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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended March 31, 2006**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission file number 1-12154**

**Waste Management, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**73-1309529**

*(I.R.S. Employer  
Identification No.)*

**1001 Fannin**

**Suite 4000**

**Houston, Texas 77002**

*(Address of principal executive offices)*

**(713) 512-6200**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The number of shares of Common Stock, \$0.01 par value, of the registrant outstanding at April 24, 2006 was 545,119,909 (excluding treasury shares of 85,162,552).

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Certification Pursuant to Section 1350, CEO

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## PART I.

Item 1. *Financial Statements.*

**WASTE MANAGEMENT, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In Millions, Except Share and Par Value Amounts)**

	March 31, 2006	December 31, 2005
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 454	\$ 666
Accounts receivable, net of allowance for doubtful accounts of \$60 and \$61, respectively	1,633	1,757
Other receivables	242	247
Parts and supplies	96	99
Deferred income taxes	91	94
Other assets	871	588
Total current assets	3,387	3,451
Property and equipment, net of accumulated depreciation and amortization of \$11,471 and \$11,287, respectively	11,063	11,221
Goodwill	5,352	5,364
Other intangible assets, net	144	150
Other assets	900	949
Total assets	<u>\$20,846</u>	<u>\$21,135</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 575	\$ 719
Accrued liabilities	1,447	1,533
Deferred revenues	482	483
Current portion of long-term debt	600	522
Total current liabilities	3,104	3,257
Long-term debt, less current portion	8,020	8,165
Deferred income taxes	1,362	1,364
Landfill and environmental remediation liabilities	1,198	1,180
Other liabilities	801	767
Total liabilities	14,485	14,733
Minority interest in subsidiaries and variable interest entities	290	281
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value; 1,500,000,000 shares authorized; 630,282,461 shares issued	6	6
Additional paid-in capital	4,485	4,486
Retained earnings	3,802	3,615
Accumulated other comprehensive income	118	126
Restricted stock unearned compensation	—	(2)
Treasury stock at cost, 84,102,636 and 78,029,452 shares, respectively	(2,340)	(2,110)
Total stockholders' equity	6,071	6,121
Total liabilities and stockholders' equity	<u>\$20,846</u>	<u>\$21,135</u>

See notes to the Condensed Consolidated Financial Statements.

**WASTE MANAGEMENT, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(In Millions, Except Per Share Amounts)**  
**(Unaudited)**

	Three Months Ended March 31,	
	2006	2005
Operating revenues	\$3,229	\$3,038
Costs and expenses:		
Operating	2,100	2,044
Selling, general and administrative	368	330
Depreciation and amortization	328	321
Restructuring	—	—
Asset impairments and unusual items	(2)	(23)
	<u>2,794</u>	<u>2,672</u>
Income from operations	435	366
Other income (expense):		
Interest expense	(136)	(116)
Interest income	9	6
Equity in net losses of unconsolidated entities	(8)	(26)
Minority interest	(12)	(10)
Other, net	1	—
	<u>(146)</u>	<u>(146)</u>
Income before income taxes	289	220
Provision for income taxes	103	70
Net income	<u>\$ 186</u>	<u>\$ 150</u>
Basic earnings per common share	<u>\$ 0.34</u>	<u>\$ 0.26</u>
Diluted earnings per common share	<u>\$ 0.34</u>	<u>\$ 0.26</u>
Cash dividends declared per common share (1st quarter 2006 dividend of \$0.22 per share declared in December 2005, paid in March 2006)	<u>\$ —</u>	<u>\$ 0.20</u>

See notes to the Condensed Consolidated Financial Statements.

**WASTE MANAGEMENT, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(In Millions)**  
**(Unaudited)**

	Three Months Ended March 31,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 186	\$ 150
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for bad debts	13	14
Depreciation and amortization	328	321
Deferred income tax provision	6	9
Minority interest	12	10
Equity in net losses of unconsolidated entities, net of distributions	10	17
Net gain on disposal of assets	(6)	(1)
Effect of asset impairments and unusual items	(2)	(23)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Receivables	99	99
Other current assets	(20)	(19)
Other assets	(2)	(6)
Accounts payable and accrued liabilities	(89)	(67)
Deferred revenues and other liabilities	28	4
Net cash provided by operating activities	<u>563</u>	<u>508</u>
Cash flows from investing activities:		
Acquisitions of businesses, net of cash acquired	(8)	(87)
Capital expenditures	(171)	(185)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	18	97
Purchases of short-term investments	(784)	(86)
Proceeds from sales of short-term investments	556	96
Net receipts from restricted trust and escrow accounts	47	53
Other, net	(11)	(9)
Net cash used in investing activities	<u>(353)</u>	<u>(121)</u>
Cash flows from financing activities:		
New borrowings	51	—
Debt repayments	(87)	(118)
Common stock repurchases	(375)	(99)
Cash dividends	(121)	(114)
Exercise of common stock options and warrants	125	26
Excess tax benefits associated with equity-based compensation	18	—
Minority interest distributions paid	(3)	(3)
Other, net	(29)	(64)
Net cash used in financing activities	<u>(421)</u>	<u>(372)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(1)</u>	<u>2</u>
Increase (decrease) in cash and cash equivalents	(212)	17
Cash and cash equivalents at beginning of period	666	424
Cash and cash equivalents at end of period	<u>\$ 454</u>	<u>\$ 441</u>

See notes to the Condensed Consolidated Financial Statements.

**WASTE MANAGEMENT, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
(In Millions, Except Shares in Thousands)  
**(Unaudited)**

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Restricted Stock Unearned Compensation	Treasury Stock	
	Shares	Amount					Shares	Amount
Balance, December 31, 2004	630,282	\$ 6	\$ 4,481	\$ 3,004	\$ 69	\$ (4)	(60,070)	\$ (1,585)
Net income	—	—	—	1,182	—	—	—	—
Cash dividends, paid	—	—	—	(449)	—	—	—	—
Cash dividends declared, but not paid	—	—	—	(122)	—	—	—	—
Common stock issued upon exercise of stock options and warrants and grants of restricted stock, including tax benefit of \$17	—	—	(11)	—	—	—	6,112	164
Earned compensation related to restricted stock	—	—	—	—	—	2	—	—
Common stock repurchases	—	—	—	—	—	—	(24,727)	(706)
Unrealized gain resulting from changes in fair value of derivative instruments, net of taxes of \$11	—	—	—	—	16	—	—	—
Realized losses on derivative instruments reclassified into earnings, net of taxes of \$4	—	—	—	—	6	—	—	—
Unrealized gain on marketable securities, net of taxes of \$1	—	—	—	—	2	—	—	—
Translation adjustment of foreign currency statements	—	—	—	—	33	—	—	—
Other	—	—	16	—	—	—	656	17
Balance, December 31, 2005	630,282	\$ 6	\$ 4,486	\$ 3,615	\$ 126	\$ (2)	(78,029)	\$ (2,110)
Net income	—	—	—	186	—	—	—	—
Cash dividends adjustment	—	—	—	1	—	—	—	—
Common stock issued upon exercise of stock options and warrants, including tax benefit of \$18	—	—	—	—	—	—	5,360	147
Common stock repurchases	—	—	—	—	—	—	(11,849)	(388)
Unrealized losses resulting from changes in fair value of derivative instruments, net of taxes of \$4	—	—	—	—	(6)	—	—	—
Realized gains on derivative instruments reclassified into earnings, net of taxes of \$1	—	—	—	—	(1)	—	—	—
Unrealized gain on marketable securities, net of taxes of \$1	—	—	—	—	3	—	—	—
Translation adjustment of foreign currency statements	—	—	—	—	(4)	—	—	—
Other	—	—	(1)	—	—	2	415	11
Balance, March 31, 2006	630,282	\$ 6	\$ 4,485	\$ 3,802	\$ 118	\$ —	(84,103)	\$ (2,340)

See notes to the Condensed Consolidated Financial Statements.

**WASTE MANAGEMENT, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Basis of Presentation**

The financial statements presented in this report represent the consolidation of Waste Management, Inc., a Delaware corporation, our wholly-owned and majority-owned subsidiaries and certain variable interest entities for which we have determined that we are the primary beneficiary. Waste Management, Inc. is a holding company that conducts all of its operations through subsidiaries. When the terms “the Company,” “we,” “us” or “our” are used in this document, those terms refer to Waste Management, Inc., its consolidated subsidiaries and consolidated variable interest entities. When we use the term “WMI,” we are referring only to the parent holding company.

WMI was incorporated in Oklahoma in 1987 under the name “USA Waste Services, Inc.” and was reincorporated as a Delaware company in 1995. In a 1998 merger, the Illinois-based waste services company formerly known as Waste Management, Inc. became a wholly-owned subsidiary of WMI and changed its name to Waste Management Holdings, Inc. (“WM Holdings”). At the same time, our parent holding company changed its name from USA Waste Services to Waste Management, Inc. Like WMI, WM Holdings is a holding company that conducts all of its operations through subsidiaries. For more detail on the financial position, results of operations and cash flows of WMI, WM Holdings and their subsidiaries, see Note 13.

The Condensed Consolidated Financial Statements as of and for the three months ended March 31, 2006 and 2005 are unaudited. In the opinion of management, these financial statements include all adjustments, which, unless otherwise disclosed, are of a normal recurring nature, necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. The results for interim periods are not necessarily indicative of results for the entire year. The financial statements presented herein should be read in connection with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2005.

In preparing our financial statements, we make numerous estimates and assumptions that affect the accounting for and recognition of assets, liabilities, stockholders’ equity, revenues and expenses. We must make these estimates and assumptions because certain information that we use is dependent on future events, cannot be calculated with a high degree of precision from data available or simply cannot be readily calculated based on generally accepted methodologies. In some cases, these estimates are particularly difficult to determine and we must exercise significant judgment. Actual results could differ materially from the estimates and assumptions that we use in the preparation of our financial statements.

*Accounting Change* — On January 1, 2006, we adopted Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), *Share Based Payment* (“SFAS No. 123(R)”), which requires compensation expense to be recognized for all share-based payments made to employees based on the fair value of the award at the date of grant. We adopted SFAS No. 123(R) using the modified prospective method, which results in the recognition of compensation expense using the provisions of SFAS No. 123(R) for all share-based awards granted or modified after December 31, 2005 and the recognition of compensation expense using the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (“SFAS No. 123”), for all unvested awards outstanding at the date of adoption. Under this transition method, the results of operations of prior periods have not been restated. Accordingly, we will continue to provide pro forma financial information for prior periods to illustrate the effect on net income and earnings per share of applying the fair value recognition provisions of SFAS No. 123.

Through December 31, 2005, we accounted for equity-based compensation in accordance with Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, as amended (“APB No. 25”). Under APB No. 25, we recognized compensation expense based on an award’s intrinsic value. For stock options, which were the primary form of equity-based awards we granted through December 31, 2004, this meant that we recognized no compensation expense in connection with the grants, as

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

the exercise price of the options was equal to the fair market value of our common stock on the date of grant and all other provisions were fixed. As discussed below, beginning in 2005, restricted stock units and performance share units became the primary form of equity-based compensation awarded under our long-term incentive plans. For restricted stock units, intrinsic value is equal to the market value of our common stock on the date of grant. For performance share units, APB No. 25 required “variable accounting,” which resulted in the recognition of compensation expense based on the intrinsic value of each award at the end of each reporting period.

The most significant difference between the fair value approaches prescribed by SFAS No. 123 and SFAS No. 123(R) and the intrinsic value method prescribed by APB No. 25 relates to the recognition of compensation expense for stock option awards based on their grant date fair value. Under SFAS No. 123, we estimated the fair value of stock option grants using the Black-Scholes-Merton option-pricing model. The following table reflects the pro forma impact on net income and earnings per common share for the three months ended March 31, 2005 of accounting for our equity-based compensation using SFAS No. 123 (in millions, except per share amounts):

	Three Months Ended March 31, 2005
Reported net income	\$ 150
Add: Equity-based compensation expense included in reported net income, net of tax benefit	4
Less: Total equity-based compensation expense per SFAS No. 123, net of tax benefit	(18)
Pro forma net income	\$ 136
<b>Basic earnings per common share:</b>	
Reported net income	\$ 0.26
Add: Equity-based compensation expense included in reported net income, net of tax benefit	0.01
Less: Total equity-based compensation expense per SFAS No. 123, net of tax benefit	(0.03)
Pro forma net income	\$ 0.24
<b>Diluted earnings per common share:</b>	
Reported net income	\$ 0.26
Add: Equity-based compensation expense included in reported net income, net of tax benefit	0.01
Less: Total equity-based compensation expense per SFAS No. 123, net of tax benefit	(0.03)
Pro forma net income	\$ 0.24

In December 2005, the Compensation Committee of our Board of Directors approved the acceleration of the vesting of all unvested stock options awarded under our stock incentive plans, effective December 28, 2005. The decision to accelerate the vesting of outstanding stock options was made primarily to reduce the non-cash compensation expense that we would have otherwise recorded in future periods as a result of adopting SFAS No. 123(R). We estimate that the acceleration eliminated approximately \$55 million of cumulative pre-tax compensation charges that would have been recognized during 2006, 2007 and 2008 as the

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

stock options would have continued to vest. We recognized a \$2 million pre-tax charge to compensation expense during the fourth quarter of 2005 as a result of the acceleration, but do not expect to recognize future compensation expense for the accelerated options under SFAS No. 123(R) unless further modifications are made to the options, which is not anticipated.

Additionally, as a result of changes in accounting required by SFAS No. 123(R) and a desire to design our long-term incentive plans in a manner that creates a stronger link to operating and market performance, our Board of Directors approved a substantial change in the form of awards that we grant. Beginning in 2005, annual stock option grants, as well as stock option grants in connection with new hires and promotions, were replaced with either (i) grants of restricted stock units and performance share units or (ii) an enhanced cash compensation award. The terms of restricted stock units and performance share units granted during 2006 are summarized in Note 8.

We recognized \$4 million of compensation expense, or \$2 million net of tax, during the three months ended March 31, 2006 and \$6 million, or \$4 million net of tax, during the three months ended March 31, 2005 associated with restricted stock, restricted stock units and performance share units. The reduction in compensation expense recognized between 2005 and 2006 was driven by a change in the awards' retirement provisions rather than the change in accounting required as a result of our adoption of SFAS No. 123(R). As discussed above, the then pending adoption of SFAS No. 123(R) significantly affected our Board of Directors' considerations related to equity-based compensation, resulting in their decision to accelerate the vesting of outstanding stock options and replace stock options with restricted stock units and performance share units. As a result of these changes, the adoption of SFAS No. 123(R) on January 1, 2006 did not significantly affect our accounting for equity-based compensation or our net income for the three months ended March 31, 2006. We do not currently expect this change in accounting to significantly impact our future results of operations. However, we do expect equity-based compensation expense to increase over the next three to four years because of the incremental expense that will be recognized each year as our Board of Directors grants additional awards.

Prior to the adoption of SFAS No. 123(R), we included all tax benefits associated with equity-based compensation as operating cash flows in the Statement of Cash Flows. SFAS No. 123(R) requires any reduction in taxes payable resulting from tax deductions that exceed the recognized compensation expense (excess tax benefits) to be classified as financing cash flows. We included \$18 million of excess tax benefits in our cash flows from financing activities for the three months ended March 31, 2006 that would have been classified as an operating cash flow if we had not adopted SFAS No. 123(R). During the first quarter of 2005, excess tax benefits improved our operating cash flows by approximately \$4 million.

*Reclassification of Segment Information* — In the third quarter of 2005, we eliminated our Canadian Group office, and the management of our Canadian operations was allocated among our Eastern, Midwest and Western Groups. We have allocated the operating results of our Canadian operations to the Eastern, Midwest and Western Groups for the first quarter of 2005 to provide financial information that consistently reflects our current approach to managing our operations. This reorganization also resulted in the centralization of certain Group office functions. The administrative costs associated with these functions were included in the measurement of income from operations for our reportable segments through August 2005, when the integration of these functions with our existing centralized processes was completed. Beginning in September 2005, these administrative costs have been included in the income from operations of our Corporate organization. The reallocation of these costs has not significantly affected the operating results of our reportable segments for the periods presented. Refer to Note 11 for additional information about our reportable segments.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2. Landfill and Environmental Remediation Liabilities

*Accounting Policies*

*Final Capping, Closure and Post-Closure Costs* — Following is a description of these asset retirement activities and our related accounting:

- *Final capping* — Involves the installation of flexible membrane liners and geosynthetic clay liners, drainage and compacted soil layers and topsoil over areas of a landfill where total airspace capacity has been consumed. Final capping asset retirement obligations are recorded on a units-of-consumption basis as airspace is consumed related to the specific final capping event with a corresponding increase in the landfill asset. Each final capping event is accounted for as a discrete obligation based on estimates of the discounted cash flows and capacity associated with each final capping event.
- *Closure* — Includes the construction of the final portion of methane gas collection systems (when required), demobilization and routine maintenance costs. These are costs incurred after the site ceases to accept waste, but before the landfill is certified as closed by the applicable state regulatory agency. These costs are accrued as an asset retirement obligation as airspace is consumed over the life of the landfill with a corresponding increase in the landfill asset. Closure obligations are accrued over the life of the landfill based on estimates of the discounted cash flows associated with performing closure activities.
- *Post-closure* — Involves the maintenance and monitoring of a landfill site that has been certified closed by the applicable regulatory agency. Generally, we are required to maintain and monitor landfill sites for a 30-year period. These maintenance and monitoring costs are accrued as an asset retirement obligation as airspace is consumed over the life of the landfill with a corresponding increase in the landfill asset. Post-closure obligations are accrued over the life of the landfill based on estimates of the discounted cash flows associated with performing post-closure activities.

