

ESTABLISHING PUBLIC-PRIVATE PARTNERSHIPS FOR WATER AND WASTEWATER SYSTEMS

■
A Blueprint for Success



About the Water Partnership Council

The Water Partnership Council seeks to partner with citizens, local governments, and organizations committed to strengthening this country's water and wastewater infrastructure. Our members are the leading providers of operational services for water and wastewater systems in the United States.

Member Companies



To learn more about public-private partnerships and the Water Partnership Council, please contact us:

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This blueprint is intended to provide a descriptive overview of important factors for you to consider in establishing public-private partnerships for water and waste-water systems. It is not intended to substitute for sound advice from your own experts, persons experienced in public-private partnerships and the potential private partners themselves. Each community and each system will have its own needs and requirements, which should be addressed in each case by persons knowledgeable about your special circumstances.

Acknowledgements

This handbook was prepared by the Water Partnership Council to offer guidance to communities on whether and how to form and manage partnerships to meet their water and wastewater needs.

Chapter 1 describes what we mean by a public-private partnership. Chapters 2 through 4 document the benefits that more than a thousand communities have derived from partnering with our member companies. Chapters 5 through 9 provide details on how your community can achieve the benefits and avoid the potential pitfalls.

This guide reflects the collective experience of the members of the Water Partnership Council and the communities they serve. To prepare the guide, the Council staff conducted over 30 interviews. We thank the many public officials and other community stakeholders who graciously shared their insights with us. We note with particular appreciation those from the following communities and labor unions whose comments are highlighted in this handbook:

Augusta, Georgia
Avalon, California
Biloxi, Mississippi
Boyerstown, Pennsylvania
Canastota, New York
Chickasha, Oklahoma
Coos Bay, Oregon
Cortland, New York
Cranston, Rhode Island
Danbury, Connecticut
Easton, Pennsylvania
Edison, New Jersey
Exton, Pennsylvania
Fairfield, California
Glen Cove, New York
Grants, New Mexico
Hoboken, New Jersey
Indianapolis, Indiana
Jersey City Municipal Utilities Authority, New Jersey
Karnes City, Texas
Lewes, Delaware
Long Beach, Mississippi
Milwaukee, Wisconsin
Oak Ridge, Tennessee
Oklahoma City, Oklahoma
Pasadena, Texas
Sugar Land, Texas
Tampa Bay, Florida

Unions:
American Federation of State, County and Municipal Employees (AFSCME), Indianapolis, Indiana

Paper, Allied-Industrial, Chemical and Energy Workers (PACE), Oak Ridge, Tennessee



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CHAPTER 1

UNDERSTANDING THE BASICS

In 1972 the wastewater treatment plant of a San Francisco suburb was plagued with effluent discharge violations and unpleasant odors. The community's leaders tried several approaches but nothing seemed to work. Then, they got creative and established a contractual partnership with a private company that specializes in operating water and wastewater treatment systems. Thirty years later, that community is still reaping the benefits of its public-private partnership.



“The benefits of this partnership have been measurable. Three years ago we were looking at a municipal division that was draining us financially, badly in need of repair, and not capable of delivering water efficiently. Today, this division is no longer a financial burden, is almost completely refurbished, and is able to adequately and efficiently serve our residents.”

Mayor George Spadaro, Edison, New Jersey, 2001

Private involvement in public infrastructure has been an American tradition for more than 200 years. As the need to upgrade facilities and services increases, public-private partnerships are gaining favor. Partnerships are not privatization. In a partnership, the public partner retains ownership and control of the assets. Well-managed partnerships benefit the community, and when these partnerships are built on sound contracts and reinforced by mutual trust, the resulting benefits are significant.

Back to the Future

The history of public infrastructure development from as far back as 1789 reveals that infrastructure projects have nearly always relied on joint public and private involvement.¹ This was particularly true up until the early 1930s.

The form of private involvement has varied over the years. It has included investment, equipment supply, technology, engineering design, construction, operations, repair, and maintenance – alone and in combination.

The needs of the 21st century call for greater private involvement once again. Water and wastewater facilities are aging. Regulatory requirements and public demands for services are increasing. Public-private partnerships offer the most practical and cost-effective means to meet the need to repair, replace, and upgrade facilities and services.

Public-Private Partnerships Grow in Number

Over 30 years ago, the City of Burlingame, California, became the first U.S. municipality to transfer the operation of a publicly owned wastewater facility from a municipal government to a private company. By 1980, approximately 100 publicly owned water and wastewater facilities were being operated by private partners. Since that



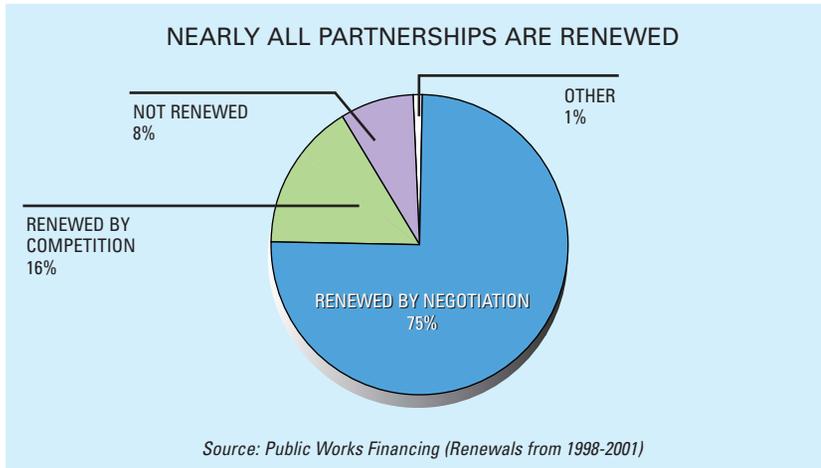
time, increasing numbers of municipalities and water/wastewater authorities have experienced the value of tapping private-sector innovation, investment, and initiative for the operation and maintenance of publicly owned systems. In 2002, private firms operated more than 2,400 publicly owned water and wastewater facilities for nearly 2,000 municipal clients.²

Those Who Try It Like It

Renewal rates attest to the popularity of public-private partnerships. Of the 489 partnerships that came up for renewal between 1998 and 2001, 91 percent elected to continue with a partnership arrangement. In addition to the Burlingame, California relationship, partnerships that have thrived for more than 14 years include Fayetteville, Arkansas; Key West, Florida; Hinesville, Georgia; Twin Falls, Idaho; Brockton, Massachusetts; Grants, New Mexico; Bartlesville,

“Some people have suggested that while municipalities may not actually give up ownership of their facilities through contract OM&M [operations, maintenance, and management], they may lose control over them. This is simply untrue. It is our plant, it is our permit, and ultimately our responsibility.”

