

THE ART OF SAYING "NO" OR BAMBI MEETS GODZILLA

Raymond A. Biering
Deputy County Counsel
Office of County Counsel
San Luis Obispo, California

ABSTRACT

The following article examines the law, economics and politics of a recent decision by the San Luis Obispo County Board of Supervisors to deny the assignment of a local solid waste franchise to USA/Waste Management, Inc. The article also discusses a sample assignment provision designed to preserve for local decision-makers maximum discretion in approving or denying transfers or assignments of solid waste franchises.

PROLOGUE

Some of us who are still able to remember the 1960's may recall an underground cartoon entitled "Bambi Meets Godzilla." The story line is based on an exquisitely simple theme: Bambi grazes in a beautiful pastoral setting and Godzilla stomps on Bambi - The End. So what do Bambi and Godzilla have to do with solid waste? They underscore the political perception in San Luis Obispo County, California, of the proposed acquisition of a local solid waste hauler by the largest waste company in the world: USA/Waste Management, Inc.

The continuing consolidation, some might say monopolization, of the solid and hazardous waste industry through mergers and acquisitions is feeding an economic Godzilla. Certainly, all Godzillas are monsters - at least in terms of their sheer magnitude. But not all Godzillas are bad monsters. Some of the nicer Godzillas contribute to our local charities, sponsor our little league teams, and help us build homeless shelters. Nevertheless, local governments must be mindful of the potential ramifications of the continuing monopolization of the waste industry, particularly where waste collection and disposal facilities are owned by the same Godzilla.

MONOPOLIZATION OF SOLID WASTE THROUGH MERGERS AND ACQUISITIONS

Much has been written in recent years about the so called "vertical and horizontal integration" of waste disposal services. The economic concepts are relatively simple: the largest waste management companies seek to acquire,

generally through merger or acquisition, smaller, local waste management companies, with the ultimate eye towards controlling both the collection and disposal ends of the process. According to the USA Waste Services, Inc., 1997 Annual Report:

The Company regularly pursues opportunities to expand its services through the acquisition of additional solid waste management businesses and operations that can be effectively integrated with the Company's existing operations. In addition, the Company regularly pursues mergers and acquisition transactions, some of which are significant, in new markets where the Company believes that it can successfully become a provider of integrated solid waste management services As one of the leading industry consolidators, the Company could announce other transactions with either publicly or privately owned businesses at any time.¹

The process of vertical integration of waste collection services is best described from a local government perspective by one commentator as follows:

A municipality often refrains from undertaking a competitive procurement of an expiring waste collection contract that has long been satisfactorily serviced by a local, family-owned hauling business. Arguing for sole-source renegotiations, the hauler might emphasize his business and social ties to the community and express his intention to remain in town for many years to come and leave the business to his children. Nevertheless, on the date he signs a new agreement, his corporate value is boosted. Despite his

¹ USA Waste Services, Inc., 1997 Annual Report, page 12.

former feelings, he might subsequently be tempted to sell his business. Understandably, from the contractor's perspective, an "offer-it-can't-refuse" is the fruit of many years' hard work and investment.²

WASTE MANAGEMENT, INC. AND USA WASTE SERVICES, INC.

As of 1991, Waste Management, Inc. (WMI) was the world's largest waste disposal company. Although precise estimates vary, one reliable report indicates that in 1991 WMI had approximately 500 subsidiaries operating in 1200 communities in North America, with 27,000 employees (6,700 in management or sales positions). For 1988, Waste Management had total assets of \$4.9 billion and revenues of \$3.6 billion. An article in the Wall Street Journal dated May 1, 1991, identified WMI's 1990 revenue as \$6.03 billion and the company's earnings as \$684.8 million. These figures, according to the article, represented that in four years, the revenue of the firm had tripled and the earnings had doubled.³ As of 1999, WMI is still the largest solid and hazardous waste company in the world, dominating the industry with \$11.2 billion in hauling and disposal revenue.⁴

Over the years, WMI developed a rather unsavory reputation for its methods of providing waste services. A brief surf on the internet reveals a long history of civil and criminal problems. The allegations about WMI have been rampant—environmental problems, public corruption, anti-trust and unfair business practices, and numerous other proven and unproven charges. The Final Report of the District Attorney of San Diego County in 1992, concluded as follows:

