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REVISITING THE PUBLIC INTEREST IN PRIVATE WATER

By Alexei Tsybine and Don S. Evans, P.E.



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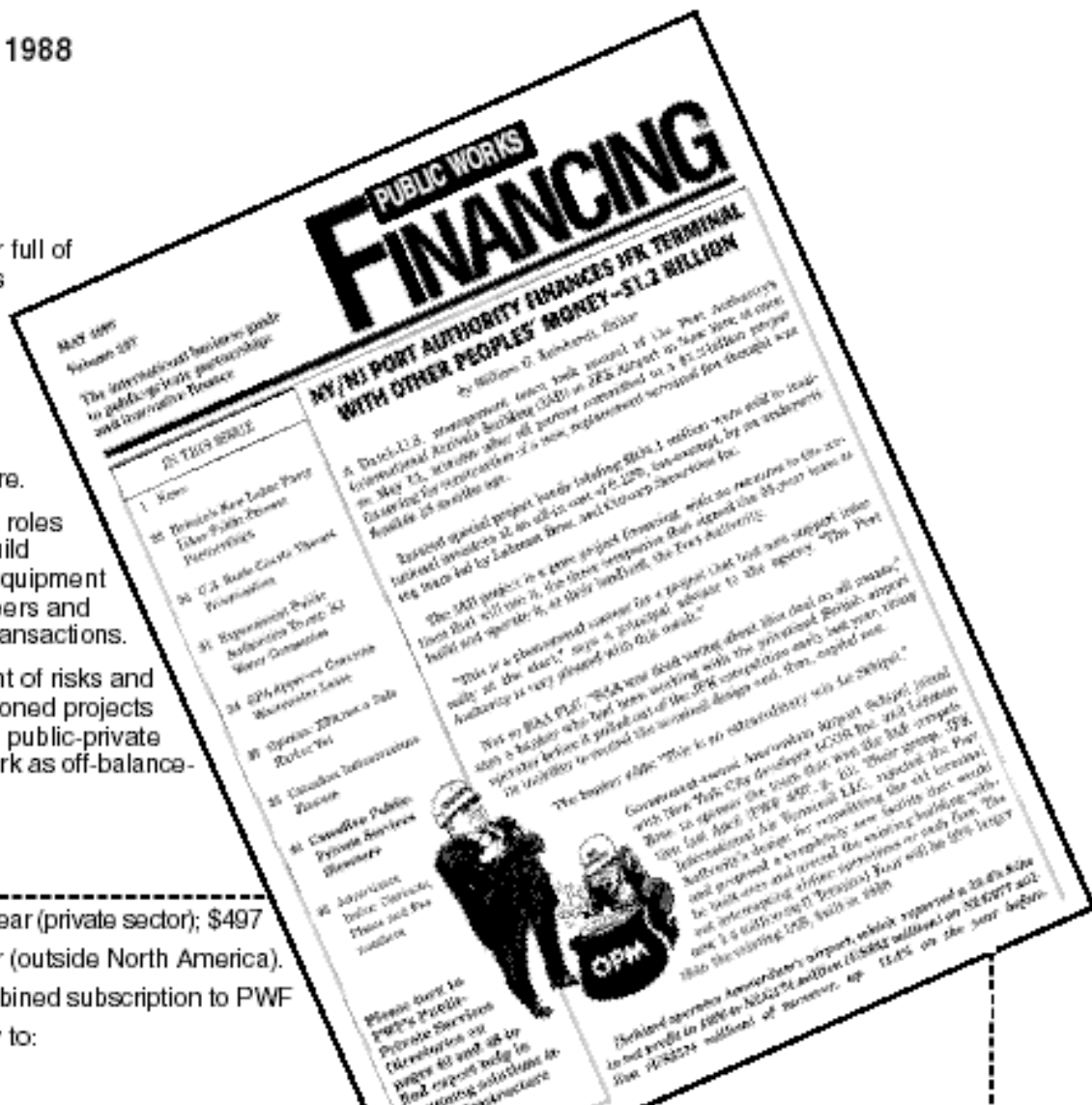
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Revisiting the Public Interest in Private Water

BY ALEXEI TSYBINE

Former Water Policy Analyst, Public Citizen's *World Water Watch*

[Originally published in *Public Works Financing* Vol. 168, December 2002]

Considering outsourcing your water system? Sure, although you may want to know that water privatization leads to higher rates, undermines water quality, and transfers control of a precious public resource to profit-driven multinational corporations, whose records are replete with corruption, poor service and environmental violations (see <http://www.citizen.org/cmep/Water/>). Doing water work for "Public Citizen", I repeated this refrain so frequently that it deserved to be added to my job description. Six months after leaving the organization, I feel compelled to share my own thoughts on the issue.

