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Private Sector Participation in Water Services: Through the Lens of Stockton

Moderator

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Panelists

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ANDERS STENSTEDT, MORRISON & FOERSTER

WOLFF: Welcome everyone, I’m delighted to see so many people out on a Saturday. We’re each going to take five minutes in the beginning to briefly introduce ourselves, talk about how we came to be involved with or knowledgeable about the City of Stockton and maybe some general, very high-level comments about our individual opinions or attitudes on this issue. After that, we’re just going to have a discussion. I’ll take questions from the audience; I also have a list of questions we prepared in advance that I’ll go to when I think it’s appropriate. Would any one of the speakers like to begin?

SEGAL: Good afternoon. My name is Geoff Segal, with the Reason Foundation. We are a nonprofit research and education group based in Los Angeles. We have been in existence for about thirty-seven years. I’m actually based in Washington D.C. now, but several years ago, during the Stockton issue, I was in L.A. and made the trek up to Stockton a number of times. I see many familiar faces, and it is great to be here.

The Reason Foundation is a free market-based think tank. We research where the private sector participates, how it participates, how to ensure that the public is safeguarded, and that services are delivered efficiently and effectively. I’ll also note that we really focus only on the United States. We don’t look at international examples. When we look here in the United States at the role the private sector can play in the provision of water services, it is certainly a trend more and more cities
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are at least examining and, in many cases, the cities themselves are deciding to enter into a contractual arrangement for the operations and maintenance of water or wastewater services. It is something that I will honestly admit does not necessarily work for every city or every entity.

Our role, if we play one, is to ensure that those cities that do decide to go forward with or at least examine a contractual arrangement do so using best practices, making sure that strict performance measures and guidelines are put into place. I look forward to hearing everyone's comments and questions, and thank you so much for having me.

HAUTER: I'm Winona Hauter and I'm Executive Director of Food and Water Watch. We're a new organization that's challenging the economic and political forces that are promoting industrialized agriculture and commodifying fresh water and ocean resources. We had been working most recently with Public Citizen—we're a spin off of Public Citizen. Public Citizen was working here in California. It had the "Water for All" campaign, which was working with citizen groups in fighting water privatization, and the "Water for All" campaign got involved in water issues.¹

We had traditionally worked on energy issues, and had followed the Enron debacle very closely. When we saw Enron getting involved in water about five or six years ago, we started getting involved in water. We have a national and international program, and we work with citizens' groups all over the U.S. and all over the world who are fighting water privatization.

Privatization has been a clear and unequivocal disaster in most places. The big water transnationals, we believe, represent a failed business model and we have a lot of evidence of that. They say that they are presenting a new paradigm, but basically what happens is that they say they're going to be more efficient, but they come in and they underbid, and they come back and ask communities for more money. They aren't transparent, so accountability is very difficult. They are often slow and don't comply with the monitoring requirements. Their economic efficiencies are achieved usually through firing about half the staff—that's a rule of thumb—so then there are all sorts of water quality problems. Often if you are talking about privatization of drinking water, it means brown water and boiled water days. They create problems with billing. Rather than seeing efficiency, we often see that bills aren't collected and, if bills are collected, they achieve some of the economic efficiency through cutoffs so that poor people aren't able to continue to get water from the water company. And we see that the contracting process—because this often occurs in the form of management

¹. For more information on the "Water for All" campaign, see Public Citizen Website, http://www.citizen.org/california/water (last visited May 5, 2006).
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contracts—is often fraught with corruption. Sometimes it’s legalized bribery through campaign contributions, because generally the water companies lobby mayors or city councils. We don’t think that this is competition when you get a management contract for twenty or thirty years. I’ll end there, and I look forward to the debate.

LoYKO: My name is Bill LoYko. I guess if I was going to give a bio, all you have to do is look at the person sitting across from you. I’m a lifelong Californian, an eight-year resident of Stockton, California, and I spent the last fifteen years in the financial services industry. I’m presently regional director for annuity marketing for a financial services firm. I’m an Eagle Scout, I’m a member of the Executive Board of the Boy Scouts in the area where I live. I’m a father of five and a grandfather of two. I campaigned and voted for Richard Nixon twice, and my wife forgives me for that. When she met me she thought, and still believes, that inside me there’s a Republican. I tell her there’s not, but I was not an activist. Getting involved, I’m like a lot of folks in your hometown: I turn on the tap, the water comes out. I flush the toilet, the water hopefully goes down. When it doesn’t, I call a plumber. The water bill comes, I pay the bill. If I don’t like the taste, then I might get somebody to deliver water to me rather than put a filter on my own faucet. So I’m a lot like all of you and I’m a lot like all of your neighbors. I don’t know where the water goes once it leaves my house and I don’t know how it got there. That’s the way I lived my life until we started the privatization conversation in Stockton.