Waste Management, Inc.'s methods of doing business and history of civil and criminal violations has established a predictable pattern which has been fairly consistent over a significant number of years. The history of the company presents a combination of environmental and anti-trust violations and public corruption cases which must be viewed

with considerable concern. Waste Management has been capable of absorbing enormous fines and other sanctions levied against it while still maintaining a high earnings ratio. We do not know whether these sanctions have had any punitive effect on the company or have merely been considered as additional operating expenses.⁵

In 1999, according to the Center for Health, Environment and Justice:

Waste Management had an eventful Spring, complete with a fine for illegally dumping medical waste, an agreement to settle a discrimination lawsuit, and the arrest of a company employee in a bribery investigation. The company was fined \$150,000 by a judge in Virginia for illegally sending medical waste to their landfill in Charles City County. The judge also warned the company to do more inspections at the Transfer Station in New York City which was the source of the medical waste. Waste Management agreed to pay up to \$750,000 to settle claims that they discriminated against fifteen minority and women applicants for truck driving jobs in Cicero and Morris, Illinois and Portage, Indiana. The settlement was a result of a discrimination claim by the Labor Department's Office of Federal Contract Compliance Programs after a routine compliance review. And in Garden City, New York, federal prosecutors charged a Waste Management official with conspiracy and witness tampering as part of their investigation into bribery in exchange for illegal dumping at a local landfill.⁶

In 1998, USA Waste Services, Inc. ("USA"), of Houston, merged with WMI.⁷ Prior to the merger, WMI had been floundering financially, taking over \$3.5 billion in write

² Constance Hornig, "Protecting Yourself From the Vertical Integration Grab," *MSW Management—Elements* 1999, p. 24.

³ Report from Ventura County Sheriff's Department to Chair of the Board of Supervisors, September 20, 1991.

⁴ *Waste News*, "Hauling and Disposal Top 100," July 12, 1999, p. 25.

⁵ Final Report, "Waste Management, Inc.," Edwin L. Miller, Jr., District Attorney, March, 1992, page 57.

⁶ Center for Health, Environment and Justice, *Everyone's Backyard*, "Corporate Corner," Volume 17, No. 2, Summer 1999, page 8.

⁷ At the time, USA Waste was the 3rd largest waste disposal company with annual operating revenues in 1997 of \$2.6 billion and net income of \$358.4 million (USA Waste Services, Inc., 1997 Annual Report, *supra*, at fn. 1).

offs in the prior year due to operating losses and overstated income since 1991. Prior to 1998, USA had been an aggressive purchaser of smaller waste companies around the nation and was now in a position to acquire an even larger waste company.⁸ The newly merged USA/WMI owns or operates more than 300 landfills across the country and has combined revenues of approximately \$12 billion.⁹ The USA/WMI merger has been valued at \$20 billion. USA took control of the combined companies, but retained the WMI name.¹⁰

Since the 1998 USA/WMI merger, the company's financial performance has been dismal. Waste News reported on July 12, 1999, "Waste Management Inc.'s shocking announcement it would fall \$250 million short of second-quarter revenue projections." The news came as a surprise to USA/WMI investors as the company's value fell nearly \$12 billion in one day in what one financial analyst referred to as a "bloodbath."¹¹ On August 12, 1999, Waste News reported as follows:

A second earnings jolt sent Waste Management Inc. stock on a nose dive again and top executives out into the field in an attempt to get a handle on financial numbers that so far this year have proven utterly unreliable.¹²

The Waste News article further quoted Douglas Augenthaler, analyst for CIBC World Markets, as follows:

[T]he problem stems from joining the old Waste Management, a giant company that was about to break, and USA Waste Services Inc. which was not as healthy as

it appeared to be. The deal allowed management to hide the companies' flaws and real post-merger results. It gives me concern they are throwing a blanket over this again, like the old Waste Management.¹³

The consolidation of the waste industry continued in 1999 as the third largest solid waste hauler, Allied Waste Industries, announced its planned acquisition of the second largest solid waste hauler, Browning-Ferris Industries (BFI) in an acquisition estimated at approximately \$9 billion. The new company will retain the BFI name in certain markets and is expected to generate revenues of \$6.6 billion per year.¹⁴ Further consolidations continue the trend toward the monopolization of the waste management industry.