We develop our estimates of these obligations using input from our operations personnel, engineers and accountants. Our estimates are based on our interpretation of current requirements and proposed regulatory changes and are intended to approximate fair value under the provisions of SFAS No. 143. Absent quoted market prices, the estimate of fair value should be based on the best available information, including the results of present value techniques. In many cases, we contract with third parties to fulfill our obligations for final capping, closure and post-closure. We use historical experience, professional engineering judgment and quoted and actual prices paid for similar work to determine the fair value of these obligations. We are required to recognize these obligations at market prices whether we plan to contract with third parties or perform the work ourselves. In those instances where we perform the work with internal resources, the incremental profit margin realized is recognized as a component of operating income when the work is performed.

Additionally, an estimate of fair value should also include the price that marketplace participants are able to receive for bearing the uncertainties inherent in these cash flows. However, when using discounted cash flow techniques, reliable estimates of market premiums may not be obtainable. In the waste industry, there is generally not a market for selling the responsibility for final capping, closure and post-closure obligations independent of selling the landfill in its entirety. Accordingly, we do not believe that it is possible to develop a methodology to reliably estimate a market risk premium. We have excluded any such market risk premium from our determination of expected cash flows for landfill asset retirement obligations.

Once we have determined the final capping, closure and post-closure costs, we inflate those costs to the expected time of payment and discount those expected future costs back to present value. During the three months ended March 31, 2006 and 2005, we inflated these costs in current dollars until the expected time of payment using an annual inflation rate of 2.5%. We discount these costs to present value using the credit-adjusted, risk-free rate effective at the time an obligation is incurred consistent with the expected cash flow

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

approach. Any changes in expectations that result in an upward revision to the estimated cash flows are treated as a new liability and discounted at the current rate while downward revisions are discounted at the historical weighted-average rate of the recorded obligation. As a result, the credit-adjusted, risk-free discount rate used to calculate the present value of an obligation is specific to each individual asset retirement obligation. The weighted-average annual rate applicable to our asset retirement obligations at March 31, 2006 is between 6.00% and 7.25%, the range of the credit-adjusted, risk-free discount rates effective since adopting SFAS No. 143 in 2003.

We record the estimated fair value of final capping, closure and post-closure liabilities for our landfills based on the capacity consumed through the current period. The fair value of final capping obligations is developed based on our estimates of the airspace consumed to date for each final capping event and the expected timing of each final capping event. The fair value of closure and post-closure obligations is developed based on our estimates of the airspace consumed to date for the entire landfill and the expected timing of each closure and post-closure activity. Because these obligations are measured at estimated fair value using present value techniques, changes in the estimated cost or timing of future final capping, closure and post-closure activities could result in a material change in these liabilities, related assets and results of operations. We assess the appropriateness of the estimates used to develop our recorded balances annually, or more often if significant facts change.

Changes in inflation rates or the estimated costs, timing or extent of future final capping and closure and post-closure activities typically result in both (i) a current adjustment to the recorded liability and landfill asset; and (ii) a change in liability and asset amounts to be recorded prospectively over the remaining capacity of either the related discrete final capping event or the landfill. Any changes related to the capitalized and future cost of the landfill assets are then recognized in accordance with our amortization policy, which would generally result in amortization expense being recognized prospectively over the remaining capacity of the final capping event or the landfill, as appropriate. Changes in such estimates associated with airspace that has been fully utilized result in an adjustment to the recorded liability and landfill assets with an immediate corresponding adjustment to landfill airspace amortization expense.

Interest accretion on final capping, closure and post-closure liabilities is recorded using the effective interest method and is recorded as final capping, closure and post-closure expense, which is included in "Operating" costs and expenses within our Consolidated Statements of Operations.

In the United States, the final capping, closure and post-closure requirements are established by the Environmental Protection Agency ("EPA") and applied on a state-by-state basis. The costs to comply with these requirements could change materially as a result of future legislation or regulation.

*Environmental Remediation* — We are subject to an array of laws and regulations relating to the protection of the environment. Under current laws and regulations, we may have liabilities for environmental damage caused by operations, or for damage caused by conditions that existed before we acquired a site. Such liabilities include potentially responsible party ("PRP") investigations, settlements, certain legal and consultant fees, as well as costs directly associated with site investigation and clean up, such as materials and incremental internal costs directly related to the remedy. We provide for expenses associated with environmental remediation obligations when such amounts are probable and can be reasonably estimated. We routinely review and evaluate sites that require remediation and determine our estimated cost for the likely remedy based on several estimates and assumptions.

Our estimations are based on several factors. We estimate costs required to remediate sites where it is probable that a liability has been incurred based on site-specific facts and circumstances. We routinely review and evaluate sites that require remediation, considering whether we were an owner, operator, transporter, or generator at the site; the amount and type of waste hauled to the site and the number of years we were associated with the site. Next, we review the same type of information with respect to other named and

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

unnamed PRPs. Estimates of the cost for the likely remedy are then either developed using our internal resources or by third party environmental engineers or other service providers. Internally developed estimates are based on:

- Management's judgment and experience in remediating our own and unrelated parties' sites;
- Information available from regulatory agencies as to costs of remediation;
- The number, financial resources and relative degree of responsibility of other PRPs who may be liable for remediation of a specific site; and
- The typical allocation of costs among PRPs.

There can sometimes be a range of reasonable estimates of the costs associated with the likely remedy of a site. In these cases, we use the amount within the range that constitutes our best estimate. If no amount within the range appears to be a better estimate than any other, we use the amount that is the low end of the range in accordance with SFAS No. 5, *Accounting for Contingencies*, and its interpretations. If we used the high ends of such ranges, our aggregate potential liability would be approximately \$185 million higher on a discounted basis than the \$278 million recorded in the Condensed Consolidated Financial Statements as of March 31, 2006.

Estimating our degree of responsibility for remediation of a particular site is inherently difficult and determining the method and ultimate cost of remediation requires that a number of assumptions be made. Our ultimate responsibility may differ materially from current estimates. It is possible that technological, regulatory or enforcement developments, the results of environmental studies, the inability to identify other PRPs, the inability of other PRPs to contribute to the settlements of such liabilities, or other factors could require us to record additional liabilities that could be material. Additionally, our ongoing review of our remediation liabilities could result in revisions that could cause upward or downward adjustments to income from operations. These adjustments could also be material in any given period.

Where we believe that both the amount of a particular environmental remediation liability and the timing of the payments are reliably determinable, we inflate the cost in current dollars (by 2.5% per annum at March 31, 2006 and December 31, 2005) until the expected time of payment and discount the cost to present value using a risk-free discount rate, which is based on the rate for United States Treasury bonds with a term approximating the weighted average period until settlement of the underlying obligation. We determine the risk-free discount rate and the inflation rate on an annual basis unless interim changes would significantly impact our results of operations. As a result of an increase in our risk-free discount rate, which increased from an annual rate of 4.25% at December 31, 2005 to an annual rate of 4.75% at March 31, 2006, we recorded a \$6 million reduction in first quarter 2006 "Operating" expenses and a corresponding decrease in environmental remediation liabilities. For remedial liabilities that have been discounted, we include interest accretion, based on the effective interest method, in "Operating" costs and expenses in our Condensed Consolidated Statements of Operations.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**Landfill and Environmental Remediation Liabilities**

Liabilities for landfill and environmental remediation costs are presented in the table below (in millions):

	March 31, 2006			December 31, 2005		
	Landfill	Environmental Remediation	Total	Landfill	Environmental Remediation	Total
Current (in accrued liabilities)	\$ 107	\$ 48	\$ 155	\$ 114	\$ 47	\$ 161
Long-term	968	230	1,198	938	242	1,180
	<u>\$ 1,075</u>	<u>\$ 278</u>	<u>\$ 1,353</u>	<u>\$ 1,052</u>	<u>\$ 289</u>	<u>\$ 1,341</u>

The changes to landfill and environmental remediation liabilities for the year ended December 31, 2005 and the three months ended March 31, 2006 are reflected in the table below (in millions):

	Landfill	Environmental Remediation
December 31, 2004	\$ 979	\$ 324
Obligations incurred and capitalized	62	—
Obligations settled	(51)	(52)
Interest accretion	66	10
Revisions in estimates	(6)	12
Acquisitions, divestitures and other adjustments	2	(5)
December 31, 2005	<u>1,052</u>	<u>289</u>
Obligations incurred and capitalized	15	—
Obligations settled	(7)	(6)
Interest accretion	17	2
Revisions in estimates	(2)	(7)
March 31, 2006	<u>\$ 1,075</u>	<u>\$ 278</u>

At several of our landfills, we provide financial assurance by depositing cash into restricted escrow accounts or trust funds for purposes of settling closure, post-closure and environmental remediation obligations. The fair value of these escrow accounts and trust funds was \$205 million at March 31, 2006, and is primarily included as long-term “Other assets” in our Condensed Consolidated Balance Sheet. Balances maintained in these trust funds and escrow accounts will fluctuate based on (i) changes in statutory requirements; (ii) the ongoing use of funds for qualifying closure, post-closure and environmental remediation activities; (iii) acquisitions or divestitures of landfills; and (iv) changes in the fair value of the financial instruments held in the trust fund or escrow account.

**3. Current Other Assets**

The primary components of current “Other assets” as of March 31, 2006 and December 31, 2005 were as follows:

*Short-term investments available for use* — We invest in auction rate securities and variable rate demand notes, which are debt instruments with long-term scheduled maturities and periodic interest rate reset dates. The interest rate reset mechanism for these instruments results in a periodic marketing of the underlying securities through an auction process. Due to the liquidity provided by the interest rate reset mechanism and the short-term nature of our investment in these securities, they have been classified as current assets in our Condensed Consolidated Balance Sheets. As of March 31, 2006 and December 31, 2005, \$534 million and \$300 million, respectively, of investments in auction rates securities and variable rate demand notes have been included as a component of current “Other assets.”

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

*Assets held for sale* — As of March 31, 2006 and December 31, 2005 our current “Other assets” included \$162 million and \$124 million, respectively, of operations and property held for sale. These balances are primarily attributable to our divestiture program, which was approved by our Board of Directors in July 2005 to divest under-performing and non-strategic operations. At that time, assets representing \$400 million in annual revenues were identified for inclusion in the program. In January 2006, we identified additional operations, representing over \$500 million in annual revenues, that may also be sold as part of this divestiture plan.

As of March 31, 2006, we had delayed the marketing of certain operations under the divestiture plan pending (i) contract negotiations with major customers in the market or (ii) our continued review of certain assets to be sold within the market. Although we are actively marketing the remaining operations, the majority of these operations do not currently qualify as assets held for sale. Held-for-sale assets are recorded at the lower of their carrying amount or their fair value less the estimated cost to sell. Our quarterly assessment of these operations includes an analysis to determine if they qualify for discontinued operations accounting. Discontinued operations were not material to our results of operations or cash flows for the three months ended March 31, 2006 and 2005.

**4. Debt**

*Debt*

The following table summarizes the major components of debt at each balance sheet date (in millions):

	March 31, 2006	December 31, 2005
Revolving credit and letter of credit facilities	\$ —	\$ —
Canadian credit facility (weighted average interest rate of 4.5% at March 31, 2006 and 4.4% at December 31, 2005)(a)	333	340
Senior notes and debentures, maturing through 2032, interest rates ranging from 5.00% to 8.75% (weighted average interest rate of 7.0% at March 31, 2006 and at December 31, 2005)(b)	5,116	5,155
Tax-exempt bonds maturing through 2039, fixed and variable interest rates ranging from 2.3% to 7.4% (weighted average interest rate of 4.1% at March 31, 2006 and 4.2% at December 31, 2005)(c),(d)	2,289	2,291
Tax-exempt project bonds, principal payable in periodic installments, maturing through 2027, fixed and variable interest rates ranging from 3.2% to 9.3% (weighted average interest rate of 5.2% at March 31, 2006 and 5.3% at December 31, 2005)	403	404
Capital leases and other, maturing through 2036, interest rates up to 12%	479	497
	<u>8,620</u>	<u>8,687</u>
Less current portion	600	522
	<u>\$ 8,020</u>	<u>\$ 8,165</u>

- a) As of March 31, 2006, we had \$342 million of principal (\$333 million net of discount) outstanding under this credit facility agreement. The advances do not accrue interest during their terms. Accordingly, the proceeds we initially received were for the principal amount of the advances net of the total interest obligation due for the term of the advance, and the debt was initially recorded based on the net proceeds received. The advances have a weighted average effective interest rate of 4.5%, which is being amortized to interest expense with a corresponding increase in our recorded debt obligation using the effective interest method. During the three months ended March 31, 2006, we increased the carrying value of the debt for the recognition of

**WASTE MANAGEMENT, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

\$4 million of interest expense for the facility. In March 2006, \$60 million of the advances under this three-year credit facility agreement matured. We elected to renew \$51 million of that advance under the terms of the facility and repaid the remaining \$9 million with available cash. The carrying value of these debt obligations was also reduced by approximately \$2 million during the three months ended March 31, 2006 as a result of a decline in the Canadian translation rate from December 31, 2005.

Our outstanding advances mature either three or twelve months from the date of issuance, but may be renewed under the terms of the facility. As of March 31, 2006, we expect to repay \$86 million of outstanding advances with available cash and renew the remaining borrowings under the terms of the facility. Accordingly, \$86 million of debt associated with these borrowings is classified as current in our March 31, 2006 Condensed Consolidated Balance Sheet and the remaining borrowings have been classified as long-term.

- b) We manage the interest rate risk of our debt portfolio principally by using interest rate derivatives to achieve a desired position of fixed and floating rate debt. As of March 31, 2006, the interest payments on \$2.35 billion of our fixed-rate senior notes have been swapped to variable rates. Fair value hedge accounting for interest rate swap contracts increased the carrying value of our senior notes by \$6 million at March 31, 2006 and \$46 million at December 31, 2005.
- c) During the three months ended March 31, 2006, \$2 million of our tax-exempt bonds matured and were repaid with available cash.
- d) Fair value hedge accounting for interest rate swap contracts increased the carrying value of our tax-exempt bonds by \$1 million at March 31, 2006 and December 31, 2005.

**Debt Covenants**

Our revolving credit facility and certain other financing agreements contain financial covenants. The most restrictive of these financial covenants are contained in our revolving credit facility. The following table summarizes the requirements of these financial covenants and the results of the calculation, as defined by the revolving credit facility:

Covenant	Requirement per Facility	Computed Results	
		March 31, 2006	December 31, 2005
Interest coverage ratio	>2.75 to 1	3.6 to 1	3.7 to 1
Total debt to EBITDA	<3.5 to 1	2.7 to 1	2.7 to 1

Our revolving credit facility and senior notes also contain certain restrictions intended to monitor our level of indebtedness, types of investments and net worth. We monitor our compliance with these restrictions, but do not believe that they significantly impact our ability to enter into investing or financing arrangements typical for our business. As of March 31, 2006, we were in compliance with the covenants and restrictions under all of our debt agreements.

**5. Income Taxes**

The current tax obligations associated with the provision for income taxes recorded in the Condensed Consolidated Statements of Operations are reflected in the accompanying Condensed Consolidated Balance Sheets as a component of "Accrued liabilities," and the deferred tax obligations are reflected in "Deferred income taxes."

The difference between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2006 is primarily due to state and local income taxes, offset in part by the favorable impact of non-conventional fuel tax credits. The difference between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2005 is primarily due to the favorable impact of non-conventional fuel tax credits, offset in part by state and local income taxes. We continue to evaluate our effective tax rate at each interim period and adjust it accordingly as facts and circumstances warrant.

*Non-conventional fuel tax credits* — The favorable impact of non-conventional fuel tax credits has been derived from our landfills and our investments in two coal-based, synthetic fuel production facilities (the

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

“Facilities”), which are discussed in more detail below. The fuel generated from our landfills and the Facilities qualifies for tax credits through 2007 pursuant to Section 45K (formerly Section 29, but re-designated as Section 45K effective for years ending after December 31, 2005) of the Internal Revenue Code, and may be phased out if the price of oil exceeds an annual average price threshold determined by the U.S. Internal Revenue Service. Our effective tax rate for the first quarter of 2006 reflects our current expectations for the partial phase out of Section 45K tax credits generated during 2006. We have developed our current expectations for the phase out of 61% of Section 45K credits using market information for current and forward-looking oil prices as of March 31, 2006. Accordingly, our current estimated effective tax rate could be materially different than our actual 2006 effective tax rate if our expectations for oil prices for the year are inconsistent with actual results.

The tax credits generated by our landfills are provided by our Renewable Energy Program, under which we develop, operate and promote the beneficial use of landfill gas. Our recorded taxes for the three months ended March 31, 2006 and 2005 include benefits of \$2 million and \$4 million, respectively, from tax credits generated by our landfill gas-to-energy projects.