Being someone who wants to look at both sides of the story, we went and talked to one of the key personnel who was driving our particular privatization issue, and we sat down in his office and we said, “How do we do this and why do we do this?” He had a very long conversation about why we would want to privatize our water operation. I was listening to what he said, and everything seemed to be going quite well. Then he looked at my wife and me, he looked us square in the eye and said, “Why wouldn’t you want to privatize?” He said to me, “You study it, you look at it, you examine what we’re going to do, and then you come back and tell us why we don’t want to do it.”

At that point I became a water activist. I read the 900-page contract. I helped orchestrate the campaign to get that contract rescinded. I helped Dale Stocking, another member of the Concerned Citizens Coalition, and many others grab 18,000 signatures so that if faced with this again in our community, the citizens can vote on whether or not this becomes a private issue. We’ve separated out the ability of a politician to decide who’s will run our water operation. It’s important that you know and you learn how your water is being taken care of. Half of the water in Stockton comes from a private company, but everybody who gets water from that private company pays more than they do from a municipal
entity. I get private water and I pay more than my neighbors on the other side of town who get it delivered from our own city. Most folks don’t know that if they have multiple services. You find that out if you become an activist or when you at least begin to take action in your community.

We all have a moral obligation to understand what is going on with our tax dollars. How they are being spent, how they are being utilized, and how they are being managed efficiently so that we pay the least amount of money possible. And wherever there is a dollar that can be saved through a private operation, that can be duplicated at the municipal level. Every dollar that can be saved in the form of a profit can be passed on to you in the form of lower rates now and in the future. I’m involved in water. It’s not what I wanted to do with my life, but it is now.

STENSTEDT: Thank you very much. I’m going to stand up here hoping everybody will keep an open mind because I’m going to have a different perspective.

Let me tell you how I got involved in water. It will clearly put me on the wrong side of the spectrum here, because we got involved in water back in 1999 with Enron. Talk about someone you don’t want running your water system. The issue, whether in Stockton, San Francisco or Lagos, Nigeria, is governance. We need to know what’s going on with providing our water and the spending our money and we don’t either wasted. I don’t want people stealing my money, I don’t want it misused, and I don’t want my water company working incorrectly, okay? With that in mind, my argument is that governance, which is how we organize our communities, is built on trust. We don’t trust Enron today, but at least we caught some of the bastards when they went wrong. Whether you’re in the private sector or you’re in the public sector, we want to catch the wrongdoers. And there are plenty of wrongdoers on both sides, so that the issue of governance is very similar whether we’re dealing with private sector operators or public sector operators. Unfortunately, we in the legal capital of the world, the United States, where we have plenty of private police to keep track of both government and private sector investments so that we can try to ferret out the problems and find the bastards wherever they are. In Nigeria, that’s not so easy. In Bolivia, it’s likewise not so easy.

I want to distinguish private sector participation from the notion of privatization. Privatization, I think, gets a bad name, especially when we’re talking about Enron taking over. Water is not a perfectly transferable commodity like gold, oil, power, or even telecoms. Water is really unique and special, like the air we breathe. But unlike the air we breathe, it’s also a business. There has been a lot of talk about this over the years, because the World Bank and others have recommended
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privatization. It didn’t work in Cochabamba, it didn’t work in Argentina, it fell apart in Atlanta; it’s had a disastrous track record. But the fault, I’m afraid, is not always the private sector player. Look also to the public sector governance. Who’s in charge here? Who’s responsible for bringing water to my kids, my household? Who’s responsible for helping the women in Nigeria get equal treatment in life so they don’t spend half of their time carrying water?

This is a governance issue of ourselves as a community. I respect the position that we don’t want waste, theft, misappropriation, and misuse of water. But the issue is so similar whether we’re dealing with a profiteer like Enron or a private lawyer like myself. I can’t work in this business unless I make a profit. I am a private sector participant in the water wars of California, and I love it because it’s a mess. It’s a great thing for lawyers, because we can profit from that. Those water wars are consuming our resources today because our governance system is all screwed up.

WOLFF: For those who haven’t guessed it yet, two of the panelists are, in theory, in favor of privatization and two are, in theory, against privatization. I’ll leave it to you to figure out who is who. I was chosen as the moderator because I am neither for nor against. I’m Gary Wolff from the Pacific Institute in Oakland. I’m an economist and a civil engineer with a background in water.

Around the end of 2001, I was asked to participate in a paper that the Pacific Institute was going to write. Peter Gleick, our president, was at the World Water Forum at the Hague and there was supposed to be a session on privatization. Hundreds of people were in the room and the session never happened. It was cancelled, apparently, because of arguments by the organizers behind the scene about things like who got to speak first, or whether people could talk about their passion or not. It was just too explosive an issue. So Peter was standing next to someone from the Rockefeller Foundation and he convinced them in the course of standing around that they ought to fund a paper.