THE SAN LUIS OBISPO COUNTY EXPERIENCE

San Luis Obispo County is located between Los Angeles and San Francisco along the California coastline. At the beginning of the southernmost point of the Big Sur coastline, the County is a major tourist-destination resort area known for its Mediterranean climate, spectacular coastline, wine production, Morro Rock, Cal Poly State University-San Luis Obispo and Hearst Castle. San Luis Obispo County is a pastoral setting in every sense of the word.

San Luis Obispo County is one of California's ten fastest growing counties. In the past 25 years the population has doubled. As of 1994, the population was approximately 232,400 people. The incorporated cities contained over half of the population, with the balance distributed throughout the unincorporated areas. By the year 2000, the population is expected to grow to 301,850 people.¹⁵ The County is comprised of the unincorporated county and seven incorporated cities: Arroyo Grande, Atascadero, Grover Beach, Morro Bay, Paso Robles, Pismo Beach, and San Luis Obispo. Historically, the economy of San Luis Obispo County has been oriented toward agriculture, services and tourism. The majority of the population is under the age of 44, with the average age at 33 years. As of 1994, the median income for San Luis Obispo County was \$42,300, the average property value was \$215,300, and a majority of

⁸ According to the 1997 USA Waste Annual Report: "The solid waste industry is a very localized and highly fragmented business. In addition to the public companies, there are thousands of small, privately-owned companies and government entities providing solid waste services to a wide range of customers. In recent years, increasing regulatory and capital intensity has caused many smaller companies to seek exit strategies and has nudged many municipalities toward privatization. Further, the economies of scale offered by larger, integrated operations often enable them to compete more effectively in the market place. All these industry trends favor the consolidation of small operations into larger ones. In fact, we are experiencing the greatest period of consolidation activity ever in our industry."

⁹ Staff Report from Ellen Sturtz via Timothy P. Nanson, County Engineer, to the San Luis Obispo County Board of Supervisors, January 5, 1999, page F-1-7.

¹⁰ Waste News, "WMI Takes Nosedive," July 12, 1999, p. 45.

¹¹ *Id.*, at p. 1.

¹² Waste News, "WMI Stock, Execs Hit Hard Times," August 2, 1999, p. 1.

¹³ *Id.*, at p. 21.

¹⁴ Center for Health, Environment and Justice, *supra*, at fn. 6.

¹⁵ San Luis Obispo County Integrated Waste Management Plan, "County Profile and Plan Administration," Chapter 3, p. VII-3-1, (1995).

the population lived in single family dwellings, rather than multi-unit dwellings or mobile homes.¹⁶

The solid waste management system in San Luis Obispo County has been driven by countywide growth. It consists of four basic elements: regulators, generators, haulers, and solid waste disposal facilities. The regulators of solid waste in the County are the incorporated cities, a few special districts, and the unincorporated county. The generators in San Luis Obispo County (cities, county, special districts and State or Federal agencies) have entered into franchise or other service agreements with private companies (haulers) to collect, haul, and dispose of solid waste from service areas. Most of the service areas are multi-jurisdictional, containing several jurisdictions within their boundaries. The haulers providing service in San Luis Obispo County are privately owned and, in addition to regular residential and commercial collection, most of the companies provide recycling, green waste disposal, and roll-off box service.¹⁷ There are three major solid waste disposal facilities in San Luis Obispo County and no permitted toxic or hazardous waste disposal facilities.¹⁸

Solid waste management planning and regulation in San Luis Obispo County consists of the San Luis Obispo County Integrated Waste Management Authority (IWMA),¹⁹ the unincorporated County, and the cities of Arroyo Grande, Atascadero, Paso Robles, Grover Beach, Morro Bay, San Luis Obispo, and Pismo Beach. The IWMA has responsibility for implementing various countywide programs to implement the Statewide mandate under AB 939. The local enforcement agency for San Luis Obispo County is the County Environmental Health Division of the Health Department, which implements regulatory standards

¹⁶ *Id.*

¹⁷ The private haulers include Mission Country Disposal, Morro Bay Garbage Company, Paso Robles Waste Disposal, Inc., San Luis Garbage Company, San Miguel Garbage Company, South County Sanitary Service, Inc., and Wilmar Disposal and Recycling, Inc. Some of the haulers share common ownership.