James D. Couch, Director of Water and Wastewater Utilities, Oklahoma City, Oklahoma, in APWA Reporter, 1997



Oklahoma; Gresham, Hood River, Lebanon, and Roseburg, Oregon; and Sugar Land, Texas. Larger cities like Oklahoma City, Indianapolis, and Milwaukee are also engaged in long-term, successful partnerships.

Public-Private Partnerships Are NOT Privatization

Although the terms *public-private partnership* and *privatization* are often used interchangeably, they are not the same. Privatization involves the sale or transfer of ownership of public assets to the private sector. In sharp contrast, under all public-private partnerships, the public partner:

- Owns the assets
- Controls the management of the assets
- Establishes user rates.

The private partner provides the services specified in a contract with the public partner. Those services typically entail operating and maintaining water and wastewater facilities and systems. The agreements also can include design and construction; meter reading, billing, and customer services; maintenance and replacement of distribution and collection

“[Our private partner] helped our wastewater treatment budget by \$1 million annually while improving the services provided to our citizens.”

Johnny Isbell, former Mayor, City of Pasadena, Texas, 2000

infrastructure; operation and maintenance of biosolids facilities; and various other public works functions.

Well-Managed Public-Private Partnerships Benefit All Stakeholders

Public entities have a responsibility to provide high-quality water and wastewater treatment services to their citizens in the most cost-effective, most environmentally sound, and safest manner possible. Thousands of public officials have found that by effectively managing a public-private partnership rather than engaging in day-to-day operations, they reap many benefits and better fulfill their responsibility to their constituents.

Lower Costs

A public-private partnership typically results in annual operating cost savings of 10 to 40 percent,³ allowing municipalities to avoid or mitigate increases in water rates. A sample of such partnerships realized average savings of 24 percent over the period 1992–1997 as reported in a joint publication of the Association of Metropolitan Sewerage Agencies and the Association of Metropolitan Water Agencies (AMSA/AMWA)⁴

Paradoxically, lower cost with no compromise in quality is a direct result of the private partner's need to generate a profit. That need motivates the private partner to operate more efficiently with respect to power consumption, chemical usage, maintenance, and technical support. Private partners take advantage of economies of scale through bulk-purchasing discounts. As specialists, private partners also bring new technologies, tools, techniques, and proven processes for lowering costs while maintaining or improving service quality. The profit motive also dictates sound maintenance because well-maintained assets function at peak efficiency, and maintenance costs are almost always lower than the costs of repair or replacement of assets allowed to deteriorate.

"From what we have seen and heard from several of our former employees, they are happy and excited to be working for your organization [private partner]. Teamwork and unity within the wastewater department is evident... empowerment to make decisions has instilled a high degree of ownership and the [private partner's] staff is to be commended for a job well done."

City Manager Bill Grile, Coos Bay, Oregon, 2000

"I continue to be a proponent of private-sector partnerships, and the relationship we have with [our private partner] only reinforces the value of cooperative programs. The success story at the Messerly and Spirit Creek plants is a shining example of value for the ratepayer."

Mayor Bob Young, Augusta, Georgia, 2003

Contract provisions guarantee that the public partner's water and wastewater budget is predictable month after month. In addition, private firms can help plan, manage, and pay for capital improvements, generally when the contract is of sufficient duration so that the investment lowers life-cycle costs. Funds from the private sector, factored into the firm's contract, can alleviate a public partner's need to issue bonds or raise user fees for capital improvements. (See Chapter 2)

Enhanced Career Opportunities for Employees

Private operation typically results in better educational and training opportunities for employees and improved worker safety. For both the private partner and the public facility owner, enhanced training and safety translates into

better-run, more efficient, and environmentally sound facilities. For the employees, enhanced training means more opportunities for professional growth and advancement. (See Chapter 3)

Environmental Stewardship

A private firm's reputation and ability to secure new contracts rests significantly on its ability to maintain safe, clean water in compliance with federal and state standards. The firm will work closely with environmental stakeholders and regulators to keep the systems in compliance with stringent regulations at all times. The private partner takes responsibility for regulatory compliance through a service agreement with specific performance standards. If the firm causes a permit violation, it pays the penalty. (See Chapter 4)

Decreased Liability Risk

In many municipalities, significant operational, financial and environmental risks go along with managing water and wastewater systems. By sharing those risks, the private partner helps to reduce its public partner's liability.

Excellent Management Is Key

To derive the full benefit of a public-private partnership, the public partner must manage the contractual relationship effectively, and managing this relationship is fundamentally different from providing water and wastewater services. (See Chapters 5-8) The public partner selects the private firm, establishes by contract how the partnership will function, and monitors the performance of the private partner.

The contractual relationship must be built on mutual trust and open communication, beginning with the procurement process and continuing through the life of the contract. Public entities and private firms that have entered into public-private partnerships have identified several guiding principles to foster trust:

- Public-sector commitment to the project prior to issuing the request for proposal (RFP)
- Contract scope clearly defined by the public partner
- Objective, balanced criteria for selecting and awarding contracts made public in advance of any RFP
- Equal treatment of competing firms
- A procurement process that is stable, reliable, and predictable to actual and potential proposers, procurement officials, and the public
- Independent engineering verification of the efficacy of design, especially for design-build-operate (DBO) contracts
- A system open to technological change and improvements
- Sound financial analysis over the life of the contract
- Clearly defined roles, responsibilities, and risk-sharing frameworks
- Open communication among all stakeholders
- A specific methodology for evaluating performance.