In 2004, we acquired minority ownership interests in the Facilities, which result in the recognition of our pro-rata share of the Facilities’ losses, the amortization of our initial investments and additional expense associated with other estimated obligations being recorded as “Equity in net losses of unconsolidated entities” within our Condensed Consolidated Statements of Operations. The equity losses and associated tax benefits would not have been incurred if we had not acquired the minority ownership interest in the Facilities. If the tax credits generated by the Facilities were no longer allowable under Section 45K of the Internal Revenue Code, we could cease making payments in the period that determination is made and not incur these losses in future periods. As discussed above, our effective tax rate for the three months ended March 31, 2006 includes the effect of a partial phase out of Section 45K credits generated during 2006. The reduction in our current period “Equity in net losses of unconsolidated entities” also reflects the impact of a partial phase out of Section 45K credits on our contractual obligations to fund the Facilities’ losses.

The following table summarizes the impact of our investments in the Facilities on our Condensed Consolidated Statements of Operations for the three months ended March 31, 2006 and 2005 (in millions):

	Three Months Ended March 31,	
	2006	2005
Equity in net losses of unconsolidated entities	\$ (10)	\$ (28)
Interest expense, net	(1)	(2)
Benefit from income taxes(a)	12	29
Net income (loss)	<u>\$ 1</u>	<u>\$ (1)</u>

a) The benefit from income taxes attributable to the Facilities includes tax credits of \$7 million and \$17 million for the three months ended March 31, 2006 and 2005, respectively. On an annual basis, we expect the reduction in our tax provision attributable to the Facilities to more than offset the equity losses and interest expense recognized during the year.

*Tax audit settlements* — The settlement of tax audits during the quarter resulted in a reduction of our provision for income taxes for the three months ended March 31, 2006 of \$6 million, or \$0.01 per diluted share. The impact of the audit settlement did not significantly affect our estimated effective tax rate for the current period.

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**6. Comprehensive Income**

Comprehensive income represents all changes in our equity except for changes resulting from investments by, and distributions to, stockholders. Comprehensive income for the three months ended March 31, 2006 and 2005 was as follows (in millions):

	Three Months Ended March 31,	
	2006	2005
Net income	\$ 186	\$ 150
Other comprehensive income (loss):		
Unrealized gains (losses) resulting from changes in fair value of derivative instruments, net of taxes	(6)	6
Realized (gains) losses on derivative instruments reclassified into earnings, net of taxes	(1)	2
Unrealized gains (losses) on marketable securities, net of taxes	3	(1)
Translation adjustment of foreign currency statements	(4)	(9)
Other comprehensive income (loss)	(8)	(2)
Comprehensive income	\$ 178	\$ 148

The components of accumulated other comprehensive income were as follows (in millions):

	March 31, 2006	December 31, 2005
Accumulated unrealized loss on derivative instruments, net of tax benefit	\$ (34)	\$ (27)
Accumulated unrealized gain on marketable securities, net of taxes	8	5
Cumulative translation adjustment of foreign currency statements	144	148
	\$ 118	\$ 126

**7. Earnings Per Share**

The following reconciles the number of shares outstanding at March 31 of each year to the number of weighted average basic shares outstanding and the number of weighted average diluted shares outstanding for the purpose of calculating basic and diluted earnings per share. The table also provides the number of shares of

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

common stock potentially issuable at the end of each period and the number of potentially issuable shares excluded from the diluted earnings per share computation for each period (shares in millions):

	Three Months Ended March 31,	
	2006	2005
Number of common shares outstanding at end of period	546.2	568.3
Effect of using weighted average common shares outstanding	—	0.5
Weighted average basic common shares outstanding	546.2	568.8
Dilutive effect of equity-based compensation awards, warrants and other contingently issuable shares	4.8	4.0
Weighted average diluted common shares outstanding	551.0	572.8
Potentially issuable shares	32.2	42.0
Number of anti-dilutive potentially issuable shares excluded from diluted common shares outstanding	6.0	7.5

**8. Stock-Based Compensation, Common Stock Dividends and Common Stock Repurchases*****Stock-Based Compensation***

Pursuant to our 2004 Stock Incentive Plan, an aggregate of 34 million shares of our common stock may be issued through various forms of equity-based compensation on terms and conditions determined by the Compensation Committee of our Board of Directors. We currently utilize treasury shares to meet the needs of our equity-based compensation programs under the 2004 Stock Incentive Plan. During 2005 and 2006, the primary forms of equity-based compensation granted to our employees under our long-term incentive programs were restricted stock units and performance share units. The significant terms of awards granted during 2006 are summarized below.

*Restricted stock units* — During the three months ended March 31, 2006, we granted approximately 733,000 restricted stock units. These restricted stock units provide the award recipients with dividend equivalents during the vesting period, but the units may not be voted or sold until time-based vesting restrictions have lapsed. The restricted stock units vest ratably over a four-year period, and unvested units are subject to forfeiture in the event of voluntary or for-cause termination. These restricted stock units are subject to pro-rata vesting upon an employee's retirement and become immediately vested in the event of an employee's death or disability.

Compensation expense associated with restricted stock units is measured based on the grant-date fair value of our common stock and is recognized on a straight-line basis over the required employment period, which is generally the vesting period. Compensation expense is only recognized for those awards that we expect to vest, which we estimate based upon an assessment of current period and historical forfeitures.

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A summary of the status of our restricted stock units as of and for the three months ended March 31, 2006 is presented in the table below (units in thousands):

	Units		Weighted Average Fair Value
Unvested, December 31, 2005	767	\$	29.04
Granted	733	\$	31.70
Vested(a)	(162)	\$	28.98
Forfeited	(4)	\$	29.68
Unvested, March 31, 2006	<u>1,334</u>	<u>\$</u>	<u>30.50</u>

a) The total fair market value of the shares issued upon the vesting of restricted stock units during the three months ended March 31, 2006 was \$5 million.

*Performance share units* — During the three months ended March 31, 2006, we granted approximately 724,000 performance share units. The performance share units are payable in shares of common stock based on the achievement of certain financial measures, after the end of a three-year performance period. Performance share units do not provide award recipients with either dividend equivalents or voting rights during the required performance period. These performance share units are payable to an employee (or his beneficiary) upon death or disability as if that employee had remained employed until the end of the performance period, subject to pro-rata vesting upon an employee's retirement and subject to forfeiture in the event of voluntary or for-cause termination.

Compensation expense associated with performance share units that continue to vest based on future performance is measured based on the grant-date fair value of our common stock, net of the present value of expected dividend payments on our common stock during the vesting period. Compensation expense is recognized ratably over the performance period based on our estimated achievement of the established performance criteria. Compensation expense is only recognized for those awards that we expect to vest, which we estimate based upon an assessment of both the probability that the performance criteria will be achieved and current period and historical forfeitures.

A summary of the status of our performance share units as of and for the three months ended March 31, 2006 is presented in the table below (units in thousands):

	Units		Weighted Average Fair Value
Unvested, December 31, 2005	693	\$	27.05
Granted	724	\$	31.93
Vested	—		N/A
Forfeited	(3)	\$	27.05
Unvested, March 31, 2006	<u>1,414</u>	<u>\$</u>	<u>29.55</u>

For the three months ended March 31, 2006, we have recognized \$4 million of compensation expense associated with restricted stock unit and performance share unit awards as a component of "Selling, general and administrative" expenses in our Condensed Consolidated Statement of Operations. Our current period "Provision for income taxes" includes a corresponding deferred income tax benefit of \$2 million. We have not capitalized any equity-based compensation costs during the three months ended March 31, 2006. As of March 31, 2006, we estimate that a total of approximately \$65 million of currently unrecognized compensation

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

expense will be recognized in future periods for unvested restricted stock unit and performance share unit awards issued and outstanding. This expense is expected to be recognized over a period of up to four years.

*Stock options* — Prior to 2005, stock options were the primary form of equity-based compensation paid to our employees under our Stock Incentive Plan. On December 16, 2005, the Compensation Committee of our Board of Directors approved the acceleration of the vesting of all unvested stock options awarded under our stock incentive plans effective December 28, 2005. The decision to accelerate the vesting of outstanding stock options was made primarily to reduce the future non-cash compensation expense that we would have otherwise recorded as a result of our January 1, 2006 adoption of SFAS No. 123(R). We estimate that the acceleration eliminated approximately \$55 million of pre-tax compensation charges that would have been recognized over 2006, 2007 and 2008 as the stock options vested. We recognized a \$2 million pre-tax charge to compensation expense during the fourth quarter of 2005 as a result of the acceleration, but will not be required to recognize future compensation expense for the accelerated options under SFAS No. 123(R) unless further modifications are made to the options, which is not anticipated.

A summary of the status of our stock options as of and for the three months ended March 31, 2006 is presented in the table below (shares in thousands):

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2005	34,786	\$ 28.15
Granted	3	\$ 30.96
Exercised(a)	(5,373)	\$ 23.93
Forfeited or expired	(76)	\$ 29.12
Outstanding, March 31, 2006(b)	<u>29,340</u>	\$ 28.91
Exercisable, March 31, 2006(b)	<u>29,337</u>	\$ 28.91

- a) The aggregate intrinsic value of stock options exercised during the three months ended March 31, 2006 was \$48 million. Approximately 1.2 million stock options were exercised during the three months ended March 31, 2005 with an aggregate intrinsic value of \$12 million.
- b) Stock options outstanding and exercisable as of March 31, 2006 have a weighted average contractual term of 5.1 years and an aggregate intrinsic value of \$232 million based on the market value of our common stock on March 31, 2006.

We received \$125 million during the three months ended March 31, 2006 from our employees' stock option exercises. We realized a tax benefit from these stock option exercises of \$18 million. These amounts have been presented in the "Cash flows from financing activities" section of our March 31, 2006 Condensed Consolidated Statement of Cash Flows.

**Common Stock Dividends and Repurchases**

In October 2004, our Board of Directors approved a capital allocation program that provides for up to \$1.2 billion in aggregate dividend payments and share repurchases each year during 2005, 2006 and 2007. Aggregate dividend payments and share repurchases under the capital allocation program were \$508 million during the three months ended March 31, 2006 and \$216 million during the three months ended March 31, 2005.

*Common Stock Dividends* — On January 28, 2005, the Board declared our first quarterly dividend under our current capital allocation program. The dividend was \$0.20 per share, and was paid on March 24, 2005 to stockholders of record as of March 1, 2005 for an aggregate of \$114 million. In October 2005, the Board of

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Directors announced that it expects future quarterly dividend payments to be \$0.22 per share. On December 15, 2005, the Board declared our first quarterly dividend for 2006 of \$0.22 per share, which was paid on March 24, 2006 to stockholders of record as of March 6, 2006 for an aggregate of \$121 million.

All future dividend declarations are at the discretion of the Board of Directors, and depend on various factors, including our net earnings, financial condition, cash required for future prospects and other factors the Board may deem relevant.

*Common Stock Repurchases* — In January 2006, we repurchased 9.0 million shares of our common stock for \$275 million through an accelerated share repurchase transaction. The number of shares purchased under the accelerated share repurchase transaction was determined by dividing the \$275 million by the fair market value of our common stock on the repurchase date. At the end of the agreement's valuation period, which was in February 2006, we were required to make a settlement payment for the difference between the \$275 million paid at the inception of the agreement's valuation period and the weighted average daily market price of our common stock during the valuation period times the number of shares we repurchased, or \$16 million. We elected to make the required settlement payment in cash.

During the three months ended March 31, 2006, we also repurchased 2.8 million shares of our common stock for \$96 million through open market transactions. Approximately \$12 million of our first quarter 2006 share repurchases was paid in April 2006. During the three months ended March 31, 2005, we repurchased 3.5 million shares of our common stock at a cost of \$102 million, of which \$3 million was paid in April 2005. Future share repurchases will be made at the discretion of management, and will depend on factors similar to those considered by the Board in making dividend declarations.

## 9. Commitments and Contingencies

*Financial instruments* — We have obtained letters of credit, performance bonds and insurance policies and have established trust funds and issued financial guarantees to support tax-exempt bonds, contracts, performance of landfill closure and post-closure requirements, environmental remediation and other obligations.

Historically, our revolving credit facilities have been used to obtain letters of credit to support our bonding and financial assurance needs. We also have letter of credit and term loan agreements and a letter of credit facility that were established to provide us with additional sources of capacity from which we may obtain letters of credit. We obtain surety bonds and insurance policies from an affiliated entity that we have an investment in and account for under the cost method. Additionally in 2003, we guaranteed the debt of a newly-formed surety company in order to assist in the establishment of that entity. We are the primary beneficiary of this entity and consolidate it under the provisions of the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). The terms of this guarantee are further discussed within the *Guarantees* section of this note. We also obtain insurance from a wholly-owned insurance company, the sole business of which is to issue policies for the parent holding company and its other subsidiaries, to secure such performance obligations. In those instances where our use of captive insurance is not allowed, we generally have available alternative bonding mechanisms.

Because virtually no claims have been made against the financial instruments we use to support our obligations, and considering our current financial position, management does not expect that any claims against or draws on these instruments would have a material adverse effect on our consolidated financial statements. We have not experienced any unmanageable difficulty in obtaining the required financial assurance instruments for our current operations. In an ongoing effort to mitigate risks of future cost increases and reductions in available capacity, we continue to evaluate various options to access cost-effective sources of financial assurance.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

*Insurance* — We carry insurance coverage for protection of our assets and operations from certain risks including automobile liability, general liability, real and personal property, workers' compensation, directors' and officers' liability, pollution legal liability and other coverages we believe are customary to the industry. Our exposure to loss for insurance claims is generally limited to the per incident deductible under the related insurance policy. Our exposure, however, could increase if our insurers were unable to meet their commitments on a timely basis.

We have retained a portion of the risks related to our automobile, general liability and workers' compensation insurance programs. For our self-insured retentions, the exposure for unpaid claims and associated expenses, including incurred but not reported losses, is based on an actuarial valuation and internal estimates. The estimated accruals for these liabilities could be affected if future occurrences or loss development significantly differ from utilized assumptions.

For the 14 months ended January 1, 2000, we insured certain risks, including auto, general liability and workers' compensation, with Reliance National Insurance Company, whose parent filed for bankruptcy in June 2001. In October 2001, the parent and certain of its subsidiaries, including Reliance National Insurance Company, were placed in liquidation. We believe that because of various state insurance guarantee funds and probable recoveries from the liquidation, currently estimated to be \$19 million, it is unlikely that events relating to Reliance will have a material adverse impact on our financial statements.

We do not expect the impact of any known casualty, property, environmental or other contingency to have a material impact on our financial condition, results of operations or cash flows.

*Guarantees* — We have entered into the following guarantee agreements associated with our operations:

- As of March 31, 2006, WM Holdings, one of WMI's wholly-owned subsidiaries, has fully and unconditionally guaranteed all of WMI's senior indebtedness, which matures through 2032. WMI has fully and unconditionally guaranteed all of the senior indebtedness of WM Holdings, which matures through 2026. Performance under these guarantee agreements would be required if either party defaulted on their respective obligations. No additional liability has been recorded for these guarantees because the underlying obligations are reflected in our Condensed Consolidated Balance Sheets. See Note 13 for further information.
- WMI and WM Holdings have guaranteed the tax-exempt bonds and other debt obligations of their subsidiaries. If a subsidiary fails to meet its obligations associated with its debt obligations as they come due, WMI or WM Holdings will be required to perform under the related guarantee agreement. No additional liability has been recorded for these guarantees because the underlying obligations are reflected in our Condensed Consolidated Balance Sheets. See Note 4 for information related to the balances and maturities of our tax-exempt bonds and other debt obligations.
- We have guaranteed certain financial obligations of unconsolidated entities. The related obligations, which mature through 2020, are not recorded on our Condensed Consolidated Balance Sheets. As of March 31, 2006, our maximum future payments associated with these guarantees are approximately \$25 million. We do not believe that it is likely that we will be required to perform under these guarantees.
- We have issued a letter of credit to support the debt of a surety bonding company. We initially guaranteed the debt of this entity during the third quarter of 2003. At that time we determined that we are the primary beneficiary of this entity under the provisions of FIN 46. As a result, since the third quarter of 2003, this variable interest entity has been consolidated into our financial statements. The guaranteed obligation is primarily included as a component of "Long-term debt" in our Condensed Consolidated Balance Sheets.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- WM Holdings has guaranteed all reimbursement obligations of WMI under its \$350 million letter of credit facility and \$295 million letter of credit and term loan agreements. Under those facilities, WMI must reimburse the entities funding the facilities for any draw on a letter of credit supported by the facilities. As of March 31, 2006, we had \$644 million in outstanding letters of credit under these facilities.
- In connection with the \$350 million letter of credit facility, WMI and WM Holdings guaranteed the interest rate swaps entered into by the entity funding the letter of credit facility. The probability of loss for the guarantees was determined to be remote and the fair value of the guarantees is immaterial to our financial position and results of operations.
- Certain of our subsidiaries have guaranteed the market value of certain homeowners' properties that are adjacent to our landfills. These guarantee agreements extend over the life of the respective landfill. Under these agreements, we would be responsible for the difference between the sale value and the guaranteed market value of the homeowners' properties, if any. Generally, it is not possible to determine the contingent obligation associated with these guarantees, but we do not believe that these contingent obligations will have a material effect on our financial position, results of operations or cash flows.
- We have indemnified the purchasers of businesses or divested assets for the occurrence of specified events under certain of our divestiture agreements. Other than certain identified items that are currently recorded as obligations, we do not believe that it is possible to determine the contingent obligations associated with these indemnities. Additionally, under certain of our acquisition agreements, we have provided for additional consideration to be paid to the sellers if established financial targets are achieved post-closing. The costs associated with any additional consideration requirements are accounted for as incurred.
- WMI and WM Holdings guarantee the service, lease, financial and general operating obligations of certain of their subsidiaries. If such a subsidiary fails to meet its contractual obligations as they come due, the guarantor has an unconditional obligation to perform on its behalf. No additional liability has been recorded for service, financial or general operating guarantees because the subsidiaries' obligations are properly accounted for as costs of operations as services are provided or general operating obligations as incurred. No additional liability has been recorded for the lease guarantees because the subsidiaries' obligations are properly accounted for as operating or capital leases, as appropriate.

