³⁸ LIR Fiore was incorporated as an LLC on February 2, 2004. Leroy Robinson signed the certificate of formation for LIR Fiore on January 29, 2004.

²³⁹ OIG interviewed Robinson during the course of the investigation, but Fiore was not available. During the course of OIG's review, Robinson was arrested and charged by the United States Attorney's Office with unlawfully engaging in money laundering transactions. As far as OIG is aware, the charges do not involve conduct that is the subject of OIG's review, but OIG is not privy to the evidence supporting the criminal charges.

deliver fill to the site since EnCap was concerned that LIR Fiore either did not have the financial liquidity to pay them or the ability to finance the payments.²⁴⁰

Although the newly formed LIR Fiore had no history of providing fill on which EnCap could rely, the evidence indicates that Gauger and Hockensmith had evidence that the principals of LIR Fiore had only limited experience in providing fill. In an independent report (the R.W.Beck Report)²⁴¹ prepared for and submitted to EnCap on April 26, 2004 and provided to the EDA with other loan documents, EnCap's independent engineer diminished the significance of their experience. The R.W. Beck Report concluded that the materials that are anticipated to be delivered pursuant to LIR-Fiore's contract with EnCap are significantly greater than the quantities delivered by T. Fiore Recycling to its recent and largest customers.²⁴² Furthermore, although it appears that Robinson had some experience with brokering or delivering fill prior to

²⁴⁰ According to the Friedman report, there was to be reconciliation every six months. The evidence indicates, however, that AIG, issuer of the performance bond and authorized to approve all payments, objected to this practice and within six months of the execution of the contract, an October amendment to the contract, discussed below, ended this practice. LIR Fiore was to thereafter invoice for the actual amount of fill delivered to the site each month.

²⁴¹ R.W. Beck, Inc. was retained by EnCap Golf Holdings, LLC to act as an Independent Engineer and R.W. Beck issued two reports in connection to the Project: Independent Engineer's Report Landfill Remediation and Site Development Project EnCap Golf Holdings, LLC. dated April 26, 2004 (R.W. Beck Report) and Update to Independent Engineer's Report Landfill Remediation and Site Development Project EnCap Golf Holdings, LLC. dated November 11, 2005 (Updated R.W. Beck Report). According to EnCap's attorneys, the R.W. Beck Report and Updated R.W. Beck Report analyzed the Project and the assumptions underlying key contracts and the R.W. Beck Report was attached as an Exhibit to the Preliminary Official Statements supporting the 2004 EDA financing and the Updated R.W. Beck Report was attached to the 2005 EIT financing documents. Unless otherwise indicated, any reference to the R.W. Beck report in this report shall refer to both the R.W. Beck Report and the Updated R.W. Beck Report.

²⁴² R.W. Beck conducted a telephone survey of some of T. Fiore's recent and largest customers who reported that recent projects for the delivery of fill similar to the services to be provided to EnCap have included:

- Supplying 35 thousand yards of recycled concrete aggregate (RCA) and fill;
- Providing \$70,000 worth of RCA, dense graded aggregate (DGA), subbase and stone; and
- Processing 30,000 yards of construction waste and supplying 10,000 yards of RCA.

While the report indicates that LIR Fiore supplied these quantities to customers, interviews with Robinson as well as previous statements made in the R.W. Beck report indicate that the quantities of fill were delivered by T. Fiore Recycling and not the joint venture, LIR Fiore.

the EnCap contract, the evidence suggests that the fill brokering experience of both Robinson and his company, LIR Consulting, was limited, of a short duration, and certainly did not involve obtaining and delivering the magnitude of high grade above barrier fill material that is required pursuant to the EnCap contract.²⁴³

Despite knowledge of the limited relevant experience of T. Fiore, LIR Consulting, and their principals, Wisler suggested them as fill providers to EnCap officials, and EnCap entered into a sole source contract for the delivery of all of the above barrier fill -- approximately 2.5 million cubic yards -- with the newly formed LIR Fiore on April 9, 2004. Although the R.W. Beck report is dated April 26, 2004, two-and-one-half weeks after the contract between LIR Fiore and EnCap, the report indicates that the independent R.W. Beck engineer had discussed LIR Fiore's limitations with EnCap principals before completing the report, and that EnCap officials stated a willingness to go ahead with the LIR Fiore contract, cynically admitting that EnCap could mitigate problems the lack of experience might cause in the future with the AIG Solid Waste Closure Policy. According to the Beck report:

...EnCap believe[d] that there are other companies in the area who could provide similar services in the event that LIR Fiore is unable to meet its contractual obligations. EnCap further advise[d] that the Solid Waste Closure policy to be

²⁴³ Robinson told OIG that he first learned about the business of fill brokering from Fiore in 2001 or 2002 and explained that prior to the joint venture with T. Fiore Recycling, he worked with Fiore finding buyers for fill and assisting him in getting demolition work. Robinson also told OIG that he could not recall the date that he brokered his first load of fill, but that he did not broker any fill while he was a member of the Board of the Essex County Utilities Authority (ECUA). Robinson stated that he was on the ECUA Board until 2002; but the Friedman report indicates that Robinson was on the ECUA Board until 2003. As stated earlier, LIR Consulting was formed in July 2001 by Leroy Robinson who serves as the company's president. Robinson also stated that he personally brokered fill to the Overpeck landfill and worked for other contractors disposing of fill. Robinson stated that his joint venture with Fiore began in 2004 during his last year as an employee of the New Jersey Turnpike Authority. Although Robinson told OIG that he stopped working for the Turnpike Authority in 2004, records reflect that his retirement was effective July 1, 2005.

issued by AIG will provide funds required to supplement or mitigate LIR-Fiore's performance.

Approximately six months into the contract period, in October 2004, two letter agreements amended the EnCap and LIR Fiore contract and increased the total contract price from \$8,000,000 to \$9,896,367. This was only months after EnCap had terminated a contract with an experienced fill provider who requested roughly the same amount (\$9 million) allegedly because the price was too high. The amendments specified that there were "Unexpected Problems" and "Unanticipated Events," resulting in, among other things, the requirement for a greater amount of fill, including fill not originally contemplated, increased testing costs and curtailment or stoppage of fill material deliveries due to site constraints.²⁴⁴

The amendments to the contract with LIR Fiore also provided for, among other things, a lump sum, up-front payment in the amount of \$100,000 to LIR Fiore in return for LIR-Fiore's attempt to obtain from DEP an amendment lowering the standard for the Above Barrier Fill Protocol from the "unrestricted" to the "residential" standard.²⁴⁵ EnCap representatives, including their engineers, had approached DEP several times in the past trying to convince DEP

²⁴⁴ Robinson told OIG that, in part, the reasons for the requirement for a greater amount of fill and for fill not originally contemplated was because, respectively, EnCap or its consultants turned away fill material due to site constraints and because of the request for a different type of material for a roadway being constructed on the project site. Robinson told OIG that the request occurred a few days after he told an EnCap consultant that he believed they were using the wrong material for the roadway.

²⁴⁵ The October 27, 2004, EnCap/LIR Fiore letter agreement states that EnCap has requested that LIR-Fiore take primary responsibility for obtaining an amendment of the Fill Protocol, dated April 7, 2004, governing the testing and receipt of fill materials to be placed above the barrier layer and in areas where EnCap will not construct remedial engineering controls. However, the Above Barrier Fill Protocol is dated November 7, 2002 and the amendment to the Above Barrier Fill Protocol is dated April 29, 2004, while the below barrier fill protocol is dated April 7, 2004. Nonetheless, the current LIR Fiore contract, which purportedly restated the letter agreement, refers to amending the November 7, 2002 Above Barrier Fill Protocol. The current contract states that LIR Fiore shall take primary responsibility for providing historical analytical data for the protocol amendment and in consideration for this effort, EnCap has previously paid LIR Fiore a lump sum up-front payment in the amount of \$100,000. The current contract also states that while EnCap and LIR Fiore shall work together to further prepare and submit the protocol amendment, EnCap shall take primary responsibility for submission to DEP.

to lower the standard in the Above Barrier Fill Protocol from “unrestricted” to “residential,” but had been uniformly rejected by DEP. Nonetheless, EnCap made the payment to LIR Fiore. EnCap made the payment without specifically outlining in the contract the specific services to be performed by LIR Fiore. The request to DEP, for which EnCap paid LIR Fiore \$100,000, was rejected by DEP.

OIG asked Robinson if he knew why EnCap had paid LIR Fiore to attempt to convince DEP to lower the standard. Robinson said he did not. Wisler told OIG that it may have been because EnCap officials believed that LIR Fiore would have a better chance of convincing DEP to amend the Above Barrier Fill Protocol than EnCap would since EnCap was the permittee that had previously agreed to the protocol. Although the October contract amendment indicated that LIR Fiore had primary responsibility for obtaining the amendment, the current contract states that while EnCap and LIR Fiore shall work together to further prepare and submit the protocol amendment, EnCap shall take primary responsibility for submission to DEP. The evidence indicates that LIR Fiore was already paid the \$100,000 at the time the current contract was executed. Without specifically explaining why EnCap made the \$100,000 payment to LIR Fiore, the Friedman report, indicated, in part, that LIR Fiore, despite its repeated statements of a full understanding of the Above Barrier Fill Protocol during contract negotiations, warned in Summer 2004 that unless there was a change in the Above Barrier Fill Protocol the costs of the project would escalate and there would be serious delays in the delivery of clean fill. The Friedman report stated that as a result LIR Fiore would take responsibility in coordination with EnCap for seeking an amendment and that because EnCap, like LIR Fiore, wanted the Above

Barrier Fill Protocol to be amended from the “unrestricted” standard to the “residential” standard, EnCap would contribute \$100,000 toward LIR Fiore’s efforts to obtain an amendment.

One year later -- one-and-one-half years after the date of the original contract -- on October 28, 2005, the EnCap/LIR Fiore contract was again amended to increase the amount to be paid to LIR Fiore. The new total contract price was almost double the original contract price: \$14,149,850. This contract amendment included the October 2004 letter amendments as well an increased cost alleged to be for testing, for an increase in the amount of fill required, and for an increase in the price for fill.²⁴⁶

Over the course of the following year, four change orders to the LIR Fiore contract were issued and were initially approved for payment by EnCap. In the first of these, in January 2006, Gauger approved a change order for approximately 112,000 cubic yards of above barrier fill for an additional cost of over \$280,000. Approximately nine months later, in September 2006, Gauger approved three more change orders that increased the cost of various types of above barrier fill to over \$580,000.

All four change orders alleged that current unexpected changes in the fill market were the reason for the cost increase. However, the evidence indicates that the stated explanations may not have been the reason for the increased price. Robinson told OIG that the price increased

²⁴⁶ The amount of fill material increased from 2,736,000 cubic yards and 65,000 tons to 2,887,000 cubic yards and 115,000 tons. The Friedman Report indicated that there was no unit price for the various fill materials included in the April LIR Fiore Contract Exhibit A because the contract was for a fixed price, but could be averaged to \$2.85 per cubic yard for each type of material. The unit price increase for the fill materials in the current LIR Fiore Contract varied from as little as \$2.45 to as much as \$16.00 for the various materials.

because he had intended to produce fill at a blending and screening facility Robinson was to construct in an area at or near the Project site. Robinson said that EnCap had failed to comply with a contract requirement to provide the area for the blending. Robinson continued that the increase in the amount he was charging EnCap for the fill was associated with the cost of transporting it from a vendor in Pennsylvania since he could not find it in New Jersey²⁴⁷. According to the Friedman report, Hockensmith understood that a reason for the increase in price of common fill, which was the material that was the subject of three of the change orders, was due to the lack of a soil blending operation on the Project site where LIR Fiore intended to create clean common fill.²⁴⁸ All four change orders were approved by EnCap and then DEP in the form presented in late January 2007.²⁴⁹

However, before the funds to pay the change orders were released, the change orders were discussed at a “working group” meeting of State and EnCap representatives whose responsibilities include providing more scrutiny to EnCap invoices.²⁵⁰ A decision was made not to authorize payment to EnCap for the LIR Fiore change orders. Rather, the working group decided to directly pay the vendor from whom LIR Fiore had purchased the fill, but had not yet

²⁴⁷ According to the change order for the vendor that provided the fill to LIR Fiore the vendor is located in New Jersey.

²⁴⁸ The fourth change order involved topsoil. The Friedman report also stated that Hockensmith explained that EnCap’s and LIR Fiore’s belief that the latter could provide clean fill at the contract price was based in part on LIR Fiore’s ability to build a soil blending operation on or at the site that would allow LIR Fiore to mix and screen soils to create fill that met the clean fill protocol, which presumably includes topsoil.

²⁴⁹ The change orders were initially documented in a “Fill Order” signed by both Gauger and Robinson. The change orders were later documented in a “Contract Modification Proposal and Acceptance” form in early January 2007, which were subsequently reviewed and approved by the DEP between January 25, 2007 and January 30 2007. DEP must approve the change order before funds from the DEP/EIT loan may be used to reimburse the cost of the change order.