The paper basically says that if you are going to privatize, there are some principles that should be involved. If water is going to be a commodity, it should also be recognized as a social good, with certain public health and social consequences. If you’re going to turn it over to private hands, you should make sure that essential public functions like environmental flows are taken care of, and so forth. This paper


presented what was, at that time, the first balanced approach to this issue. Astonishingly, and I don’t say that with a great deal of pride, it was the first balanced approach, and we had tens of thousands of downloads of this full document in the months after it was released. It’s the most-requested document off of our website, and we’ve been in business for fifteen years.

Subsequent to that, I was asked to get involved in the Stockton situation to take a look at what was going on out there. I reviewed some materials and wrote a letter to the City Council informing them that while I was neither in favor of or against privatization, there were some things in their process to think about that they may be getting into trouble on. One of those things was California Environmental Quality Act ("CEQA")4 and, indeed, it turned out that they got into trouble over the CEQA.

About three months later I released an independent technical review of the proposed water sector privatization in Stockton.5 Again, I didn’t take a position. I just pointed out that the operating cost and capital cost numbers being thrown around had not been thought through carefully enough. Depending on what assumptions you make about inflation, you could have large savings from the privatization or you could have no savings from the privatization. In the capital area, there were some potential savings, but it was because the low bidder, OMI/Thames,6 was proposing to use a wetland wastewater treatment facility that the City’s own consultants had said they didn’t think would work at a reasonable cost, and that the other bidders hadn’t touched with a ten foot pole—they didn’t want to bid it. But OMI/Thames actually has operating experience with that technology. They said, “We think we can do it. We can provide financial guarantees.” It’s really not a bad offer to a City, to save $20 million by someone taking a technology risk and providing financial guarantees for it. That’s actually one of the things the private sector can be good at. So I commented on that in the report.

Finally, there were some risk issues which they weren’t really thinking about very clearly. The City’s legal consultants had said, “Oh, all the risk is being transferred to the contractor. It is all covered. You are shedding risk.” I pointed out that, if you enter into a contract, you are at contract risk. It’s like getting married. If you get married, you are at risk of divorce. You don’t have any risk of divorce if you are unmarried. But the consultants didn’t think that was a good argument. In

any case, I put it before the City Council, which ultimately voted four-to-three to award the contract. The citizens, about a month after that, voted to create a requirement through referendum that all future contracts would require public approval. The litigation has been going on ever since. That's kind of the context of the situation. I'm still not for or against what they did, except of course they should have followed CEQA, in my opinion. But as to whether they should have awarded the contract or not, I really have no clear position on that.

Last thing—just last month my new report came out. The Joyce Foundation, a large foundation based in Chicago, was receiving queries from a lot of people in municipal government in the upper Midwest: Should they or shouldn't they enter into a privatization? So they commissioned us to write a piece that was sort of like the New Economy of Water piece, but with more detail, that explains the fact, how systems that have improved performance have improved performance, and how systems that have been failing have been failing. Some of them are public, some of them are private. We present that information in this report.

LOYKO: Just one little thing on the Stockton vote. They signed the contract two weeks before we went to vote because if they had waited the two weeks we would have had to go to a vote on whether to privatize. And while they may have argued that saved us money by avoiding an election, the reality is that they took the vote away from us. Sixty percent of the folks had said, "We want it. We deserve it." But the council decided on a four to three vote, two weeks before the election, to sign and enter into a contract. I think that it is really important to understand that four people decided our privatization issue. Sixty percent of the voters said, "We want to vote," but four people said, "No."

WOLFF: That leads to an excellent opening question. I'm going to ask it of all the panelists, and then maybe turn to the audience. But first, I want to mention that the words we use can be confusing. I use "privatization" to mean any time assets and operations that are in public hands are transferred somewhat into private hands. Whether that is a private contract, an operation with a private company to operate public assets, or whether that is a divestiture, a sale of a public asset, to a private company. I use "privatization" to mean either one. Others use them differently, so as we talk today we should try to be clear as to whether we're talking about a sale or purchase of assets between public and private hands, or about an operational contract where the assets remain

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in public hands. Those are two fairly different structures of legal and financial arrangement.

STENSTEDT: Do you want to define the Stockton contract?

WOLFF: The Stockton contract is a contract for operations. All the assets belong to the public. The rate decisions are made by the City Council.

LOYKO: Actually that's a contract for the operation, maintenance, and the initial capital improvements necessary for the wastewater and utilities. We should be clear that one single contract includes both capital improvements and the operation and management of our water assets. It is a contract with what appears to be two complete, different kinds of things, but it is a contract that includes both in that written document.

WOLFF: Yes, that's absolutely right. Let me just clarify my remark. It is an operation of publicly-owned assets. The company is hired to operate existing assets and they are hired to build some new assets and operate them. But all the assets are still owned by the City in the end.