¹⁸ The three major facilities are the Cold Canyon Landfill (located southeast of San Luis Obispo), Chicago Grade Landfill (located northeast of Atascadero) and Paso Robles Landfill (located on city property northeast of Paso Robles proper).

¹⁹ The San Luis Obispo County Integrated Waste Management Authority (IWMA) was created through a Joint Powers Agreement (JPA) by the cities of Arroyo Grande, Grover Beach, Morro Bay, Pismo Beach, San Luis Obispo, Atascadero, and the County to prepare a Countywide Integrated Waste Management Plan as required by the California Integrated Waste Management Act of 1989 (AB 939).

imposed by the State of California Integrated Waste Management Board.²⁰

Solid waste services within San Luis Obispo County are provided by relatively small, locally-owned businesses. The local haulers are owned and operated by families who have long standing ties to the community and are widely respected. They own local businesses, they serve on local PTA's and 4-H organizations, and their children and grandchildren attend local schools.²¹

In the mid-1990's, the County of San Luis Obispo elected to augment its existing permit regulatory system over solid waste by establishing through ordinance a new franchise system. Essentially, the County divided the historical permit territories into individual franchise areas based upon franchise agreements. In addition to the existing regulatory authority over solid waste disposal facilities, the franchise system also provided a contractual basis to regulate the disposal facilities, as well as a revenue base for the County through franchise fees.

After years of relative isolation from the mergers and acquisitions being experienced throughout the rest of the country, San Luis Obispo County finally caught the eye of the USA/WMI Godzilla. In 1998, USA/WMI decided to purchase one of the locally-owned haulers, Wilmar Disposal and Recycling, Inc., which operated within the City of Atascadero and outlying unincorporated area of the County by virtue of franchise agreements with the City of Atascadero and the County.²²

COUNTY/WILMAR FRANCHISE AGREEMENT

As part of the newly established franchise system, exclusive franchise agreements were offered to each historical solid

²⁰ San Luis Obispo County Integrated Waste Management Plan, *supra*. at fn. 15. The County Environmental Health Division serves as the enforcement agency throughout the County, except in the City of Paso Robles.

²¹ The local haulers include the families of Dale and Kathy Gomer, George and Linda Kardashian, Charles Cattaneo, Al and Mary Rizzoli and Peter Andre.

²² The precise terms and conditions of the USA/WMI-Wilmar sale have not been publicly disclosed. The corporate process of acquiring local companies was described by the Center for Health, Environment and Justice as follows: "WMI usually will buy up companies by offering the present owners a job with WMI and stock. In so doing, WMI gains corporate control of the subsidiary but leaves the same officials in charge of it. This is a fundamental pattern of corporate acquisition in the garbage industry (NYS, 1984 Crooks, 1983) as well as in many other corporate arenas. "Waste Management, Inc.: A Corporate Profile," Center for Health, Environment and Justice, 1988.

waste hauler, originally subject to five year terms.²³ Wilmar Recycling and Disposal, Inc. (Wilmar) was granted a solid waste franchise to provide collection services in the unincorporated areas in the vicinity of Atascadero, California.²⁴ The current Wilmar Franchise Agreement has a term of seven years, with provisions for extensions until June 2008. Less than three months after signing the franchise agreement, Wilmar notified the County of the proposed merger of Wilmar and USA/WMI.²⁵

All of the franchise agreements granted by the County are subject to an identical assignment provision, which provides that the franchise may not be assigned, sold, subcontracted or transferred, either in whole or in part, without the prior written consent of the County. Although the assignment provision provides that the "County may deny or approve such a request at its discretion," it also provides that the "County will not unreasonably withhold its consent." A complete copy of the assignment provision follows this article as "Appendix A."