²⁵⁰ According to the Friedman report, AIG refused to approve change orders 1, 2 and 3, but approved and released a partial payment toward change order 4. DEP representatives told OIG that they understand that AIG did not approve any payments to EnCap for the LIR Fiore change orders.

been paid.²⁵¹ According to a change order for this vendor, direct payment was “. . . necessary in order to make [the vendor] whole and thus allow the project to use [the vendor] to satisfy current and immediate fill needs for the project. [The vendor] is a large publicly traded company which the project must work with on an ongoing basis in order to maintain a reliable source of fill to the project as the project proceeds.” In June 2007, EnCap withdrew three of the change orders from consideration and by August direct payment to the vendor was approved by all appropriate State parties. OIG was told by DEP representatives that, to date, EnCap has not requested payment for the fourth change order.

During the summer of 2007, LIR Fiore sued EnCap alleging breach of contract and unjust enrichment. Specifically, the complaint alleges, in part, that EnCap has failed and refused to pay LIR Fiore the agreed upon price for material that was supplied to EnCap pursuant to the agreement. According to the complaint, LIR Fiore is seeking from EnCap \$1,242,362 as well as other unspecified damages.

Although representatives from both EnCap and LIR Fiore have offered several reasons for the increase in the amounts EnCap agreed to pay to LIR Fiore, none of the reasons sufficiently demonstrates that the original LIR Fiore contract was reasonable. While the purported fill budget increase provided to the State is allegedly based upon calculations by an engineer who said he considered, in part, several quotes provided to him by EnCap from fill

²⁵¹The fill associated with the three change orders withdrawn by EnCap was provided by one fill provider, who was ultimately paid for the fill, while the fill associated with the fourth change order was provided by another fill provider and, as stated above, OIG was told that EnCap has not requested payment for this change order. As discussed elsewhere in this report, the “working group” consisted of representatives of EIT, DEP, AIG and EnCap, and was charged with reviewing each of EnCap’s requisitions and identifying any requests for payment that are not adequately documented and/or are ineligible for payment.

sources other than LIR Fiore, EnCap has not provided sufficient documentation to the State to support the projected budget increases making it difficult to determine the reasonableness of the originally anticipated costs and the purported increases to the budget.

ii. Selection of LIR Fiore as Above Barrier Fill Provider

OIG attempted to understand why EnCap would choose a small, inexperienced company to provide large amounts of difficult to find fill that was an important requirement of the Project. The explanations provided to OIG by EnCap officials and its representatives were inconsistent and not credible.

According to Wisler, Gauger, and Hockensmith, it was Wisler who first suggested to them that they talk to Robinson and/or Fiore about providing above barrier fill for the Project. Wisler told OIG that at the time, he was aware of an EDA requirement that EnCap have all fill contracts in place before the EDA loan would close, and EnCap was hoping to close the EDA loan and break ground on the Project in Spring 2004. Wisler said that he was aware of EnCap's urgent need to contract with a supplier for the above barrier fill since he attended daily meetings at the site.²⁵² OIG is not aware of a specific requirement by the EDA to have had all of the fill contracts in place before the loan would close, but it is possible that these requirements are included in other broader requirements associated with the EDA loan.

²⁵² As has been discussed earlier, Wisler was involved in the financing aspects of the Project, including the EDA refinancing in 2004. Wisler indicated that the EDA required that all material contracts required for the closing of the landfill in accordance with the DEP permits and timelines set forth in the NJMC agreement must be in place prior to the refinancing. Wisler indicated that a contract with a clean fill provider was also needed at the time to satisfy AIG and MACTEC requirements.

Wisler acknowledged to OIG that at the time he suggested Robinson and Fiore as possible fill providers to EnCap representatives that he had a longstanding personal and business relationship with Robinson and he had also known Fiore for some period of time. More particularly, the evidence indicates that Wisler met Robinson in the 1990's when Wisler, who was then a member of the DeCotiis firm, was counsel to the Essex County Utilities Authority (ECUA) and Robinson was a member of the ECUA Board. The Friedman report indicates that Wisler met Fiore a few years before and that Wisler knew Fiore from Wisler's experience as ECUA Board counsel.

According to Wisler and Robinson, the two became close friends, and this led to their families becoming friendly as well. OIG learned that Wisler also provided personal and professional legal services to Robinson in the past.²⁵³ For instance, in 2000, Wisler assisted Robinson in setting up LIR Consulting (the entity that eventually joined LIR Fiore), and Wisler was the registered agent for the LIR Consulting until summer of 2007.²⁵⁴

According to Wisler and Robinson, in early 2004, although possibly late 2003, Wisler's wife began working for Robinson doing clerical work and bookkeeping at Robinson's title

²⁵³ The period of time when Wisler represented Robinson appears to overlap with Wisler's firm's representation of the ECUA Board. OIG is not aware of whether the ECUA Board was advised of the potential conflict.

²⁵⁴ Robinson apparently perceived the potential for conflicting interests and told OIG that he replaced Wisler as the registered agent when Robinson became involved with the Project. Wisler told OIG that at the end of 2005, his law firm made a decision to cease being the registered agent for any of its clients, but he was unsure whether he was replaced as a registered agent for LIR Fiore at his firm's request or at the request of Robinson. Regardless of the reason for the change of the agency relationship, documents filed with the State indicate that relationship did not change officially until July 2007.

Wisler and Robinson told OIG that Wisler has no financial interest in LIR Consulting or any other business venture with Robinson.

insurance company in Newark for no compensation.²⁵⁵ It appears that this relationship began at about the same time that the EnCap negotiations with Robinson and Fiore were on-going, and continued during at least the first year of the contract.

Wisler and Robinson played down Mrs. Wisler's job, stating that she took it on as a housewife (with an investment banking background) returning to the workforce. However, the evidence indicates that after LIR Fiore entered the contract with EnCap, her work became more significant. Robinson and Wisler told OIG that Mrs. Wisler worked for Robinson prior to the EnCap contract (thus, while the negotiations occurred between LIR Fiore and EnCap), but that once LIR Fiore entered into the EnCap contract, Mrs. Wisler helped with some of the billing on the EnCap project as well as other tasks associated with the EnCap project.²⁵⁶ Checks and invoices for the Project were sent to the Wisler's home address, and Mrs. Wisler's name was on the checking account. Robinson confirmed that Mrs. Wisler had the authority to issue and deposit checks on behalf of LIR Fiore. Apparently, Mrs. Wisler referred to herself as the company comptroller and sometimes used her maiden name on company documents.

According to the Friedman report, the majority of Mrs. Wisler's time was spent on projects other than the EnCap Project, but since Robinson claimed that he did not keep track of Mrs. Wisler's time, it is difficult to confirm to what extent she was involved with the EnCap

²⁵⁵ Since it is alleged that Mrs. Wisler was not compensated when she began working for Robinson and records of her time were not kept, it is difficult to state with certainty when she actually began working for Robinson.

²⁵⁶ For instance, Robinson and Wisler told OIG that Mrs. Wisler helped write out the fill tickets, or bills of lading, that were to be issued to the truckers delivering fill to the site. Robison explained that RMI, successor to Cherokee OENJ and also owned by Cherokee, was to issue the tickets, but that in the beginning of the project they were not organized and did not have the computer system in place to issue the tickets so Robinson, Mrs. Wisler and other employees of LIR Fiore would go to RMI's site trailer in Elizabeth to help write fill tickets.

Project. Records reflect that Mrs. Wisler was paid a total of \$30,000 by LIR Fiore for work beginning in the third quarter of 2004 and ending in the second quarter of 2005.²⁵⁷

Wisler told OIG that at the time Wisler did not object to his wife's work for Robinson or LIR Fiore, but in hindsight, he regrets the decision and acknowledged that it was poor judgment on his part to not recognize the negative implications that could flow from her employment by the fill supplier. However, Wisler insisted that there was no impropriety in his wife working for LIR Fiore.

According to Wisler and Gauger, Wisler told Gauger about the potential conflicting relationships and, according to Wisler, Gauger was not concerned about them at the time. Although the Friedman report indicates that the firm has found no evidence that the relationship between the Wislers and the Robinsons affected any "substantive issues" with respect to the EnCap project, it is virtually impossible to state with certainty that it did not. The difficulty in ascertaining the effect or lack thereof, of related party transactions is the basis for prohibiting potential conflicts.

In view of Robinson's and Fiore's limited history as fill providers, OIG asked Wisler what it was about them that caused him to suggest them as a potential provider of huge quantities of high grade fill to an important client, EnCap. Wisler provided an explanation, but his explanation appears to be contradicted by other credible evidence, raising the question of

²⁵⁷ However, it is unclear when Mrs. Wisler started working for LIR Fiore, if she in fact initially worked for no compensation, and why she began receiving wages in the third quarter of 2004.

whether his reasons for introducing the EnCap representatives to Robinson and Fiore as fill providers were what he said they were.

Wisler told OIG that he identified LIR Fiore as a potential fill provider for the Project since Wisler was counsel to the ECUA and was aware that LIR Fiore had a contract with the ECUA to haul away by-products of garbage incineration (ECUA ash contract). Wisler told OIG that, in fact, LIR Fiore was formed as a special purpose corporation for the ECUA ash contract and that LIR Fiore had already been in business and was performing satisfactorily under the ECUA ash contract when he suggested to Gauger and Hockensmith that they talk to LIR Fiore.

The EnCap Project required the provider to locate hundreds of thousands of cubic yards of above the barrier fill that would be difficult to find; provide certified test results from an engineer demonstrating that the fill was what it was supposed to be; and deliver the fill at specified times as needed at the Project site. The ECUA ash contract, on the other hand, required only that the contractor pick up large quantities of ashes at the incinerator and transport them to a Gloucester, New Jersey landfill. Wisler acknowledged that the ECUA ash contract was not the same type of service required for the Project, but said that under the ash hauling contract, LIR Fiore was required to handle and transport large quantities of material long distances under the contract, which he implied was relevant experience to the work for the EnCap Project.

Wisler told OIG that he had never talked privately with Robinson or Fiore about the possibility of working on the Project prior to speaking with Gauger and Hockensmith. The

Friedman report appears to contradict Wisler in this regard, reporting: “Wisler ... raised with Robinson and Fiore the possibility of their providing clean fill for the site.”

Robinson also appears to contradict Wisler. Robinson told OIG that Wisler came to him because he knew that Robinson had a relationship with Ted Fiore and asked Robinson if he thought that Ted Fiore, not LIR Fiore, could supply the material. Robinson further told OIG that it was only after EnCap officials met with Ted Fiore for the first time that Ted Fiore asked Robinson to be involved with the Project and to handle the testing requirements associated with the Project. Robinson told OIG that Fiore did not want to be bothered with all the nuances of the engineers’ testing and the reporting requirements for the Project. Robinson’s recollection is supported by other facts, chiefly the fact that LIR Fiore was not formed until two days before the letter of intent was executed between EnCap and LIR Fiore.

Other aspects of Wisler’s explanation appear to be contradicted by credible evidence. Although Wisler’s alleged reliance on the ECUA ash contract as a demonstration of LIR Fiore’s relevant experience and ability to provide 2.5 million yards of difficult to find fill, if true, raises questions, the evidence indicates that Wisler’s explanation that he relied on LIR Fiore’s performance under the ECUA ash contract as a basis for his suggestion that EnCap speak to LIR Fiore’s principals can not be true in any event.

The ECUA ash contract commenced weeks subsequent to EnCap reaching the decision to retain LIR Fiore, and by consequence, subsequent to Wisler’s identification and suggestion to EnCap principals that LIR Fiore was a potential fill provider. The letter of intent to hire LIR

Fiore was signed by EnCap officials on February 4, 2004. Any introductions and negotiations that occurred prior to that letter between EnCap representatives, Robinson and LIR Fiore occurred before February 4, 2004. The ECUA ash contract was awarded on February 17, 2004; the ECUA ash contract agreement was dated March 1, 2004 and work on the ECUA ash contract was not to commence until March 1.²⁵⁸

Moreover, the ECUA ash contract was awarded to T. Fiore Demolition and not LIR Fiore.²⁵⁹ It appears that LIR Fiore became involved with the ECUA ash contract, at least on paper, as of March 9, 2004, when T. Fiore Demolition executed an agreement to assign all payments pursuant to the ECUA ash contract to the recently formed LIR Fiore.²⁶⁰

In this regard, Robinson's statements to OIG appear to be consistent with the documentary evidence and inconsistent with Wisler's assertion that LIR Fiore or even its principles were in business and performing satisfactorily on the ECUA ash contract prior to Wisler's introduction of Fiore and/or Robinson to Gauger and Hockensmith. Robinson told OIG that LIR Fiore was formed specifically for the EnCap Project, not the ECUA ash contract; that Robinson was not initially involved with the ECUA ash contract and that, initially, he was not

²⁵⁸ The ECUA issued a request for bids for the ash contract first in November 2003 and later in December 2003 when the first bids, including a bid from T. Fiore Demolition, were rejected. After the first bids were rejected, T. Fiore Demolition, not LIR Fiore, submitted a second bid and was awarded the contract on February 17, 2004.