Is a public-private partnership the right choice for your community? This handbook will help you decide. If your answer is yes, you will find guidance here to ensure that your community realizes the considerable benefits that partnerships can produce.

“A 12-month review of [the private partner’s] performance by MMSD shows the New Jersey-based contractor not only saved the district money, but it also exceeded all environmental quality standards. ...”

Pete Millard, The Milwaukee Business Journal, 1999

CHAPTER 2

REALIZING COST SAVINGS

Communities most often cite cost savings as their reason for forming public-private partnerships. Public-private partnerships typically result in cost savings of 10 to 40 percent, with no deterioration in service quality. In fact, service often improves. Can a public entity achieve similar results on its own? In principle, yes, but in practice, the time and effort needed are greater, and results are not guaranteed.



Two Choices

Public-private partnerships have set the benchmark for efficient and effective operation of publicly owned water and wastewater facilities. According to an AMSA/AMWA publication,⁵ private operators, on

average, deliver services of comparable quality at 24 percent lower cost than public operators.

The choice for the public sector is, therefore, either to emulate private operators or to partner with one. Both options require commitment from local government leaders. Significant change is required under either option. Leaders in most communities need to make this choice if they are to repair decaying infrastructure, meet increasingly stringent regulatory requirements, and still keep competitive and reasonable user rates.

“Government is downsizing more and more, so I want to concentrate on the broader infrastructure responsibilities of the city and not operate a wastewater plant. It is easier to have a [private partner] to keep up with all of the DEC requirements for operating a sewerage plant. I did believe that I could achieve operating cost reductions, but [the private partner] is doing multifaceted jobs with the workforce, which the city was not able to do.”

Nick DeSantis, Director of Public Works, City of Glen Cove, New York, 2003

Public-Private Partnerships Facilitate Changes Needed for More Efficient Operations

Change in any organization is difficult to achieve, and so it is with changes to improve the efficiency of water or wastewater treatment. Some staff will resist change, and this is true whether the changes are introduced by a private partner or by a public agency.

Private partners have the advantage of years of experience in change management. They also have the know-how that enables them to operate cost effectively, to meet or exceed the objectives set by the public partner, and to ease the transition for operating personnel. Private partners can point to the success of other partnerships to demonstrate that efficiencies can be realized without any sacrifice in service quality or environmental stewardship.

Public officials attempting to emulate private operators cannot point to a record of success. They also face greater difficulty in gaining the necessary support for changes in operating procedures that run counter to “the way we have always done it.”

Public-Private Partnerships Overcome Institutional Barriers to Operational Efficiency

A few public agencies have achieved cost reductions comparable to those achieved by private operators. Public-private partnerships, however, bring about cost efficiencies faster and more easily. A key reason is that the public-private partnership is free of institutional barriers that impede the public entity's ability to operate more efficiently. As identified by AMSA/AMWA,⁶ these barriers include:

- Bureaucratic requirements and procedures that often hamper pursuit of least-cost options
- Restrictions on procurement and capital expenditures
- Limits on pay rates
- Prohibitions against incentive compensation.

None of these barriers is insurmountable, but all can be overcome most rapidly with a public-private partnership.

Public-Private Partnerships Provide Guarantees, Not Just Promises

The private partner guarantees performance. If decreased operating costs are promised, the private partner is bound by contract to deliver. Costs to the public partner increase over time only as allowed by the contract. These prescribed increases are typically tied to inflation indices and to unforeseen changes in demand or changes in environmental laws or regulations. Because contract terms ensure a level of predictability, private operation provides elected officials with greater control than public operation over the user rates required for a self-sustaining enterprise.

When a public agency attempts to reduce costs, it cannot guarantee that a specific level of savings will be achieved. If the promised savings are not achieved, the only recourse available to the community is to increase rates or begin the process of seeking a private partner.

“Contrary to what many believe, city workers are not inherently inferior. The monopolistic and bureaucratic system in which they work is what makes them inefficient. The public system, not public employees, is the problem.”

*Mayor Stephen Goldsmith,
Indianapolis, Indiana, Competing for a
Change: Market Approaches to State
Government, Washington Research
Council, January 1993*

“Under Jersey City’s partnership, the City is benefiting from the company’s management expertise while retaining ownership of the utility’s assets and the ability to set rates for service. All the things we were looking for – water quality, service, low cost, and good revenue – we are getting.”

*William Macchi, Executive Director,
Jersey City Municipal Utilities Authority,
New Jersey, 2001*

Private firms are financially motivated to achieve results. Prior to pursuing partnership opportunities, private firms ask themselves the question, “Can we improve operations sufficiently to provide significant cost savings without compromising the quality of services to the community?” They will submit a bid only if they can answer that question affirmatively and with some degree of confidence. Cost savings are essential to providing an adequate return on investment, and quality services are essential to maintaining the kind of reputation necessary to stay in business.

In addition to financial motivation, private firms are legally bound to produce results in terms of operational improvements, quality of service, and environmental compliance. If the private partner fails to meet its contractual obligations, the public partner can impose sanctions up to and including contract termination. A performance bond or other form of surety often can provide the public partner with additional financial protection.

Private Operators Apply Technology and Know-How to Achieve Cost Savings

The three largest cost elements in operating water or wastewater facilities are labor, energy, and chemicals. Private operators achieve cost savings by implementing such measures as:

- More efficient work practices
- Cross-training of staff
- Process automation and instrumentation
- More efficient energy use
- Reduced use of chemicals
- Bulk purchasing to obtain discounts
- Predictive and preventive maintenance.

