

Privatization At-Bat: The Game Is Not Over Yet

By: Matthew Ryan and John Williams

Baseball fans sometimes leave the game early when their team is trailing by several runs. Occasionally, they discover that the home team made up the difference and tied the score in the ninth inning. The game was not over.

A lot of people involved in the water and wastewater treatment industry also are ready to hit the road, assuming that the game between the private sector and the public team is over. Scores from Indianapolis, Ind., Atlanta, Ga.; and Milwaukee, Wis.; – hundreds of millions in projected savings – sound like the private team is winning, but is it really?

The private sector–public competition is not a baseball game where scores are recorded as runs are earned, but a game in which the “score” (the projected savings) is published right after the national anthem and before either team takes the field. Similar to the baseball example above, the winner of the water and wastewater treatment game cannot be known until the 10- or 20-year service contract ends.

The Pregame

The privatization pregame involves big-name teams, coaches, publicists, agents, and player interviews just like the baseball pregame. At this stage, the owner is developing the request for qualifications and proposals, creating the service agreement and, in some cases, forming an in-house bidding team. At the same time, the bidders jockey for position trying to make the most of the technical, political, or public relations advantages they may have. Each competitor will move into a lobbying mode in order to shape the process in a way that allows the rules that are established to favor its specific team. The *rules* are the terms and conditions the buyer wishes to establish to clearly describe what it wants to purchase and how it will go about making its purchasing decision. Out-of-town teams will try to attract local players or recruit home-team management. The home team tries to convince the commissioners that there is no need for a game at all. Once a decision to play the game is made, political realities and the cost of running a procurement process make it difficult to turn back. It is a safe bet that bids will be taken. After the bids are opened and a conclusion is reached, one team is declared a winner. Due to the level of effort required to work through one of these processes and the need to show a positive outcome, press releases are often generated placing emphasis on the promised savings associated with the winning bid. The releases rarely provide a clear caveat stressing the long-term nature of the deal and that it is rare that savings will match original claims over time. The local newspapers often will print headlines such as, “City to Save \$100 Million!” Many communities hope to use savings that result from the public–private competition for the development of other sometimes, not related facilities so, the headline “Time to Build a New Stadium!” may appear.

The First Few Innings

In public-private competition, only one team plays after bids are accepted and a successful team selected. That team is expected to play under conditions described in the procurement documents (the request for qualifications, request for proposals, and service agreement). Those conditions are described as specifically as possible, given the knowledge that exists when the documents are prepared. Over time, however, the “rules” change. By the time the game is completed, there may be

an entirely different regulatory and economic environment, customer base, and level of service demanded. Facilities involved may have been dramatically altered or expanded. There may be a reduced need for facilities and service as well. The specific owners or team members originally proposed may have experienced changes as well; considerable consolidation has occurred in the industry over the past few years.

If the original bids were based on the reality of what will actually occur over a 20-year period, would the low bid be the final score? The game or projected results look pretty good in the first few innings while the media are interested and the rules are predictable. However, when facilities age, team members and owners change, new regulatory requirements emerge, and demand for service changes, the team may not score as well. In the water and wastewater industry, there is little experience beyond the first few years of service, particularly with big-league systems, so no one can know what will happen.

There is another game that does have long-term experience. The waste-to-energy industry pioneered public-private competition in the mid-1970s. Since then, more than 150 municipal waste-burning power plants have been developed, many featuring operations contracts with private-service providers. The rules governing that industry are similar to those that guide the water and wastewater industry today. In fact, the lawyers, financial specialists, and engineers engaged in today's game were brought in from the waste-to-energy league. They understand the impact that changing rules can have on the final results. The changes have included new federal air quality standards (the Clean Air Act Amendments), new or adjusted requirements aimed at buy-product management and disposal, waste flow-control changes resulting from U.S. Supreme Court rulings, as well as major shifts in market-based economics. These changes have broad implications that include project economics but also technological factors and public acceptance challenges. The former waste-to-energy league players admit that there is no way to predict or mitigate all price-changing events over a 20-year period and that contract negotiations often continue many years into the contract term. This is a little discussed or understood fact often overlooked by many communities that pursue public-private competition in the water and wastewater field. Media that cover these sectors are tempted to walk away from the story once contracts are signed. Examination of the waste-to-energy industry would reveal that the story often lives on as long as there are facilities operating in a changing environment.

Down the Home Stretch

What will happen as the water and wastewater industry nears the end of its service contracts? If the waste-to-energy league experience is any indicator, the headlines will report that "City Costs Never Higher!" or "Should the County Close Its Plant?" Why? Did the winning team fail to deliver the terms or did technology fail? Was the team made up of rascals? No, the headlines will change because the rules changed after the original bidding process concluded. The winning team renegotiated a new score without another team being able to bid and rekindle a competitive challenge. Negotiations often occur without the benefit of institutional knowledge as to what was really meant in the original agreement. The individuals that understood what was intended during the development of the original agreement may have moved on. That understanding may be lost and interpretation of the original agreement could fall victim to a loss of memory and the appearance of new "gray areas" in the agreement. The customers were expected to accept the new score even though savings were eroded, and the original reasons for declaring a winner evaporated as laws changed, flow increased or decreased, and team ownership changed.

Postgame Review

In the waste-to-energy league, communities that declared victory at the conclusion of bidding processes often experienced a rude awakening. Residents of North Andover and Saugus, Mass.; Mecklenburg County, N.C.; Syracuse, Islip, Huntington, and Westchester County, N.Y.; Hillsborough, Miami-Dade, and Lee Counties, and the City of Tampa, Fla.; Baltimore, Md.; Alexandria, Va.; Arlington and Fairfax counties, Va. are among those that can attest that by declaring victory before the game begins, a signal is sent that the competition is over. The pressure for the winning team to save money diminishes.

Those communities that experienced major changes and did not have a way to respond in a competitive environment nearly always pay more. This will be true for the water and wastewater industry as it encounters further consolidation and regulatory changes like waste-to-energy's experience with CAAA. Numerous examples exist of higher pricing for solutions offered to facility owners when there was no viable service alternative. For Montgomery County, Ohio; the Southeast Public Service Authority of Virginia; and Pinellas County, Fla.; which maintained a public operation or the ability to rebid the overall service agreement in order to incorporate revisions for CAAA retrofits, they experienced savings anywhere from 20% to 200% (from \$10 to more than \$100 million on individual projects) as compared to similar privately operated examples.

Moral of the Story

To keep a winning score, communities must make competition continuous to the very end of the game by

- maintaining a viable public team as an alternative to private operations so that the community has the option to seek either service provider;
- considering continuous operation of a portion of the system with a public workforce if the water or wastewater system has multiple facilities;
- using 3- to 5-year contracts, when possible, for the operation and maintenance of existing systems;
- reserving the right for convenience termination or an early buyout when contracting for new facilities;
- avoiding long-term contracts if relying primarily on public financing; or
- building mechanisms into long-term contracts that make it possible to invite competition when rules requiring major capital investments or significant retrofits change.

In addition, for publicly operated facilities, the community can reserve the right to terminate its memorandum of understanding if the public workforce fails to perform. Just as in private operations, it is important to make use of a performance measuring and monitoring team to ensure that expectations are met and equitable adjustments are made as conditions change. The team should include individuals with knowledge of the intent of the original agreement. Sufficient technical, financial, and legal resources must be available to fully administer either a private or public sector service agreement.

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