Private sector involvement in providing water services deserves a discussion that reaches beyond the sound bites offered by the privatization critics or the polished promotional materials distributed by the water companies. No special expertise is required to recognize that the arguments put forth by unions and consumer groups present only one side of the story. If the purpose of privatization opponents is to highlight the risks that transferring water operations to a private firm entails, then their reports and fact sheets successfully accomplish that. However, these materials fall short of offering a comprehensive analysis that local decision makers desperately need.

By lumping together private ownership, operations, and water rights, the critics have oversimplified and confused the privatization debate. Having conducted much research on my own, I have come to conclude that some of the criticism is clearly misplaced.

Water Rates

Private water operators can and do deliver lower rates. The argument goes that the "privateers" will increase rates to boost their profit. This may be true for private utilities because they can, with the regulator's approval, set their own rates. However, the argument does not hold up with O&M contractors because (1)

the municipality retains control over rate-setting, and (2) no city will outsource water services to a private firm unless doing so will reduce the cost of providing these services, thus creating savings for the city and the ratepayers. Indeed, many cities outsource to mitigate the rate increases from infrastructure upgrades.

The rates are based on the fee the firm charges to run the system. The fee is generally static, with minor adjustments reflecting inflation. Because the private operator cannot unilaterally change the terms of contract, it cannot arbitrarily increase the fee, compelling the city to raise rates. It is true, however, that private operators can indirectly cause rate hikes by charging more than expected by means of change orders. However, the abuse of these reimbursement requests can be prevented by exercising care in drafting and monitoring the contract.

Service Quality and Performance

Contrary to the critics' contentions, private operators have a respectable record of providing quality water and complying with environmental standards. Many communities choose to outsource because of daunting compliance problems. Private operators employ their expertise to solve the problems and improve water quality. The privatization opponents have few examples to back allegations of systematic non-compliance. In most instances, the cited violations are committed not by private operators, but by private utilities that answer not to local governments, but to regulatory agencies with less enforcement zeal and ability.

In other cases, the critics do not tell the entire story. For example, the often-cited New Orleans sewage discharge incident is blamed on the contractor on the basis of a newspaper-quoted remark of a city councilman, relaying what he had been told by someone else. No mention is made of the fact that the subsequent fire department's report on the fire that caused the discharge showed that the company was blameless. Neither is it noted that the councilman is known to hold less than sympathetic views of privatization.

To accurately evaluate the service record of private operators it must be compared with the record of public utilities. It is no secret that public providers have occasional problems with poor water quality, leaks, and discharges. The mere existence of instances where a company experienced the same problems is not enough to condemn the service record of all private companies. It must be shown that their record, on average, is worse than that of public utilities. The ball is in the critics' court to offer evidence of this. Documenting few isolated instances of problems will not substitute for a systematic evaluation of the private alternative.

Local Control

Privatization opponents correctly note that selling a water system to a private company would result in a loss of local control. However, this is hardly the case with short-term operation contracts, where the community retains ownership of the system, controls the rates, and has the option of refusing to renew the contract if the company's performance is inadequate.

Many municipal officials that I interviewed spoke complimentarily of the city's relationship with the company, describing it as a partnership. For example, director of Burlingame's public works commented that he viewed the company employee's as his own staff.

Conservation

It is true that private utilities are not fans of water conservation because their profits increase with the sales. At the same time, private operators benefit from selling less because it reduces treatment costs. In any case, public ownership or operation does not necessarily translate into environmental responsibility. Many environmentalists support private operations, believing that O&M contractors do a better job protecting the environment.

Short-Term v. Long-Term Contracts

The critics are right to be skeptical of the long-term contracts. With a short-term contract, a municipality can renew or renegotiate the existing contract, solicit new bids, or return the system to public operations. Competitive pressure encourages the firm to provide high-quality service at the market rate. And the municipality does not have to wait for years to show a failing firm to the door.

Long-term contracts, however, defeat the idea of competition. A company with a 20-year contract has a 20-year monopoly on providing the service. The community cannot benefit from better offers when locked into a long-term contract. Whereas short-term agreements encourage companies to develop good relationship with the municipality and perform in good faith because the contract's renewal is at stake, long term-contracts allow companies to take advantage of the municipality. Because such deals are a recent development and not one has run its full course they have no real track record. The highly politicized nature of the process and the companies' readiness to underbid often make matters worse (think Atlanta). Finally, the concerns about the long-term financial stability of the companies are not without merit.