Other than bulk purchasing, public entities could adopt similar measures, but according to the AMSA/AMWA handbook on how

municipalities can become more competitive, public agencies are constrained by entrenched work practices and lack of in-house expertise.⁷

Automation, energy efficiency, optimization of chemical usage, and predictive maintenance require a level of technical expertise that few public water or wastewater utilities can afford to maintain in-house. They need to rely on outside consultants, who may lack hands-on operating experience and typically cannot be responsible for the overall system performance. The private partner is not burdened by this disadvantage. The private firm can afford to have all of the necessary specialists in-house because it can spread the costs of these experts across all of the facilities it operates.

For most local governments, providing water and wastewater services to the community is not a core competency. In contrast, the private partner exists for that very reason – to operate and maintain water and wastewater facilities and systems efficiently and effectively. That is what their business is all about.

The use of automation by publicly owned and privately operated wastewater treatment plants is illustrative of the advantages of the private partner. Alan Manning, a well-regarded consultant to water and wastewater utilities, comments in a recent paper,⁸ “In public wastewater facilities today, typically only 50 percent of the automation or information systems is being effectively utilized. In many cases, the automatic portion is turned off because operators and managers do not believe it will work.” He further notes that in privately operated wastewater facilities, 100 percent of the automation is being used to improve productivity and lower costs.

“[Our private partner] has been instrumental in helping the Village reduce sewer rates by a third by not only reducing overall system operating costs but also by increasing industrial sewer revenues by implementing an aggressive industrial pretreatment program. The value they have added goes way beyond simply effecting incremental cost reductions. Their ability to analyze problems and recommend solutions with a long-term view, and then manage them effectively day to day, can be measured in hundreds of thousands of dollars a year in cash flow to the Village.”

Todd Rouse, Mayor, Canastota, New York, 2002

According to AMWA and AMSA, when a public agency attempts to reduce costs significantly, the reinvention process normally takes three to five years to become fully operational. The process, as described in the AMWA/AMSA case studies,⁹ typically requires the use of an outside consultant. One of the consultant's functions is to inform the public-sector client of the best practices and associated cost savings of privately operated facilities. These become the benchmarks for the public sector's reinvention initiative.

The consultant can play a valuable technology transfer function, but few consultants can effect that transfer as well as a public-private partnership. In a partnership, the private partner shares with the public owner and existing staff a wealth of hands-on, practical experience in running efficient operations. In order to achieve comparable savings without a private partner, public officials need to reinvent operating processes that the private operator has already perfected through trial and error and has put into practice elsewhere.

"[Our private partner] has reached our cost objectives. The first year was a little high because they had a lot of work to do to get the sewer plant in compliance and operating correctly. In doing so, they eliminated the need for half a million dollars of capital improvements that the borough was considering."

*Patricia Spaide, Borough Manager,
Boyerstown, Pennsylvania, 2003*

Time Is Money

Generally, partnerships achieve cost savings more quickly than a public agency acting alone. For those agencies that may be able to match the current performance standards of partnerships, in the three to five years that it takes to do so, partnerships will have reduced costs still further. In comparing cost savings achieved by public agencies with those achieved by partnerships, accounting for how quickly the savings are achieved is an important variable.

Partnerships can accelerate the implementation of cost-saving capital improvements.

Even though the public partner often retains responsibility for funding major capital improvements because of its access to tax-advantaged debt, private partners invest in capital improvements in approximately one-third of operation and maintenance (O&M) contracts with a five-year life and in close to 100 percent of longer term contracts. The private partner is likely to invest its own funds

in capital improvements if the operating cost reductions offset its cost of capital over the life of the contract. The longer the contract, the more likely such capital improvements will be undertaken. This is one of the many benefits that communities derive from longer-term contracts. The private partner is not subject to political approval processes or public bidding requirements that might delay a comparable investment by a public agency. The sooner capital improvements are made, the sooner cost savings are achieved.

In some instances the private partner is able to eliminate the need for capital expenditures by using advanced technology. Often, the private partner can reduce the magnitude of required capital investment with more effective procurement and construction practices.

In addition to investing in capital improvements to reduce life-cycle costs, the private partner may provide its public counterpart with financial assistance. The public partner may request assistance for such reasons as:

- Exceedance of the local government's debt ceiling
- Desire to retain debt capacity for other necessary public services
- Expected delay in obtaining approval for a bond issue or for loans from the state revolving loan fund
- Poor credit rating.

In providing financial support, if operating cost reductions do not allow a positive return over the life of the contract, the private partner would expect to recoup its investment via an additional service fee that it charges the local government. The longer the length of the contract, the more years over which the investment can be amortized, and the smaller the amount of the annual service fee.

Although the private partner may provide financing, the public partner typically retains responsibility for funding major capital improvements. The public partner can utilize tax-exempt bonds or can borrow from state revolving loan funds, both of which usually carry lower interest rates than private debt. The private partner can often provide advice to the public partner on the type and level of capital investment required, taking into account life cycle costs.

CHAPTER 3

TAKING CARE OF EMPLOYEES

Employees have the most to gain from a public-private partnership, but as the people who will be most directly affected by the change, they are also often the most apprehensive. Most firms that compete for public-private partnerships readily agree to contract terms that protect existing employees:

- *All current employees receive job offers*
- *No one is dismissed, except for cause*
- *Employee compensation is equivalent or greater*
- *Staff reductions, if any, occur only through attrition, termination for cause, or transfer*
- *Unions are recognized as bargaining agents for those employees who are unionized.*



Private partners typically offer employees better training, enhanced safety procedures, more incentives, and greater opportunities for career advancement. Private partners can and want to make these commitments because they know that the existing employees provide the best source for knowledgeable and motivated employees. Private operators do not maintain a "pool" of employees who can be sent to various locations to "take over" operations. Instead the private operators prefer to hire local experience and skills.

Public-Private Partnerships Lead to Enhanced Employee Benefits

Once the partnership goes into effect, employees are generally pleased with the enhanced benefits in terms of compensation, training, and opportunities for advancement.

"The contractor we brought in had an awareness of the feelings of the people we had working for us at that time. They put in place a good benefits package and improved their working conditions. They made employment opportunities available to all the employees provided they could pass the drug test. Our experience was that three months after the contract started some folks went on to other employment. You have to find a company that has leadership that you feel comfortable with, communicate with and can build a relationship."

