JEFFERSON COUNTY COMMISSION

DAVID CARRINGTON - PRESIDENT
GEORGE F. BOWMAN
SANDRA LITTLE BROWN - PRESIDENT PRO TEMPORE
T. JOE KNIGHT
JAMES A."JIMMIE" STEPHENS

DAVID CARRINGTON – COMMISSIONER
CHAIR ADMINSTRATIVE SERVICES
DISTRICT 5
Suite 230 Courthouse
716 Richard Arrington, Jr. Blvd. N.
Birmingham, Alabama 35203
Telephone (205) 325-5503
FAX (205) 325-5960

May 10, 2011

Mr. John Young
Receiver
Jefferson County Environmental Services Department
716 Richard Arrington Jr. Boulevard North
Birmingham, AL 35203

Dear John:

By this letter, we will provide our views in response to your recent communications with a portion of the sewer creditors. This letter is sent in connection with ongoing settlement discussions, is in connection with an offer of compromise and is subject to Rule 408 of the Federal Rules of Evidence and similar state rules. It is therefore not admissible in any court proceeding.

As an initial matter, we acknowledge that the creditors' general proposals were prepared well before the tornadoes that struck our area two weeks ago. Although preliminary reports indicate approximately 4,800 homes were permanently destroyed, it will take some time for the County to quantify completely the extent of the damage caused by the storms, the impact on sewer system operations, and the effect on sewer revenues. We assume you and the creditors will also want time to re-evaluate your positions in light of the changed circumstances. As Receiver, you should reassess the assumptions underlying your conclusions about reliability of the system's base revenues, the costs of maintaining and repairing the system facilities, the reasonableness of rate increases, and the willingness and ability of the sewer users to pay higher rates. Likewise, the creditors must understand that the fair value of the debt they hold -- already substantially less than face value even before the storms -- is now only a fraction of the original $3.2 billion. In the near-term at least, and probably for several years, they should expect a *decline*, not an increase, in net sewer revenues. In any event, no one can accurately predict the feasibility of a refinancing until more definitive information about the effects of the storm on the system facilities, operations and revenues is collected and thoroughly analyzed.

Turning now to the information you relayed from the creditors several weeks ago about possible settlement terms, we were very disappointed that you were unable to present us with a formal settlement offer from the creditors, even though, as you've acknowledged several times, the County has made numerous formal settlement offers to the creditors. While we appreciate your efforts and the limited information you were able to provide to us, we really need to have a formal, written settlement offer that includes the underlying assumptions, a creditor listing with the concessions each is willing to make, and a better understanding of the final resolution of all outstanding litigation against the County, including the Syncora, JP Morgan and Wilson cases.

All of these details, and more, must be clarified in writing before the County can assess the fairness or viability of any proposed solution.

Since the County wants to encourage any dialogue that can lead to a permanent solution, we are willing to respond in that spirit to the concepts you presented in our meeting. The broad concepts you provided are listed in italics below, with our comments to each immediately following:

- *The County (or a separate authority created by the County) would be required to issue $2.2 to $2.4 billion of refinancing debt.*

The amount of refinancing sewer debt that can be issued and the cost of that debt (driven by interest rates, credit spreads, etc.) is not a matter about which the County can "negotiate". The reality is that given the available and achievable revenue stream from the system, these proposed numbers are not practical or realistic. The solution must reflect numbers that are practical and achievable under the circumstances. Our attention needs to be focused on what debt level and debt cost the sewer system can afford. Even before the recent storms, $2.2 to $2.4 billion was unrealistic given the failure of the original debt structure, the demise of the bond insurers and the attendant collapse of their credit ratings, and the loss of the County's and the County's warrants' credit ratings, all during the past three years. Even if the County were willing to settle at that amount, which it is not, any attempt to make the sewer system perform at that debt service level is doomed to failure. We need a solution that is concrete and realistic. This concept, as presented to us, is neither. We want to reiterate though that we do remain receptive to any settlement offer that falls within realistic cash flow models and projections, as long as it remains within the dedicated revenue stream of the indenture.

- *Based on your projections, the revenue increases required to pay $2.2 to $2.4 billion of debt would be 25+% for each of the first three years and 3% for each year thereafter.*

As you have pointed out, these are revenue increases, not rate increases. Since higher rates will lead to lower demand, the actual rate increases required to achieve the targeted revenue increases would likely be even greater than 25%. Our creditors must remember that the only monies available for payment of the sewer debt are the net system revenues. Any sewer rate increases that support refunding debt must be reasonable. They have to survive scrutiny by public officials at the County and in the State Legislature. They also have to survive rating agency and market scrutiny for feasibility. Proposed increases may have to survive judicial scrutiny if challenged by rate payers, as well as the economic test of the elasticity of demand. Like the principal amount of the debt, this is not a matter of "negotiation" for the County. A set of rate projections that all parties believe will survive scrutiny must be part of the solution. Above all, it must be fair to the rate payers. Creditors have an interest in this question, just as the County does. We need to work together, with your guidance, to evaluate the current position of the system after the effect of the recent tornadoes, and the future increases, if any, that will work and remain equitable to all involved. We are confident that the rate increases embedded in the creditors' communication will not survive scrutiny at all these levels.

- *The County would be required to bear the risk of market acceptance and the risk that interest rates might rise or credit spreads might widen before the refinancing could be accomplished.*

The County simply cannot assume the risk of market acceptance, the risk of rising interest rates, or the risk of widening credit spreads. We do not know what the creditors have assumed on this point, but all parties can agree that if those assumptions change (for example, interest rates rise), then the revenue required to pay the refinancing debt goes up. The County has nothing to backstop those risks other than additional increases in sewer revenues to even more unreasonable levels. It would only be realistic for the County to agree to a target amount of refinancing debt and interest cost. If market conditions deteriorate, the only means available to fill the resulting gap is to decrease the debt or adjust the interest rate until the debt payments match the available cash flow.

- *All litigation against the County, including the litigation challenging historical rate increases, would be settled and released.*

The County does not control the dismissal of lawsuits against the County. Only the plaintiffs can dismiss those cases. If the creditors can persuade the plaintiffs to dismiss their claims, the County will welcome their assistance.

- *Legislation must be adopted by the Alabama Legislature that allows the transfer of the sewer system to a separate public corporation (a new "Super-GUSC" so to speak), which would operate the system and issue the refinancing debt. The creditors insist the Super-GUSC must be prohibited from filing a Chapter 9 petition.*

If a settlement with our creditors can be reached, we will support and encourage passage of a "Super-GUSC" bill by the State Legislature. We believe, however, that any newly formed GUSC under this legislation should have the ability to file for protection under Chapter 9, if necessary. Obviously, the County does not control the State Legislature and cannot predict when, if or in what form the bill might ultimately be adopted.

With these factors in mind, the County has proposed and continues to propose a debt exchange rather than a publicly-marketed refinancing. A debt exchange would allow the creditors and the County to establish a known principal amount and interest rate, which could be measured against projected cash flows. That is a workable track to a solution. Asking the County to accept the execution risk of a refinancing with changing market conditions is not. The creditors could accept this risk; the County does not have that ability.

John, the County appreciates your efforts to find an acceptable, holistic solution to this problem. We need to get this matter behind us. We are ready, willing and able to work toward a solution based on reasonable, good faith negotiations with a designated committee of creditors who are authorized to speak on behalf of the entire group. Please let us know what we can do to facilitate the process on that basis.

Sincerely,

David Carrington
Commission President

Jimmie Stephens
Chairman of the Finance Committee