We currently believe that it is not reasonably likely that we will be required to perform under these guarantee agreements or that any performance requirement would have a material impact on our consolidated financial statements.

*Environmental matters* — Our business is intrinsically connected with the protection of the environment. As such, a significant portion of our operating costs and capital expenditures could be characterized as costs of environmental protection. Such costs may increase in the future as a result of legislation or regulation. However, we believe that we generally tend to benefit when environmental regulation increases, because such regulations increase the demand for our services, and we have the resources and experience to manage environmental risk.

Estimates of the extent of our degree of responsibility for remediation of a particular site and the method and ultimate cost of remediation require a number of assumptions and are inherently difficult, and the ultimate outcome may differ materially from current estimates. However, we believe that our extensive experience in the environmental services industry, as well as our involvement with a large number of sites, provides a reasonable basis for estimating our aggregate liability. As additional information becomes available, estimates are adjusted as necessary. It is reasonably possible that technological, regulatory or enforcement developments, the results of environmental studies, the nonexistence or inability of other PRPs to contribute to the

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

settlements of such liabilities, or other factors could necessitate the recording of additional liabilities which could be material.

As of March 31, 2006, we had been notified that we are a PRP in connection with 72 locations listed on the EPA's National Priorities List ("NPL"). Of the 72 sites at which claims have been made against us, 16 are sites we own. Each of the NPL sites we own were initially developed by others as landfill disposal facilities. At each of these facilities, we are working in conjunction with the government to characterize or remediate identified site problems, and we have either agreed with other legally liable parties on an arrangement for sharing the costs of remediation or are pursuing resolution of an allocation formula. We generally expect to receive any amounts due from these parties at, or near, the time that we make the remedial expenditures. The 56 NPL sites at which claims have been made against us and that we do not own are at various procedural stages under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, which is known as CERCLA or Superfund.

The majority of these proceedings involve allegations that certain of our subsidiaries (or their predecessors) transported hazardous substances to the sites, often prior to our acquisition of these subsidiaries. CERCLA generally provides for liability for those parties owning, operating, transporting to or disposing at the sites. Proceedings arising under Superfund typically involve numerous waste generators and other waste transportation and disposal companies and seek to allocate or recover costs associated with site investigation and cleanup, which costs could be substantial and could have a material adverse effect on our consolidated financial statements. At some of the sites at which we've been identified as a PRP, our liability is well defined as a consequence of a governmental decision and an agreement among liable parties as to the share each will pay for implementing that remedy. At other sites, where no remedy has been selected or the liable parties have been unable to agree on an appropriate allocation, our future costs are uncertain. Any of these matters potentially could have a material adverse effect on our consolidated financial statements.

For more information regarding commitments and contingencies with respect to environmental matters, see Note 2.

*Litigation* — In December 1999, an individual brought an action against the Company, five former officers of WM Holdings, and WM Holdings' former independent auditor, Arthur Andersen LLP, in Illinois state court on behalf of a proposed class of individuals who purchased WM Holdings common stock before November 3, 1994, and who held that stock through February 24, 1998. The action is for alleged acts of common law fraud, negligence and breach of fiduciary duty. This case has remained in the pleadings stage for the last several years due to numerous motions and rulings by the court related to the viability of these claims. The defendants removed the case to federal court in Illinois, but a remand order has been issued. An appeal of that remand has been filed by the Company. Only limited discovery has occurred and the defendants continue to defend themselves vigorously. The extent of possible damages, if any, in this action cannot yet be determined.

In April 2002, a former participant in WM Holdings' ERISA plans and another individual filed a lawsuit in Washington, D.C. against WMI, WM Holdings and others, attempting to increase the recovery of a class of ERISA plan participants based on allegations related to both the events alleged in, and the settlements relating to, the securities class action against WM Holdings that was settled in 1998 and the securities class action against us that was settled in November 2001. Subsequently, the issues related to the latter class action have been dropped as to WMI, its officers and directors. The case is ongoing with respect to WM Holdings and others, and WM Holdings intends to defend itself vigorously.

Two separate lawsuits currently pending in Texas state court against WMI and certain former officers of WMI allege that the plaintiffs are substantial holders of the Company's common stock who intended to sell their stock in 1999, or to otherwise protect themselves against loss, but that WMI made public statements regarding its prospects, and in some instances individual defendants, all of whom were members of prior

**WASTE MANAGEMENT, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

management, made statements that were false and misleading and induced the plaintiffs to retain their stock or not to take other protective measures. The plaintiffs assert that the value of their retained stock declined dramatically and that they incurred significant losses. The plaintiffs assert claims for fraud, negligent misrepresentation, and conspiracy. The first of these cases was dismissed by summary judgment by a Texas state court in March 2002. That dismissal was ultimately upheld by the appellate court and the plaintiffs have appealed this decision to the highest state court in Texas. The second case is stayed pending resolution of the first case. We intend to continue to vigorously defend ourselves against these claims.

Additionally, another shareholder has sued the Company in Louisiana making allegations similar to those made in the securities class action referred to above and by the plaintiffs claiming damages for having held stock. The case has been removed to federal court and transferred to Texas where we are seeking a dismissal. The Company believes the plaintiff's claim will be dismissed on procedural grounds and, in any event, the extent of possible damages would not have a material adverse effect on the Company's financial condition and results of operations.

The Company has been defending allegations related generally to the termination of a joint venture to which one of our wholly-owned subsidiaries was a party. The claim involves the value of the joint venture, our interest in which was divested in 2000. The matter has been arbitrated and we are awaiting a final ruling. The other party in this matter is seeking a variety of remedies, ranging from monetary damages to unwinding the transaction; however, the nature and extent of the outcome cannot be predicted at this time.

From time to time, we pay fines or penalties in environmental proceedings relating primarily to waste treatment, storage or disposal facilities. At March 31, 2006, there were three proceedings involving our subsidiaries where we reasonably believe that the sanctions could exceed \$100,000. The matters involve allegations that subsidiaries (i) improperly operated a solid waste landfill by failing to maintain required records, properly place and cover waste and adhere to proper leachate levels; (ii) failed to comply with air permit and emission limit requirements at an operating landfill; and (iii) violated a number of state solid waste regulations and permit conditions (including, but not limited to, exceedence of permitted grades, exceedences of leachate head levels, failure to maintain records and notify the state regulatory agency of noncompliance) and federal air regulations at an operating landfill. We do not believe that the fines or other penalties in any of these matters will, individually or in the aggregate, have a material adverse effect on our financial condition or results of operations.

From time to time, we also are named as defendants in personal injury and property damage lawsuits, including purported class actions, on the basis of having owned, operated or transported waste to a disposal facility that is alleged to have contaminated the environment or, in certain cases, on the basis of having conducted environmental remediation activities at sites. Some of the lawsuits may seek to have us pay the costs of monitoring and health care examinations of allegedly affected sites and persons for a substantial period of time even where no actual damage is proven. While we believe we have meritorious defenses to these lawsuits, the ultimate resolution is often substantially uncertain due to the difficulty of determining the cause, extent and impact of alleged contamination (which may have occurred over a long period of time), the potential for successive groups of complainants to emerge, the diversity of the individual plaintiffs' circumstances, and the potential contribution or indemnification obligations of co-defendants or other third parties, among other factors. Accordingly, it is possible such matters could have a material adverse impact on our consolidated financial statements.

It is not always possible to predict the impact that lawsuits, proceedings, investigations and inquiries may have on us, nor is it possible to predict whether additional suits or claims may arise out of the matters described above in the future. We intend to defend ourselves vigorously in all the above matters. However, it is possible that the outcome of any of the matters described, or others, may ultimately have a material adverse impact on our financial condition, results of operations or cash flows in one or more future periods.

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Under Delaware law, corporations are allowed to indemnify their officers, directors and employees against claims arising from their actions in such capacities if the individuals acted in good faith and in a manner they believed to be in, or not opposed to, the best interests of the corporation. Further, corporations are allowed to advance expenses to the individuals in such matters, contingent upon the receipt of an undertaking by the individuals to repay all expenses if it is ultimately determined that they did not act in good faith and in a manner they believed to be in, or not opposed to, the best interests of the corporation. Like many Delaware companies, WMI's charter and bylaws require indemnification and advancement of expenses if these standards have been met. Additionally, WMI has entered into separate indemnification agreements with members of its Board of Directors as well as its Chief Executive Officer, President and Chief Financial Officer. Additionally, the charter and bylaw documents of certain of WMI's subsidiaries, including WM Holdings, include similar indemnification provisions, and some subsidiaries, including WM Holdings, entered into separate indemnification agreements with their officers and directors prior to our acquisition of them that provide for even greater rights and protections for the individuals.

The Company may in the future incur substantial expenses in connection with the fulfillment of its advancement of costs and indemnification obligations in connection with current actions involving former officers of the Company or its subsidiaries or other actions or proceedings that may be brought against its former or current officers, directors and employees in the future. The Company's obligations to indemnify and advance expenses continue after individuals leave the Company for claims related to actions that occurred before their departure from the Company.

We are involved in routine civil litigation and governmental proceedings, including litigation involving former employees and competitors arising in the ordinary course of our business. We do not believe that any such matters will ultimately have a material adverse impact on our consolidated financial statements.

*Tax matters* — We are currently under audit by the IRS and from time to time are audited by other taxing authorities. We fully cooperate with all audits, but defend our positions vigorously. Our audits are in various stages of completion. We have concluded several audits in the last two years. The IRS audit for the years 2002 and 2003 is currently at joint committee review and we expect resolution in the second quarter of 2006. In addition, we have started the examination phase of an IRS audit for the year 2004. We expect this audit to be completed within the next 18 months. To provide for certain potential tax exposures, we maintain an allowance for tax contingencies, the balance of which management believes is adequate. Results of audit assessments by taxing authorities could have a material effect on our quarterly or annual cash flows as audits are completed, although we do not believe that current tax audit matters will have a material adverse impact on our results of operations.

As discussed in Note 4, we have approximately \$2.7 billion of tax-exempt financings as of March 31, 2006. Tax-exempt financings are structured pursuant to certain terms and conditions of the Internal Revenue Code of 1986, as amended (the "Code"), which exempts from taxation the interest income earned by the bondholders in the transactions. The requirements of the Code can be complex, and failure to comply with these requirements would cause certain past interest payments made on the bonds to be taxable and could cause either outstanding principal amounts on the bonds to be accelerated or future interest payments on the bonds to be taxable. Some of the Company's tax-exempt financings have been, or currently are, the subject of examinations by the IRS to determine whether the financings meet the requirements of the Code. It is possible that an adverse determination by the IRS could have a material adverse effect on the Company's liquidity and results of operations.

*Unclaimed property audit* — We are currently undergoing an unclaimed property audit, which is being conducted by various state authorities. The property subject to review in this audit process generally includes unclaimed wages, vendor payments and customer refunds. State escheat laws generally require entities to report and return abandoned and unclaimed property. Failure to timely report and remit the property can result in assessments that include substantial interest and penalties, in addition to the payment of the escheat

**WASTE MANAGEMENT, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

liability itself. During the three months ended March 31, 2006, we made filings with various state authorities under previously established voluntary disclosure agreements. As a result of our findings, we determined that we had unrecorded obligations associated with unclaimed property of approximately \$19 million for escheatable items for various periods between 1980 and 2004. Our “Selling, general and administrative” expenses for the current quarter include the charge required to record these obligations. During the current quarter, we also recognized \$1 million of estimated interest obligations associated with our findings, which has been included in “Interest expense, net” in our Condensed Consolidated Statement of Operations. We have determined that the impact of these adjustments is not material to current or prior periods’ results of operations. Although we cannot currently estimate the potential financial impacts that any remaining audit findings may have, we do not expect any resulting obligations to have a material adverse effect on our consolidated results of operations or cash flows.

**10. Restructuring**

During the third quarter of 2005, we reorganized and simplified our management structure by reducing our Group and Corporate staffing levels. This reorganization increased the accountability and responsibility of our Market Areas and allowed us to streamline business decisions and reduce costs at the Group and Corporate offices. Additionally, as part of our restructuring, the responsibility for the management of our Canadian operations was assumed by our Eastern, Midwest and Western Groups, eliminating the Canadian Group. See discussion at Notes 1 and 11.

The reorganization eliminated about 600 employee positions throughout the Company. In the third and fourth quarters of 2005, we recorded \$28 million for costs associated with the implementation of the new structure. These charges included \$25 million for employee severance and benefit costs, \$1 million related to abandoned operating lease agreements and \$2 million related to consulting fees incurred to align our sales strategy to our changes in both resources and leadership that resulted from the reorganization.

Through March 31, 2006, we had paid approximately \$22 million of the employee severance and benefit costs incurred as a result of this restructuring. Approximately \$4 million of these payments were made during 2006. As of March 31, 2006, \$3 million of the related accrual remained for employee severance and benefit costs. The length of time we are obligated to make severance payments varies, with the longest obligation continuing through the third quarter of 2007.

**11. Segment and Related Information**

We manage and evaluate our operations primarily through our Eastern, Midwest, Southern, Western, Wheelabrator and Recycling Groups. These six Groups are presented below as our reportable segments. Our segments provide integrated waste management services consisting of collection, disposal (solid waste and hazardous waste landfills), transfer, waste-to-energy facilities and independent power production plants that are managed by Wheelabrator, recycling services and other services to commercial, industrial, municipal and residential customers throughout the United States and in Puerto Rico and Canada. The operations not managed through our six operating Groups are presented herein as “Other.”

In the third quarter of 2005, we eliminated our Canadian Group, and the management of our Canadian operations was allocated among our Eastern, Midwest and Western Groups. We have allocated the operating results of our Canadian operations to the Eastern, Midwest and Western Groups for the first quarter of 2005 to provide financial information that consistently reflects our current approach to managing our operations.

Our July 2005 reorganization also resulted in the centralization of certain Group office functions. The administrative costs associated with these functions were included in the measurement of income from operations for our reportable segments through August 2005, when the integration of these functions with our existing centralized processes was complete. Beginning in September 2005, these administrative costs have

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

been included in income from operations of “Corporate and other.” The reallocation of these costs has not significantly affected the operating results of our reportable segments.

Summarized financial information concerning our reportable segments for the three months ended March 31 is shown in the following tables (in millions):

Three Months Ended:	Gross Operating Revenues	Intercompany Operating Revenues(c)	Net Operating Revenues(d)	Income from Operations(e),(f)
<b>March 31, 2006</b>				
Eastern	\$ 906	\$ (178)	\$ 728	\$ 98
Midwest	720	(122)	598	102
Southern	935	(142)	793	207
Western	766	(107)	659	108
Wheelabrator	218	(18)	200	59
Recycling	194	(5)	189	7
Other(a)	80	(18)	62	8
Total	3,819	(590)	3,229	589
Corporate and Other(b)	—	—	—	(154)
Total	<u>\$ 3,819</u>	<u>\$ (590)</u>	<u>\$ 3,229</u>	<u>\$ 435</u>
<b>March 31, 2005</b>				
Eastern	\$ 850	\$ (172)	\$ 678	\$ 65
Midwest	696	(120)	576	84
Southern	861	(134)	727	169
Western	726	(99)	627	98
Wheelabrator	202	(16)	186	55
Recycling	205	(9)	196	2
Other(a)	69	(21)	48	26
Total	3,609	(571)	3,038	499
Corporate and Other(b)	—	—	—	(133)
Total	<u>\$ 3,609</u>	<u>\$ (571)</u>	<u>\$ 3,038</u>	<u>\$ 366</u>

- a) Our other revenues are generally from services provided throughout our operating Groups for in-plant services, methane gas recovery and certain third party sub-contract and administration revenues managed by our National Accounts and Upstream organizations. Other operating results reflect the combined impact of (i) the services described above; (ii) non-operating entities that provide financial assurance and self-insurance support for the operating Groups or financing for our Canadian operations; and (iii) certain quarter-end adjustments recorded in consolidation related to the reportable segments that, due to timing, were not included in the measure of segment profit or loss used to assess their performance for the periods disclosed.
- b) Corporate operating results reflect the costs incurred for various support services that are not allocated to our six operating Groups. These support services include, among other things, treasury, legal, information technology, tax, insurance, centralized service center processes, other administrative functions and the maintenance of our closed landfills. Income from operations for “Corporate and Other” also includes costs associated with our long-term incentive program and managing our international and non-solid waste divested operations, which primarily includes administrative expenses and the impact of revisions to our estimated obligations. As discussed above, we recently centralized support functions that had been provided by our Group offices. Beginning in the third quarter of 2005, our corporate operating results also include the costs associated with these support functions.
- c) Intercompany operating revenues reflect each segment’s total intercompany sales, including intercompany sales within a segment and between segments. Transactions within and between segments are generally made on a basis intended to reflect the market value of the service.