Robert Bass, Mayor, Long Beach, Mississippi, 2003

Compensation Is Equivalent or Better

Contracts generally require the private partner to hire public employees at the same or equivalent salary and benefit levels. Private partners also often introduce innovative compensation packages such as incentive pay plans and bonuses tied to performance. These allow former public employees to earn even higher compensation.

A recent IRS ruling generally allows employees hired by the private partner to continue to participate in a public pension system. Where the practice is permitted by state law, the private partner can thus opt to make contributions into a public employee pension system instead of transferring employees to a new system. Employees may choose the pension system they prefer.

Safety Procedures Are Enhanced

Ensuring safe operations is of paramount importance to private operators of water and wastewater facilities. They employ rigorous safety protocols that have proven effective at the many facilities they operate. Each employee undergoes intensive safety training, and updates and refresher courses are regularly scheduled and required of all employees.

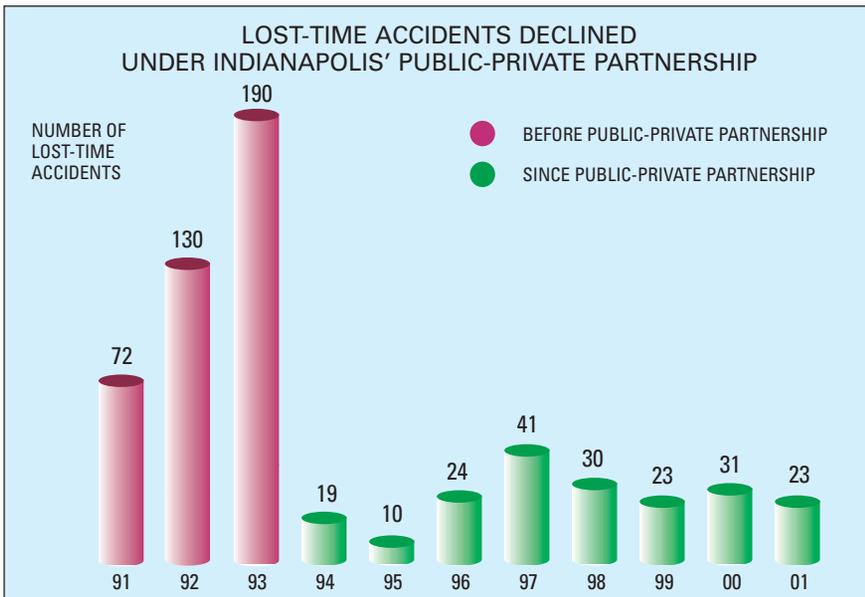
The following exhibit shows the dramatic decline in lost-time accidents for the Indianapolis wastewater system since the public-private partnership went into effect in 1994.

Similarly, the safety program developed by the private partner in Vancouver, Washington, has resulted in 11 years with no lost-time accidents. Under the terms of the contract, the city is

“[The private partner] offered equal salary and benefits to all plant employees. In the first year, the firm conducted intensive training. Many employees attended a local college to prepare for certification, with tuition reimbursed by [the private partner]. Employees who did not choose to work for [the private partner] could remain with the City.”

EPA case study on Oklahoma City, Oklahoma, 1998

(Environmental Financial Advisory Board/Environmental Financial Center Guidebook, <http://www.epa.gov/efinpage/guidbk98/gbk4b.htm>)



“All workers were involved in our receiving the Award of Excellence from the Tennessee Labor Management Association in August 2001. It takes teamwork to win this award. [Our private partner] worked to get this award ... Any time you get an award like that, you are proud of it ... I wish all of my companies were as good as [our private partner].”

Rick Gallaher, Union President, Paper, Allied-Industrial, Chemical and Energy Workers (PACE), 2003

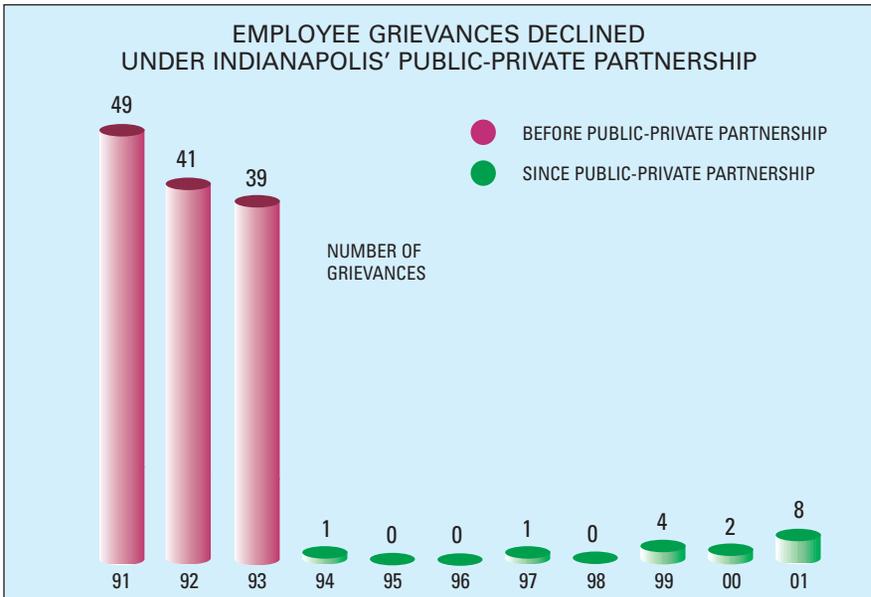
responsible for paying workers' compensation insurance. Thus an added benefit to the city has been a significant reduction in the cost of this insurance.

Employee Grievances Decline

The public-private partnership for the Indianapolis wastewater system also resulted in a dramatic decline in the number of employee grievances.

