

THE KINDNESS OF STRANGERS
More on the SIC's Bad Investment in Earthstone International

**A Report for the Rio Grande Foundation
By Jim Scarantino**

Third in a Series

Broken pledges, breached contracts, misrepresented assets, and missed interest payments. For most companies and individuals, such a string of faults would have been enough for the State of New Mexico to say "Enough!" But the politically connected owners of Earthstone International can't seem to do any wrong in the eyes of Bill Richardson's State Investment Council. No matter how egregious or disappointing their conduct, they keep getting more money.

As shown in the Rio Grande Foundation's preceding two reports, Governor Richardson overrode the objections of the professionals in the State Investment Office and urged that a \$9 million loan be made to Earthstone International. Earthstone's founders are political supporters of Richardson and contributors to him and other New Mexico Democrats. He said he was "encouraged" by their "pledge" to open a new plant in Santa Teresa, New Mexico and create 200 new jobs. The Richardson Administration has been not the least bit bothered by the fact though it received \$9 million dollars of state money, Earthstone never even broke ground on the promised plant, and instead has exported jobs to Mexico and Arkansas.

After burning through the state's \$9 million without producing a single one of the promised jobs and breaching material conditions of its contract with the SIC, Earthstone has continued to receive millions more from the state. This report reveals how the public's money is virtually Earthstone's for the asking.

"Boy, you guys are being real nice to them!"

Earthstone received the first \$5 million of the \$9 million loan from the SIC in March 2004. Under the terms of the Convertible Note Purchase Agreement with the SIC, Earthstone could not receive the next \$4 million unless it met a milestone of gross revenue of \$4 million in a period of six consecutive months. Earthstone also had to comply with all other terms and conditions of the Convertible Note Purchase Agreement or the SIC would have no obligation to extend the balance of the loan.

The second report in this series revealed how Earthstone did not meet the gross revenue milestone. In fact, the numbers it submitted to the SIC were found by auditors for the SIC to be misleading and inflated.

But failing to meet the gross revenue milestone was not Earthstone's only breach of contract. Earthstone was required to make a \$125,000 interest payment in September 2004. It missed that payment but the SIC didn't seem to care. In fact, the SIC never gave notice to Earthstone that it was in default.

Earthstone was also in breach of contract because liens had been placed on its intellectual property. Earthstone also misrepresented facts about encumbrances on its patents in its disclosures to the SIC.

Earthstone's agreement with the SIC did not provide any means by which Earthstone could cure its defaults. Any default simply and forever released the SIC of its obligations to purchase more debt from Earthstone.

By December 2004, the SIC had transferred its convertible debt agreement with Earthstone to the New Mexico Co-Investment Partners ("NMCIP"). This organization was essentially managing the Earthstone investment for the SIC as part of its management of other SIC venture capital investments. In a December 23, 2004, letter, legal counsel for the NMCIP laid out how Earthstone had repeatedly breached its contract, thus relieving NMCIP (and the SIC) of any obligation then or in the future to extend further credit to Earthstone.

But, Earthstone got the other \$4 million anyway. What happened? As Charles Wollman, public information officer for the SIC, explained in an August 15, 2005, letter to a curious State Auditor, the SIC and NMCIP "did not fund Earthstone under the old agreement, [but] renegotiated the terms of the state's funding position." In simpler language, because Earthstone could not live up to the terms of its original loan, the SIC overlooked all of Earthstone's breaches of contract and misrepresentations and gave them a new, even sweeter deal.

As for that little matter of \$125,000 in overdue interest dating back to September 2004, the SIC never took action to collect the arrearage. By the time the "renegotiation" was underway in March 2005, Earthstone owed even more in past due interest. The amount of unpaid interest had by then grown to \$163,598. Half that amount was essentially forgiven when it was converted to equity in Earthstone. In fact, the entire \$9 million was essentially forgiven when it was all later converted to equity, thus putting taxpayers on the hook to sink or swim with Earthstone, instead of simply being repaid, with interest, pursuant to the terms of the loan.

Earthstone was not legally entitled to this largesse at the taxpayers' expense. In a March 14, 2005, e-mail to persons working out details in the renegotiation with Earthstone, the SIC's manager for alternative equity investments summed up his feelings about the favorable treatment the company was receiving. "Boy, you guys are being real nice to them!" he wrote. The exclamation point is his.