**WASTE MANAGEMENT, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- d) Our operating revenues tend to be somewhat lower in the first quarter, primarily due to the lower volume of construction and demolition waste during winter months. The volumes of industrial and residential waste in certain regions also tend to decrease during the winter months. Additionally, certain harsh weather conditions may result in the temporary suspension of operations.
- e) The operating results of our reportable segments generally reflect the impact the various lines of business and markets in which we operate can have on the Company's consolidated operating results. The income from operations provided by our four geographic segments is generally indicative of the margins provided by our collection, landfill and transfer businesses, although these groups do provide recycling and other services that can affect these trends. The operating margins provided by our Wheelabrator segment (waste-to-energy facilities and independent power production plants) have historically been higher than the margins provided by our base business generally due to the combined impact of long-term disposal and energy contracts and the disposal demands of the region in which our facilities are concentrated. Income from operations provided by our Recycling segment generally reflects operating margins typical of the recycling industry, which tend to be significantly lower than those provided by our base business. From time to time the operating results of our reportable segments are significantly affected by unusual or infrequent transactions or events.
- f) For those items included in the determination of income from operations, the accounting policies of our segments are the same as those described in the summary of significant accounting policies included in our December 31, 2005 Form 10-K.

The table below shows the total revenues contributed by our principal lines of business (in millions):

	Three Months Ended March 31,	
	2006	2005
Collection	\$ 2,159	\$ 2,057
Landfill	750	676
Transfer	421	387
Wheelabrator	218	202
Recycling and other(a)	271	287
Intercompany(b)	(590)	(571)
Operating revenues	<u>\$ 3,229</u>	<u>\$ 3,038</u>

- a) In addition to the revenue generated by our Recycling Group, we have included revenues generated within our four geographic operating Groups derived from recycling, methane gas operations and Port-O-Let® services in the "recycling and other" line-of-business.
- b) Intercompany revenues between lines of business are eliminated within the Condensed Consolidated Financial Statements included herein.

**12. Asset Impairments and Unusual Items**

We recognized \$2 million of gains on divestitures during the first quarter of 2006. During the first quarter of 2005, we recognized a \$39 million gain as a result of the divestiture of a landfill in Ontario, Canada, which was required as a result of a Divestiture Order from the Canadian Competition Bureau. This gain on divestiture was partially offset by a charge of approximately \$16 million for the impact of a litigation settlement reached with a group of stockholders that opted not to participate in the 2000 settlement of the securities class action lawsuit against us related to 1998 and 1999 activity.

**13. Condensed Consolidating Financial Statements**

WM Holdings has fully and unconditionally guaranteed all of WMI's senior indebtedness. WMI has fully and unconditionally guaranteed all of WM Holdings' senior indebtedness and its 5.75% convertible subordinated notes that matured and were repaid in January 2005. None of WMI's other subsidiaries have guaranteed any of WMI's or WM Holdings' debt. As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information (in millions):

WASTE MANAGEMENT, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

CONDENSED CONSOLIDATING BALANCE SHEETS

March 31, 2006  
(Unaudited)

ASSETS

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets:</b>					
Cash and cash equivalents	\$ 434	\$ —	\$ 20	\$ —	\$ 454
Other current assets	534	—	2,399	—	2,933
	968	—	2,419	—	3,387
Property and equipment, net	—	—	11,063	—	11,063
Investments in and advances to affiliates	9,487	8,489	—	(17,976)	—
Other assets	29	11	6,356	—	6,396
<b>Total assets</b>	<b>\$ 10,484</b>	<b>\$ 8,500</b>	<b>\$ 19,838</b>	<b>\$ (17,976)</b>	<b>\$ 20,846</b>

LIABILITIES AND STOCKHOLDERS' EQUITY

<b>Current liabilities:</b>					
Current portion of long-term debt	\$ 52	\$ 302	\$ 246	\$ —	\$ 600
Accounts payable and other current liabilities	116	25	2,363	—	2,504
	168	327	2,609	—	3,104
Long-term debt, less current portion	4,094	887	3,039	—	8,020
Due to affiliates	—	—	2,650	(2,650)	—
Other liabilities	151	9	3,201	—	3,361
<b>Total liabilities</b>	<b>4,413</b>	<b>1,223</b>	<b>11,499</b>	<b>(2,650)</b>	<b>14,485</b>
Minority interest in subsidiaries and variable interest entities	—	—	290	—	290
Stockholders' equity	6,071	7,277	8,049	(15,326)	6,071
<b>Total liabilities and stockholders' equity</b>	<b>\$ 10,484</b>	<b>\$ 8,500</b>	<b>\$ 19,838</b>	<b>\$ (17,976)</b>	<b>\$ 20,846</b>

December 31, 2005

ASSETS

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>Current assets:</b>					
Cash and cash equivalents	\$ 698	\$ —	\$ —	\$ (32)	\$ 666
Other current assets	300	—	2,485	—	2,785
	998	—	2,485	(32)	3,451
Property and equipment, net	—	—	11,221	—	11,221
Investments in and advances to affiliates	9,599	8,262	—	(17,861)	—
Other assets	34	11	6,418	—	6,463
<b>Total assets</b>	<b>\$ 10,631</b>	<b>\$ 8,273</b>	<b>\$ 20,124</b>	<b>\$ (17,893)</b>	<b>\$ 21,135</b>

LIABILITIES AND STOCKHOLDERS' EQUITY

<b>Current liabilities:</b>					
Current portion of long-term debt	\$ —	\$ 303	\$ 219	\$ —	\$ 522
Accounts payable and other current liabilities	202	26	2,539	(32)	2,735
	202	329	2,758	(32)	3,257
Long-term debt, less current portion	4,183	890	3,092	—	8,165
Due to affiliates	—	—	3,006	(3,006)	—
Other liabilities	125	8	3,178	—	3,311
<b>Total liabilities</b>	<b>4,510</b>	<b>1,227</b>	<b>12,034</b>	<b>(3,038)</b>	<b>14,733</b>
Minority interest in subsidiaries and variable interest entities	—	—	281	—	281
Stockholders' equity	6,121	7,046	7,809	(14,855)	6,121
<b>Total liabilities and stockholders' equity</b>	<b>\$ 10,631</b>	<b>\$ 8,273</b>	<b>\$ 20,124</b>	<b>\$ (17,893)</b>	<b>\$ 21,135</b>

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

Three Months Ended March 31, 2006  
(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues	\$ —	\$ —	\$ 3,229	\$ —	\$ 3,229
Costs and expenses	—	—	2,794	—	2,794
Income from operations	—	—	435	—	435
Other income (expense):					
Interest income (expense), net	(71)	(21)	(35)	—	(127)
Equity in subsidiaries, net of taxes	231	244	—	(475)	—
Minority interest	—	—	(12)	—	(12)
Equity in net losses of unconsolidated entities and other, net	—	—	(7)	—	(7)
	160	223	(54)	(475)	(146)
Income before income taxes	160	223	381	(475)	289
Provision for (benefit from) income taxes	(26)	(8)	137	—	103
Net income	\$ 186	\$ 231	\$ 244	\$ (475)	\$ 186

Three Months Ended March 31, 2005  
(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Operating revenues	\$ —	\$ —	\$ 3,038	\$ —	\$ 3,038
Costs and expenses	—	—	2,672	—	2,672
Income from operations	—	—	366	—	366
Other income (expense):					
Interest income (expense), net	(64)	(22)	(24)	—	(110)
Equity in subsidiaries, net of taxes	191	205	—	(396)	—
Minority interest	—	—	(10)	—	(10)
Equity in net losses of unconsolidated entities and other, net	—	—	(26)	—	(26)
	127	183	(60)	(396)	(146)
Income before income taxes	127	183	306	(396)	220
Provision for (benefit from) income taxes	(23)	(8)	101	—	70
Net income	\$ 150	\$ 191	\$ 205	\$ (396)	\$ 150

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

Three Months Ended March 31, 2006  
(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ 186	\$ 231	\$ 244	\$ (475)	\$ 186
Equity in earnings of subsidiaries, net of taxes	(231)	(244)	—	475	—
Other adjustments and charges	9	(2)	370	—	377
Net cash provided by (used in) operating activities	<u>(36)</u>	<u>(15)</u>	<u>614</u>	<u>—</u>	<u>563</u>
Cash flows from investing activities:					
Acquisitions of businesses, net of cash acquired	—	—	(8)	—	(8)
Capital expenditures	—	—	(171)	—	(171)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	—	—	18	—	18
Purchases of short-term investments	(784)	—	—	—	(784)
Proceeds from sales of short-term investments	550	—	6	—	556
Net receipts from restricted trust and escrow accounts and other, net	—	—	36	—	36
Net cash used in investing activities	<u>(234)</u>	<u>—</u>	<u>(119)</u>	<u>—</u>	<u>(353)</u>
Cash flows from financing activities:					
New borrowings	—	—	51	—	51
Debt repayments	—	—	(87)	—	(87)
Common stock repurchases	(375)	—	—	—	(375)
Cash dividends	(121)	—	—	—	(121)
Exercise of common stock options and warrants	125	—	—	—	125
Other, net	22	—	(36)	—	(14)
(Increase) decrease in intercompany and investments, net	355	15	(402)	32	—
Net cash provided by (used in) financing activities	<u>6</u>	<u>15</u>	<u>(474)</u>	<u>32</u>	<u>(421)</u>
Effect of exchange rate changes on cash and cash equivalents	—	—	(1)	—	(1)
Increase (decrease) in cash and cash equivalents	(264)	—	20	32	(212)
Cash and cash equivalents at beginning of period	698	—	—	(32)	666
Cash and cash equivalents at end of period	<u>\$ 434</u>	<u>\$ —</u>	<u>\$ 20</u>	<u>\$ —</u>	<u>\$ 454</u>

## WASTE MANAGEMENT, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Three Months Ended March 31, 2005  
(Unaudited)

	WMI	WM Holdings	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	\$ 150	\$ 191	\$ 205	\$ (396)	\$ 150
Equity in earnings of subsidiaries, net of taxes	(191)	(205)	—	396	—
Other adjustments and charges	10	—	348	—	358
Net cash provided by (used in) operating activities	(31)	(14)	553	—	508
Cash flows from investing activities:					
Acquisitions of businesses, net of cash acquired	—	—	(87)	—	(87)
Capital expenditures	—	—	(185)	—	(185)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	—	—	97	—	97
Purchases of short-term investments	(70)	—	(16)	—	(86)
Proceeds from sales of short-term investments	89	—	7	—	96
Net receipts from restricted trust and escrow accounts and other, net	1	—	43	—	44
Net cash provided by (used in) investing activities	20	—	(141)	—	(121)
Cash flows from financing activities:					
New borrowings	—	—	—	—	—
Debt repayments	—	(35)	(83)	—	(118)
Common stock repurchases	(99)	—	—	—	(99)
Cash dividends	(114)	—	—	—	(114)
Exercise of common stock options and warrants	26	—	—	—	26
Other, net	—	—	(67)	—	(67)
(Increase) decrease in intercompany and investments, net	214	49	(263)	—	—
Net cash provided by (used in) financing activities	27	14	(413)	—	(372)
Effect of exchange rate changes on cash and cash equivalents	—	—	2	—	2
Increase in cash and cash equivalents	16	—	1	—	17
Cash and cash equivalents at beginning of period	357	—	67	—	424
Cash and cash equivalents at end of period	\$ 373	\$ —	\$ 68	\$ —	\$ 441

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

When we make statements containing projections about our accounting and finances, plans and objectives for the future, future economic performance or when we make statements containing any other projections or estimates about our assumptions relating to these types of statements, we are making forward-looking statements. These statements usually relate to future events and anticipated revenues, earnings, cash flows or other aspects of our operations or operating results. We make these statements in an effort to keep stockholders and the public informed about our business, and have based them on our current expectations about future events. You should view such statements with caution. These statements are not guarantees of future performance or events. All phases of our business are subject to uncertainties, risks and other influences, many of which we do not control. Any of these factors, either alone or taken together, could have a material adverse effect on us and could change whether any forward-looking statement ultimately turns out to be true. Additionally, we assume no obligation to update any forward-looking statement as a result of future events or developments. The following discussion should be read together with the Condensed Consolidated Financial Statements and the notes to the Condensed Consolidated Financial Statements.

Some of the risks that we face and that could affect our business and financial statements for the remainder of 2006 and beyond include:

- competition may negatively affect our profitability or cash flows, our price increases may have negative effects on volumes, and price roll-backs and lower than average pricing to retain and attract customers may negatively affect our yield on base business;
- we may be unable to maintain or expand margins as volumes increase if we are unable to control variable costs or fixed cost base increases;
- we may be unable to attract or retain qualified personnel, including licensed commercial drivers and truck maintenance professionals, due to any number of factors including qualified workforce shortages;
- we may not be able to successfully execute or continue our operational or other margin improvement plans and programs, including pricing increases, passing on increased costs to our customers, divesting of under-performing assets and purchasing accretive businesses, any of which could negatively affect our revenues and margins;
- fuel price increases or fuel supply shortages may increase our expenses, including our tax expense if Section 45K (formerly Section 29) credits are phased out due to continued high crude oil prices;
- fluctuating commodity prices may have negative effects on our operating revenues and expenses;
- inflation and resulting higher interest rates may have negative effects on the economy, which could result in decreases in volumes of waste generated and increases in our financing and expenses;
- the possible inability of our insurers to meet their obligations may cause our expenses to increase;
- weather conditions cause our quarter to quarter results to fluctuate, and extremely harsh weather or natural disasters may cause us to shut down operations;
- possible changes in our estimates of site remediation requirements, final capping, closure and post-closure obligations, compliance and regulatory developments may increase our expenses or reduce revenues;
- regulations may negatively impact our business by, among other things, increasing the cost to comply with regulatory requirements and the potential liabilities associated with disposal operations;
- if we are unable to obtain and maintain permits needed to operate our facilities our results of operations will be negatively impacted;

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- limitations or bans on disposal or transportation of out-of-state or cross-border waste or certain categories of waste can increase our expenses;
- possible charges as a result of shut-down operations, uncompleted development or expansion projects or other events may negatively affect earnings;
- trends toward requiring recycling, waste reduction at the source and prohibiting the disposal of certain types of wastes could have negative effects on volumes of waste going to landfills and waste-to-energy facilities, which are higher margin businesses than recycling;
- efforts by labor unions to organize our employees may divert management's attention and increase operating expenses and we may be unable to negotiate acceptable collective bargaining agreements with those who have chosen to be represented by unions, which could lead to union-initiated work stoppages, including strikes, which could adversely affect our results of operations and cash flows;
- negative outcomes of litigation or threatened litigation or governmental proceedings may increase our costs or limit our ability to conduct our operations;
- possible errors or problems in connection with the implementation and deployment of new information technology systems may decrease our efficiencies and increase our costs to operate;
- the adoption of new accounting standards or interpretations may cause fluctuations in quarterly results of operations or adversely impact our results of operations; and
- the reduction or elimination of our dividend or share repurchase program or the need for additional capital if cash flows are less than we expect or capital expenditures are more than we expect, and the possibility that we cannot obtain additional capital on acceptable terms if needed.

These are not the only risks that we face. There may be additional risks that we do not presently know of or that we currently believe are immaterial which could also impair our business and financial position.

### **General**

Our principal executive offices are located at 1001 Fannin Street, Suite 4000, Houston, Texas 77002. Our telephone number at that address is (713) 512-6200. Our website address is <http://www.wm.com>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K are all available, free of charge, on our website as soon as practicable after we file the reports with the SEC. Our stock is traded on the New York Stock Exchange under the symbol "WMI."

We are the leading provider of integrated waste services in North America. Using our vast network of assets and employees, we provide a comprehensive range of waste management services. Through our subsidiaries we provide collection, transfer, recycling, disposal and waste-to-energy services. In providing these services, we actively pursue projects and initiatives that we believe make a positive difference for our environment, including recovering and processing the methane gas produced naturally by landfills into a renewable energy source. Our customers include commercial, industrial, municipal and residential customers, other waste management companies, electric utilities and governmental entities.

### **Overview**

The first quarter of 2006 was very positive for the Company. Our operating results continued to demonstrate the progress we are making on our primary financial goals of earnings growth, margin expansion and strong free cash flow. We believe our successes in these areas during the current quarter are primarily due to our focus on improving revenue growth from yield through our pricing excellence initiatives and identifying operating efficiencies that translate into cost savings across the organization.

*Earnings Growth and Margin Improvement* — Our first quarter 2006 income from operations was \$435 million, an increase of \$69 million, or 18.9%, when compared with the prior year period. Income from operations as a percentage of revenues for the first quarter of 2006 was 13.5% as compared with 12.0% in the prior year period. When focusing on our core operating costs (which are Operating; Selling, General and

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Administrative; and Depreciation and Amortization expenses) our margin improvement was even more pronounced, increasing over two percentage points to 13.4% in 2006.

These improvements have been driven by the continued increase in our revenues as a result of the successful execution of our pricing strategies and our focus on cost control by improving productivity, standardizing operating and maintenance practices and emphasizing the importance of safety throughout the organization. Our pricing strategies are focused on (i) developing our prices to appropriately reflect our full cost structure and the unique and capital intensive nature of our disposal assets, (ii) ensuring that we are compensated for all of the services that we provide to our customers, and (iii) maintaining acceptable margins and returns for our shareholders. Revenue growth from yield was \$118 million, or 3.9%, during the first quarter of 2006 as compared with \$60 million, or 2.1%, in the first quarter of 2005. Progress was also made on our operational excellence initiative during the first quarter of 2006, as demonstrated by the decline in our operating expenses as a percentage of revenue, making this the third consecutive quarter that our operating expenses as a percentage of revenue have improved on a year-over-year basis. We are encouraged by the strength of our pricing and cost control initiatives and are confident that the recent trends in our revenue growth and cost control will continue to benefit the Company.