Employee Ideas Are Welcomed and Rewarded

Private partners readily agree to a no-layoffs policy because they value the knowledge and experience of existing employees with the specific system they operate. Many private partners reward employees' noteworthy or creative ideas with a spot bonus program. The program is typically administered at the facility level so that the



bonus can often be paid immediately. Private partners not only encourage and reward employees' ideas, but also stimulate a flow of ideas by training employees to think like business owners. This emphasis on encouraging and rewarding operational innovations is not often found at publicly operated systems due to the inhibiting influences of bureaucracy and municipal regulations.

Opportunities for Career Advancement Are Greater

Employment by the private partner presents employees with opportunities for upward mobility. These opportunities extend beyond the local partnership to other operations that the private partner manages. Ambitious employees often take on increased responsibilities or go on to other projects. Some private partners belong to organizations that operate worldwide. Employees who are willing and able to relocate may qualify for higher level positions in other parts of the U.S. or abroad.

Union Representation Continues

Many public water and wastewater employees are represented by unions like the American Federation of State County and Municipal Employees (AFSCME). Although AFSCME has generally opposed public-private partnerships at the national level, at the local union level, concerns over the impact of change usually prove to be unfounded. For example, Stephen Fantauzzo, Executive Director of AFSCME Council 62, commented on the wastewater public-private partnership in Indianapolis one year after it went into effect. He wrote:

“I can honestly say that I never thought I would be in the position of now endorsing the public-private partnership which now exists between the city, [the private partner], and AFSCME Council 62.

“We would like to thank the Mayor, City Council, and City Manager for sending us to work for [our private partner]. [Our private partner] has given us a chance to expand our careers, learn, and express ourselves. We now feel we have the support to better serve the residents of Grants.”

Project Team, Grants, New Mexico, 1994

Working together with [the private partner], the parties have not only negotiated a new successor agreement which was overwhelmingly ratified by the employees, but also:

- Established a new career ladder for employees providing skill enhancement and salary improvement opportunities;
- Eliminated frozen job salary rates;
- Minimized the use of outsourced contractors through employee training programs;
- Offered employees the opportunity to participate in the company's programs nationwide; and
- Established a new pride in their workforce through employee involvement and empowerment programs.”

Addressing Employee Concerns

The prospect of transferring from public-sector to private-sector employment often produces anxiety among employees, as would the prospect of any new “boss.” While the partnership contract typically addresses the most common sources of employee anxiety, in most successful transitions, both public and private partners make additional efforts to alleviate employee anxiety.

The private partner typically extends job offers to all current employees who want to continue working and who pass a drug and alcohol test. Existing employees are usually protected by partnership contracts that not only prohibit layoffs, except for cause, but also limit staff reductions to attrition and transfers. Attrition may occur through voluntary resignations, normal retirement, or the acceptance of attractive early retirement packages. Transfers may be to new jobs in the same or other municipal departments or to other parts of the private partner's organization. For those employees who prefer to continue public employment, the public partner can ensure that they

“When [the private partner] came to the ETP site [Oak Ridge, TN] in 1998 to assume the contract for utilities, PACE and [the private partner] formed a win-win partnership. We formed a number of teams, including health and safety, community involvement, and training. These teams give all bargaining unit associates a chance to participate.”

Dennis Pennington, Chairman of PACE (Paper, Allied-industrial, Chemical, and Energy Workers), 1998

are made aware of openings in other departments, and that they receive preferential treatment in competing for those jobs.

Partnership contracts also typically protect employees' existing compensation either by precluding reductions in salaries and fringe benefits or by requiring equivalent total compensation. Contracts also preserve union rights.

The public partner may require the private partner to establish a transition process that encourages open communication with employees. The private partner should not only be available to respond to questions and concerns, but the public partner should also ask the private partner to take the initiative to solicit feedback from employees who are not forthcoming. Employees often need to be reassured that they will not be fired, laid off or transferred involuntarily to another location. To further assist in the transition, many private partners provide their new employees with open and confidential access to their counterparts at other partnership locations so the new employees can find out first-hand how they will be treated by their new boss.

Most Employees Adapt Readily to Public-Private Partnerships

Although most partnership contracts address typical employee concerns, this does not mean that a partnership represents a continuation of business as usual. The workforce will experience change. Adjustments to this change may take as long as a year. Not all employees will choose to stay. Some may leave because they do not want the additional responsibility. Others leave because they like working for the municipality and do not want to experiment with working for a private company. Those who do remain usually come to view the changes made by the partnership as beneficial to the community and to themselves.

"I can honestly say that [our private partner] is the best company that I have worked for. The morale has turned completely around since [they] started to run the plant. Their management philosophy really does work, and they actually do what they say they will do. I have had a chance to meet and talk to other [of their] associates from various locations and I have not heard one bad thing about [them]."

Dennis Ostlund, Operator, Union Steward, Fairfield, California, 1996

CHAPTER 4

PROMOTING ENVIRONMENTAL STEWARDSHIP AND OTHER COMMUNITY VALUES

Improving environmental stewardship is the second most often cited reason that municipalities give for establishing public-private partnerships. Many communities with environmental compliance issues have resolved those issues rapidly and cost effectively by working with a private partner. Even communities that are in compliance can benefit because the private partner may be able to improve environmental performance, and generally assumes the risks of paying fines, while also reducing overall operating costs. Private partners also contribute to their communities socially and economically in ways that go far beyond contractual obligations.



Concern for the Environment

Private partners have the technical know-how to apply up-to-date technology and the management tools for ensuring cost-effective regulatory compliance. The private partner will bring to a partnership a detailed understanding of current and proposed regulations, an in-depth knowledge of the options available for complying with them, and sufficient hands-on experience with each of the options to select the best one and apply it effectively. In addition, because many private partners operate multiple plants in the states where they do business, they not only understand the regulations thoroughly, they also maintain good working relationships with the agencies that enforce the regulations.

“Since having entered into a public-private partnership for our wastewater plant in 1990 and our water plant in 1993, I have more confidence that the plants will stay in compliance. I could see from the way we were operating that the impact of new regulations could put us out of compliance if we did not engage a partner. Our private partner has relieved the city of all the hassle and potential for fines that result from operating the facilities directly.”