STENSTEDT: That was the clarification I wanted to note. In the end, these capital improvements don't belong to OMI/Thames, they belong to the municipality of Stockton.

HAUTER: We find that people who are in favor of privatization like wiggle room, and they like to say that management contracts aren't privatization. We like to speak very simply. If a private company is making decisions about your water supply, most citizens consider that to be privatization.

SEagal: Well, if you look at the fundamental root of where the term "privatization" started, it came from Eastern Europe and Europe, where true nationally-owned utilities or services were privatized. They were divested. British Airways, for example, was once part of the British Crown, owned by the government. The government no longer has a role, outside of regulating them as a business. When we talk about water privatization here in the United States, cities and counties are not divesting their utilities. They still own the pipes in the ground. The contract is a 900-page document. I actually think it is 811, give or take. I acknowledge anybody who's brave enough to read that, especially someone not being paid to do it. There are so many remedies and safeguards written in that contract that I do believe it is unfair to call it a "transfer" to the private hands. Yes, the private sector will be participating, but there is plenty of oversight and the City Manager and the Utility Board still have a role in deciding what projects go forward.

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and how they are operated.

HAUTER: Can I comment on that? What we find is that the management contracts are even worse than the regulated utilities. These 900-page contracts are written by the private companies, usually transnational companies, by highly-experienced attorneys. And we have read some of these contracts as well, such as the one in New Orleans, where privatization was defeated.10 There is all sorts of wiggle room and protection for the company. The municipal government is kind of lured into believing that they're going to get this great benefit and really there is very little accountability. If the city wants to get out of the contract, like Atlanta did, it is much more difficult. Rates aren't regulated under the Public Utilities Commission and there are far fewer protections.

WOLFF: Let's use the Stockton situation as our lens. With respect to the Stockton contract, what lack of accountability do you see in the contract? And what inability to get out of the contract do you see, given that there is a million dollar buyout clause?

HAUTER: Well, there have been rate increases that citizens did not expect. There have been problems with wastewater.

WOLFF: Where is that lack of accountability in the contract?

HAUTER: If a citizen has a public water utility and they are unhappy with the rates or with what's going on, they have the ability, through elections, to deal with the problem. If there is a contract, then there is a barrier between citizens and the ability to actually do something about the way their utility is being run.

WOLFF: So it's not the structure of the contract that you're concerned about. It's the existence of a contract.

HAUTER: Well, there are structural problems with the contract as well.

LOYKO: On the contract itself, there are components built in there for guarantees. There is a whole section all about guarantees. There are also several appendices that detail what OMI/Thames is required to provide. The contract details those expectations. The downside to the contract, though, is that on only one issue is there any kind of consequence. I take that back—there are two issues for not complying with those guarantees. Now, there are some state-mandated consequences for failure to produce clean water. That is a state law issue. And they are simply required to follow state law and federal law on that. So while the contract says that if you put out brown water, the contract won't do anything, you're going to have to deal with federal and state issues. But the contract itself details what OMI/Thames is to provide.

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The biggest problem we have with the contract is the question of who's watching it. They’re your elected officials. We have a twenty-year contract and elected officials in office for how long? Four years, maybe? Of the people who started putting this whole issue together for us, the mayor that put this together is gone. There are only three members of the City Council left to vote on it. The only two that approved it have left. The City Manager, who was the engineer behind it, is gone. The Assistant City Manager, who was behind it, is gone. The head of the Municipal Utilities Department, who started out with privatization, is gone. When you have a contract as sophisticated as what we have in Stockton, our institutional memory is gone. It's left to people who are willing to read a 900-page document. You're just going to turn on the water and hope it comes out clear.

SEGAL: Well, the City does have people who are paid to read that contract and to make sure that the performance by the contractor meets not only the requirements in the contract but also state and other laws that guide the operation. In terms of the rate increase issue, the rates did go up slightly, but this assumes—and I have a report from the new City Manager, who has laid out the full case—that the rates would not have gone up otherwise. In fact, historically this rate increase is much lower than what would have happened had the contract not been entered into, according to the City Manager and the documents provided by the City of Stockton.

WOLFF: This raises some great issues. One we are going to come back to is the rate increase. Another we’re going to come back to is the earlier issue of public power via the referendum process, and whether that’s appropriate or not. Also, we'll address the question of quality of staff to oversee a contract.

STENSTEDT: My concern is accountability. That's the question. Who is responsible for delivering water services? The issue here really is process—do we have an adequate government machine that is capable of (a) operating a water system (and that's questionable); and (b) managing a contract? What can a government do?