Good Money After Bad?

Earthstone got another \$4 million from the state in 2005, even though it never fulfilled its pledge to build the Santa Teresa facility that was supposed to have created 200 jobs. The SIC was aware of this broken promise at the time it nearly doubled the taxpayers' stake in this company.

Correspondence between the SIC and its fund manager in 2006 described Earthstone as one of the "bad" investments made by the SIC. But Earthstone has continued to receive more money from state coffers, even though it has exported jobs to Mexico and Arkansas. Earthstone once

claimed 33 employees at its Santa Fe facility. Today, that facility runs only five months out of the year and employs but eight people.¹

According to SIC records, New Mexico currently has \$10.735 million invested in Earthstone, \$1.735 million more than the original investment. One million of this amount came from a \$5 million round of raising venture capital completed in January 2008. That additional million dollars from the SIC was transferred to Earthstone to help it develop new products. The other amounts came from odd requests from the manager through whom the SIC maintains its investment in Earthstone—the same fund manager who has described Earthstone as a “bad” investment. Occasionally the manager has requested several hundred thousand dollars here and there, as though the SIC were covering Earthstone’s shortfalls in cash flow and operating expenses.

Earthstone has spun off a subsidiary called Growstone. This subsidiary uses recycled glass as a growing medium for greenhouses. As Earthstone sought to use recycled glass to replace pumice, Growstone seeks to use recycled glass to replace growing mediums mined from the Earth such as perlite.

Andrew Ungerleider, Earthstone’s founder, likes to display an artist’s conception of the Growstone facilities he envisions springing up around the nation. These facilities will be constructed at large urban landfills where there is a steady, voluminous supply of waste glass. The facilities will be a completely “green,” getting all their power from windmills and methane produced within the landfill. Cities will gladly supply Growstone with all the waste glass it wants, glass that would otherwise occupy limited landfill space. Ungerleider predicts a booming market for Growstone’s services and products that will completely transform the solid waste management and horticultural industries. Ungerleider once had similarly grandiose expectations for Earthstone.

In October 2008, the City of Albuquerque announced it would construct a small building at its west side landfill where Growstone would install a grinder for waste glass. Growstone would ship the pulverized glass to Earthstone’s Santa Fe facility where Growstone’s growing medium would be produced. Mayor Martin Chavez announced that negotiations were underway to construct a second, larger facility that would produce Growstone products on site. The financing for that larger project has yet to be negotiated, though Chavez predicted the building for Growstone’s use would be ready by mid-2010.

In announcing the project, city officials said they hoped Growstone will take all of the city’s recycled glass, about 15,000 tons a year.

The City of Albuquerque has been cautious in its dealings with Growstone. According to Leonard Garcia, director of the city’s solid waste department, while the city would like to see Growstone succeed and take more of the city’s discarded glass; it has not risked the taxpayers’ money in the company. It has retained ownership to the small building being used by Growstone to house a glass grinder. That building can readily be restored to the city’s use if Growstone falters. So

¹ When the Rio Grande Foundation discovered that Earthstone was employing fewer than a dozen people, contrary to public statements it had been employing many more.

We notified the SIC. They in turn questioned Earthstone which informed them that sometimes it would run double shifts. However, when confronted directly, Earthstone’s founder and principal, Andrew Ungerleider admitted they were employing fewer than a dozen people. In a January 28, 2008, interview with *The Albuquerque Journal*, Earthstone’s CEO, Rich Kiley, stated Earthstone’s facility operated only 5 months out of the year and had a payroll of eight people.

far, Growstone has taken only about 85 tons of glass from the city's landfill. Growstone pays \$20 per ton, a little more than the city gets from other users of the material.

The SIC, on the other hand, has shown little reluctance to risk more taxpayer money in Ungerleider's latest grand vision. In January, 2008 the SIC invested \$1.69 million in Growstone. A year after receiving the SIC's money and \$3 million in the same round of financing from other investors, Growstone continues to share space and a handful of employees with Earthstone at its modest Santa Fe facility. Growstone's website says its products are now available in a half-dozen cities, including Albuquerque. But this reporter was unable to locate any store in Albuquerque that carried Growstone products. A call to Growstone referred us to a store on Central Avenue in Albuquerque, a store not even listed in the White Pages.