Larry Shelton, City Manager, Chickasha, Oklahoma, 2003

Public officials must recognize, however, that there are real limits to what a private partner can accomplish with a system that is antiquated, inadequate, or improperly designed. Although the private partner's operating and environmental expertise may help mitigate environmental problems, the public partner needs to be willing to make the commitment to solve the issues. No private partner is ready to assume liability for fines for a facility that cannot meet environmental standards.

For some communities, environmental stewardship means more than just meeting regulatory standards. These communities may produce water with added margins of safety and generate wastewater discharges that are substantially cleaner than required. In these situations, the private partner usually commits to maintaining the same quality standards. In fact, because of the private partner's operating know-how, the quality of water and wastewater effluent usually

improves, regardless of the level of past performance under public operation.

Private partners have three powerful incentives to conduct operations in full compliance with environmental regulations and to minimize discharges that could damage the environment:

- Contract terms
- Responsibility for payment of fines for non-compliance
- Protection of reputation.

Contract Terms Require Attainment of Standards

Under the terms of a contract, the private partner usually accepts responsibility for operating a facility in compliance with all applicable federal, state, and local environmental regulations. Where the public partner's past performance has been better than required by law, the contract may require that these higher performance standards be met.

Responsibility for Payment of Fines for Non-compliance

The private partner typically has responsibility for paying any fines associated with non-compliance, and the threat of fines provides a further incentive for compliance. This responsibility normally relates to non-compliance events that are within the control of the private partner. Events that would typically be considered beyond the control of the private partner would include influent loadings that exceeded the capability of the plant or failure of the public partner to fund promised capital improvements that both partners have agreed are necessary for compliance.

"The manager of a municipality needs to wear a lot of different hats. Our water and wastewater facilities were beginning to get rather complex compared to twenty years ago when the regulations were not so stringent. Our private partner utilizes people who stay on top of the regulations."

*Patricia Spaide, Borough Manager,
Boyerstown, Pennsylvania, 2003*

“With our public-private partnership now in its third year, we are delighted with the professional and exemplary environmental management of our wastewater treatment facility that [our private partner] provides our City. We look forward to partnering with [them] in future endeavors.”

Mayor Gene Eriquez, Danbury, Connecticut, When the partnership won the Excellence in Public-Private Partnership Award, 1999

Protection of Reputation

Growth is a business imperative. In order to grow, a firm must retain its existing client base and win new contracts. Meeting both of these challenges requires a solid reputation. The importance of corporate reputation, the desire to achieve customer satisfaction, and the competitiveness of the water partnership market work together to create strong incentives for maintaining environmental compliance. Private partners will not be selected by public officials if they have a lackluster reputation, and nothing tarnishes a firm's reputation more than having regulatory problems at the facilities it operates. This simple fact of business stands behind the outstanding record of accomplishment of almost all public-private partnerships.

Public-Private Partnerships Get Results

Under the stewardship of private partners, environmental violations decline, the need for capital improvements to achieve compliance can be reduced, and operating efficiencies improve environmental performance while reducing costs.

Environmental Violations Decline

A survey conducted by the Hudson Institute in 1999 documents improved environmental performance by private operation of publicly owned facilities. The survey covered 14 public-private partnerships at drinking water facilities in the U.S.¹⁰ Four of the 14 (29 percent) had not been in full compliance with environmental regulations at the time the partnerships were formed. One year later, the four non-complying facilities were meeting or surpassing regulatory standards. The other 10 continued to be operated in compliance. The results were achieved through operational improvements based

on the prior experience and expertise of the private partner. No additional capital expenditures were required.

Need for Capital Improvements Is Reduced

Private partners have the expertise and experience to identify and address the root causes of non-compliance. By so doing, they often achieve compliance without the need for major capital improvements. For example, Augusta, Georgia, entered into a public-private partnership in 1999 for its Messerly Wastewater Treatment Plant largely because the state had fined the city \$160,000 and identified dozens of deficiencies to be corrected. The private partner found the root cause of the problem to be violation of pretreatment standards by industrial facilities hooked up to the city's system. The city had been lax in imposing and collecting fines. In contrast, the private partner has issued 844 notices of violation to 40 facilities and has collected \$354,380 in fines. The fines have served as a wake-up call. Now, more companies are providing adequate pretreatment before discharging wastes to the sewer system. The improved influent quality has reduced the costs of operating the plant in compliance with environmental regulations.

Local industry was outraged by the private partner's actions. The public operator had been reluctant to come down hard on an important political constituency. In this instance, the private partner acted as a buffer between the public partner and its industrial constituents. Environmental performance improved, sewage rates stabilized, and the public partner was provided with a level of political cover.

"I believe that [our private partner's] expertise and guidance is going to keep us from being in violation of our permits and help keep us out of litigation. I think what we're doing here is a win-win-win situation – for the City, for its employees and for [our private partner] – and we should add a fourth win for our neighbors who must live with our environmental practices."

Tom Goldsmith, Mayor, City of Easton, Pennsylvania, 1999

Operating Efficiencies Improve Environmental Performance While Reducing Costs

Communities enter into public-private partnerships for two main reasons. The first is cost reduction. A close second is ensuring environmental compliance. Three examples illustrate that communities contracting with a private partner primarily to improve environmental performance also derive economic benefits.

“We needed to change the culture of our water and wastewater operations and the way we were doing business. [Our private partner] has turned everything around. Our relationship with [our partner] has been outstanding. [They have] helped us regain the community’s respect for what we are doing and also helped us significantly gain the respect of regulatory agencies at the state and federal level.”

Michael McFadden, Easton’s Business Manager, Easton, Pennsylvania, 2001

Vancouver, Washington, Benefits from the Environmental Stewardship of Its Private Partner.

Compliance was the driving force that led Vancouver to forge a public-private partnership for its wastewater facility. The private partner’s knowledge and experience with new technology, combined with its strong business management skills, have reduced costs by 15 percent while achieving full compliance with environmental and safety regulations. Following installation of a process control system, the facility has incurred no major fines or penalties in 22 years of private operation.