WOLFF: Three really good issues have come up. One has to do with overseeing a large contract like this, and how difficult that is with the loss of institutional memory. The National Academy of Sciences has a book out on privatization of water services,11 where they state that when a government entity goes from operating its services to having a contract operator, the skills required to manage a contract are quite different than the skills required to directly manage an operation. They urge any

government going through that transition to be sure to have the right people on board with the right training to manage the contract. This is a comment that was made to the City of Stockton very early on.

In the course of researching the Beyond Privatization report, I discovered that some of the entities that have outsourced in this way for a contract operation have invested heavily in contract skills. The strongest example is the Milwaukee Metropolitan Sewerage District, which hired United Water in maybe 1998 to operate and build some large wastewater facilities. They put together a team of between three and a half and four full-time-equivalent employees whose only job was to supervise United Water. But the size of the savings that they estimated in the United Water contract were about $1 million per month, so they were well able to justify 3.5 fulltime-equivalent employees to pay for that. They claim, six years later, that they have saved that amount of money or more. In particular, they have been crowing in the last year or two because the contract does not allow energy cost pass-throughs. I talked to someone from United Water who verified that's true.

AUDIENCE MEMBER: Until the contractor complains, right?

WOLFF: No, apparently they've attempted to get the sanitation district to allow energy price pass-throughs and the contract managers, who are well trained, have said, "No. It's clearly in the contract, you've signed it, and there's no justification for a change order." So we'll see how that plays out in the end, if they can force them into bankruptcy or not. This issue of contract management is an important one. Some places have done it well, others have done it poorly, and we don't even really know what other places have done. Are there any other panelists who want to comment on that—the issue of contract management—with specific examples?

LOYKO: From a Stockton perspective, because that's all that I can speak on, the City did not hire and has not hired anyone highly trained in contract management. We don't have anybody different looking at that contract than we had prior to that contract. There is a monthly report by OMI/Thames, and it comes out in the middle of the month. That report is reviewed, but it is not compared to how that contract is performed. In contract performance, we do not have someone who understands the complexities of this contract and we have not had one single report on the performance of how this company is doing with our facility. Now, there is a report available, and it's on our website, because we created one. And the second one will be posted in about a week on how they've

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12. For more information regarding the United Water Services Contract, see Milwaukee Metropolitan Sewage District, http://www.mmsd.com/about/united_water.cfm (last visited May 5, 2006).
done in the second year.\textsuperscript{13}

HAUTER: I'd like to talk about the Milwaukee example, because one of the ways we work is that activists call us to tell us what is going on in the community. One of the things that has happened in Milwaukee is that the company turned off the pumps to save electricity. They want to run the pumps at the time of day when it's cheapest. The result has been millions and millions of gallons of waste spilled into the Wisconsin waterways. A group of citizens in Milwaukee are beginning to organize and supervise this contract.

I would also like to give a national perspective by looking at the Atlanta contract. No discussion on contracts is really complete without talking about Atlanta, which is supposed to be about the largest privatization in the country. It was going to be a new paradigm. What Atlanta found was that things written in the contract just didn’t have a lot of meaning. First of all, the company under-bid. Once again, this is United Water, which is the affiliate of Suez, one of the top three giant transnational companies in the world that deal with water. Atlanta signed this twenty-four-year, $428 million contract. The company was able to lobby though the conference of mayors to get the deal signed. It's not like the government performed a deliberate study of the contract and all of its pros and cons. A lot of this is accomplished instead through our system of “legalized bribery.” So there were a lot of things in the contract that the City didn't like and was very displeased with. They were immediately asked to pay an additional $80 million because United had under-bid. Then United came back and billed the City for $36 million for work that was supposed to be completed. They paid about $16 million of the $36 million, then found out that the work had not even been completed. The City had to hire its own auditor to audit the contract to make sure it wasn’t being ripped off. Regarding the billing, it found that money was not even being collected from citizens. There was also a backlog of work orders. The City was constantly on the watch for the terms that were not being met.

In January 2003, the mayor finally kicked Suez out of the City, and now they have the difficult task of trying to recreate their public utility because they lost all of that expertise.\textsuperscript{14}

SEGAL: A couple of points. The issue on contract management is an important one. We need to have the right safeguards and performance measures. EPA studies show that, where there is private involvement, the rate of violations go down. When we look at what happens in public


\textsuperscript{14} For more information on the privatization issues in Atlanta and other cities, see Water Activist, http://www.wateractivist.org (last visited May 5, 2006).
facilities, things are not as widely reported. I do think we all have the same common goals: improve quality, reliability and safety. My organization is only interested in finding the best mechanism to get there. It is not always going to be private; it is not always going to be public. There is going to be some overlap.

Five seconds on Atlanta, since it was brought up: it is a great example of what not to do with a contract. The system and the bid were fundamentally wrong. My recommendation is that low-bid is not the way to go. There must be some concept of value, there has to be some concept of safeguards, and performance must be put ahead of low bids. As an aside, it is important to note that, although Atlanta did go through this contract and this cancellation of contract, they have since contracted out for their wastewater system. They have learned from their failures. They did not put blackball the initiative or the concept completely. In fact, they figured out what they did wrong and how they can do it better. And I am assured that their operations in wastewater are significantly better and that the City is satisfied with that contract.