²⁵⁹ Theodore Fiore is the owner of T. Fiore Demolition, Inc. Included in the bid documents submitted by T. Fiore Demolition is an undated organizational chart for T. Fiore Demolition which describes, in part, Theodore Fiore as President/Operations and Leroy Robinson as Public Sector Executive. There is no explanation of Robinson's duties and as stated earlier, Robinson denies that he was involved in the ECUA bid. There is no mention of LIR Fiore in the bid documents.

²⁶⁰ Robinson told OIG that as a part of the ECUA contract, Fiore was required to obtain a bond in connection with the incinerator contract and that when Fiore could not come up with the money, Robinson agreed to take out a loan in satisfaction of the bond requirement and in return Ted Fiore assigned the project to LIR Fiore.

going to be involved in the Project; and that Robinson only became involved with the Project at Ted Fiore's request that he handle any testing that had to be done for the soil.²⁶¹

Accordingly, the ECUA ash contract was not executed and the work did not commence until at least one month after the letter of intent between EnCap and LIR Fiore was executed; and LIR Fiore did not become involved with the ECUA ash contract until long after Wisler identified Robinson and/or Fiore to Gauger and Hockensmith as potential fill providers. Thus Wisler's explanation that it was LIR Fiore's work on the ash hauling contract that caused him to identify the company as a potential fill provider to EnCap cannot be true.

In further explaining the context in which he identified LIR Fiore as a potential fill provider, Wisler told OIG that in addition to T. Fiore's experience hauling large amounts of ash, Wisler was aware that Ted Fiore had a Class B Recycling Center facility in close proximity to the Project site which had a very large stockpile of clean fill. He said that he believed, at the time, the stockpile could be used for the Project. However, as discussed below, the stockpile was not suitable, and the evidence tends to indicate that, from the outset, none of the parties thought that it was.

OIG was told that EnCap selected LIR Fiore to supply the above barrier fill in large part because, after meeting with them, they learned that Fiore had one million yards of stockpiled fill

²⁶¹ Robinson further explained to OIG that he was not involved in the initial meeting with EnCap officials, but that before Ted Fiore met with officials from EnCap a second time, he talked with Ted Fiore who asked Robinson to be present at a second meeting with EnCap. Robinson explained that Ted Fiore told him that EnCap officials had asked to come to the T. Fiore Recycling site to test a stockpile of fill material located on the site and Ted Fiore asked Robinson to come to the second meeting to talk to the EnCap officials. Robinson told OIG that it was Ted Fiore's request to create the joint venture so that he would not have to handle the paperwork associated with testing the fill.

at the T. Fiore Recycling site. They said that they believed that the stockpile could be used as above barrier fill on the Project and since it was only five miles away from the Project site, it would be economical.

However, both their actions and statements of others whom OIG interviewed indicated that this was not a reason that LIR Fiore was selected as the above barrier fill provider. Although EnCap representatives alleged that they visited the site of stockpile, they did not ensure that the stockpile was of the quality of fill that could be used for above barrier fill on the Project. A report from an independent engineer certifying that the stockpiled fill met the unrestricted test would be the minimum due diligence required if in fact EnCap was relying on the stockpile as the reason for selecting LIR Fiore.²⁶²

Robinson told OIG that he directed his engineer to test the stockpiled material and that some of the stockpiled materials actually passed the Above Barrier Fill Protocol. Indeed, both Robinson and an environmental attorney working on the Project told OIG that EnCap representatives had discussed the possibility of having the stockpile tested. The attorney told OIG that when he asked EnCap representatives if they were going to use the stockpile, they told him that they were not. Robinson also told OIG that to the best of his knowledge he believed that EnCap had tested the stockpile prior to entering into the contract.

²⁶² The Friedman report asserts that language in the EnCap/LIR Fiore contract indicates that it was EnCap's intent to rely upon the stockpile. These assertions ignore the significance that no matter what the language in the contract, the fill could not be used for the above the barrier layer without the certification of an independent engineer that the fill had passed the unrestricted test.

According to the Friedman Report, EnCap did not determine until the Summer of 2006, in conjunction with its engineers, that the stockpiled material was not suitable for the Project because it was unlikely that anyone could ensure that the stockpiled material would meet the standards of the Above Barrier Fill Protocol.²⁶³ This information could have been and actually may have been available in early 2004. Wisler told OIG that not testing the stockpiled material prior to the execution of the LIR Fiore contract was “inexplicable” and that he knows of no explanation for EnCap’s failure to require a test of the composition of the fill.

Under the circumstances, one reasonable conclusion was that the stockpile was not tested before EnCap signed the letter of intent to sign a contract with LIR Fiore; before the contract was signed two months later; or during the next months each time EnCap agreed to amend the contract with LIR Fiore was because all knew that, while a portion of the stockpile might pass the unrestricted test, the entire stockpile was unreliable and could not be used. If that was the case, the explanation that the stockpile was the basis for a belief that LIR Fiore could fulfill its contractual obligations is likely recently contrived.

At best, EnCap’s actions in regard to obtaining a supply of above barrier fill demonstrate EnCap’s failure to manage the Project. The evidence indicates that EnCap had never put in place a reliable contract to provide the enormous amounts of difficult to find above barrier fill. Nor has EnCap provided a reasonable explanation for the alleged cost overruns.

²⁶³ An earlier Friedman report dated July 25, 2007, indicated that EnCap determined to suspend the acceptance of materials from Class B facilities, but that in the future EnCap may accept Class B materials subject to a higher sampling frequency.

Another inference supported by the evidence was that EnCap entered into the contract with LIR Fiore knowing or suspecting that it was unlikely that LIR Fiore would be able to perform under the contract in order to convince the State and financial authorities to release EDA funds. Wisler recently indicated to OIG and EnCap's attorneys that EnCap hurriedly entered the contract with the company because EnCap's EDA refinancing was about to occur and it was necessary to have the above the barrier fill contract in place in advance of the financing.

OIG's review of the EDA documents and other evidence does not reflect that the EDA required that the above barrier fill contract be in place before the loan closed, although this requirement may be included without being specifically referenced in EDA requirements. Even if there was not a specific requirement, Wisler said that in his view, the success of the financing turned on EnCap's showing that a large part of the project, including the above the barrier fill contract, was "nailed down".

However, if Wisler's statement is correct and EnCap used the LIR Fiore contract to convince EDA that a contract to produce the above barrier fill was in place, EnCap's actions in this regard are yet another example of EnCap's disregard for the State's legitimate concerns and EnCap's use of half truths to manipulate the State.

EnCap did not perform even the most basic due diligence to convince itself that LIR Fiore could provide in a timely fashion the quality and quantity of above barrier fill at the contract price that was required for the project. As it turned out, LIR Fiore could not perform under the terms of the original contract; the alleged bases for entering the contract offered by

EnCap's attorneys were insufficient and did not, in any event materialize. Most importantly, if at the time EnCap entered the contract, EnCap representatives did not, in fact, understand that LIR Fiore could not perform under the terms of the contract, they had warning of that possibility. An inability to perform could have been discovered by EnCap's representatives prior to entering the contract.²⁶⁴

Finally, the statements of EnCap representatives during meetings about the cost overruns, including the cost of fill, with State representatives, and during interviews by OIG demonstrate a lack of concern for accurate representations when dealing with all of these entities and in turn those whom they represent.

c. Contaminated Fill

In addition to the problems discussed above regarding LIR Fiore's contract, LIR Fiore also delivered a load of fill material that was contaminated with PCBs to the Project site. LIR Fiore contracted for a stream of fill consisting of 2500 cubic yards, which was excavated from under the asphalt cover of a parking lot at the Garden State Plaza Mall that was certified to be clean fill. However, despite being certified as clean, a load of fill contaminated with PCBs was delivered to the Project site on June 22, 2006. EnCap's independent fill review engineer discovered the suspect load when it was dumped at the site. Unlike previous loads delivered from the Garden State Mall, the suspect load was different in color and contained wood and large

²⁶⁴ When Wisler was presented with the possible inference that EnCap was using the LIR Fiore contract as a subterfuge to convince EDA that EnCap had the necessary contracts in place, he said that he did not believe that that was a correct inference. However, he offered no evidence to refute that inference.

brick or concrete block. EnCap told OIG the suspect load was segregated and samples were taken for further testing.

According to EnCap, before results of the testing were obtained, EnCap's general contractor for the Project, MACTEC, spread the contaminated fill at the site. On June 29, 2006, the test results revealed PCB contamination in the samples of the fill material. The area where the contaminated load was spread was marked off and additional samples were taken. Some sample results taken from the area where the load was spread evidenced higher levels of PCB than the samples taken from the load before it was spread.²⁶⁵ The area where the suspect load was spread was excavated and that fill was removed. Accordingly, despite the procedures in place to ensure that only fill that satisfies the Protocols is delivered to the site, a load of fill contaminated with PCBs was delivered in 2006.²⁶⁶

d. Processed Dredge Material

As discussed above, EnCap has stated that fill costs and difficulties obtaining acceptable above barrier fill have contributed to the projected budget increases. However, problems with processed dredge material (PDM) which can be used as below barrier fill and as the cap, have also contributed to the current status of the project.

²⁶⁵ EnCap reported that because a few of the samples showed significantly higher concentrations of the PCBs detected in the samples taken from the load, it is likely that the contamination in that area predated the spreading of the suspect load.

²⁶⁶ OIG was told by an attorney hired by EnCap to represent it with regard to OIG's investigation of the Project that he had conducted an internal independent investigation of the matter, the findings of which were sent to OIG on July 25, 2007. EnCap's internal investigation does not provide evidence of why and/or how the load that was delivered was not consistent with the documents certifying that the fill satisfied the "unrestricted" criteria.

EnCap is required by DEP to use PDM as fill at the site. PDM consists of dredge from waterways that is mixed with cement. Upland disposal sites are needed for dredge that is excavated because the United States Environmental Protection Agency and Army Corps of Engineers determined that certain types of dredge can no longer be dumped at sea. The New Jersey and New York harbor is being dredged to make them wider and deeper for larger ships to pass through. An integral part of the Project from the State's perspective is use of the EnCap site as an upland disposal facility for PDM.

DEP and EnCap executed the Fill Capacity and Approval Agreement in February of 2003 (Fill Agreement), revised in 2004,²⁶⁷ requiring EnCap to accept a minimum of 2.55 million cubic yards of PDM and 2.55 million cubic yards of recyclables. The Fill Agreement states that the use of the EnCap project as an upland disposal site for PDM is a matter of great interest to the State. Under the Fill Agreement, EnCap is paid \$5.23²⁶⁸ per cubic yard for PDM, enabling EnCap to receive a total of \$13,336,500 in revenue from PDM.

EnCap began accepting PDM in September of 2004; however, DEP has determined that EnCap subsequently breached the Fill Agreement. In October of 2006 EnCap committed to accept 600,000 cubic yards from a PDM supplier at the rate of 3,000 cubic yards a day. In March of 2007 EnCap committed to accept 400,000 cubic yards of PDM from a different supplier at a rate of 2,000 cubic yards per day. Harbor contracts were awarded to these two

²⁶⁷ The Fill Agreement was revised in 2004 to include the Kingsland Landfill. Under the Revised Fill Agreement the maximum amount of recyclables that EnCap can accept increased from 908,092 cubic yards to 2,550,000 cubic yards. Although the Kingsland Landfill was added to the project, the minimum amount of PDM/dredge materials that EnCap was required to accept decreased in the Revised Agreement from 3,291,600 cubic yards to 2,550,000 cubic yards.

²⁶⁸ OIG was told by DEP that the Fill Agreement was structured at \$5.23 per cubic yards so that EnCap would be the "go to" site.

suppliers in reliance upon EnCap's commitment to accept a total of one million cubic yards of dredge.

OIG was told that in March/April of 2007 it became clear to DEP that the placement of dredge was going to become a significant problem for the State, as EnCap was slowly reducing the amount of trucks coming into the site. In June of 2007 EnCap informed DEP that it could only accept PDM in limited quantities and provided a schedule/table to DEP that indicated that EnCap will have the capacity to accept only 515,000 cubic yards through March 2009, thereby leaving 485,000²⁶⁹ cubic yards of PDM without a disposal site. DEP personnel told OIG that EnCap's failure to accept the quantities of PDM to which it had committed is "crippling" dredging in the New York/New Jersey Harbor because once dredging begins, the process cannot be stopped and the dredge must now be placed at an alternative site. To date EnCap has not accepted any dredge under the commitment entered into in March of 2007 for 400,000 cubic yards and has accepted some quantities of the 600,000 cubic yards committed to in March 2006. OIG was told by DEP that EnCap and its engineers were not comfortable working with dredge and that EnCap's general contractor, MACTEC, had no prior experience working with PDM. DEP personnel believe that the reason EnCap agreed to commit to such a large amount of PDM is due to a disconnect between EnCap management and the management "on the ground."

Under the Fill Agreement EnCap is required to pay any costs (maximum of \$4 million per harbor contract) incurred by the State for an alternative disposal site if EnCap fails to accept

²⁶⁹ EnCap's failure to accept 485,000 cubic yards of PDM (at \$5.23 per cubic yard) is a loss of revenue to EnCap of \$2,536,550.

available PDM. Accordingly, the State is currently seeking the costs for alternative disposal from EnCap totaling \$3.3 million, which is described elsewhere in this Report.

