



NAVAJO NATION DEPARTMENT OF JUSTICE
OFFICE OF THE ATTORNEY GENERAL

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MEMORANDUM:

To: Speaker and Members of the 23rd Navajo Nation Council

From:

Ethel Branch, Attorney General
Office of the Attorney General
Navajo Nation Department of Justice

Date: December 26, 2018

Subject: **Public Comments re 0448-18 (NNOGC Investment)**

Proposed Legislation No. 0448-18 is legally deficient and should be withdrawn. The legislation suggests that it is modifying and reducing a previously authorized investment in Navajo Nation Oil & Gas Company (NNOGC) for which the Navajo Nation Investment Committee (Investment Committee) conducted due diligence and made a recommendation to the Budget and Finance Committee (BFC) for approval. Section 2, Paragraph F, Legislation No. 0448-18. However, that original financing was authorized to facilitate a one-time urgent bail-out, the primary purpose of which was to allow NNOGC to refinance a \$74.1 million bank loan they had defaulted on and reinstate their crude oil hedging program to protect NNOGC from future financial uncertainty. Section 2, Paragraph E, Resolution No. BFMA-13-18 (“the NNOGC Board of Directors and the NNOGC Shareholder Representatives have requested that the Navajo Nation approve an investment in NNOGC that would facilitate the complete replacement of the Bank Loan and permit NNOGC to reestablish its crude hedging program to reduce risk and avoid similar credit crises in the future”). However, NNOGC chose a different path. Rather than avail itself of the up to \$40 million redeemable preferred stock investment from the Nation, NNOGC chose to directly refinance their defaulted loan and invest in hedging through a new loan from Guggenheim Partners, LLC (Guggenheim). Section 2, Paragraph C, Legislation No. 0448-18. So the financial duress that NNOGC was in when it sought its initial loan from the Nation no longer exists, and the purpose of that initial loan was met by the Guggenheim loan.

The investment being presented to BFC for approval in Legislation No. 0448-18 serves an entirely different purpose: “to make additional investments in oil, gas and helium properties, including seismic exploration, for increased staffing to drive and manage growth (administrative, financial, engineering, and geological), and for other appropriate purposes.”

Section 2, Paragraph G, Legislation No. 0448-18. Accordingly, the loan that Legislation No. 0448-18 seeks to authorize has been neither reviewed for due diligence by the Investment Committee as required by the Nation's Master Investment Policy, nor has it been recommended to BFC by the Investment Committee. The Nation's Master Investment Policy was last amended and approved by BFC just a week ago, in Legislation No. 387-18, and Section 8.1(i) of that Policy provides that "Direct investment of Nation funds in any entity or enterprise owned in whole or part by the Nation, is permitted subject to investment and operational due diligence by the Investment Committee or its designee." However, that due diligence has not been conducted, and as NNOGC now has a new financial position due to its Guggenheim loan, there is a need to assess this and any covenants that NNOGC has in place with Guggenheim. This is a necessary first step in order to assess any risks that may be associated with the Nation providing NNOGC with a \$15 million loan on top of the \$80 million loan NNOGC has from Guggenheim.

Part of the due diligence on the new proposed NNOGC loan/investment should investigate whether NNOGC has sufficient revenues to both cover their debt service to Guggenheim on a loan that is millions of dollars greater than the loan NNOGC previously could not pay debt service on, and pay back the Nation on the timeline contemplated in the Term Sheet for this new Cumulative Redeemable Preferred Stock Investment.¹ The Nation is already investing over \$200 million in Navajo Nation Gaming Enterprise, and has had to bail them out repeatedly by reducing their interest rate (most recently from 13 percent to roughly 6 percent, which will reduce the Nation's investment returns by over \$100 million; as a then-voting member of the Investment Committee, I voted against this write-off as any prudent investor would). Given this cautionary experience investing in the Nation's enterprises, it is critical that due diligence be conducted, and that the Nation's Investment Policy be followed to ensure proper management and use of the Nation's investment funds.

Indeed, the purpose of the Nation's principal investment fund, our Permanent Fund, is to replace lost income from natural resources development, such as what we face with the potential shutdown of Navajo Generating Station. The function of the Investment Committee is to vet potential investments and recommend those investments to the Budget and Finance Committee for approval. As this specific investment has not been so vetted or recommended, presentation of this investment to the Budget and Finance Committee for approval is premature and violates the procedures for approving the Nation's investments. Due diligence is a critical and necessary first step in proposing any investment in or loan to NNOGC, and assists the Investment Committee and the BFC in fulfilling their fiduciary duty to maximize the Nation's investment returns while protecting the principal as required by Section 3.1 of the Master Investment Policy.

For these many reasons Legislation No. 0448-18 is both premature and defective and should be withdrawn. It can be re-introduced when due diligence has been completed and the Investment Committee has made a formal recommendation for investment to the BFC.

¹ Note that the Term Sheet was not included with the version of Legislation No. 0448-18 made available to the public and it should have been as it is formal Exhibit B to the Legislation, which further calls into question the validity of this Legislation.