In an ideal world, positions would be based on an objective assessment, not on ideology. But this world is far from ideal. Water privatization opponents correctly point out some of the water privatization risks. If their mission ends there—they have done their job. However, criticism alone will not help pay for necessary infrastructure upgrades or save ratepayers money. The risks must be weighed against the benefits. If the decision to outsource is made, local officials must meticulously evaluate the companies' records and interview officials in the communities served by the companies before choosing the winner.

Although privatization has great potential, it will not be a panacea for each community. Local governments should be guided neither by the unions and consumer groups in distant Washington, D.C., nor by the companies. Instead, they should evaluate each option and make the decision that works best for their community.

About the Author

Alex Tsybine, now in law school, authored the following reports from June 2001 to August 2002 while he led water policy, research, media, legislative, coordination and outreach for Ralph Nader's non-profit group, Public Citizen:

- "The Big Greedy"
- "Thirsting for Profits"

- "Water Privatization: A Broken Promise"
- "Liquid Assets: Enron's Dip Into Water Business Highlights Pitfalls of Privatization"
- "Reclaiming Public Assets: From Private to Public Ownership of Waterworks"

From <http://www.citizen.org>: "Public Citizen is a national, nonprofit consumer advocacy organization founded by Ralph Nader in 1971 to represent consumer interests in Congress, the executive branch and the courts. We fight for openness and democratic accountability in government, for the right of consumers to seek redress in the courts; for clean, safe and sustainable energy sources; for social and economic justice in trade policies; for strong health, safety and environmental protections; and for safe, effective and affordable prescription drugs and health care."

The Public Interest in Private Water

BY DON S. EVANS, P.E.

**TREASURER, WATER PARTNERSHIP COUNCIL (PRESIDENT AND CHIEF EXECUTIVE OFFICER, OMI)
[ORIGINALLY PUBLISHED IN *PUBLIC WORKS FINANCING* VOL. 169, JANUARY 2003]**

Communities considering public-private partnerships to address complex water and wastewater service needs can rejoice at Alexei Tsybine's rethinking of the positions he advocated as a Water Policy Analyst for Public Citizen (PWF 12/02 p. 17). Since leaving Public Citizen, Mr. Tsybine has reviewed his own research more objectively and now advocates the "comprehensive analysis that local decision makers desperately need." The industry is pleased to join him in that dialogue.

Public Citizen and other opponents continue to exploit confusion that stems from lumping together "privatization" and "public-private partnerships." As Tsybine now points out, public-private partnerships take many forms, but none involves transfer of assets to private ownership (privatization), and all have two important characteristics: The public partner retains ownership of the assets, and the public partner maintains control over the management of the assets throughout the life of the contract.

By now it is indisputable, as Tsybine acknowledges, that public-private partnerships can result in lower rates with no deterioration in service quality. In many instances, private operation and maintenance of publicly owned facilities results in improved performance and environmental stewardship. Citizens hold their local governments responsible for providing them with safe drinking water and adequate wastewater treatment. Local government cannot ever relinquish that responsibility, but in a public-private partnership, the public partner fulfills that responsibility in a new way. Rather than conducting day-to-day operations, the public partner takes on the role of ensuring that its private partner operates in the best interests of the public.

The industry does take exception to Tsybine's continued advocacy of short-term contracts. His thesis that long-term contracts discourage competition and allow the private partner to "take advantage" of the public partner is short-sighted. He effectively proposes to throw the baby out with the bath water. With the help of legal, technical and financial teams, communities are quickly learning that three benefits are achievable and enforceable in any long-term public-private partnership:

1. Long-term contracts allow the private partner to amortize its investment over an extended period. As a result, the private partner has an incentive to invest more of its managerial expertise and capital in measures that reduce costs without impairing quality. The longer amortization period also lowers the annual fees that the private partner must charge to ensure a market return on its investments over the life of the contract.
2. Optimum competitive value is captured by structuring comprehensive requests for proposals that translate long-term public policy goals into measurable performance standards that challenge the private bidders to develop technical and management proposals that minimize life-cycle costs. In this way, the community derives the maximum benefit of competition over the entire contract life from the moment of selection through to the final day.
3. The risk to the public partner is minimal because detailed contractor performance and default and termination provisions are part of every long-term contract. Contract termination is not a desirable outcome for either the private or the public partner. Nonetheless, the contract provisions give the public partner the most powerful enforcement tool it has ever possessed to ensure the highest level of contract compliance throughout the contract life. These provisions enable the community to terminate and replace a contractor—often at the offending contractor's expense—in the face of contract noncompliance.

Mr. Tsybine is to be applauded by public and private sectors alike for a refreshingly honest reassessment of public-private partnership benefits. Over time, the industry expects that he, too, will come to understand the benefits of long-term contracts.



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