Not only has EnCap failed to accept the required amount of PDM, it has also improperly stockpiled PDM. Located at the site is an interim stockpile area (ISP area) that is designed with engineering controls located around the perimeter of the ISP area to manage the stormwater runoff and contain any contaminants. OIG was told by DEP personnel that EnCap was not satisfied with the moisture content of the PDM that was delivered during the winter of 2004-2005 and that DEP permitted EnCap to stockpile the PDM through the winter season “with the understanding that it would” be properly placed in the Spring. The piles of PDM go well beyond the ISP area, and therefore well beyond the engineering controls, thus, any potential contaminants found in the stormwater runoff are not being contained.²⁷⁰ DEP staff told OIG that they believe that EnCap stockpiled PDM and brought in recyclables, as they received a higher price for the recyclables, and that, when the Spring arrived, the space was filled with recyclables. It is unclear why the PDM stockpile has not been moved as it can still be used as below barrier fill.

To date, the piles of PDM placed outside of the ISP area have not been relocated and DEP assessed EnCap with a violation, pursuant to DEP regulations, for the incorrect placement of the PDM and is seeking monetary penalties.²⁷¹ The evidence reveals that EnCap’s

²⁷⁰ Although the stockpiled PDM was certified to be acceptable for use as below barrier fill, EnCap used 17,000 cubic yards of the stockpiled material as a PDM cap. EnCap ultimately had to remove the material as the PDM cap. DEP sent a letter to EnCap in June of 2006 authorizing them to accept only PDM cap material²⁷⁰ as EnCap has received a sufficient amount of below barrier PDM.

²⁷¹ DEP has assessed numerous violations against EnCap and is seeking a total of \$ 1.197 million in penalties. These violations are discussed elsewhere in this Report.

mismanagement of the PDM component of the project has contributed to the escalated costs of the project as it has caused a loss of revenue generated by the acceptance of PDM; necessitated additional costs to EnCap for the re-handling of the PDM to move it from the ISP area for final placement;²⁷² resulted in a penalty assessed by DEP; and caused DEP to demand payment from EnCap for alternate disposal of the PDM that EnCap committed to accept but has not taken.

2. Issues Concerning the Ground Improvement Program

During OIG's investigation certain questions and concerns regarding the Ground Improvement Program (GIP) were raised by various State representatives pertaining to its eligibility for reimbursement from EIT, the amendment to the Brownfields legislation that includes dynamic compaction (a component of the GIP) as an expense eligible for reimbursement, and that the cost of the GIP has increased.

a. GIP Eligibility for Reimbursement From EIT Funding

EIT and DEP examined whether GIP-related expenses were related to remediation or vertical development. Costs associated with the GIP were approved by DEP as eligible for EIT reimbursement. DEP personnel explained to OIG that the GIP is looked upon favorably as an element of the remediation and therefore eligible for reimbursement because it is designed to hasten the process of pollution abatement. This conclusion was supported by a letter from Paulus, Sokolowski & Sartor provided to DEP in March 2005 stating that the GIP "is directly

²⁷² EnCap is being charged \$2 per cubic yard (possibly less depending on how far the PDM had to be moved) by its general contractor to re-handle the PDM that has been stockpiled and not properly placed when initially delivered.

related to the closure and remediation of the Lyndhurst and Rutherford Landfills and the long-term performance of the engineering controls required for water quality improvement.”²⁷³

b. Dynamic Compaction Eligible for Brownfields Reimbursement

Dynamic compaction, a component of the GIP, is specifically addressed in the amendment to the Brownfields law. Under the Brownfields legislation DEP may review the remediation costs associated with a Brownfields redevelopment project to determine whether they are reasonable.²⁷⁴ As discussed elsewhere in this Report the Brownfields legislation was amended in January 2002 to expand the definition of reimbursable remediation costs to include closure and remediation for this project only. According to counsel for EnCap the DeCotiis firm provided a draft of the proposed amendment to the bill’s sponsor. Regarding dynamic compaction, the controlling law was amended to provide:

Reimbursable remediation costs shall include costs that are incurred in preparing the area of land whereon the contaminated site is located for remediation and may include costs of dynamic compaction of soil necessary for the remediation.²⁷⁵

The amendment ensures that the costs associated with dynamic compaction will be considered by DEP to be eligible for reimbursement. DEP personnel explained that, as noted above, a private developer needs to believe that his project will be profitable; as such,

²⁷³ NJMC told OIG, however, that it has never utilized any of these ground improvement techniques as part of closing any of the landfills in the Meadowlands area. Additionally, the GIP is primarily being installed in those areas where there will be vertical development or roadways.

²⁷⁴ N.J.S.A. 58:10B-31(b).

²⁷⁵ N.J.S.A. 58:10B-31 (b).

reimbursements such as those provided by the Brownfields law provide a meaningful incentive to private parties contemplating Brownfield remediation projects.

c. Cost Overruns Contributable to GIP

Gauger told OIG that in 2006 he estimated that the Project was \$25 million over budget and that he believed that the Ground Improvement Program (GIP) was one of the factors causing the current cost overruns. The original proposed cost of the GIP was approximately \$12.75 million.²⁷⁶ By June 2007, the cost of the GIP had increased by approximately 66% (increase of \$8.2 million), as PS&S estimated the cost of the GIP going forward to be \$20.5 million.²⁷⁷ To date, the State has not been provided with any information to support these alleged cost increases.

3. Current violations

DEP has the authority pursuant to numerous environmental statutes to impose civil penalties on parties that violate DEP rules and regulations. Penalties are assessed by way of an Administrative Order and Notice of Civil Administrative Penalty Assessment (AONOCAPA). On September 20, 2007, DEP issued an AONOCAPA against EnCap²⁷⁸ seeking \$1.197 million

²⁷⁶ Yonkers Contracting Company contracted with EnCap to perform the GIP. In the amended contract dated April 16, 2004, the total base bid price was \$12,756,965.05.

²⁷⁷ This estimate was provided in the “Budget Proposed to NJMC” and supporting schedules dated June 12, 2007.

²⁷⁸ The Commissioner of DEP has the authority to issue an AONOCAPA against EnCap pursuant to N.J.S.A. 13:1D-1, et seq., the Solid Waste Management Act, N.J.S.A. 13:1E-1 et seq., and/or the Solid Waste Utility Control Act, N.J.S.A. 48:13A-1 et seq., the Air Pollution Control Act, N.J.S.A. 26:2C-1 et seq., and the Floor Hazard Control Act, N.J.S.A. 58:16A-50 et seq. Pursuant to N.J.S.A. 13:1B-4, this authority is delegated to the Assistant Commissioner of Compliance and Enforcement.

in penalties for numerous violations, including but not limited to, violations pertaining to fill, PDM and permits; failure to cover exposed waste; and failure to control dust, odors and fires.

Additionally, as discussed above, DEP has determined that EnCap has failed to accept dredge in compliance with the Fill Agreement. Accordingly, on September 19, 2007 DEP issued EnCap a Demand for Payment in the amount of \$3.3 million²⁷⁹ for the costs incurred by the State due to EnCap's breach. EnCap responded to the State's Demand on October 19, 2007 asserting that DEP "inappropriately relied" on the schedule/table EnCap provided DEP in June of 2007 setting forth the amounts of PDM that EnCap could accept. EnCap asserts that the table/schedule was not a legally enforceable document. According to EnCap, it does not have an indemnity obligation to the State for alternative disposal because it did not reject available PDM at the site or instruct that the PDM not be delivered. This issue is currently under review by DEP.

C. State Leadership of Project and EnCap's Failure to Communicate

From the inception of the EnCap project, there was no senior State official or State entity designated as the lead or primary point of contact on behalf of the State for all elements of the project. The evidence indicates that while there were State offices responsible for various aspects of the project, and that these offices worked diligently to protect their interests and those of the State while endeavoring to facilitate the project where appropriate, there was no one office charged with coordinating the entire project on behalf of the State. EnCap took advantage of this by selectively communicating with the State stakeholders in what appears to be an intentional

²⁷⁹ The cost to the State for disposing the 485,000 cubic yards of PDM is \$6.77 per cubic yard.

attempt to manipulate and mislead. OIG was told by representatives of every State entity with which it met that EnCap did not fully communicate relevant information and would even make incorrect or misleading representations about elements of the project, including misrepresentations about what State officials or entities said or did.

The evidence indicates that State entities coordinated their efforts periodically and that they communicated with each other as needed. By way of example, the Attorney General's Office represents each State agency and thus must approve the agreements that the State enters into. There is evidence of email correspondence from the Attorney General's Office to EIT, DEP and the Governor's Office concerning various elements of the project and serving as a method for coordination.²⁸⁰ There is also evidence that, among other efforts, the Attorney General's Office sought to compel EnCap to comply with various reporting requirements established in the Development Agreement, with which EnCap did not readily comply.

OIG was told, however, that if the Attorney General's Office rejected a proposal made by EnCap or otherwise negotiated a term of an agreement that was unsatisfactory to EnCap, EnCap would address the issue directly with the relevant agency, without including the Attorney General's Office. OIG was told that, upon learning that EnCap was working with State agencies independently and without the involvement of the Attorney General's Office, the Attorney General's Office wrote to counsel for EnCap, indicating that EnCap is not authorized to speak directly with the State entities without the involvement of the Attorney General's Office, as it is

²⁸⁰ OIG was advised, however, that, as legal counsel, the Attorney General's Office is not always involved with respect to policy determinations or other matters when they do not also involve questions requiring legal analysis.

counsel to the State entities. OIG was told that EnCap persisted in communicating directly with at least one State department, with the consent of the department's commissioner.

It also appears that there may have been a lack of clarity about the roles of certain State officials. OIG was told by at least one State official that the former Commissioner of the Department of Community Affairs was the lead negotiator of the Second Landfill Closure Agreement between NJMC and EnCap. The Commissioner, however, told OIG that while she did renegotiate the terms of the Agreement, she focused primarily on its financial elements and she was not involved in the daily management of the project.

Compounding these difficulties was EnCap's practice of isolating its transactions with each State entity. The evidence shows that EnCap routinely worked with government entities individually and relayed information on an inconsistent and/or "need to know" basis, as determined by EnCap. The evidence further shows that EnCap, at times, withheld information from State and local government entities and played the entities off each other. By isolating its discussions and negotiations, EnCap facilitated a system that often eliminated additional input and, perhaps, contradictory viewpoints. The resultant lack of coordination and information sharing contributed to consequent failures in communication between government entities at all levels, failures which have been acknowledged to OIG by State entities' representatives.

The evidence shows that in or about late 2004, a system for regular communication was put in place at the State level. OIG was told that this was occasioned by a discovery by the State parties that counsel for EnCap encouraged the NJMC to not communicate with EIT. OIG was

told that, at or about the latter part of 2004, the Executive Director of NJMC told a representative of EIT that counsel for EnCap discouraged communication by NJMC with EIT because EIT would seek to intervene in and alter the Landfill Closure Agreement between NJMC and EnCap. Upon learning this, the parties began to regularly communicate with one another and conducted group meetings as necessary. At that point the project was already five years old. Moreover, it appears that it was not until April 2007 that all of the stakeholders met together at one time to discuss the status of the project.²⁸¹ OIG is advised that at that time the State agencies agreed to not meet with EnCap separately.

Also, as noted in this Report, EnCap independently negotiated financial agreements with Lyndhurst and Rutherford and that these agreements materially impacted the financing of the project. There was and is no formal mechanism for State oversight or involvement in negotiations of this type. Local government entities are not required by law to communicate with any State entity as they negotiate financial agreements with private redevelopers. OIG is advised that it is not uncommon for towns to independently negotiate and enter into agreements for payments in lieu of taxes.

In this instance, EnCap negotiated independently with Lyndhurst and Rutherford for the financial agreements that provided for PILOT payments and formed the foundation for PILOT-backed bonds. NJMC was made aware, to a limited extent, of these negotiations and other items

²⁸¹ The April 2007 meeting was initiated by EIT and was occasioned by EnCap's representations that the project was significantly over budget and EnCap's request that the State subordinate one of its loans in order to aid EnCap in obtaining additional financing. This is discussed elsewhere in this Report.

being discussed by EnCap and the towns.²⁸² OIG was told that it offered to coordinate any negotiations between the towns and EnCap and perhaps facilitate joint negotiations where appropriate. This was not embraced by all of the towns.²⁸³ Consequently, there were neither joint negotiations with EnCap on behalf of the towns nor was the State consulted during the negotiations. The State did not become involved in any meaningful way with the financial agreements until the LFB was called upon to approve the securitization of the PILOT payments.

D. Vulnerabilities/Trust Issues

Although the project has been characterized as a public/private partnership, EnCap sought to advantage itself such that the State and local government entities needed to protect themselves. While the State is obligated to represent all facts accurately and thoroughly to its private partners, the private partner in this case was seemingly not bound by a similar obligation. This produced an unbalanced partnership, which hampered the relationship between the State and EnCap. Moreover, the parties had different interests and goals, which exacerbated this uneven relationship. The State was motivated by its ultimate goal of cleaning and productively using the landfills, with minimum financial output by the State. EnCap was motivated by its

²⁸² As noted above, however, NJMC did not have notice of the terms, conditions and magnitude of the financial agreements and EnCap's proposed PILOT bonds and counsel to EnCap acknowledged that meaningful notice was not given to the State. Moreover, the proposal, as discussed above, was unlike any that had come before it.