WOLFF: I just want to comment that the wastewater operation was contracted out before the water operation, and there has been no noticeable argument over that contract, so Geoffrey’s point is basically correct. I just want to correct that fact—it has been there longer.

STENSTEDT: First, I have to comment about accountability. The system of legalized bribery, just like the incapability of contract management, is not a failure of the private sector but instead a failure of our government. If the government, or the municipal utility district, can’t manage a contract, how can they manage the water system? Who is managing the monitoring, the auditing, the remedying, and the relief? If we have recourse here, it is to fix the government.

WOLFF: Before I go to the question of rates with Bill, I want to make a quick point about something Wenonah said. I work in an organization where facts and knowledge-based decision making are what we advocate for, but facts and knowledge don’t take you all the way. In the end, you have to make some judgments on your own. But getting the facts right is important. With respect to Milwaukee and the overflows there, it is important to know that there have been two independent audits commissioned by the City of Milwaukee, one of United Waters’ operation and the other one of the Metropolitan Sanitation District, both of which were headed up by the Chief of Water and Wastewater at Seattle Public Utilities. Both of these independent audits said that there was no basis for the claim that United Water had spilled extra sewage because they were trying to save money on electricity rates.

LOYKO: The argument with respect to privatization is that a private company can come in and operate the facility with customer savings and
a reduction in water bills. In this paper Geoff Segal found that OMI/Thames has no influence or control over rates or water availability, and that is absolutely true. OMI/Thames does not control rates. Rates are controlled by our government.15

Geoffrey also says that OMI/Thames’ water cost and performance are guaranteed, and will result in only a seven percent increase in rates, and no more. Because of our contract, our City Council has had to add a consumer price index (CPI) increase to our water and our wastewater rates. It has been added because of the contract; because the contract carries with it an automatic CPI increase. So despite the statement that our rates will not rise more than 7%, we have already seen an 8.1% increase in our rates in the first two years of the contract. Last year, the rate increase was 3.7%. Social Security recipients only got a 2.7% increase. OMI/Thames did not cause the water increase, but privatization and having a contract caused a rate increase. We have a rate increase because we have a contract. We didn’t have annual CPI increases prior to having a contract. It is now projected that our rates will increase over the term of this contract by nearly sixty-three percent.

WOLFF: Other comments on the rates?

SEGAL: Historically, the City of Stockton has adopted large rate increases on a periodic basis. This method did not recognize the reality that costs increase on an annual basis and also resulted in large and unexpected rate increases to the public. In response to this, City staff, not OMI/Thames staff, recommended changing to a rate structure that included an annual inflationary adjustment.

There is a detailed response regarding how the rate increases came about, why the rate increases are there and why, at least in the City’s view, they are not as extensive as they would have been otherwise. With respect to not issuing the contract, rate increases would have grown at a much faster rate to cover the capital expenses and everything else.

LOYKO: At the time of the rate increase the Mayor told us at a City Council meeting that our CPI increase in our water rate is the result of a contract. It’s not because of projects we want to build. We know there are rate increases that are going to come because of projects we have to build. It would be silly to think that we don’t have that. But I will tell you that the Mayor who signed the contract said, “We have a rate increase because we have a contract.” That is a cause and effect.

WOLFF: Thank you Bill. I want to go to the audience now for questions.

AUDIENCE MEMBER: I’m curious about the possible effects of

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privatization on management of watershed level effects. Is there any reason to think that there is a difference between how public utilities interact with larger watershed ecosystem services concerns and private companies handling those responsibilities?

WOLFF: Any comments on Stockton or specific examples elsewhere?

STENSTEDT: That's a regulatory question, and so long as you have the California water regulatory system in place, whether its Stockton or anybody else with water rights, they have to comply with the regulatory systems, so none of that changes.

WOLFF: Others?

LOYKO: The only thing I would say is that, as complex as it is to look at our little system and our little city, imagine the complexity you would have if you were to take that out to a huge watershed.

WOLFF: There is a general problem with all water companies, public and private, in that they make their money from the sale of water, for the most part, so there is an under-incentive to conserve. This is a severe problem for public and private companies that a number of people are working on.

HAUTER: Thames, the parent company managing the contract, has a very bad track record on environmental issues. In the United Kingdom it was named one of the top polluters three years in a row in the late 1990s. They have straightened some of that up, but they have been cited for having worse water leakages than when the water was publicly managed, and for having spills in waterways.

SEGAL: The University of California, Santa Barbara, Bren School for Environmental Science and Management actually reviewed a couple of systems and asked that very question. That report, although I don't have the specifics, outlines some policy guidelines and recommendations on how to move forward and integrate those guidelines.