The quarter-over-quarter change in our income from operations was also affected by (i) a \$19 million charge to Selling, General and Administrative expenses during the first quarter of 2006 to record unrecorded obligations associated with an unclaimed property audit, which is discussed further in Note 9 to our Condensed Consolidated Financial Statements, and (ii) a \$21 million decline in the favorable effect of Asset Impairments and Unusual Items primarily due to a decrease in gains on divestitures, which was driven by the sale of a landfill in Canada in the first quarter of 2005.

As summarized in Note 5 to the Condensed Consolidated Financial Statements, our “Equity in net losses of unconsolidated entities” and “Provision for income taxes” for the three months ended March 31, 2006 have been significantly affected by our current expectations for the phase out of 61% of Section 45K (formerly Section 29, but re-designated as Section 45K effective for years ending after December 31, 2005) tax credits for 2006. The 3.8 percentage point increase in our current estimated effective tax rate as compared with the prior year period is primarily due to the expected impact of the partial phase out of the Section 45K tax credits. We will monitor changes in oil prices throughout the year and update our effective tax rate, as necessary, to reflect changes in our expectations associated with the applicability of Section 45K tax credits.

Our “Net income” and “Diluted earnings per common share” increased by 24% and 31%, respectively, when comparing the first quarter of 2006 with the first quarter of 2005. The significant increase in each of these earnings measurements was largely driven by the positive impact of the growth in our operating income discussed above. A 4% decline in the number of common shares outstanding also contributed to the improvement in our diluted earnings per share, which increased from \$0.26 in the first quarter of 2005 to \$0.34 in the first quarter of 2006. The continued reduction in common shares outstanding is attributable to our focus on share repurchases as a means of providing our shareholders with a solid return on their investment.

*Free Cash Flow* — The improvement in our income from operations provided by revenue growth and our focus on operating efficiencies also yielded a significant increase in our operating cash flows during the current quarter. The increase in cash provided by operating activities was key to our strong free cash flow in 2006, which declined by only \$10 million from the prior year period in spite of a \$79 million decline in proceeds from

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divestitures and other sales of assets. Free cash flow for the three month periods ended March 31, 2006 and 2005 is summarized in the table below (in millions):

	Three Months Ended March 31,	
	2006	2005
Net cash provided by operating activities	\$ 563	\$ 508
Capital expenditures	(171)	(185)
Proceeds from divestitures of businesses, net of cash divested, and other sales of assets	18	97
Free cash flow	<u>\$ 410</u>	<u>\$ 420</u>

Free cash flow is not a measure of financial performance under generally accepted accounting principles (“GAAP”) and is not intended to replace the Condensed Consolidated Statements of Cash Flows that have been presented elsewhere herein in accordance with GAAP. We include our free cash flow in our disclosures because we use this measure to manage our business, we believe that the production of free cash flow is a very important measure of our liquidity and operating results, and it is indicative of our ability to pay our quarterly dividends, repurchase our common stock and fund our acquisition program.

*Divestiture Program* — We continue to make progress on our plan to divest under-performing and non-strategic operations. We are actively marketing the majority of the operations that we have identified as part of this program and expect to make significant progress toward the divestiture of these operations over the remainder of the year.

### ***Basis of Presentation of Consolidated and Segment Financial Information***

*Accounting Change* — On January 1, 2006, we adopted Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), *Share Based Payment* (“SFAS No. 123(R)”), which requires compensation expense to be recognized for all share-based payments made to employees based on the fair value of the award at the date of grant. We adopted SFAS No. 123(R) using the modified prospective method, which results in the recognition of compensation expense using the provisions of SFAS No. 123(R) for all share-based awards granted or modified after December 31, 2005 and the recognition of compensation expense using the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (“SFAS No. 123”), for all unvested awards outstanding at the date of adoption.

Through December 31, 2005, we accounted for equity-based compensation in accordance with Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, as amended (“APB No. 25”). Under APB No. 25, we recognized compensation expense based on an award’s intrinsic value. For stock options, which were the primary form of awards we granted through December 31, 2004, this meant that we recognized no compensation expense in connection with the grants, as the exercise price of the options was equal to the fair market value of our common stock on the date of grant and all other provisions were fixed. As discussed below, beginning in 2005, restricted stock units and performance share units have been the primary form of equity-based compensation awarded under our long-term incentive plans. For restricted stock units, intrinsic value is equal to the market value of our common stock on the date of grant. For performance share units, APB No. 25 required “variable accounting,” which resulted in the recognition of compensation expense based on the intrinsic value of each award at the end of each reporting period.

In December 2005, the Compensation Committee of our Board of Directors approved the acceleration of the vesting of all unvested stock options awarded under our stock incentive plans, effective December 28, 2005. The decision to accelerate the vesting of outstanding stock options was made primarily to reduce the non-cash compensation expense that we would have otherwise recorded in future periods as a result of adopting SFAS No. 123(R). We estimate that the acceleration eliminated approximately \$55 million of cumulative pre-tax compensation charges that would have been recognized during 2006, 2007 and 2008 as the stock options would have continued to vest. We recognized a \$2 million pre-tax charge to compensation expense during the fourth quarter of 2005 as a result of the acceleration, but do not expect to recognize future

compensation expense for the accelerated options under SFAS No. 123(R) unless further modifications are made to the options, which is not anticipated.

Additionally, as a result of changes in accounting required by SFAS No. 123(R) and a desire to design our long-term incentive plans in a manner that creates a stronger link to operating and market performance, our Board of Directors approved a substantial change in the form of awards that we grant. Beginning in 2005, annual stock option grants, as well as stock option grants in connection with new hires and promotions, were replaced with either (i) grants of restricted stock units and performance share units or (ii) an enhanced cash compensation award. The terms of restricted stock units and performance share units granted during 2006 are summarized in Note 8 to the Condensed Consolidated Financial Statements.

We recognized \$4 million of compensation expense during the three months ended March 31, 2006 and \$6 million during the three months ended March 31, 2005 associated with restricted stock, restricted stock units and performance share units. The reduction in compensation expense recognized between 2005 and 2006 was driven by a change in the awards' retirement provisions rather than the change in accounting required as a result of our adoption of SFAS No. 123(R). As discussed above, the then pending adoption of SFAS No. 123(R) significantly affected our Board of Directors' considerations related to equity-based compensation, resulting in their decision to accelerate the vesting of outstanding stock options and replace stock options with restricted stock units and performance share units. As a result of these changes, the adoption of SFAS No. 123(R) on January 1, 2006 did not significantly affect our accounting for equity-based compensation or net income for the three months ended March 31, 2006. We do not currently expect this change in accounting to significantly impact our future results of operations. However, we do expect equity-based compensation expense to increase over the next three to four years because of the incremental expense that will be recognized each year as our Board of Directors grants additional awards.

*Reclassification of Segment Information* — In the third quarter of 2005, we eliminated our Canadian Group office, and the management of our Canadian operations was allocated among our Eastern, Midwest and Western Groups. We have allocated the operating results of our Canadian operations to the Eastern, Midwest and Western Groups for the first quarter of 2005 to provide financial information that consistently reflects our current approach to managing our operations. This reorganization also resulted in the centralization of certain Group office functions. The administrative costs associated with these functions were included in the measurement of income from operations for our reportable segments through August 2005, when the integration of these functions with our existing centralized processes was completed. Beginning in September 2005, these administrative costs have been included in the income from operations of our Corporate organization. The reallocation of these costs has not significantly affected the operating results of our reportable segments for the periods presented.

#### ***Critical Accounting Estimates and Assumptions***

In preparing our financial statements, we make several estimates and assumptions that affect our assets, liabilities, stockholders' equity, revenues and expenses. We must make these estimates and assumptions because certain information that is used in the preparation of our financial statements is dependent on future events, cannot be calculated with a high degree of precision from available data or is simply not capable of being readily calculated based on generally accepted methodologies. In some cases, these estimates are particularly difficult to determine and we must exercise significant judgment. The most difficult, subjective and complex estimates and the assumptions that deal with the greatest amount of uncertainty relate to our accounting for landfills, environmental remediation liabilities, asset impairments and self-insurance reserves and recoveries, as described in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2005.

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**Results of Operations**

The following table presents, for the periods indicated, the period-to-period change in dollars (in millions) and percentages for the respective Condensed Consolidated Statement of Operations line items:

	Period-to-Period Change For the Three Months Ended March 31, 2006 and 2005	
Operating revenues	\$ 191	6.3%
Costs and expenses:		
Operating	56	2.7
Selling, general and administrative	38	11.5
Depreciation and amortization	7	2.2
Restructuring	—	—
Asset impairments and unusual items	21	(91.3)
	<u>122</u>	4.6
Income from operations	<u>69</u>	18.9
Other income (expense):		
Interest income (expense), net	(17)	15.5
Equity in net losses of unconsolidated entities	18	(69.2)
Minority interest	(2)	20.0
Other, net	1	*
	<u>—</u>	—
Income before income taxes	<u>\$ 69</u>	31.4%

\* Percentage change is not meaningful

The following table presents, for the periods indicated, the percentage relationship that the respective Condensed Consolidated Statement of Operations line items bear to operating revenues:

	Three Months Ended March 31,	
	2006	2005
Operating revenues	<u>100.0%</u>	<u>100.0%</u>
Costs and expenses:		
Operating	65.0	67.3
Selling, general and administrative	11.4	10.9
Depreciation and amortization	10.2	10.6
Restructuring	—	—
Asset impairments and unusual items	(0.1)	(0.8)
	<u>86.5</u>	<u>88.0</u>
Income from operations	<u>13.5</u>	<u>12.0</u>
Other income (expense):		
Interest income (expense), net	(3.9)	(3.6)
Equity in net losses of unconsolidated entities	(0.2)	(0.9)
Minority interest	(0.4)	(0.3)
Other, net	—	—
	<u>(4.5)</u>	<u>(4.8)</u>
Income before income taxes	<u>9.0%</u>	<u>7.2%</u>

### Operating Revenues

Our operating revenues for the three months ended March 31, 2006 were \$3.2 billion compared with \$3.0 billion for the three months ended March 31, 2005. We manage and evaluate our operations primarily through our Eastern, Midwest, Southern, Western, Wheelabrator (which includes our waste-to-energy facilities and independent power production plants, or IPPs) and Recycling Groups. These six operating Groups are our reportable segments. Shown below (in millions) is the contribution to revenues during each period provided by our six operating Groups and our Other waste services:

	Three Months Ended March 31,	
	2006	2005
Eastern	\$ 906	\$ 850
Midwest	720	696
Southern	935	861
Western	766	726
Wheelabrator	218	202
Recycling	194	205
Other	80	69
Intercompany	(590)	(571)
Total	<u>\$3,229</u>	<u>\$3,038</u>

Our operating revenues generally come from fees charged for our collection, disposal, transfer, Wheelabrator and recycling services. Some of the fees we charge to our customers for collection services are billed in advance; a liability for future service is recorded when we bill the customer and operating revenues are recognized as services are actually provided. Revenues from our disposal operations consist of tipping fees, which are generally based on the weight, volume and type of waste being disposed of at our disposal facilities and are normally billed monthly or semi-monthly. Fees charged at transfer stations are generally based on the volume of waste deposited, taking into account our cost of loading, transporting and disposing of the solid waste at a disposal site, and are normally billed monthly. Our Wheelabrator revenues are based on the type and volume of waste received at our waste-to-energy facilities and IPPs and fees charged for the sale of energy and steam. Recycling revenue, which is generated by our Recycling Group as well as our four geographic operating Groups, generally consists of the sale of recyclable commodities to third parties and tipping fees. Intercompany revenues between our operations have been eliminated in the consolidated financial statements. The mix of operating revenues from our different services is reflected in the table below (in millions):

	Three Months Ended March 31,	
	2006	2005
Collection	\$2,159	\$2,057
Landfill	750	676
Transfer	421	387
Wheelabrator	218	202
Recycling and other	271	287
Intercompany	(590)	(571)
Total	<u>\$3,229</u>	<u>\$3,038</u>

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The following table provides details associated with the period-to-period change in revenues (in millions) along with an explanation of the significant components of the current period changes:

	Period-to-Period Change For the Three Months Ended March 31, 2006 and 2005	
Average yield:		
Base business	\$ 118	3.9%
Commodity	(35)	(1.1)
Electricity (IPPs)	1	—
Fuel surcharge and mandated fees	43	1.4
Total	127	4.2
Volume	57	1.9
Internal growth	184	6.1
Acquisitions	21	0.7
Divestitures	(23)	(0.8)
Foreign currency translation	9	0.3
	<u>\$ 191</u>	<u>6.3%</u>

*Base Business* — Our pricing excellence initiative continues to be the primary contributor to internal revenue growth. Base business yield provided revenue growth for each line of business during the current quarter, but was driven by our collection operations, where we experienced substantial revenue growth in every geographic operating group. The significant revenue growth from base business yield in the collection line of business is primarily the result of our continued focus on pricing our business based on market specific factors, including our costs. As discussed below, the significant increase in our collection revenues due to price has resulted in partially offsetting declines in our revenue from collection volumes. In assessing the impact of higher collection yield on our volumes, we continue to find that, in spite of volume declines, revenue growth from base business yield and a focus on controlling variable costs are providing notable margin and cash flow improvements.

In addition to the improvements in the collection line of business, we experienced substantial yield contributions to revenues from our waste-to-energy facilities, transfer stations and on construction and demolition and municipal solid waste streams at our landfills. Revenue improvements at our waste-to-energy facilities were largely due to significant increases in the rates charged for electricity under our long-term contracts with electric utilities, which generally are indexed to natural gas prices. Base business yield improvements at our transfer stations and landfills are due to the improved pricing practices implemented as a result of our findings from our landfill pricing study during 2005.

An environmental cost recovery fee, which increased revenues by \$12 million during the first quarter of 2006 and \$5 million in the comparable prior year period, and other fee programs targeted at recovering the costs we incur for items, such as the collection of past due balances, have also contributed to yield improvement during the current quarter.

*Commodity* — Our first quarter revenues declined due to price decreases in the recycling commodities that we process. Average prices for old corrugated cardboard dropped by 33% when comparing the first quarter of 2006 to the first quarter of 2005, from \$87 per ton in 2005 to \$58 per ton in 2006. Average prices for old newsprint were also down by about 12%, from \$86 per ton in the first quarter of 2005 to \$76 per ton in the first quarter of 2006.

*Fuel surcharge and mandated fees* — When comparing revenues for the first quarter of 2006 to those of the comparable prior year period, fuel surcharges increased revenues by \$43 million. This increase is due to (i) an increase in market prices for fuel; (ii) an increase in the number of customers who participate in our fuel surcharge program; and (iii) the revision of our fuel surcharge program at the beginning of the third quarter of 2005 to incorporate the indirect fuel cost increases passed on to us by subcontracted haulers and

vendors. During the three months ended March 31, 2006, increased operating costs due to higher diesel fuel prices, which are included within both *Operating Expenses — Subcontractor Costs* and *Operating Expenses — Fuel*, were recovered by our fuel surcharge program. There was not a significant change in revenues attributable to mandated fees during the first quarter of 2006 when compared with the first quarter of 2005.

*Volume* — The increase in volume-related revenues during the three months ended March 31, 2006 when compared with the corresponding prior year period is primarily due to higher disposal, transfer station and recycling volumes, which were partially offset by a decline in collection volumes.

We believe that warm and dry weather in many parts of the country and the strength of the economy were the primary drivers of the higher disposal volumes, which were particularly strong in the Southern Group. The improvement in volume-related revenues for our transfer stations was principally contributed by our Eastern Group, where the transfer station business is critical due to the disposal constraints of the region. The current quarter growth in volume-related revenues is also due to higher revenues associated with continued hurricane related services, which were driven by subcontracted services in New Orleans and Mobile in connection with Hurricane Katrina efforts and by increased disposal volumes in Southern Florida. This volume-related revenue growth more than offset hurricane related volume declines in Louisiana and Mississippi due to lower residential and commercial collection volumes.

The \$16 million decline in volume-related revenues in our collection business is due to our focus on improving the margins in this line of business through pricing. When comparing our revenues for the three months ended March 31, 2006 with the comparable prior year period, residential and commercial operations experienced volume-related revenue declines in each of our geographic operating Groups. The volume decline during the current quarter was the most significant in our Eastern Group's residential collection operations where we continue to bid large municipal residential contracts at higher prices that will provide for an acceptable return on our invested capital.

### ***Operating Expenses***

Our operating expenses include (i) labor and related benefits (excluding labor costs associated with maintenance and repairs included below), which include salaries and wages, bonuses, related payroll taxes, insurance and benefits costs and the costs associated with contract labor; (ii) transfer and disposal costs, which include tipping fees paid to third party disposal facilities and transfer stations; (iii) maintenance and repairs relating to equipment, vehicles and facilities and related labor costs; (iv) subcontractor costs, which include the costs charged by independent haulers who transport our waste to disposal facilities and are driven by transportation costs such as fuel prices; (v) costs of goods sold, which are primarily the rebates paid to suppliers associated with recycling commodities; (vi) fuel costs, which represent the costs of fuel and oil to operate our truck fleet and landfill operating equipment; (vii) disposal and franchise fees and taxes, which include landfill taxes, municipal franchise fees, host community fees and royalties; (viii) landfill operating costs, which include landfill remediation costs, leachate and methane collection and treatment, other landfill site costs and interest accretion on asset retirement obligations; (ix) risk management costs, which include workers' compensation and insurance and claim costs and (x) other operating costs, which include, among other costs, equipment and facility rent and property taxes.