²⁸³ It should be noted that the former mayor of North Arlington, who negotiated with EnCap a development agreement that contemplated PILOT payments, told OIG that he actively sought the counsel of State government entities. There is, however, a basis for distinguishing the scope of his negotiations from those of the other negotiations. North Arlington's development agreement involved property that is outside the NJMC, thus the development agreement was entered into independently by the town and EnCap. Accordingly, there was no role for NJMC oversight with respect to this element of the project. It should also be noted that it appears that the towns were represented by counsels of differing levels of experience with respect to financial agreements and PILOT bonds. EnCap may have been able to take greater advantage of a town if it were represented by a less experienced counsel, particularly given the complexity of the issues and the fact that PILOT bonds, in general, were a relatively new concept; were certainly new to the towns with the NJMC district; and EnCap's proposed bond was outside the scope of the few previously proposed bonds.

pursuit of profit. While the State and local government parties acknowledge and agree that EnCap is entitled to a fair return on its investment, EnCap's pursuit of profit ultimately placed the State entities in positions that were not always advantageous to the State. This manifested itself in a quasi-adversarial relationship that deteriorated over time due to an evolving lack of trust of EnCap. The failure of trust developed over time and was occasioned by the manner in which EnCap comported itself. OIG was told that EnCap's representatives would "threaten" to go to administration officials if State entities were not acting in a manner that EnCap considered to be satisfactory, generally acted like "bullies," and misrepresented facts. This eventually generated a sense among State entities that they needed to be "on guard" at all times.

EnCap officials have acknowledged that EnCap did not properly communicate with the State and others and that this generated a resultant lack of trust on the part of State entities. Counsels to EnCap both told OIG they recognized that EnCap's relationship with the State was seriously damaged as a result of their failure to alert the State to the planned PILOT payment securitization, which was discussed at length above. EnCap's former president also told OIG that EnCap did not adequately communicate with the various stakeholders, including the State, with respect to a variety of issues. EnCap's current president acknowledged to OIG and the State stakeholders that EnCap did not adequately communicate with the State.

Moreover, EnCap's representatives have made several significant statements that were not true or at least created (apparently intentionally) an incorrect impression. By way of example, EnCap attorneys stated during a meeting with the State stakeholders that the Local Finance Board had recently approved a PILOT bond that is identical or nearly identical to the one proposed by EnCap. OIG's review of the approved bond revealed that it is not identical to

EnCap's proposal and there are some significant differences between the two. Upon questioning, EnCap's counsel told OIG that EnCap is pursuing amendments to its PILOT bond application that would more closely align it with that of the recently approved bond. While the two bonds may eventually be similarly structured, it is not correct that they are identical or nearly identical at this time.

In addition, OIG was told that EnCap's manager was eventually "kicked out" of the NJMC due to a history of making intentional misrepresentations. By way of example, OIG was told that the manager advised the NJMC that a mayor had approved a particular element of the project even though the mayor made no such representation. Similarly, OIG was told that EnCap management would represent to stakeholders that NJMC denied EnCap certain entitlements when, in fact, EnCap did not have an entitlement to that particular item (for instance, use of a private road owned by the NJMC). Rather, NJMC had exercised its discretion in not granting EnCap's request; NJMC had not denied EnCap something to which it was entitled.

Furthermore, as discussed above, EnCap misrepresented, or made statements that created misunderstandings, concerning the necessity of the financial agreements with the towns. While the local government officials who negotiated with EnCap stand by their agreements, which they had analyzed before signing, they were not apprised of EnCap's other financing options and monies received and were thus denied all of the facts that would have benefited them in further evaluating the terms of their agreements.

Also, EnCap frequently represented to State and local government entities that it would be unable to proceed without particular funding or concessions but ultimately adopted alternative approaches when the funding or concessions were not provided. By way of example, EnCap represented that it was important that the State to subordinate its interest in a loan it had issued to EnCap in order for EnCap to procure new funding. It was represented that the State's action was essential to EnCap obtaining the necessary additional funding, without which the project would be in jeopardy.

At that time, EnCap advised the State stakeholders that the project was \$95 million over budget. Based on the new project budget, EnCap asked DEP to subordinate the collateral for its loan (10% of the PILOT revenues) in order for EnCap to receive an additional \$20 million from a new private lender. EnCap told the State stakeholders that the project would be halted if this does not happen. Within a week of this statement, however, an EnCap representative told OIG there was no longer a need for DEP to subordinate its loan because Cherokee said it would subordinate its loan instead. Despite this, during a subsequent meeting with State stakeholders, EnCap continued to press for DEP to subordinate its loan. When asked by OIG about the prior statement, that DEP was no longer needed to subordinate, EnCap's attorney (who was hired to represent EnCap for the purposes of the investigation by the OIG), told OIG that EnCap would prefer that the State, and not Cherokee, make this concession and that, despite Cherokee's willingness to act, it could "still ask" the State. Ultimately, although EnCap claimed that financial failure lay ahead if the State refused to comply with its request, EnCap proceeded to obtain the funding it claimed was necessary, notwithstanding the State's refusal.

E. Lack of Information About Cost Overruns

As noted above, EnCap met with State entities (NJMC, DEP, EIT, and OIG) in April 2007 to explain its new costs and privately told the State representatives that the cost of remediation had increased by \$95 million. Nonetheless, EnCap did not discuss the \$95 million new cost during the meeting and did not provide data to support cost overruns. EnCap did acknowledge during the meeting that its management had not handled the project well and had brought in a new manager who believed in being open and direct. The new manager, however, had been involved only two weeks at the time of the meeting. As such, EnCap said that it was preparing a financial statement that would explain all remediation costs.

A second meeting was held approximately two weeks later. At that time, EnCap did not have a complete financial statement; it only had rough projections. It was still unable to substantiate the new costs and did not provide a dollar figure for the cost overruns, notwithstanding its representations, in private, that the cost overruns were \$95 million. Since then, EnCap has provided some information purporting to represent its projected cost increases. OIG has learned, however, that the State entities have spent considerable time attempting to elicit a complete and accurate budget from EnCap officials. Despite this effort, to date, it appears that EnCap has not provided satisfactory data and supporting documents that could support a complete budget upon which the State can rely.

F. Attempts to Manipulate Administrative Processes

OIG also learned from State representatives who have been involved with the project that EnCap's representatives routinely delayed in meeting its deadlines, while expecting, and pressuring, the State entities to meet their deadlines. This placed the State entities in untenable positions. OIG was told that this not only compressed the time the State had to meet its obligations, it generated a sense, on the part of some State representatives, that EnCap's representatives were engaging in intentional misrepresentation and/or were acting in bad faith by not giving the State adequate time to review EnCap submissions and by exerting pressure on them and their superiors to generate desired actions. There is considerable evidence of consternation on the part of State officials and employees over EnCap's abuse of deadlines and unrealistic expectations for action by the State.

Furthermore, OIG has reviewed email correspondence between DEP personnel that evidences an attempt by EnCap to mislead or confuse. In one email, a DEP employee inquired of a supervisor about the rationale for a decision that had been made relating to an element of the remediation. The dialogue between the employee and supervisor revealed that EnCap attributed a certain decision concerning the method for proceeding with a particular element of the Project to DEP, stating explicitly that DEP independently made that decision. In fact, the decision had been occasioned by EnCap's refusal to consider alternative approaches. DEP was constrained by EnCap's refusal. As such, it had not independently issued the decision but rather had reacted to EnCap's refusal to act.

There is also evidence that counsel to EnCap inappropriately sought to pressure DEP to issue certain approvals. OIG is in receipt of correspondence from a deputy DEP commissioner to William Gauger, President, EnCap Golf Holdings, LLC, in response to a letter in which counsel to EnCap sought an expedited review by DEP of the issuance of all necessary approvals for the “Northern Node” portion of the project. In the request, counsel to EnCap explained that “failure to receive all of these necessary approvals...would trigger a default under certain financing documents...which in turn could have serious negative consequences not only for EnCap, but also for the Township of Lyndhurst, the Borough of Rutherford, the New Jersey Meadowlands Commission, the New Jersey Environmental Infrastructure Trust, the Department [of Environmental Protection], the State of New Jersey and the public at large.” The Deputy Commissioner wrote that EnCap’s counsel further contended that “various other consequences...will result from a delay in the sale of the remediated land to the vertical developers, including a delay in the vertical development of the remediated sites. The corresponding result will be a delay in the repayment by EnCap of the loan made by the Department (the “Fund Loan”), since the source of such repayment is tax revenue to be generated by the vertical development of the remediated site.”²⁸⁴

The Deputy Commissioner replied that EnCap’s attempt to associate the administrative approval process with the repayment of DEP’s loan was inappropriate. Moreover, the Deputy Commissioner reminded EnCap’s President that this had been discussed with EnCap when the loan was being negotiated and that it was unfortunate that EnCap would nonetheless pursue this argument:

²⁸⁴ September 13, 2006 letter from Deputy Commissioner Zellner to William Gauger, quoting June 21, 2006 letter from EnCap counsel to DEP.

Prior to the closing with respect to the Fund Loan, thorough discussions took place among representatives of the Department and the New Jersey Environmental Infrastructure Trust (the “Trust”) with respect to the nexus between the issuance by the Department of the No Further Action letters and other transaction events, including, most significantly, the repayment to the Department of the Fund Loan. Lengthy consideration was given to the potential for pressure to be applied to regulatory determinations by the Department given the interest of the Department in full and timely repayment of the Fund Loan. Significant negotiations were undertaken with EnCap to, in part, address this concern and, with the implementation of various structural revisions and in the interest of fostering an effective public-private partnership to undertake a challenging environmental remediation, the Department moved forward and extended the Fund Loan. Regrettably, the concerns that were the subject of Department and Trust discussions have come to fruition.

It is important for EnCap to understand the factors that the Department will consider in evaluating the issuance of all necessary approvals, including the issuance of a No Further Action letter. Full compliance with the applicable regulatory and policy requirements is the only criteria that the Department will consider in issuing the No Further Action letter. Such considerations supersede all others, including the risk of any EnCap transaction default. (emphasis in original).

This serves as an example of the methods that EnCap utilized to achieve its goals. Such methods generated distrust on the part of State officials and employees and undermined the viability of a true partnership relationship.

G. State Corrective Actions

In response to their experiences with EnCap, DEP, EIT and NJMC have revised their procedures to avoid similar problems in the future.

Although the EIT program is highly regulated and retained the services of skilled outside counsel and advisors, and OIG was told that EIT applied more levels of review and structure to the EnCap loan than any prior loan in the history of the EIT Program, EIT is now evaluating new rules that would govern loans when some private entities seek financing for clean water (*i.e.*, waste water) projects through local government conduits and, particularly, when an unusual collateral structure is involved. Such efforts are being undertaken by EIT in coordination with DEP. Indeed, as noted above, although certain aspects of the loan structure developed for the EnCap Project were at one point early in the process viewed as a potential template for future comparable projects, this concept was eliminated. In fact, it was explicitly stated in the Amended and Restated Participation Agreement that the agreement with EnCap shall not commit EIT and/or DEP to utilizing such financing structures in the future.

Similarly, the OIG was told that the NJMC instituted a revised procedure for review and approval of proposed changes to the Project. For the first time, the NJMC required a public process, including a public hearing, for review of any changes to the Project that required NJMC approval. OIG was told by NJMC that this new process was applied to the EnCap project.

Furthermore, OIG was told that, beginning at or about early Spring 2007, DEP and EIT established a “working group” for review of EnCap’s requisitions. The “working group” consisted of representatives of EIT, DEP, AIG and EnCap and was charged with reviewing each of EnCap’s requisitions and identifying any requests for payment that are not adequately documented and/or are ineligible for payment. OIG was told that this process was established in response to concerns about a large number of change orders submitted by EnCap, which sought

reimbursement at a level higher than originally planned, and requisitions that were lacking sufficient documentation.

IX. POLITICAL CONTRIBUTIONS

Governor Corzine requested that OIG's investigation of the Meadowlands Remediation and Redevelopment Project include a review to determine whether campaign contributions have had any effect on the Project. Therefore, OIG interviewed several individuals associated with the Project, including EnCap management and counsel, elected officials representing the districts and municipalities effected by the Project, current and former commissioners of State entities and key decision makers regarding campaign contributions. In conjunction with the interviews conducted, OIG reviewed several candidate and committee reports provided on the New Jersey Election Law Enforcement Commission (ELEC) and Federal Election Commission (FEC) online public information databases.²⁸⁵ The evidence gathered during OIG's investigation does not indicate that elected officials changed their position or voted on a particular matter in such a way to benefit the Project as a result of receiving campaign contributions.