AUDIENCE MEMBER: In Stockton, were the public employees or the public utility in any way allowed to bid for continued operation against the private bidders?

LOYKO: No.

WOLFF: That was my understanding as well. I should editorialize slightly here. In the Beyond Privatization report, I describe one of the things that goes wrong so often, a false start. A false start can occur in a number of ways, but the most common one is the one we saw in Stockton, where someone at the political level decides that involving a private company is the solution. Or, the flip side to that is where someone at the political level decides that the local investor-owned water

utility is the problem and we need to buy them out. That gets a whole process underway of buying them out or of privatizing without the people in the community ever being asked, “What are the services that you care about? Is the present service quality good, or bad? If it’s the quality that’s bad, what do you want changed? If this is bad, how might we change it? Does that, or could that, involve private participation?” And walk through it from the ground up. But it doesn’t happen. You get a false start when someone jumps ahead to, “The solution is to change the form of ownership.” That’s a false start that occurred in Stockton, and it is a very big part of what has happened up there.

AUDIENCE MEMBER: I was an employee of the Public Utilities Commission Department. It was clearly a political decision to enter into the contract. The employees were never ever asked whether or not they could submit a better proposal, which we tried to do. It had nothing to do with the operation. Stockton, in my estimation, was not in a position to be privatized because we were a finely run system/utility. That’s what made us ripe for the picking by a multinational. We were never allowed to participate in the process.

WOLFF: Since I’m editorializing, I should comment—and this is in support of Mr. Stenstedt’s point—that you cannot blame the private bidders for having structured a bidding situation where the public operation was not permitted to bid. You cannot blame the private bidders for having a situation in which a discussion did not take place with the public about whether bids should even be solicited at all. So those were the government’s failures, and I’m supporting your point.

STENSTEDT: What’s missing here is, “What was wrong with Stockton to begin with?” If there wasn’t anything wrong with it, why change it? If it’s not broken, don’t fix it. That’s clearly the issue. If someone decided unilaterally that it’s broken, it needs a fix, without talking to anyone—that’s a bad idea.

AUDIENCE MEMBER: Could some of the rate-shock that occurs in these settings result from the fact that water has not been actually-costed in the past and that rates have been set politically, so that as soon as you shift to actual-cost pricing, you’re going to have a rate-shock no matter who’s in charge?

HAUTER: This isn’t necessarily the case. Pennsylvania is a good example. Pennsylvania has a lot of privatized water. It’s been regulated by the Public Utilities Commission there. In Pennsylvania, the private companies charge four-times the amount for water that the public utilities do, and they’ve been private for a long, long time.\(^{17}\) Here in California, CAL-AM is about thirty-six percent more expensive than the

\(^{17}\) *Id.* at 10.
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public utilities. There are times when rates will go up because of infrastructure repairs that are needed—that’s one of the reasons that a large coalition has come together to try to promote federal funding to a trust fund to fix infrastructure.

STENSTEDT: Can I just give a quick example of this issue? In Nigeria the public municipal agency responsible for water delivery is so broke that it can’t be relied on at all. You don’t get water more than maybe one day a week and it’s brown at best. The result is the creation and growth of an industry of private water purveyors. They sell water in the streets, driving around with their tanker trucks, and they charge unbelievable prices. I talked to a taxi driver in Lagos and I asked, “Where do you get your water for your family?” He says, “It’s about sixty percent of my income to pay for water.” It’s unbelievable. So this rate issue is huge.

AUDIENCE MEMBER: You had indicated that the council voted four to three, two weeks prior to your referendum, Mr. Loyko? Why did you not propose your referendum? Under California law, as I understand it, you have thirty days to overturn an ordinance.

LOYKO: The City Council did vote four to three, and we then went forward with a referendum. We were 800 signatures short of overturning the City Council. In California, if you don’t like what your city council has done, you have thirty days with which to gather enough signatures to overturn that. And that’s a lot of people and a lot of process—to put it in perspective, the contract is 811-pages long. We had to reprint that contract and attach it to every signature document under California law. So you’re paying to print up, in our particular case, 125 copies of an 811-page document.

WOLFF: Out of curiosity, how many signatures did you need?

LOYKO: I think we needed about 11,000 and I think we came up with about 10,200. It’s very labor-intensive. We learned a lot about government, we learned a lot about initiatives, and we learned a whole lot more about referendums. And we learned a whole lot about communication amongst your community organization.

AUDIENCE MEMBER: Bashing government may be self-satisfying, but it’s not very helpful. It seems to me that comparing public sector actors with private sector actors is not only a misrepresentation of reality, but it’s a misrepresentation of what the purposes and what the drivers are of each. When you look at the public sector, the intent is to provide and to maximize public services. In the private sector, corporations are in it to make profits for shareholders. There’s a fundamental difference, and if you don’t maximize profits for the shareholders, you can be sued for breach of your fiduciary responsibilities. How this should be dealt with? That then spills over into questions like, “Do you care about the watershed? Do you care about conservation? Do you care about
security?"