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The following table summarizes the major components of our operating expenses, including the impact of foreign currency translation, for the three months ended March 31, 2006 and 2005 (in millions):

	Three Months Ended March 31,		Period to Period Change	
	2006	2005		
Labor and related benefits	\$ 612	\$ 601	\$ 11	1.8%
Transfer and disposal costs	299	295	4	1.4
Maintenance and repairs	292	282	10	3.5
Subcontractor costs	238	205	33	16.1
Cost of goods sold	140	157	(17)	(10.8)
Fuel	135	112	23	20.5
Disposal and franchise fees and taxes	152	148	4	2.7
Landfill operating costs	50	54	(4)	(7.4)
Risk management	76	75	1	1.3
Other	106	115	(9)	(7.8)
	<u>\$ 2,100</u>	<u>\$ 2,044</u>	<u>\$ 56</u>	<u>2.7%</u>

As summarized in the table above, our operating expenses for the three months ended March 31, 2006 increased from the prior year period. However, operating expenses as a percentage of revenue improved significantly during the current quarter, from 67.3% for the three months ended March 31, 2005 to 65.0% in 2006. This improvement can be attributed to the increase in revenues, as well as progress on our operational excellence initiatives such as improving productivity, reducing fleet maintenance costs, standardizing operating practices and improving safety. Our operating expenses continue to reflect our focus on identifying operational efficiencies that will translate into cost savings. The most significant factors affecting the change in operating expenses between the first quarter of 2005 and the first quarter of 2006 are summarized below.

*Subcontractor costs* — The primary drivers of these cost increases were an increase in the fuel surcharges we are paying to third party subcontractors due to higher diesel fuel prices and volume-related cost increases particularly in our National Accounts organization and Eastern Group. Subcontractor cost increases attributable to higher fuel costs were offset by the revenue generated from our fuel surcharge program, which is reflected as fuel price increases within *Operating Revenues*.

*Cost of goods sold* — This cost decrease is primarily attributable to a decline in market prices for the commodities processed by our Recycling Group. Changes in the market prices for commodities also affect our revenues, resulting in a corresponding decline in commodity related revenues.

*Fuel* — We experienced an average increase of \$0.43 per gallon in the cost of fuel from the first quarter of 2005 to the first quarter of 2006, which drove the fuel cost increase. However, this cost increase is offset by our fuel surcharges to customers, which are reflected as fuel price increases within our *Operating Revenues* section above.

### ***Selling, General and Administrative***

Our selling, general and administrative expenses consist of (i) labor costs, which include salaries, bonuses, related insurance and benefits, contract labor, payroll taxes and equity-based compensation; (ii) professional fees, which include fees for consulting, legal, audit and tax services; (iii) provision for bad debts, which includes allowances for uncollectible customer accounts and collection fees; and (iv) other general and administrative expenses, which include, among other costs, facility-related expenses, voice and data telecommunication, advertising, travel and entertainment, rentals, postage and printing.

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The following table summarizes the major components of our selling, general and administrative costs for the three months ended March 31, 2006 and 2005 (in millions):

	Three Months Ended March 31,		Period to Period Change	
	2006	2005		
Labor and related benefits	\$ 205	\$ 201	\$ 4	2.0%
Professional fees	39	36	3	8.3
Provision for bad debts	14	14	—	—
Other	110	79	31	39.2
	<u>\$ 368</u>	<u>\$ 330</u>	<u>\$ 38</u>	<u>11.5%</u>

We are currently undergoing an unclaimed property audit, which is being directed by several state authorities. The property subject to review in this audit process generally includes unclaimed wages, vendor payments and customer refunds. During the three months ended March 31, 2006, we made filings with various state authorities under previously established voluntary disclosure agreements. As a result of our findings, we determined that we had unrecorded obligations associated with unclaimed property for escheatable items for various periods between 1980 and 2004. The increase in our "Other" Selling, General and Administrative expenses is primarily due to a \$19 million charge to record these unrecorded obligations. Refer to Note 9 of our Condensed Consolidated Financial Statements for additional information related to the nature of this charge.

### ***Depreciation and Amortization***

Depreciation and amortization includes (i) depreciation of property and equipment, including assets recorded due to capital leases, on a straight-line basis from three to 50 years; (ii) amortization of landfill costs, including those incurred and all estimated future costs for landfill development, construction, closure and post-closure, on a units-of-consumption method as landfill airspace is consumed over the estimated remaining capacity of a site; (iii) amortization of landfill asset retirement costs arising from final capping obligations on a units-of-consumption method as airspace is consumed over the estimated capacity associated with each final capping event; and (iv) amortization of intangible assets with a definite life, either using a 150% declining balance approach or a straight-line basis over the definitive terms of the related agreements, which are from two to ten years depending on the type of asset.

Depreciation and amortization expense for the three months ended March 31, 2006 was \$328 million, or 10.2% of revenues, compared with \$321 million, or 10.6% of revenues, for the comparable prior year period.

### ***Restructuring***

During the third quarter of 2005, we reorganized and simplified our organizational structure by eliminating certain support functions performed at the Group or Corporate office. We also eliminated the Canadian Group office, which reduced the number of our operating groups from seven to six. This reorganization has reduced costs at the Group and Corporate offices and increased the accountability of our Market Areas. In the second half of 2005, we recorded \$28 million of pre-tax charges for costs associated with the implementation of the new structure, principally for employee severance and benefit costs.

### ***Asset Impairments and Unusual Items***

We recognized \$2 million of gains on divestitures during the first quarter of 2006. During the first quarter of 2005, we recognized a net credit of \$23 million, or \$13 million net of tax, from asset impairments and unusual items. This credit primarily related to the divestiture of one of our landfills in Ontario, Canada, which resulted in a gain of \$39 million. This divestiture was required by a Divestiture Order from the Canadian Competition Tribunal. This gain on divestiture was partially offset by a charge of approximately \$16 million

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for the impact of a litigation settlement reached in February 2005 with a group of stockholders that opted not to participate in the settlement of the class action lawsuit against us related to 1998 and 1999 activity.

### ***Income From Operations by Reportable Segment***

The following table summarizes income from operations by reportable segment for the three months ended March 31, 2006 and 2005 and provides explanations of significant factors contributing to the identified variances (in millions):

	Three Months Ended March 31,		Period to Period Change	
	2006	2005		
Eastern	\$ 98	\$ 65	\$ 33	50.8%
Midwest	102	84	18	21.4
Southern	207	169	38	22.5
Western	108	98	10	10.2
Wheelabrator	59	55	4	7.3
Recycling	7	2	5	*
Other	8	26	(18)	*
Total	589	499	90	18.0
Corporate and Other	(154)	(133)	(21)	15.8
Total	\$ 435	\$ 366	\$ 69	18.9%

\* Percentage change is not meaningful

The quarter over quarter operating income improvement for our Eastern, Midwest, Southern, and Western reportable segments was primarily due to the favorable effect of revenue growth provided by base business yield improvement, which is the result of our focus on pricing. Base business yield provided revenue growth for each line of business during the current quarter, but was driven by our collection operations, where we experienced substantial revenue growth in every geographic operating group. The significant increase in our collection revenues due to price has been partially offset by declines in our volume-related revenue. In assessing the impact of higher collection yield on our volumes, we continue to find that, in spite of volume declines, revenue growth from base business yield and a focus on controlling variable costs are providing notable margin and cash flow improvements. See additional discussion in the *Operating Revenues* section above.

*Other* — The decrease in income from operations from the prior year quarter is primarily due to a pre-tax gain of \$39 million resulting from the divestiture of one of our landfills in Ontario, Canada during the first quarter of 2005. This impact is included within asset impairments and unusual items within our Condensed Consolidated Statement of Operations. As this landfill had been divested at the time of our 2005 reorganization, historical financial information associated with its operations were not allocated to our remaining reportable segments. Accordingly, these impacts have been included in Other. Partially offsetting this gain are certain quarter-end adjustments recorded in consolidation related to the reportable segments that, due to timing, were not included in the measure of segment income from operations used to assess their performance for the periods disclosed.

*Corporate and Other* — The higher expenses in the current quarter as compared to the prior year quarter were primarily driven by (i) a \$19 million charge to record unrecorded obligations associated with unclaimed property, which is discussed further in the *Selling, General and Administrative* section above, (ii) higher consulting fees and sales commissions primarily related to our pricing initiatives, (iii) an increase in our advertising costs and (iv) the centralization of support functions that were provided by our Group offices prior to our 2005 reorganization. These higher expenses during the current year were partially offset by the prior year impact of a \$16 million charge for a legal settlement reached in February 2005.

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### **Other Components of Net Income**

The following table summarizes the other major components of our net income for the three months ended March 31, 2006 and 2005 (in millions):

	Three Months Ended March 31,		Period to Period Change	
	2006	2005		
Interest (income) expense, net	\$ 127	\$ 110	\$ 17	15.5%
Equity in net losses of unconsolidated entities	8	26	(18)	(69.2)
Minority interest	12	10	2	20.0
Other, net	(1)	—	(1)	*
Provision for income taxes	103	70	33	47.1

\* Percentage change is not meaningful.

*Interest (income) expense, net* — The \$17 million increase during the three months ended March 31, 2006 is a result of a \$20 million increase in interest expense. This increase in interest expense is generally attributable to higher market interest rates, which impact the interest expense associated with the variable portion of our debt obligations. As of March 31, 2006, interest expense on 35% of our total debt is driven by variability in market interest rates.

*Equity in net losses of unconsolidated entities* — In 2004, we acquired an equity interest in two coal-based, synthetic fuel production facilities. The activities of these facilities drive our equity in net losses of unconsolidated entities. Our equity in the losses of these facilities was \$10 million and \$28 million for the three months ended March 31, 2006 and 2005, respectively. These equity losses were offset by the tax benefit realized as a result of these investments as discussed below within *Provision for income taxes*. The decrease in these losses in 2006 as compared with the comparable prior year period is attributable to the effect of a partial phase out of Section 45K (formerly Section 29) credits generated during 2006 on our contractual obligations associated with funding the facilities' losses. As discussed in Note 5 to the Condensed Consolidated Financial Statements, if, for any reason, the tax credits generated by the facilities cease to be allowable under Section 45K of the Internal Revenue Code, we could cease making payments in the period that determination is made and not incur equity losses in future periods.

*Provision for income taxes* — Our effective tax rate for the three months ended March 31, 2006 and 2005 has benefited from the favorable impact of non-conventional fuel tax credits derived from our landfills and our investments in two coal-based, synthetic fuel production facilities discussed in the *Equity in net losses of unconsolidated entities* section above. These tax credits are available through 2007 pursuant to Section 45K of the Internal Revenue Code, and may be phased out if the price of oil exceeds a threshold annual average price determined by the IRS. Our effective tax rate for the first quarter of 2006 reflects our current expectations for the partial phase out of Section 45K tax credits generated during 2006. We have developed our current expectations for the phase out of Section 45K credits using market information for current and forward-looking oil prices as of March 31, 2006. Accordingly, our current estimated effective tax rate could be materially different than our actual 2006 effective tax rate if our expectations for oil prices for the year are inconsistent with actual results. Our synthetic fuel production facility investments resulted in a decrease in our tax provision of \$12 million for the three months ended March 31, 2006 and \$29 million for the three months ended March 31, 2005.

### **Liquidity and Capital Resources**

As an organization that has consistently generated cash flows in excess of its reinvestment needs, our primary source of liquidity has been cash flows from operations. However, we operate in a capital-intensive business and continued access to various financing resources is vital to our continued financial strength. In the past, we have been successful in obtaining financing from a variety of sources on terms we consider attractive. Based on several key factors we believe are considered important by credit rating agencies and financial

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markets in determining our access to attractive financing alternatives, we expect to continue to maintain access to capital sources in the future. These factors include:

- the essential nature of the services we provide and our large and diverse customer base;
- our ability to generate strong and consistent cash flows despite the economic environment;
- our liquidity profile;
- our asset base; and
- our commitment to maintaining a moderate financial profile and disciplined capital allocation.

We continually monitor our actual and forecasted cash flows, our liquidity and our capital resources, enabling us to plan for our present needs and fund unbudgeted business activities that may arise during the year as a result of changing business conditions or new opportunities. In addition to our working capital needs for the general and administrative costs of our ongoing operations, we have cash requirements for: (i) the construction and expansion of our landfills; (ii) additions to and maintenance of our trucking fleet; (iii) refurbishments and improvements at waste-to-energy and materials recovery facilities; (iv) the container and equipment needs of our operations; and (v) capping, closure and post-closure activities at our landfills. We are also committed to providing our shareholders with a return on their investment through our capital allocation program that provides for up to \$1.2 billion in aggregate dividend payments and share repurchases each year during 2005, 2006 and 2007. We also continue to invest in acquisitions that we believe will be accretive and provide continued growth in our core business.

### **Summary of Cash, Short-Term Investments, Restricted Trust and Escrow Accounts and Debt Obligations**

The following is a summary of our cash, restricted trust and escrow accounts and debt balances as of March 31, 2006 and December 31, 2005 (in millions):

	March 31, 2006	December 31, 2005
Cash and cash equivalents	\$ 454	\$ 666
Short-term investments available for use	534	300
Total cash, cash equivalents and short-term investments available for use	<u>\$ 988</u>	<u>\$ 966</u>
Restricted trust and escrow accounts:		
Tax-exempt bond funds	\$ 139	\$ 185
Closure, post-closure and remediation funds	205	199
Debt service funds	59	58
Other	18	18
Total restricted trust and escrow accounts	<u>\$ 421</u>	<u>\$ 460</u>
Debt:		
Current portion	\$ 600	\$ 522
Long-term portion	8,020	8,165
Total debt	<u>\$ 8,620</u>	<u>\$ 8,687</u>
Increase in carrying value of debt due to hedge accounting for interest rate swaps	<u>\$ 7</u>	<u>\$ 47</u>

*Cash and cash equivalents* — Cash and cash equivalents consist primarily of cash on deposit, certificates of deposit, money market accounts, and investment grade commercial paper purchased with original maturities of three months or less.

*Short-term investments available for use* — These investments include auction rate securities and variable rate demand notes, which are debt instruments with long-term scheduled maturities and periodic interest rate reset dates. The interest rate reset mechanism for these instruments results in a periodic marketing of the underlying securities through an auction process. Due to the liquidity provided by the interest

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rate reset mechanism and the short-term nature of our investment in these securities, they have been classified as other current assets in our Condensed Consolidated Balance Sheets.

*Restricted trust and escrow accounts* — Restricted trust and escrow accounts consist primarily of funds held in trust for the construction of various facilities or repayment of debt obligations, funds deposited in connection with landfill closure, post-closure and remedial obligations and insurance escrow deposits. These balances are primarily included within long-term “Other assets” in our Condensed Consolidated Balance Sheets.

### *Debt* —

*Revolving credit and letter of credit facilities* — The table below summarizes the credit capacity, maturity and outstanding letters of credit under our revolving credit facility, principal letter of credit facilities and other credit arrangements as of March 31, 2006 (in millions):

Facility	Total Credit Capacity	Maturity	Outstanding Letters of Credit
Five-year revolving credit facility(a)	\$ 2,400	October 2009	\$ 1,461
Five-year letter of credit and term loan agreement(b)	15	June 2008	15
Five-year letter of credit facility(b)	350	December 2008	350
Seven-year letter of credit and term loan agreement(b)	175	June 2010	175
Ten-year letter of credit and term loan agreement(b)	105	June 2013	104
Other(c)	—	Various	68
Total	<u>\$ 3,045</u>		<u>\$ 2,173</u>

- This facility provides us with credit capacity that could be used for either cash borrowings or letters of credit. At March 31, 2006, no borrowings were outstanding under the facility, and we had unused and available credit capacity of \$939 million.
- These facilities have been established to provide us with letter of credit capacity. In the event of an unreimbursed draw on a letter of credit, the amount of the draw paid by the letter of credit provider generally converts into a term loan for the remaining term under the respective agreement or facility. Through March 31, 2006 we had not experienced any unreimbursed draws on our letters of credit.
- We have letters of credit outstanding under various arrangements that do not provide for a committed capacity. Accordingly, the total credit capacity of these arrangements has been noted as zero.

We have used each of these facilities to support letters of credit that we issue to support our insurance programs, certain tax-exempt bond issuances, municipal and governmental waste management contracts, closure and post-closure obligations and disposal site or transfer station operating permits. These facilities require us to pay fees to the lenders and our obligation is generally to repay any draws that may occur on the letters of credit. We expect that similar facilities may continue to serve as a cost efficient source of letter of credit capacity in the future, and we continue to assess our financial assurance requirements to ensure that we have adequate letter of credit and surety bond capacity in advance of our business needs.