In addition to the basic restriction on assignments, subject to reasonable consent, the assignment provision defines the measures for "discretion" and "reasonableness." The assignment provision references the experience, skill, reputation, and financial resources of the proposed franchisee as factors in considering an assignment. The provision also sets forth specific points of proof which the proposed franchisee is required to provide. In order to deny a proposed assignment, the County is required by the

²³ California Public Resources Code section 40059(A)(2) authorizes a county to provide for the collection and disposal of solid waste service through exclusive solid waste franchises, with or without a competitive bidding process. The Board of Supervisors initially decided to offer franchises without competitive bidding to the existing haulers, but preserved the ability to establish all future franchises, including franchise renewals, through competitive bidding. In addition to State law, the County enacted a franchise ordinance, which, among other things, established the basic terms and conditions for future franchise agreements.

²⁴ Solid Waste Franchise Agreement Between San Luis Obispo County and Wilmar Disposal, Inc., June 16, 1998.

²⁵ By a letter dated September 9, 1998, legal counsel for Wilmar, Frank Zumwalt, notified the County of the proposed merger of Wilmar with USA/WMI. The letter requested the County's approval of the assignment of the franchise agreement from Wilmar to USA/WMI, stating as follows:

The proposed merger contemplates no change in the existing Franchise Agreement and current rate structure, nor would the acquisition costs form any basis for a rate increase. The merger contemplates that the current key management personnel responsible for county's franchise retain their positions to supervise the company's operations. USA Waste of California will, however, provide greater resources and expert guidance to operate the company's solid waste business.

assignment provision to reasonably make at least one of the following findings:

- that [the proposed franchisee] does not have ten years of solid waste experience on a scale equal to or greater than the existing franchisee
- that [the proposed franchisee] has received significant governmental citations or censures in the past five years
- that [the proposed franchisee] has not conducted its operations in an environmentally safe and conscientious manner
- that [the proposed franchisee] does not conduct its solid waste management practices in accordance with sound waste management practices in compliance with law
- that [the proposed franchisee] cannot otherwise fulfill the terms of the Franchise Agreement in a timely, safe and effective manner

The Franchise Agreement also contemplates that, upon notification of a proposed assignment, the County will "investigate the suitability of [the] proposed assignee," based in part on information to be provided by the franchisee.²⁶ The franchisee is required by the Franchise Agreement to pay the County its "reasonable expenses for attorneys' fees" with respect to an assessment of the proposed assignment. The County's fee ordinance further requires reimbursement of direct and indirect costs.²⁷

Prior to the consideration of the assignment request by the County Board of Supervisors, County staff requested and obtained substantial additional information pertaining to the proposed assignment, and specifically pertaining to

²⁶ Solid Waste Franchise Agreement, *supra*, sections 6.E.1 and 6.E.3. Wilmar's request for approval of the assignment enclosed supporting material for the County's review, including an operations map, USA Waste's 1997 Annual Report, and SEC Form 10-Q Filing and a Statement of Financial Report.

²⁷ In accordance with the Franchise Agreement, Wilmar initially deposited \$15,000 towards the costs for the County to evaluate the assignment request. Subsequently, the County retained Peters & Varco, LLP, to assist in the preparation of a staff report to the Board of Supervisors and the accounting firm of Hilton, Farnkopf & Hobson, LLC, to assist with the assessment of financial issues. Wilmar later paid the balance of the County's costs to evaluate the request.

USA/WMI. The information included rate histories, claims against USA/WMI, financial information, compliance histories, and related materials. An administrative record of the entire proceedings pertaining to the Wilmar-USA/WMI assignment is available pursuant to the California Public Records Act through the office of the County Clerk-Recorder for the County of San Luis Obispo.²⁸