EnCap is a single purpose entity created solely for the Project and did not have any business interests in the State prior to responding to the NJMC Request for Qualifications in 1999. EnCap had very few employees -- as many as a dozen and as few as three depending on the date -- including William Gauger III, the President and Manager of EnCap until Spring 2007; and James Hockensmith, Senior Vice President until Spring 2007; and EnCap relied heavily on

²⁸⁵ The candidate and committee reports that were reviewed were specific to the relevant New Jersey districts and municipalities included in the Project and not a search of all candidates and committees in districts and municipalities where Cherokee or any of its affiliated entities have been or are currently involved in redevelopment projects. Contributions to Candidates for federal elected office were not included.

consultants to perform the required work. While Gauger and Hockensmith are no longer working on the Project, having been removed by EnCap owners in March 2007, they managed EnCap from 1998 to early 2007, time that is the subject of OIG's review. EnCap's main equity investor is Cherokee Investment Partners II (CIP II), which is managed by Cherokee Investment Partners (Cherokee) and has several affiliates and subsidiaries. Thomas Darden is the Chief Executive Officer (CEO) of Cherokee.

A search of the ELEC and FEC online campaign contribution records demonstrates that Cherokee²⁸⁶ or individuals that worked for or had an interest in EnCap or Cherokee,²⁸⁷ including Gauger, Hockensmith and Darden, contributed to New Jersey candidates and committees at the state and local level starting as early as 1999.²⁸⁸ Those contributions are as follows:

William Gauger

- On May 4, 2001, Gauger contributed \$2,000 to the Committee to Re-Elect Guida Team, Lyndhurst Township Commissioners;

²⁸⁶ State campaign contribution reports have included either contributions from one of the following entities or from individuals who have listed one of the following entities as their employer: Cherokee, Cherokee Realty, Cherokee Realty Partners, Cherokee Northeast, OENJ Cherokee, OENJ Cherokee Corp., OENJ Cherokee Realty, OENJ Cherokee Realty Corp., OENJ Cherokee Realty Holdings, and OENJ Cherokee Realty Holdings, LLC.

²⁸⁷ N.J.A.C. 19:25-10.2A Reporting of occupation and employer information indicates that: Occupation and employer information shall be reported for each individual contributor whose contribution is more than \$300, or whose contributions are more than \$300 in the aggregate, in an election to a candidate committee, joint candidates committee, or political committee, or in a calendar year to a continuing political committee, political party committee, or legislative leadership committee. OIG's search of individuals that worked for or had an interest in EnCap or Cherokee was limited to Darden, Gauger, and Hockensmith.

²⁸⁸ At the time of this search, the ELEC database indicated that the following information was available: Primary Elections from 1985, General Elections from 1985, County Wide Races from 1999 to 2001; Gubernatorial Elections: Primary Elections from 1981 to 2005; General Elections from 1981 to 2005; and Inaugural Committees from 1982 to 2006; NJ State Political Party Committees from 1994 through 2007 1st Quarter; Legislative Leadership Committees from 1994 through 2007 1st Quarter; County Democratic and Republican Political Party Committees from 1998 through 2007 1st quarter; Democratic National Committee Non-Federal General 2001-2002; Republican National State Elections Corp 2001-2002.

- On July 11, 2001, Gauger contributed \$500 to State Senator Robert E. Littell's election fund, 24th Legislative District²⁸⁹;
- On November 15, 2002, Gauger contributed \$5,000 to the New Jersey Republican State Committee;
- On June 20, 2003, Gauger contributed \$500 to the Election Fund of Paul Sarlo, State Senate 36th Legislative District²⁹⁰;
- On April 24, 2004, Gauger contributed \$25,000 to the New Jersey Democratic Committee; and
- On June 3, 2005, Gauger contributed \$4,000 to the Committee to Re-Elect Guida Team, Lyndhurst Township Commissioners.

James Hockensmith

- On November 15, 2002, Hockensmith contributed \$2,000 to the New Jersey Republican State Committee;
- On March 21, 2003, Hockensmith contributed \$2,500 to the New Jersey Democratic State Committee;
- On June 9, 2003, Hockensmith contributed \$1,000 to Bryan Christiansen for Assembly, 38th Legislative District²⁹¹;
- On June 3, 2005, Hockensmith contributed \$2,000 to the Committee to Re-Elect Guida Team, Lyndhurst Township Commissioners.

Thomas Darden²⁹²

²⁸⁹ The 24th Legislative District includes: Andover Borough, Andover Township, Branchville Borough, Byram Township, Califon Borough, Chester Borough, Chester Township, Frankford Township, Franklin Borough, Fredon Township, Green Township, Hamburg Borough, Hampton Township, Hardyston Township, Hopatcong Borough, Lafayette Township, Montague Township, Mount Olive Township, Netcong Borough, Newton Town, Ogdensburg Borough, Sandyston Township, Sparta Township, Stanhope Borough, Stillwater Township, Sussex Borough, Tewksbury Township, Vernon Township, Walpack Township, Wantage Township, Washington Township.

²⁹⁰ The 36th District includes a portion of the area designated in the redevelopment of the Meadowlands and includes Carlstadt Borough, East Rutherford Borough, Garfield City, Lyndhurst Township, Moonachie Borough, North Arlington Borough, Nutley Township, Passaic City, Rutherford Borough, Wallington Borough, and Wood Ridge Borough.

²⁹¹ The 38th Legislative District includes: Cliffside Park Borough, Edgewater Borough, Elmwood Park Borough, Fair Lawn Borough, Fort Lee Borough, Hasbrouck Heights Borough, Little Ferry Borough, Lodi Borough, Paramus Borough, Ridgefield Borough, Saddle Brook Township, South Hackensack Township, Teterboro Borough.

²⁹² As discussed *infra*, Cherokee has diversified interests throughout the State. However, Darden listed EnCap Golf Holdings, LLC (whose only project was the Meadowlands remediation and redevelopment project) as his employer for two of the three contributions. These two contributions include the April 25, 2002 contribution of \$25,000 and the April 23, 2004 contribution of \$15,000 both to the New Jersey Democratic State Committee. Darden listed Cherokee Investment Partners, which manages Cherokee Investment Partners II and is the majority owner of EnCap, as his employer for the November 15, 2002 contribution of \$3,000 to the New Jersey Republican State Committee.

- On April 25, 2002, Thomas Darden contributed \$25,000 to the New Jersey Democratic State Committee;
- On November 15, 2002, Darden contributed \$3,000 to the New Jersey Republican State Committee; and
- On April 23, 2004, Darden contributed \$15, 000 to the New Jersey Democratic State Committee.

Gauger told OIG that he believed he had never made a campaign contribution in the State of New Jersey prior to the commencement of the Project. While Gauger characterized himself as “politically naïve” and said that he and Darden did not feel comfortable making political contributions, he nonetheless did make political contributions in the State with the intent to benefit the Project. Gauger told OIG that while he did not make contributions with the expectation that they would generate a certain outcome or a *particular* benefit for the Project, he understood that by making a contribution it could help “. . .to make sure something bad doesn’t happen because you were not involved in the political process.”

As to specific campaign contributions, Gauger characterized his May 2001 \$2,000 contribution and his June 2005 \$4,000 contribution to James Guida as relatively small; at the time of each contribution Guida was campaigning for re-election as Mayor of Lyndhurst. The town of Lyndhurst was the site of several acres being remediated and developed by EnCap pursuant to the Development Agreement with NJMC and was one of the towns with which EnCap negotiated financial agreements entitling EnCap to share in future PILOT revenues.

Gauger also characterized his November 2002 \$5,000 contribution to the New Jersey Republican State Committee as relatively small. At the time, New Jersey had a Democratic Governor, and the State Assembly was controlled by members of the Democratic Party, but

power was shared between members of both the Republican and Democratic parties in the State Senate.

Gauger said that his April 2004 \$25,000 contribution to the Democratic Party was very “painful”, but he gave it because he truly supported Governor McGreevey. He told OIG that he was not reimbursed for this contribution by EnCap or its related entities and that he is sure he made a few other contributions.

Gauger stated that when his and other Cherokee employees’ campaign contributions began being reported in the media, a corporate decision was made to stop making such contributions in New Jersey as Cherokee did not want to become “the issue”. OIG’s search of the campaign contribution databases revealed that, while there were several contributions by Cherokee between 1999 and June 2005 OIG’s research did not reveal a significant campaign contribution made by Cherokee or individuals that worked for or had an interest in Cherokee in the State subsequent to June 2005.²⁹³

Gauger told OIG that he was aware that EnCap’s counsel, the DeCotiis firm, was heavily involved in New Jersey politics, including making “significant campaign contributions” throughout the State. An online search of the ELEC database confirmed that, for a number of years, the DeCotiis firm and its members have made campaign contributions to political candidates and committees throughout the State.

²⁹³ Records indicate that there is only one campaign contribution for \$300 between June 2005 and June 2007; that contribution was made to a State Assembly candidate in the 11th district on June 26, 2007 and is listed as having been made by an entity named Cherokee Realty with a PO Box address in East Brunswick, New Jersey.

Eric Wisler, the member of the DeCotiis firm who was the lead attorney for EnCap, told OIG that, as a state-wide firm with many years of collective experience in the State, the firm receives many solicitations for campaign contributions and that the firm has a process to determine whether the firm will make a contribution. Specifically, Wisler told OIG, that the firm receives “a phenomenal amount of requests” that are generally discussed at the management committee level and that decisions whether to make a contribution are based the firm’s relationship with the potential recipient and whether or not the potential recipient supports matters of importance to the firm.

Wisler stated that, generally, the decision to give campaign contributions is made on a political event-by-event basis and that the firm does not have a predetermined campaign contribution budget for each year. Wisler further explained that it is not unusual for people who solicit the firm to ask it to pass such requests on to clients or other friends in their network. The decision to contribute, however, is left entirely up to the client or individual to whom the solicitation was relayed.

Wisler acknowledged that from time to time the firm had suggested to Cherokee and EnCap that they make “tactical” contributions, but that neither the firm’s political contributions nor those of Cherokee or EnCap, to the extent that they made them, were tied to any action or event happening during the Project. Wisler told OIG that he could recall only one affirmative request to Cherokee or EnCap representatives to contribute to the Democratic State Committee in 2002; however, Wisler believes that neither Cherokee nor EnCap ever followed through on any recommendation or request from his firm. When told of Gauger’s general understanding that

you make contributions not to generate a specific desired result, but to keep something bad from happening to the Project, Wisler told OIG that he never said that to Gauger and never heard Gauger articulate that philosophy.

It has come to OIG's attention that some state employees and other individuals believe, whether appropriately or not, that members of the DeCotiis firm have had the opportunity to meet with elected and appointed officials concerning the Project as a result of their campaign contributions. This impression apparently is that the firm's members have gained a certain level of access to high level decision makers related to the Project that is greater than access typically available to the public or even some state employees.

There is ample evidence that members of the DeCotiis firm and their clients have on several occasions had conversations and met with high ranking decision makers concerning the Project. By way of example, Gauger told OIG that in 2002 Governor McGreevey attended a meeting at the DeCotiis firm for the purpose of meeting with some of the firm's important clients. Gauger explained that he and Darden were present at that meeting to provide the Governor with an understanding of the Project.

However, notwithstanding the evidence of campaign contributions by the firm and its members and its seemingly unlimited access to high ranking officials, it is clear that the DeCotiis firm has a long standing relationship with State government, having represented clients on numerous matters and providing advice to State agencies during several administrations. This relationship extends well beyond the firm's involvement with the EnCap Project, and

accordingly there could be any number of reasons why state officials would meet with members of the firm. There is not, however, evidence that campaign contributions generated this access. Moreover, State officials with whom OIG spoke denied that such access was a result of campaign contributions but rather because they conducted meetings as necessary to respond to matters relating to the Project and were supportive of the Project generally and desirous of its successful completion.

A. Review of Campaign Contributions and Legislative Events

OIG conducted a review of campaign contributions made by EnCap or individuals primarily responsible for work on the Project close in time to legislation and other events that are significant to the Project, including the Sanitary Landfill Act amendment, Brownfields amendment, and RAB Law amendments. Given the prohibitively large number of campaign contributions made over the course of many years, OIG reviewed campaign contributions made six months prior, and six months subsequent to, the introduction and passage of these bills. The six month review period was chosen by OIG in an effort to give a snapshot of contributions and to determine whether the timing or amount of a specific contribution had any effect in the context of these events. Specifically, OIG reviewed the contributions made to candidate committees and other political committees by Cherokee or its related entities, EnCap, Gauger, Hockensmith and Darden, the DeCotiis firm, and Eric Wisler and Stephen Pearlman who were partners with the firm that were largely responsible for the firm's work on the Project. OIG's search included contributions to the following²⁹⁴:

²⁹⁴ The list of campaign contributions is not exhaustive, does not include all contributions by members of the DeCotiis firm, does not include contributions made outside of the time frames specified herein, nor does it include contributions to candidates or committees that are not included in the specified categories. Further, in reviewing

- Legislators and candidates in the 36th legislative district, that includes property in the Project area;
- Sponsors of the above-mentioned legislation;
- The New Jersey Republican and Democratic State Committees; and
- Governor(s) who signed into law the above-referenced bills.