*Canadian Credit Facility* — In November 2005, Waste Management of Canada Corporation, one of our wholly-owned subsidiaries, entered into a three-year credit facility agreement. The agreement was entered into to facilitate WMI’s repatriation of accumulated earnings and capital from its Canadian subsidiaries. As of March 31, 2006, we had \$342 million in advances outstanding under this credit facility agreement. The advances have a weighted average effective interest rate of 4.5% and mature either three months or twelve months from the date of issuance. As of March 31, 2006, we expect to repay \$86 million of outstanding advances within the next twelve months with available cash and renew the remaining borrowings under the terms of the facility. Accordingly, \$86 million of debt associated with these borrowings is classified as current in our March 31, 2006 Condensed Consolidated Balance Sheet and the remaining borrowings have been classified as long-term.

*Senior notes* — As of March 31, 2006, we had \$5.1 billion of outstanding senior notes. The notes have various maturities, ranging from October 2006 to May 2032, and interest rates ranging from 5.00% to 8.75%.

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We have \$300 million of 7.0% senior notes that mature in October 2006 that we currently expect to repay with available cash.

*Tax-exempt bonds* — We actively issue tax-exempt bonds as a means of accessing low-cost financing for capital expenditures. As of March 31, 2006, we had \$2.3 billion of outstanding tax-exempt bonds. The proceeds from the issuance of tax-exempt bonds are deposited directly into a trust fund. Accordingly, the restricted funds provided by these financing activities are not included in “New borrowings” in our Consolidated Statements of Cash Flows. These funds may only be used for the specific purpose for which the money is raised, which is generally the construction of collection and disposal facilities and for the equipment necessary to provide waste management services. As we spend monies on the specific projects being financed, we are able to requisition cash from the trust funds. As discussed in the restricted trusts and escrow accounts section above, we have \$139 million held in trust for future spending as of March 31, 2006. During the three months ended March 31, 2006, we received \$48 million from these funds for approved capital expenditures.

As of March 31, 2006, \$613 million of our tax-exempt bonds are remarketed weekly by a remarketing agent to effectively maintain a variable yield. If the remarketing agent is unable to remarket the bonds, then the remarketing agent can put the bonds to us. These bonds are supported by letters of credit that were issued primarily under our \$2.4 billion, five-year revolving credit facility that guarantee repayment of the bonds in the event the bonds are put to us. Accordingly, these obligations have been classified as long-term in our March 31, 2006 Condensed Consolidated Balance Sheet.

Additionally, we have \$284 million of fixed rate tax-exempt bonds subject to repricing within the next twelve months, which is prior to their scheduled maturities. If the re-offering of the bonds is unsuccessful, then the bonds can be put to us, requiring immediate repayment. These bonds are not backed by letters of credit supported by our long-term facilities that would serve to guarantee repayment in the event of a failed re-offering and are, therefore, considered a current obligation. However, these bonds have been classified as long-term in our Condensed Consolidated Balance Sheet as of March 31, 2006. The classification of these obligations as long-term was based upon our intent to refinance the borrowings with other long-term financings in the event of a failed re-offering and our ability, in the event other sources of long-term financing are not available, to use our five-year revolving credit facility.

*Tax-exempt project bonds* — As of March 31, 2006, we had \$403 million of outstanding tax-exempt project bonds. These debt instruments are primarily used by our Wheelabrator Group to finance the development of waste-to-energy facilities. The bonds generally require periodic principal installment payments. As of March 31, 2006, \$46 million of these bonds are remarketed either daily or weekly by a remarketing agent to effectively maintain a variable yield. If the remarketing agent is unable to remarket the bonds, then the remarketing agent can put the bonds to us. Repayment of these bonds has been guaranteed with letters of credit issued under our five-year revolving credit facility. Accordingly, these variable rate obligations have been classified as long-term in our March 31, 2006 Condensed Consolidated Balance Sheet. Approximately \$51 million of our tax-exempt project bonds will be repaid with available cash within the next twelve months and have been classified as current in our March 31, 2006 Condensed Consolidated Balance Sheet.

*Capital leases and other debt* — As of March 31, 2006, we had \$479 million of other miscellaneous debt obligations. These debt balances include (i) capital leases and other obligations incurred in the normal course of our business, (ii) obligations of consolidated variable interest entities, and (iii) our remaining obligation associated with our initial investments in the synthetic fuel facilities discussed in the *Provision for income taxes* section above.

*Interest rate swaps* — We manage the interest rate risk of our debt portfolio principally by using interest rate derivatives to achieve a desired position of fixed and floating rate debt. As of March 31, 2006, the interest payments on \$2.35 billion of our fixed rate debt have been swapped to variable rates, allowing us to maintain 65% of our debt at fixed interest rates and 35% at variable interest rates. Fair value hedge accounting for interest rate swap contracts increased the carrying value of debt instruments by \$7 million at March 31, 2006 and \$47 million as of December 31, 2005. Interest rate swap agreements reduced net interest expense by \$3 million and \$16 million for the three months ended March 31, 2006 and 2005, respectively. The continued

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decline in the benefit recognized as a result of our interest rate swap agreements is largely attributable to the increase in short-term market interest rates. Our periodic interest obligations under our interest rate swap agreements are based on a spread from the three-month LIBOR, which has increased from 3.1% at March 31, 2005 to 5.0% at March 31, 2006.

### **Summary of Cash Flow Activity**

The following is a summary of our cash flows for the three months ended March 31, 2006 and 2005 (in millions):

	Three Months Ended March 31,	
	2006	2005
Net cash provided by operating activities	<u>\$ 563</u>	<u>\$ 508</u>
Net cash used in investing activities	<u>\$(353)</u>	<u>\$(121)</u>
Net cash used in financing activities	<u>\$(421)</u>	<u>\$(372)</u>

*Net Cash Provided by Operating Activities* — Growth in cash flows from operating activities was \$55 million, or 10.8%, for the three months ended March 31, 2006 when compared with the first quarter of 2005. Our operating cash flows continue to provide us with a significant source of liquidity, providing the cash resources needed for our capital expenditures, dividends and share repurchases. In general, the growth in our current period operating cash flow can be attributed to the increase in our operating income.

As a result of adopting SFAS No. 123(R) on January 1, 2006, reductions in income taxes payable attributable to excess tax benefits associated with equity-based compensation for the three months ended March 31, 2006 have been included in cash flows from financing activities discussed below. During the first quarter of 2005, excess tax benefits improved our operating cash flows by approximately \$4 million and are included as a change in “Accounts payable and accrued liabilities” in the 2005 Statement of Cash Flows.

*Net Cash Used in Investing Activities* — The \$232 million increase in net cash used in investing activities is primarily due to a \$238 million increase in net cash outflows associated with purchases and sales of short-term investments. In the first quarter of 2006, net purchases of short-term investments resulted in cash outflows of \$228 million, while net sales of short-term investments provided \$10 million of cash in the first quarter of 2005. The increase in our investment activity is principally due to an increase in available cash as a result of the growth in our operating cash flows.

A \$79 million decrease in proceeds from divestitures of businesses and other sales of assets also affected the year-over-year change in net cash used in investing activities. In 2005, divestitures and other sales of assets contributed \$97 million, and were primarily attributable to the sale of one of our landfills in Ontario, Canada as required by a Divestiture Order from the Canadian Competition Tribunal. Although cash flows associated with divestitures were not significant during the first quarter of 2006, as we continue to focus on our plan to divest of certain under-performing and non-strategic operations, we expect proceeds from divestitures and other asset sales to make comparatively greater contributions to our cash flows later in the year.

The changes in investing cash flows related to our investment activity and divestitures were partially offset by a decline in acquisition spending, which decreased from \$87 million in 2005 to \$8 million during the three months ended March 31, 2006. As we make progress on our divestiture program, we plan to increase our focus on accretive acquisitions and other investments that will contribute to improved future results of operations and enhance and expand our existing service offerings.

We used \$171 million during the three months ended March 31, 2006 for capital expenditures compared with \$185 million during the comparable prior period. Funds received from our restricted trust and escrow accounts, which are generated from the issuance of tax-exempt bonds, continued to contribute to our capital expenditure activities. During 2006, we used \$48 million of these funds for our capital needs compared with \$53 million during the first quarter of 2005.

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*Net Cash Used in Financing Activities* — The primary drivers of the \$49 million increase in financing cash outflows are an increase in share repurchases, which was partially offset by an increase in cash generated from the exercise of stock options and warrants and a decline in net debt repayments.

During the three months ended March 31, 2006, we repurchased approximately 11.8 million shares of our common stock for \$387 million. Approximately 9.0 million of the common shares purchased during the first quarter of 2006 were purchased under an accelerated share repurchase agreement. Pursuant to that agreement, we repurchased \$275 million of our common stock in January and made an additional \$16 million settlement payment for the increase in the volume weighted average price of our common stock during the agreement's defined valuation period. All other share repurchases during the first quarter of 2006 were open market transactions. Approximately \$12 million of the open market share repurchases in the first quarter of 2006 were settled in cash in April 2006. We repurchased 3.5 million shares of our common stock for \$102 million during the three months ended March 31, 2005, of which \$3 million was settled in cash in April 2005.

Our 2005 and 2006 share repurchases have been made in accordance with a three-year capital allocation program that was approved by our Board of Directors, which authorizes up to \$1.2 billion of combined share repurchases and dividend payments each year during 2005, 2006 and 2007. During the first quarter of 2006, the Company paid a quarterly dividend of \$0.22 per share for an aggregate of \$121 million compared with a \$0.20 per share dividend paid in the first quarter of 2005 for an aggregate of \$114 million. Share repurchases and dividend payments during the remainder of the year will be made within our capital allocation program at the discretion of our Board of Directors and management, and will depend on various factors, including our net earnings, financial condition and projected cash requirements.

The exercise of common stock options and warrants and the related excess tax benefits generated a total of \$143 million of financing cash flow during the three months ended March 31, 2006, an increase of \$117 million from the comparable prior year period. The significant increase in stock option and warrant exercises in the first quarter of 2006 is due to the accelerated vesting of all outstanding stock options in December 2005 and the substantial improvement in the market value of our common stock. As discussed above, the adoption of SFAS No. 123(R) on January 1, 2006 resulted in the classification of tax savings provided by equity-based compensation as a financing cash inflow rather than an operating cash inflow beginning in the first quarter of 2006. This change in accounting increased cash flows from financing activities by \$18 million for the three months ended March 31, 2006.

In the first quarter of 2006, net debt repayments were \$36 million as compared with \$118 million in debt repayments during the first quarter of 2005. The repayment and refinancing of an outstanding advance under our Canadian credit facility were the primary components of our current year borrowing and repayment activity.

### **Off-Balance Sheet Arrangements**

We are party to guarantee arrangements with unconsolidated entities as discussed in the *Guarantees* section of Note 9 to the Condensed Consolidated Financial Statements. Our third-party guarantee arrangements are generally established to support our financial assurance needs and landfill operations. These arrangements have not materially affected our financial position, results of operations or liquidity during the three months ended March 31, 2006 nor are they expected to have a material impact on our future financial position, results of operations or liquidity.

### **Seasonal Trends and Inflation**

Our operating revenues tend to be somewhat higher in the summer months, primarily due to the higher volume of construction and demolition waste. The volumes of industrial and residential waste in certain regions where we operate also tend to increase during the summer months. Our second and third quarter revenues and results of operations typically reflect these seasonal trends. Additionally, certain destructive weather conditions that tend to occur during the second half of the year can actually increase our revenues in the areas affected. However, for several reasons, including significant start-up costs, such revenue often

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generates comparatively lower margins. Certain weather conditions may actually result in the temporary suspension of our operations, which can significantly affect the operating results of the affected regions. The operating results of our first quarter also often reflect higher repair and maintenance expenses because we rely on the slower winter months, when electrical demand is generally lower, to perform scheduled maintenance at our waste-to-energy facilities.

While inflationary increases in costs, including the cost of fuel, have affected our operating margins in recent periods, we believe that inflation generally has not had, and in the near future is not expected to have, any material adverse effect on our results of operations. However, management's estimates associated with inflation have had, and will continue to have, an impact on our accounting for landfill and environmental remediation liabilities.

### **Item 4. Controls and Procedures.**

#### ***Effectiveness of Controls and Procedures***

We maintain a set of disclosure controls and procedures designed to ensure that information we are required to disclose in reports that we file or submit with the SEC is recorded, processed, summarized and reported within the time periods specified by the SEC. An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective in ensuring that we are able to collect, process and disclose the information we are required to disclose in the reports we file with the SEC within required time periods.

## **PART II.**

### **Item 1. Legal Proceedings.**

Information regarding our legal proceedings can be found under the "Litigation" section of Note 9, *Commitments and Contingencies*, to the Condensed Consolidated Financial Statements.

### **Item 1A. Risk Factors.**

There have been no material changes from risk factors previously disclosed in our Form 10-K for the year ended December 31, 2005 in response to Item 1A to Part I of Form 10-K.

**Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.**

In October 2004, the Company announced that its Board of Directors approved a capital allocation program that included the authorization of up to \$1.2 billion of stock repurchases and dividend payments annually for each of 2005, 2006 and 2007. All of the common stock repurchases made in 2006 have been pursuant to that program. The following table summarizes our first quarter 2006 activity:

**Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased	Average Price Paid per Share(a)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs(b)
January 1 - 31(c)	9,035,175	\$ 32.23	9,035,175	\$ 788 Million
February 1 - 28	125,000	\$ 33.61	125,000	\$ 784 Million
March 1 - 31	2,688,900	\$ 34.16	2,688,900	\$ 692 Million
Total	11,849,075	\$ 32.79	11,849,075	

- a) This amount represents the weighted average price paid per share and includes a per share commission paid for all repurchases.
- b) This disclosure is required by the SEC. For each period presented, the maximum dollar value of shares that may yet be purchased under the program has been provided as of the end of each respective period. These amounts are not necessarily an indication of the amount we intend to repurchase during the remainder of the year. The amount of capital approved for share repurchases during 2006 is \$1.2 billion, less the amount of dividends paid. During the three months ended March 31, 2006, we paid \$121 million in cash dividends under this program. The maximum dollar value of shares that may be purchased under the program included in the table above includes the effect of these dividend payments as if all payments had been made at the beginning of the earliest period presented. However, this amount does not include the impact of dividend payments we expect to make throughout the remainder of 2006 as a result of future dividend declarations.
- c) The shares purchased in January 2006 were purchased pursuant to an accelerated share repurchase agreement entered into in December 2005. The amounts reflected as "Average Price Paid per Share" and the "Approximate Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs" for January include the impact of a \$16 million cash settlement payment that was made by the Company in February 2006 for the difference between the weighted average daily market price of our stock during the agreement's valuation period and the weighted average share price we paid at the inception of the agreement's valuation period.

**Item 6. Exhibits.**

Exhibit No.	Description
10.1	Employment Agreement between the Company and James Schultz, dated March 27, 2006 (incorporated by reference to Exhibit 10.1 to Form 8-K dated March 27, 2006)
12	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification Pursuant to Rule 15d — 14(a) under the Securities Exchange Act of 1934, as amended, of David P. Steiner, Chief Executive Officer
31.2	Certification Pursuant to Rule 15d — 14(a) under the Securities Exchange Act of 1934, as amended, of Robert G. Simpson, Senior Vice President and Chief Financial Officer
32.1	Certification Pursuant to 18 U.S.C. §1350 of David P. Steiner, Chief Executive Officer
32.2	Certification Pursuant to 18 U.S.C. §1350 of Robert G. Simpson, Senior Vice President and Chief Financial Officer



**Exhibit Index**

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32.1	— Certification Pursuant to 18 U.S.C. §1350 of David P. Steiner, Chief Executive Officer
32.2	— Certification Pursuant to 18 U.S.C. §1350 of Robert G. Simpson, Senior Vice President and Chief Financial Officer

**WASTE MANAGEMENT, INC.**  
**COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**  
(In Millions, Except Ratios)  
(Unaudited)

	Three Months Ended March 31,	
	2006	2005
Income before income taxes, losses in equity investments and minority interests	\$ 310	\$ 258
Fixed charges deducted from income:		
Interest expense	136	116
Implicit interest in rents	13	13
	<u>149</u>	<u>129</u>
Earnings available for fixed charges	<u>\$ 459</u>	<u>\$ 387</u>
Interest expense	\$ 136	\$ 116
Capitalized interest	3	3
Implicit interest in rents	13	13
Total fixed charges	<u>\$ 152</u>	<u>\$ 132</u>
Ratio of earnings to fixed charges	<u>3.0x</u>	<u>2.9x</u>

**SECTION 302 CERTIFICATION**

I, David P. Steiner, certify that:

1. I have reviewed this report on Form 10-Q of Waste Management, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a —(15e) and 15d — (15e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15 (f) and 15d — 15 (f))for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 27, 2006

By: /s/ David P. Steiner  
David P. Steiner  
*Chief Executive Officer*

**SECTION 302 CERTIFICATION**

I, Robert G. Simpson, certify that:

1. I have reviewed this report on Form 10-Q of Waste Management, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a —(15e) and 15d — (15e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15 (f) and 15d — 15 (f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 27, 2006

By: /s/ Robert G. Simpson

Robert G. Simpson

*Senior Vice President and Chief Financial Officer*

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Waste Management, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David P. Steiner, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ David P. Steiner

David P. Steiner

*Chief Executive Officer*

April 27, 2006

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Waste Management, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert G. Simpson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Robert G. Simpson  
Robert G. Simpson  
*Senior Vice President and  
Chief Financial Officer*

April 27, 2006