FRANCHISE ASSIGNMENT LAW

The law of assignment in the context of franchises and other contracts is beyond the scope of this article. However, certain basic contractual principles should be kept in mind when considering the actions of the County of San Luis Obispo with regard to the proposed Wilmar franchise assignment. For example, Wilmar expressly stipulated in the Franchise Agreement that the County selected Wilmar for its particular experience, skill and reputation in providing solid waste management services and for its financial resources.²⁹ Typically, where a contract calls in this way for the skill, credit and other personal qualities of a promisor, such as Wilmar, it is *not* assignable.³⁰ As previously mentioned, the County's Franchise Agreement is assignable by its terms, subject to the consent of the County, if the standards set forth in the Franchise Agreement are satisfied.³¹

It is also important to consider that solid waste franchises, to the extent that they create legal public monopolies, raise significant public policy concerns. Generally, monopolies are not favored creatures in the eyes of the law, particularly in view of the inevitable antitrust concerns. Nevertheless, monopolies in the form of solid waste franchises are expressly permitted by California law.³² The public policy

concerns resulting from the establishment of legal solid waste monopolies through franchise agreements create additional concerns because solid waste is essentially comparable to public utilities like electricity, water, and natural gas.

THE POLITICS OF THE DECISION TO APPROVE OR DENY THE USA/WMI ASSIGNMENT REQUEST

Compared to the rest of the civilized world, San Luis Obispo County is a strong pro-environmental community influenced by the coastal politics of California, as well as Cal-Poly State University at San Luis Obispo. For example, in 1988, the voters of San Luis Obispo County enacted Initiative Measure A, which requires a vote of the people before any onshore facilities can be established to support offshore oil platforms (which were proposed) off the coastline of San Luis Obispo County.³³ In 1976, the City of San Luis Obispo established one of the first curbside recycling programs in California. In 1990, the City of San Luis Obispo enacted one of the first municipal ordinances prohibiting smoking in public places, including bars and restaurants.³⁴ Throughout the 1990's, the County of San Luis Obispo and most of the incorporated cities adopted various forms of growth management ordinances, designed to limit new construction to prescribed annual limits based on resource constraints.³⁵

As a picturesque community of bike lanes, alternative transportation, and scenic open space, it is hardly surprising that the residents of San Luis Obispo County might not be entirely enthralled with the idea of Godzilla coming to town.³⁶ Reflecting the political consciousness of the community, the San Luis Obispo County Board of

²⁸ A copy of the Administrative Record can be obtained through the San Luis Obispo County Clerk-Recorder, subject to reasonable reproduction costs. Contact:

Office of the County Clerk-Recorder
County of San Luis Obispo
1144 Monterey Street
San Luis Obispo, CA 93408
805-781-5080

²⁹ Solid Waste Franchise Agreement, *supra*, section 6.D.

³⁰ 1 Witkin, Summary of California Law, pp. 831-832, Contracts, section 931 (9th ed. 1987).

³¹ For cases discussing "reasonable consent" in other contexts, see *Shamrock Motors, Inc. v. Ford Motor Company*, (9th Cir. 1997) 120 F.3d 196; *Anheuser-Busch, Inc. v. Natural Beverage Distributors*, (9th Cir. 1995) 69 F.3d 337; *Carma Developers, Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342.

³² California Public Resources Code sections 400059(2) and 49200, et seq.

³³ The enactment of Measure A led to Federal litigation, *WOGA v. Sonoma County, et al.* in which the cities and counties successfully defended the right of the voters to enact an initiative measure which regulates offshore oil development. To this date, there are still no offshore oil platforms located off the coast of San Luis Obispo County.

³⁴ San Luis Obispo County Code, Chapter 8.16 et seq.

³⁵ See e.g., San Luis Obispo County Code, Title 26 et seq.

³⁶ For example, a local "alternative" newspaper offered the following opinion: "County Staff and just about everyone else with a light on upstairs was uniformly against letting WMI take over the trash collection franchise of Wil-Mar Disposal Co., a local company WMI is trying to buy, along with every other garbage company in the Free World. Here is what I think: WMI really sucks. We're talking about some very bad people with a nasty track record of indictments for environmental damage, buying off political support, lying to regulators and even their own shareholders, strong-arming competitors, price fixing, and making threats to the counties they serve, including SLO County a few years back. . . . But don't worry. That's never stopped us from making dumb decisions in the past." *New Times*, "Opinion-The Shredder," January 7, 1999, page 10.