The evidence gathered during OIG's investigation did not support a conclusion that any legislator voted for the Sanitary Landfill Act amendment, Brownfields amendment, and RAB Law amendments as a result of having received campaign contributions. However, as is illustrated in the following list, which is not inclusive of all contributions made by EnCap, Cherokee or DeCotiis representatives, the timing of contributions can raise speculation by members of the public that campaign contributions somehow affected the introduction and/or approval of specific legislation that was beneficial to the Project. These contributions should be viewed in light of the fact that the DeCotiis firm has multiple clients with multiple projects throughout the State, and contributions could have been made to support candidates for reasons other than the specific legislation of importance to EnCap. Moreover, contributions are likely made by members of the firm over time without a particular bill in mind and OIG did not analyze the numerous contributions made over time by all partners and members of the firm.

- *In January 2002, during a lame duck session, Senate Bill No. 2753²⁹⁵ was passed to amend the Brownfields Act.²⁹⁶ The Brownfields amendment expanded the definition of reimbursable*

contributions made by the DeCotiis firm and certain of its employees, OIG reviewed candidate and committee reports provided on the ELEC online public information databases, but did not review the candidate and committee reports provided on the FEC online public information databases.

²⁹⁵ S-2753 - Debt Defeasance and Brownfields Amendment-Sponsors: Senator McNamara and Senator Cardinale – A-3953 (identical bill) – Sponsors: Assemblyman Kelly (R), Assemblyman Rooney , and Co-sponsor Assemblywoman Charlotte Vandervalk. This amendment was signed into law by Acting Governor Donald DiFrancesco on January 8, 2002.

²⁹⁶ The Brownfields legislation provides incentives, including reimbursement for costs, for private developers to remediate contaminated sites, referred to as “Brownfields,” and ultimately develop those sites. EnCap's environmental attorney told OIG that EnCap could have proceeded under the Municipal Landfill Site Closure,

remediation costs specifically and exclusively for the Project. More particularly, the Brownfields amendment expanded the definition of reimbursable remediation costs to include costs specifically incurred in connection to the closure of the Rutherford, Lyndhurst, Avon, and Kingsland landfills. As noted previously, these four landfills are being closed and remediated by EnCap pursuant to its agreement with NJMC. Accordingly, the Brownfields amendment appears to permit EnCap, as exclusive developer of the Rutherford, Lyndhurst, Avon, and Kingsland landfills, to receive reimbursement for certain costs associated with the closure of those landfills that could not otherwise be deemed reimbursable remediation costs if incurred in connection to other Brownfields projects in the State.²⁹⁷

- Also in January 2002, Senate Bill No. 2753, which additionally amended the Sanitary Landfill Facility Closure and Contingency Fund Act (Sanitary Landfill Act) also has implications to the Project.²⁹⁸ This Amendment to the Sanitary Landfill Act permitted the NJMC to withdraw up to \$42 million from its statutorily established closure funds and to transfer the funds to the State Treasurer to be deposited in a debt defeasance fund created with respect to any County within the Hackensack Meadowlands district.²⁹⁹ As discussed previously, the \$96 million debt incurred by the BCUA Transfer Station was required to be satisfied before ownership of the BCUA Transfer Station could be transferred to NJMC and then in turn sold to EnCap. The amendment to the Sanitary Landfill Act permitted the NJMC to apply the \$42 million in partial satisfaction of the BCUA Transfer Station debt.³⁰⁰ OIG was also told by Wisler that this amendment to the Sanitary Landfill Closure Act was drafted by the DeCotiis firm.

Remediation and Redevelopment Act (“Municipal Landfill Act” N.J.S.A. 13:1E-116.1 et seq.) which provides for reimbursement of 75% of closure and remediation costs, whereas the Brownfields Act provides for reimbursement of 75% of remediation costs only. N.J.S.A. 58:10B-26; N.J.S.A. 58:10B-27. Thus, EnCap sought to expand the definition of reimbursable costs for the Project under Brownfields to also include closure costs. EnCap chose to proceed under the Brownfields program as opposed to the Municipal Landfill Act because the tax base that funds the reimbursement consists of several taxes, including but not limited to, corporate business taxes, sales and use taxes and taxes imposed on certain insurers. N.J.S.A. 58:10B-30. Reimbursement under the Municipal Landfill Act is funded by half of the applicable sales and use tax. N.J.S.A. 13:1E-116.6.

²⁹⁷ N.J.S.A. 58:10B-27.1. One example of an additional cost that would be reimbursable pursuant to the amendment is the costs associated with dynamic compaction performed in conjunction with the closure of the Rutherford, Lyndhurst, Avon, and Kingsland landfills. N.J.S.A. 58:10B-31 EnCap has used dynamic compaction as part of its Ground Improvement Program on the Project.

²⁹⁸ N.J.S.A. 13:1E-100, et seq. The Sanitary Landfill Facility Closure and Contingency Fund Act is discussed elsewhere in this report.

²⁹⁹ P.L. 2001, Chapter 398; N.J.S.A. 13:1E-109.1

³⁰⁰ The defeasance of the \$96 million debt incurred by the BCUA Transfer Station and the sale of the Transfer Station to EnCap is discussed elsewhere in this report.

In the six months prior to the introduction of the amendments to the Brownfields and Sanitary Landfill Acts, a total of \$35,233.32 in campaign contributions was made to candidates or committees, as described by the aforementioned search parameters. The specific contributions are:

- June 12, 2001 –\$2466.66 from Eric Wisler to the NJ Republican State Committee;
- July 6, 2001 –\$333.33 from Eric Wisler to James E. McGreevey, candidate for governor;
- July 24, 2001 - \$2,600 from Cherokee Corp. OENJ to James McGreevey;
- July 31, 2001- \$1,333.33 from Eric Wisler to James McGreevey;
- September 6, 2001 - \$27,000 from Cherokee Realty Holdings OENJ to NJ Democratic State Committee;
- September 28, 2001 - \$1,000 from Cherokee Realty Holdings OENJ to NJ Democratic State Committee;
- October 29, 2001 - \$500 by the DeCotiis firm to Gerald Cardinale, State Senate, Sponsor of S-2753.

On November 26, 2001, S-2753 was introduced in the Senate, which passed the bill on December 17, 2001 by a vote of 39-0. The Assembly substituted S-2753 for its Assembly counterpart, A-3953, and the bill passed on January 7, 2002 by a vote of 70-3-1 and was signed into law on January 8, 2002. Within the six months following the approval of S-2753, a total of \$26,500 in campaign contributions was made as follows:

- April 25, 2002 - Contribution of \$25,000 from Thomas Darden of EnCap to the NJ State Democratic Committee;
- May 19, 2002 - Contribution of \$500 from the DeCotiis firm to Henry McNamara, State Senate and Sponsor of S-2753;
- July 9, 2002 - Contribution of \$1,000 from Cherokee Realty Holdings OENJ to Paul DiGaetano, State Assembly; 36th Legislative District.

➤ *On May 10, 2004, Senate Bill No. 1564 and Assembly Bill No. 2791, which would amend the RAB Law, were introduced in their respective houses by sponsors Senator Sarlo and Assemblymen Impreveduto and Scalera. As discussed at length above, the amendment was to include the municipalities that are within the jurisdiction of the NJMC. The amendment provided the mechanism for EnCap to pursue financial agreements with the towns that would involve the use of PILOT-backed bonds.*

In the six months prior to the introduction³⁰¹ of the amendment to the RAB Law, a total of \$43,577.90 in campaign contributions was made to candidates or committees, as described by the aforementioned search parameters. The specific contributions are:

- February 11, 2004 – Contributions totaling \$3,577.90 from Eric Wisler and Stephen Pearlman to the NJ Democratic State Committee;
- April 23, 2004 - \$15,000 from Thomas Darden of EnCap Golf to NJ Democratic State Committee;
- April 24, 2004 - \$25,000 from William Gauger of EnCap to NJ Democratic State Committee.

On May 10, 2004, A-2791 and S-1564 were introduced.

- May 12, 2004 – Contributions totaling \$355.79 from Stephen Pearlman and Eric Wisler to the NJ Democratic State Committee;
- June 10, 2004 - \$1,000 from the DeCotiis firm to the Election Fund of Paul Sarlo, State Senate; 36th Legislative District and Sponsor of S-1564.
-

On June 21, 2004, A-2791 was passed by the Assembly by a vote of 54-23-2.

- June 23, 2004 – \$555.85 from Eric Wisler to the New Jersey Republican State Committee.
-

On June 24, 2004, S-1564 was substituted by A-2791 and passed the Senate by a vote of 35-5.

- June 30, 2004 – Contribution totaling \$2,862.39 from Stephen Pearlman and Eric Wisler to the Democratic State Committee.

³⁰¹ For purposes of this review, “introduction” shall include the period of time from the date when the legislation was first introduced in either the Senate or Assembly to the date that the bill was passed.

On August 4, 2004, A-2791 was approved. In the six months following the approval of the amendment to the RAB Law, the following campaign contribution was made:

- October 14, 2004 - \$750 from the DeCotiis firm to the Election Fund of Paul Sarlo, State Senate.
- *On June 8, 2006, Senate Bill No.1927 (PILOT bond bill), which further amended the RAB Law, was introduced by its sponsors, Senators Sarlo and Doria. As discussed in greater detail elsewhere in the Report, EnCap's representatives have said the amendment is an essential component of their plan to issue bonds backed by the PILOT payment revenue that it anticipated receiving.*

In the six months prior to the introduction³⁰² of this amendment to the RAB Law, the following contribution was made:

- March 11, 2006 - \$380 from Eric Wisler to Gary Schaer for Assembly; 36th Legislative District.

On June 8, 2006, S-1927 was introduced in Senate.

- June 27, 2006 – \$152 from Eric Wisler to the Gary Schaer for Assembly.

On December 4, 2006, S-1927 was passed by the Senate by a vote of 21-16 and was received in the Assembly. There has been no further legislative action on this bill. In the six months following the Senate passage of S-1927, the following contribution was made:

³⁰² For purposes of this review, “introduction” shall include the period of time from the date when the legislation was first introduced in either the Senate or Assembly to the date that the bill was passed.

- June 12, 2007 – Contributions totaling \$690 from Stephen Pearlman and Eric Wisler to Gary Schaer for Assembly.

B. Financial Agreements with Lyndhurst and Rutherford

As discussed elsewhere in this Report, in December 2004, EnCap entered into financial agreements, pursuant to the RAB Law, with Lyndhurst and Rutherford providing for payments of lieu of taxes (PILOTs) to be paid by the future owners of vertical development that would be built on the remediated site. Specifically, on December 14, 2004, the financial agreement between EnCap and Lyndhurst was executed and signed by then-Mayor of Lyndhurst James Guida, Eric Wisler, in his capacity as EnCap secretary, and William Gauger, in his capacity as President of EnCap. On December 29, 2004, the financial agreement between EnCap and Rutherford was executed and signed by then-Mayor of Rutherford Bernadette McPherson, Eric Wisler, in his capacity as EnCap secretary, and William Gauger, in his capacity as President of EnCap. The agreements would allow EnCap to share in a percentage of the PILOT payment revenue, with the county and towns receiving the remainder. The agreements were also intended to lay the groundwork for the securitization of the PILOTs (sale of bonds with a promise to pay back the bonds with the PILOT payment proceeds), with EnCap to realize up to \$450 million from the securitization.

OIG reviewed whether campaign contributions were made by EnCap or Cherokee, or any EnCap or Cherokee representatives involved in the execution of the Lyndhurst and Rutherford financial agreements, to the elected municipal officials that were signatories of the agreements. OIG's search revealed contributions to the Committee to Re-Elect the Guida Team in Lyndhurst

from William Gauger in the amount of \$2,000 in May 2001; a \$500 contribution from the DeCotiis firm in May 2001; a \$522 contribution from Eric Wisler in March 2005; and a total contribution of \$8,000 in June 2005 from EnCap or Cherokee representatives, including, but not limited to, William Gauger and James Hockensmith. The then-Mayor of Lyndhurst, Guida, was seeking re-election in 2001 and 2005 and was successful in 2001, but was defeated in 2005.³⁰³ OIG's search did not reveal contributions to then-Rutherford Mayor McPherson's election fund.

C. Development Agreement with North Arlington

North Arlington, New Jersey has not entered into a financial agreement with EnCap similar to those entered into by Rutherford and Lyndhurst. However, as discussed elsewhere in the Report, on October 6, 2005, North Arlington, under the leadership of then-Mayor Russell Pittman, entered into a Memorandum of Agreement (MOA) with a pair of Cherokee subsidiaries for the purchase and development of certain land (previously declared to be in need of rehabilitation) in North Arlington by the Cherokee subsidiaries. The MOA was signed by then-Mayor Pittman, William Gauger in his capacity as Manager of Cherokee Porete, LLC and Eric Wisler in his capacity as secretary of EnCap. OIG reviewed whether campaign contributions were made by EnCap or Cherokee or any EnCap or Cherokee representatives involved in the execution of the North Arlington MOA to Mayor Pittman. OIG's search did not reveal any contributions to Mayor Pittman.

³⁰³ Mayor Guida was defeated by a candidate who was not opposed to the concept of the financial agreement but believed that further concessions by EnCap, for the benefit of the town, were required.