Wolff: This is a good question. I'm going to rephrase it slightly. For each of the Panel speakers: Do you think that the fundamental difference between the way government operates and the way corporations operate is relevant to whether water services should be offered by government or by private enterprise? And I want to add another twist to that: If you believe that the public should maintain control of water, under this argument, then how is water different than food, energy, or any other essential?

Segal: You're right, there is a difference between how public and private entities operate and how they function. So much of this conversation has been about ensuring that the safeguards are there regardless of who operates, and I will admit there are plenty of examples of successful and brilliantly run public operations, and on the flipside the same is true of private operations. Incentives do matter. Private companies have to turn a profit, but their incentives to earn that profit include providing a good service. They include not being fined by the regulatory authorities or the City for failing to provide that service. The only way they can sell a product is to provide a good one. With respect to the fundamental question of whether water should be different, I look at achieving outcomes. Let's determine what is the best process to achieve those outcomes. Our goals here are ensuring clean and safe water and, if there is a role that the private sector can play, and we can make sure we can do it safely to where those outcomes are achieved, I think we should embrace it.

Wolff: I think that it's a very good question. Any public service, to be good, requires that citizens be involved to make sure that it's working well, that their local government is working well. So it's a question of whether we want to strengthen democracy, or whether we want to continue to move ahead in this process of privatizing everything and giving over the control of everything to corporations. We can look at energy. I worked in energy issues for years, and overall in the United States public power is seventeen percent cheaper than private power. And I think we could have a very good debate about whether the transnational control of our food supply is really benefiting people and how food is being distributed. So maybe we need to have a whole new discussion about how we distribute basic necessities.

LoYko: If you have a system that is in trouble and you do not have the wherewithal to fix it, you may have to resort to bringing in some private resources to help you do that. But Stockton didn't have a problem. We didn't have a difficult situation. We had a situation that worked fine, but we had a political machine that wanted to change how we were operating. In changing how that was operated, we didn't get to participate. But there isn't anything being done out at our facility by a
private provider that cannot be done, and was not being done, by a public service. We’re in the process of, and the City was moving in this direction, taking our system and moving it into a computerized, centralized operation and training the operators on how to operate that system from wherever they are in the plant. That was a City plan. That plan is still going on. It’s the construction of those kinds of things—we’re not in the construction business, we’re in the operation and delivery of service business, and we were doing very well without a private contractor.

STENSTEDT: There is a dramatic distinction between private governance and public governance, and this question of profiteering is certainly central. Yet once we are in a business environment, business doesn’t function without profitability. On the other hand, government should be independent of that. So eliminating profiteering and greed from government is equally a problem and a challenge here, and there are always accusations that contracts such as these are manipulated by interests that are driven by profiteering and greed. But most importantly, water is so different. It’s not like power, it’s not like telecom, it’s not like roads or bridges or these other components of public infrastructure. And it’s not like air, but it’s right there with air in that everybody has to have water. And yet the notion that clean water is not a business, or that it is somehow delivered to our doorsteps clean and that wastewater is taken away without a business component—meaning there is an economic issue here of cost recovery and investment required—is just not sound.

Therefore, the studies on this have distinguished between water as a commodity and water as a human right, and balancing these two things to say there is a public-private partnership. Just like Bill said, they’re not in the business of building and construction projects—that’s engineering and construction expertise. Therefore, they outsource. They have private sector participation to do that stuff. And so our public procurement is what we rely on for private sector participation to work. If the system doesn’t work, if the public procurement system doesn’t work, fix that.

WOLFF: My quick answer is that food is different than water and energy. Water and energy are natural monopolies. Assets exist that would be foolish to duplicate, such as pipes or electrical wires. There’s a natural monopoly there. In food we don’t have that same situation, so water and energy are different than food. But in water and energy, whether it’s operated or owned privately and regulated effectively, or whether it’s fully part of a governmental operation where the assets and operation are all governmental, I think both are models that can work. But both of them depend upon very effective governance at the top, very effective management at the top, good democratic processes, transparency, etc. The problem is, in most parts of the world where there is a water problem or an energy problem, the government structure is
very weak, so you really don't have any good solutions available to you. And that's really what I think we're up against in most cases.

Lovko: I'd like to say one thing before you all leave. Stockton does have a contract, but it's because of citizens like all of you sitting in the audience that that the contract is better. The contract could have been a lot worse on our citizenry than it has been, because of citizen involvement in the entire process, forcing ourselves to be in their face and demanding public hearings, which you have to do if it comes to your community. It makes for a better contract.

Wolff: Thank you all.