

## “Privatization of American Water Utilities”

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The pressure is growing on local municipalities to consider privatization of their water and wastewater systems. Both the EPA and the Bush Administration favor privatization as a way for local municipalities to meet ever tightening regulations. These systems are critical to public health and economic development. Despite the critical nature of these systems maintenance and upgrades have lagged as the quality standards have increased.

Cities such as Buffalo, Jersey City, Atlanta, Indianapolis, Felton, CA, Laredo, TX and New Orleans have all tried privatization. The degree of success usually depends upon the affiliations of the reporting agency. What is clear is that these partnerships were entered into with out both parties fully understanding the allocation of risk for aging equipment and infrastructure.

In addition to companies such as United Water, American Water Works and Veolia/US Filter there are a number of investor owned water utilities such as Philadelphia Suburban, traded on the NYSE and San Jose Water, traded on AMEX. These companies have an advantage over there private brethren due to the availability of low cost financing from the federal government. Investor owned utilities are also eligible for bond issue proceeds; reduced/no tax at the federal, state and local level and other tax exempt financing forms. The traditional private companies are trying to avail themselves of the same benefits.

### **PRIVATIZATION CONTRACT ISSUES**

There are a number of ways privatization contracts can be structured, including:

*Acquisition* - Public partner sells facility to private partner resulting in private ownership and operation.

*Joint Venture* -Private partner owns facility in conjunction with public partner.

*Concession or Built, Own and Transfer* - Private partner builds, owns and operates the facility. At the end of the specified period, such as 30 years, the facility may be transferred to the public partner for a nominal fee.

*Turn Key Facility* - Private partner designs, constructs and operates the facility. The public partner retains ownership and generally assumes the financing risk, while the private partner assumes the performance risk for minimum levels of service and/or compliance.

*Full Service Contract* - Public partner contracts with private partner for a fee to operate and maintain the facility. The public partner owns the facility (although it may have been built by the private partner).

*Contract Operations* - Private partner operates and maintains public partner's facilities over long or short term.

*Contract Management* - Private partner manages and supervises the public partner's personnel.

*Operations Assistance* - Private partner provides transition management or program management to improve effectiveness of public partner's operations.

During the negotiation of an agreement both industry and government must maintain a fair allocation of risk. There also needs to be an understanding that privatization does not mean that the government is not involved. Suggested items to consider in privatization contracts are:

1. Ensure that the constituency's needs continue to be met. Local government must determine the balance between individuals, health care and industry to define the ir constituency, not the private company. This groups needs and growth should be met first and additional costs for growth or sale of resources should be borne by others. These needs must be clearly defined.
2. Environmental concerns and maintenance must be addressed and regulated by the appropriate government agencies.
3. If poverty is a concern the government should be prepared with subsidies to address price increases due to artificially low pricing.
4. A status of the infrastructure should be documented and agreed upon by both parties with an allowance for unexpected failures.
5. Rates should be reviewed, with public hearings; just as any other utility is reviewed. Provisions and a procedure should be put in place with the opportunity for both government official and public review.
6. Rate increases should be linked to specific infrastructure improvements or unexpected failures beyond those initially contemplated.
7. Implementation of new technologies or development of alternative sources must be based upon improved efficiency, conservation or environmental concern. No rate increases for capital investment is permitted without justification.
8. The governments should retain ownership rights, licensed to the private operator.
9. Water quality determination and testing is conducted by the government or an independent service not the local supplier.
10. Acceptable performance criteria must be explicit.
11. Government agencies must be permitted continuing oversight, auditing and involvement in decision making.
12. Clear dispute resolution procedure should be in place.
13. Governments should maintain their own technical advisory group with review rights.

During negotiation of these contracts both parties should strive for openness and disclosure to avoid the public perception of impropriety. Strong and well documented contracts will be worth the investment costs for both parties. It also serves to define risks to help both parties determine future costs and supply financial projections to shareholders, constituency and customers.

Privatization will continue. We as an industry are committed to this path in the belief that we bring value to the community while making a fair profit. The federal government, by supporting this trend can be in a position to treat the industry like defense and information technology. The industry is also in a position to work with local, state and federal governments to maximize the social benefit derived from this limited resource. The business will continue to grow and be a profitable place for investors if we manage expectations, force government to continue its involvement and import the latest technologies from other applications.