D. Summary

OIG interviewed several public officials associated with the Project regarding campaign contributions and/or the effect that any contribution may have had on their decision making regarding the project. These public officials indicated that campaign contributions from individuals and entities associated with EnCap represented only general support for a campaign as the elected officials are considered “stakeholders” in the 36th district or support for a particular campaign event and did not represent efforts by EnCap to persuade a public official to act in his or her official capacity to benefit the Project. However, the public officials interviewed by OIG indicated that any actions taken in furtherance of the Project were based upon the fact the recipient was generally supportive of the overall goal of the Project and that no decision was based upon a campaign contribution. Moreover, at least one elected official interviewed by OIG indicated that without public financing of campaigns or a candidate’s personal wealth from which to draw, candidates must rely on the acceptance of campaign contributions to fund their campaigns.

OIG’s interviews with current and former commissioners and key decision makers associated with the Project also corroborated the elected officials’ contentions that EnCap employees or their representatives did not exert undue influence through political contributions to benefit the Project. These individuals were asked whether any public officials associated with the Project exerted any pressure in an effort to benefit EnCap or the Project. The current or former commissioners and key decision makers told OIG that they were supportive of the overall goal of the Project and that they were not pressured by public officials to make certain decisions regarding the Project.

OIG did not uncover during its investigation evidence that actions, decisions or votes by certain public officials who received campaign contributions, made by or on behalf of EnCap and/or the firm, were in return for, or as a result of, those campaign contributions. Nonetheless, the timing of the contributions and the nature of certain actions relating to or benefiting the Project could cause a perception that access is granted or decisions are made strictly or partially because of campaign contributions. For instance, in looking at the snapshot of the contributions in relation to the timing of certain legislative events, an individual might attach significance to the fact that Gauger and Darden contributed a total of \$40,000 in April 2004 to the New Jersey Democratic State Committee, approximately three weeks prior to the introduction of the amendment to the RAB law. As stated earlier, that amendment is significant to the Project because it provided the mechanism for EnCap to pursue financial agreements with the towns that were intended to result in the issuance of PILOT-backed bonds. Consequently, an individual might perceive that such contribution is sufficient to garner support for legislation even if the contribution was not given for that reason. Such perceptions are not healthy for the system as they can lead to a loss of public confidence and an erosion of public support for projects, particularly where the State has partnered with a private entity. However, OIG found no connection between these large contributions, or any contribution, and this or any other significant legislative event.

APPENDIX A

List of Key Permits and Approvals

Permit / Approval	Responsible Agency	Current Status	Comments
State			
RAW/CP & MLD Lyndhurst and Rutherford Landfills	NJDEP Division of Solid and Hazardous Waste	NJ069691656 Original Approval: 12/31/01 Revised Approval: 10/29/02 Amended: 5/13/04	Approves the RAW/CP Modification for ground improvement program (GIP) (Condition 16 of the Approval)
Landfill Closure Plan/Post Closure Care Plan Amendment & Major Landfill Disruption Approval Kingsland	NJDEP	Closure Plan Modification approved 1/27/03. Plan Approval of financial plan: 4/23/03	
Kingsland Disruption Approval for Force Main Construction and Borings	NJDEP	Approval: 7/7/04 Expiration Date: 7/7/05	Work related to this approval has been completed.
Kingsland Disruption Approval for Landfill Gas Collection System Upgrades	NJDEP	Approval: 3/16/05 Expiration Date: 9/16/05	EnCap has requested a extension of this approval for 2 years. Construction will begin fourth quarter of 2005 and end third quarter 2006.
Site Specific Geotechnical Monitoring Plan Approval Kingsland	NJDEP	Approved: 11/15/04	The plan is for monitoring the site slope stability and any potential movement of the landfill during closure.
Site Specific Monitoring Geotechnical Plan (revised) Rutherford East Site	NJDEP	Approved: 2/28/05	Subject to compliance with conditions provided in the approval.

Site Specific Monitoring Geotechnical Plan Rutherford West Landfill and Williams Pipeline	NJDEP	Approved 2/28/05	Subject to compliance with conditions provided in the approval.
Site Specific Monitoring Geotechnical Plan Lyndhurst East Site (related to the Golf Course portion of the Project)	NJDEP	Approved 2/28/05	Subject to compliance with conditions provided in the approval. A separate monitoring plan for the part of Lyndhurst East that will undergo ground improvements for future development may also be required.
Site Specific Monitoring Geotechnical Plan Avon Landfill (New Jersey Transit Main Line)	NJDEP	Submitted 2/25/05	Internally approved by NJDEP. Approval notice to EnCap will coincide with final construction plan modification review, since approval is not required prior to then.
Site Specific Monitoring Geotechnical Plan JCMUA Aqueducts/Avon Landfill Test Fill Work Plan	NJDEP	Submitted: 2/25/05	Internally approved by NJDEP. Approval notice to EnCap will coincide with final construction plan modification review, since approval is not required prior to then.
Site Specific Monitoring Geotechnical Plan JCMUA Aqueducts	NJDEP	Submitted: 2/25/05	Internally approved by NJDEP. Approval notice to EnCap will coincide with final

			construction plan modification review, since approval is not required prior to then.
Fill Protocol Approval for Material above Barrier Layer Avon, Lyndhurst, Kingsland, and Rutherford Landfills	NJDEP	Original Issuance Date: 11/7/02 Amended: 4/29/04	Subject to all terms and conditions detailed in 11/7/02 Fill Protocol Approval, this amendment approves the inclusion of materials produced by Class B Recycling Facilities as acceptable for use above the barrier layer.
Use of Recycled Masonry & CDS for the temporary haul roads Avon, Lyndhurst, Rutherford and Kingsland Landfills			Approval is subject to compliance with several conditions, including that contamination in the DCS material is comparable in concentration to those present in the reviewed document. NJDEP will address the issue that the recycled concrete and CDS to be used for the haul roads not be considered part of the amount of recyclable set forth in the Fill Capacity Approval dated February 7, 2003.
Construction & Demolition Screening (CSD)	NJDEP	Approved 11/15/04	Six month approval of the Pilot Program for acceptance of

from New York Sources			CDS. The pilot program began 12/04 for the purpose of monitoring potential gas emissions.
Use of Recycled Masonry & CDS for Construction of Haul Roads and Construction of Temporary Roads in the Interim Stockpile Area Avon, Lyndhurst and Rutherford Landfills	NJDEP	Issued 4/7/04	Approves request to use recycled masonry and CDS for the temporary haul roads.
Contingency Plan for Use of CDS and Recycled Masonry to Construct Temporary Haul Roads Avon, Lyndhurst and Rutherford Landfills	NJDEP	Approved: 10/14/04	Defines intermediate cover depth for temporary haul roads in place for over six months.
Fill Capacity Approval and Agreement	NJDEP	Issued: 2/6/03 Amended: 4/19/04	Amendment to the ratio of PDM and recyclables allowed for fill.
Northeast Water Quality Plan Amendment	NJDEP	Approved: 10/20/04	Removes the Rutherford and Kingsland Landfills and the NJMC Environmental Center from the BCUA sewer service area and adds them to the PVSC sewer service area. EnCap must implement several water quality

			<p>treatment Best Management Practices (BMPs) on portions of the site before discharging stormwater to Berry's Creek. In addition, the amendment will allow the use of potable water as the primary source of irrigation for a period not to exceed three years during which time NJMC must develop alternate water sources for irrigation.</p>
<p>Treatment Works Approvals (TWA)</p> <p>TWA#3: Avon and Lyndhurst East Landfill</p> <p>TWA#4A: Rutherford Landfills Permit No. 04-0580</p>	<p>NJDEP, Division of Water Quality</p>	<p>TWA#3: Issue Date 4/28/05 Expiration Date: 4/27/07 Issue Date: 12/6/04 Expiration Date: 12/5/06</p>	<p>For construction and operation of three pump station and 5,800 LF or pipeline to convey leachate from Lyndhurst East Landfill and four pump station and 4,600 LF of pipeline to convey leachate from Avon Landfill. Approval of the Northeast Water Quality Plan Amendment was required prior to approval of TWA#4A. For construction of a Rutherford West Pump Station and 6,700 LF of force main, a Rutherford East Pump Station and 3,572 LF of force main, and</p>

[illegible]

<p>Kingsland Park Sanitary Landfill Pump Station and Force Main CH. 251 Appl. #: 04-B7831 SCD RFA#: 02-32- 04-048</p>		<p>Effective: 6/8/04 – 12/8/07</p>	
<p>Lyndhurst West of Viola Ditch Remediation Project CH. 251 Appl. #04- B7832 SCD RFA#: 02-32- 04-012</p>		<p>Effective: 5/12/04 – 11/21/07</p>	
<p>MACTEC Trailer Compound Area (off Valley Brook Avenue) CH. 251 Appl.#: 04- B7899 SCD RFA#: 02-32- 04-071</p>		<p>Effective: 8/13/04 – 2/13/08</p>	
<p>North Node Access Road (Rutherford West) CH. 251 Appl. #: 04-B7993 SCD RFA#: 02-56- 05-04I</p>		<p>Effective: 10/18/04 – 4/18/08</p>	
<p>North Node Access Road (Rutherford East) CH. 251 Appl. #: 04-B8028 SCD RFA#: 02-56- 05-058</p>		<p>Effective: 11/8/04 – 5/8/08</p>	

Soil Erosion and Sediment Control (SESC) Plan Certification	BCSCD		Required prior to commencement of land disturbing construction activities.
Valley Road (Former American Fuel Harvesters) Appl. #: 00-B6483		Issued: 10/19/04	
North Node Access Road Appl. #: 03-B7696		Issued: 5/21/04	
Lyndhurst West of Viola Appl. #: 04-B7792		Issued: 5/21/04	
Kingsland Pump Station and Force Main (TWA-1A) Appl. #: 04-B7899		Issued: 6/8/04	
North Access Road (MACTEC Trailer Compound Area) Appl. #: 04-B7899		Issued: 8/13/04	
North Access Road (Rutherford West) Appl. #: 04-B7993		Issued: 10/18/04	
North Node Access Road (Rutherford East) Appl. #: 04-B8028		Issued: 11/8/04	

Avon Landfill Closure Appl. #: 04-B8055		Issued: 3/31/05	
Lyndhurst East Landfill (east of Viola Ditch) Appl. #: 05-B8199		Issued: 3/29/05	
Industrial Sewer Use Permit Permit #: 2263001	Passaic Valley Sewerage Commission (PVSC)	Effective: 11/1/04-10/31/09	For discharge of landfill leachate to PVSC. Basis for Permit Conditions: User Charge and Pretreatment if deemed to be required once leachate is delivered to PVSC.

APPENDIX B

Below is a list of acronyms used in this report and their corresponding meanings:

<u>ACRONYM</u>	<u>TITLE</u>
AIG	American International Group
AONOCAPA	Administrative Order and Notice of Civil Administrative Penalty Assessment
BCIA	Bergen County Improvement Authority
BCUA	Bergen County Utilities Authority
BDA	Brownfield Development Area
BFI	Browning and Ferris Industries
BLB	Bayerische Landesbank Girozentrale
CHEROKEE	Cherokee Investment Partners
CIAAs	County Improvement Authorities
CIP	Cherokee Investment Partners
CIP II	Cherokee Investment Partners II
CIP III	Cherokee Investment Partners III
COAH	Council on Affordable Housing
DCA	New Jersey Department of Community Affairs
DEP	New Jersey Department of Environmental Protection
DRSA	Development Rights Sale Agreement
DRSP	Development Rights Sales Proceeds
ECI	Environmental Capital International
ECUA	Essex County Utilities Authority

EDA	New Jersey Economic Development Authority
EIT	New Jersey Environmental Infrastructure Trust (or Trust)
ELEC	Election Law Enforcement Commission
ERA	Economics Research Associate
FEC	Federal Election Commission
GIP	Ground Improvement Program
HMRDA	Hackensack Meadowlands Reclamation and Development Act of 1968
IOU	Interval Occupancy Units
ISP	Interim Stockpile Area
LCA	Landfill Closure Act
LFB	Local Finance Board
LRHL	Local Redevelopment and Housing Law
MICS	Master Invoice Control Sheet
MOA	Memorandum of Agreement
NJMC	New Jersey Meadowlands Commission
OIG	Office of the Inspector General
PCB	Polychlorinated Biphenyl
PDM	Processed Dredge Materials
PILOT	Payment in Lieu of Taxes
PS&S	Paulus, Sokoloski & Sartor
PVSC	Passaic Valley Sewerage Commissioners
RAB Law	Redevelopment Area Bond Financing Law
RAW	Remedial Action Workplan

RAW/CP	Remedial Action Workplan and Closure Plans
RFP	Request for Proposal
RIR	Remedial Investigation Reports
RMI	Redevelopment Materials Inc.
SOQ	Statement of Qualifications
SRF	State Revolving Fund Program (or Fund)
SWMA	Solid Waste Management Act
TIF	Tax Increment Financing
USEPA	United States Environmental Protection Agency
VHB	Vericle Hydraulic Barrier