Oklahoma City Complies with Regulations While Keeping Rates Reasonable.

Oklahoma City had received several federal administrative orders in the three years prior to entering into a public-private partnership in 1988. The private partner introduced operating efficiencies that have improved effluent quality and increased wet-weather peak flow capacity. There have been no compliance issues or fines since the partnership

was formed. And the community has saved \$150 million since the partnership was initiated.

Mount Vernon, Illinois’, Design-Build-Operate (DBO) Contract Pays Dividends. Economic growth was stymied in Mount Vernon when the city entered into a 20-year DBO partnership with a private contractor in the mid-1980s. The EPA had imposed a ban

on new sewer connections because the wastewater treatment plant was out of compliance. The DBO partner completed an upgrade and expansion of the wastewater facility ahead of schedule. Sewer restrictions were lifted after completion of the first phase of construction. Effluent quality is now better than required by permit, and the city has attracted \$300 million in private investment.

Public-Private Partnerships Win Awards for Environmental Stewardship

Publicly owned and privately operated facilities have won multiple awards for exemplary environmental performance. For example:

- The Corning, California, facility operated by a public-private partnership has been named Plant of the Year many times by the Northern Sacramento Valley Section of the California Water Environment Association (CWEA).
- The public-private partnership in Milwaukee received the High Performance Award from the Association of Metropolitan Sewerage Agencies (AMSA) for perfect compliance with environmental permits at two treatment facilities from 1998 through 2002 – the first time in their history that both plants won this award for five consecutive years.
- The public-private partnership in Athens, Tennessee, received the Pollution Abatement Award of the Kentucky-Tennessee Water Pollution Control Association.
- The public-private partnership in Woonsocket, Rhode Island, received the Maguire Award for Outstanding Achievement in Water Pollution Control from the Narragansett Water & Pollution Control Association.

“Although I don’t believe [contracting out] is always the answer for improving city services, our longstanding partnership with [a private firm] has proven to be an unqualified success. By building state-of-the-art treatment plants with municipal revenue bonds and [contracting out] the operations, we were able to comply with the most stringent regulations and still keep our rates very reasonable.”

*James Couch, City Manager,
in Oklahoma City upon receiving the
2001 NCPPP Award*

One Water Partnership Council member has received over 250 awards for operations, laboratory, and safety excellence in the last three years. Protection of the environment is a major concern in the U.S. Private operators of publicly owned facilities have proven that they have the will and the skill to meet the challenge.

“[The public partner] has been involved in various community outreach programs over time. They have sponsored teams. They have always been willing to participate, whether it is a planting-the-trees program or an adopt-a-highway initiative. There are programs in the area that could not survive without the participation of private corporations. When [the private partner] first came on board there were a lot of statements like, ‘Why do we want to hire a firm from [a different State]?’ Now for all intents and purposes they are a local company.”

Fred Pocci, Executive Director, North Hudson Sewer Authority, New Jersey, 2003

Private Partners Care About the Communities They Serve

In addition to promoting environmental quality, private operators and their employees live and work in the communities they serve, and they contribute to the well-being of their communities in a variety of ways that far exceed contract terms.

- In Corning, California, the private partner provided the labor for a city revitalization project, constructing dozens of brick planters and benches to enhance the appearance of the downtown area.
- In Indianapolis, the private partner purchases 20 percent of its goods and services from local women- and minority-owned businesses. The private partner also employed 30 local high school students as interns, and received the Martin Luther King Jr. 25th Annual Human Rights Award in 1998 for the city’s most outstanding school/business partnership.
- In Hoboken, New Jersey, the private partner collaborated with secondary school teachers to develop a wastewater treatment curriculum combining classroom teaching with student tours of the facilities.

- In the Kingswood area of Houston, the private partner for water and wastewater systems has awarded over \$2.2 million in contract work to local minority- and women-owned businesses.
- In Bessemer, Alabama, the private partner has donated over \$20,000 in equipment and computers to the two local elementary schools.
- In Williamson, West Virginia, the private partner sponsors Little League softball, baseball, and basketball teams; donates to the Kiwanis Golf Tournament to raise money for college scholarships; and participates in a community barbeque to raise funds for the local Railroad Museum.

As these examples attest, public-private partnerships are more than a business proposition for saving money; they are also about advancing the values of protecting the environment and building stronger communities.

CHAPTER 5

GETTING STARTED

Nearly 2,000 municipalities and water districts are enjoying the benefits of public-private partnerships described in the preceding chapters. Could a public-private partnership benefit your community as well? The following checklist will help you decide.



Should Your Community Consider a Public-Private Partnership?

Question	Yes	No
Are your rates higher than those in neighboring communities?		
Is your community considering rate increases?		
Do you want to control the future costs of providing water and wastewater services?		
Have you recently been cited for non-compliance with any environmental regulations?		
Do you foresee having problems meeting new regulatory standards?		
Have water customers complained about taste, odor, or appearance?		
Do you have high employee turnover?		
Is your safety performance lower than the industry average?		
Is your treatment plant or collection and distribution system in need of capital improvements?		
Does your utility receive subsidies from general revenues?		
Could limited system capacity stall growth?		
Is your billing collection rate worse than the industry average?		
Could updated automation and control systems improve your operations?		
Are you unable to get budget authorization for needed operational improvements?		
Are you concerned that your staff may not be able to make the necessary improvements to your system?		

Even one yes answer warrants consideration of a public-private partnership. This chapter will help you get started.

Starting Out Right

Starting out right goes a long way toward ensuring that the anticipated benefits of a public-private partnership will be achieved. The right start entails developing answers to key questions:

- What are the water and wastewater service needs of the community?
- What changes must be made to meet them?
- What are the options for bringing about the necessary changes?
- Who will champion the change effort and generate consensus for a partnership among stakeholders and decision makers?
- What steps will be taken to garner stakeholder support?

Addressing such questions is important, but how they are addressed depends on the community. Many communities address them using an informal process. Others, particularly larger jurisdictions, use a more formal and systematic approach as outlined below.

Determining Water and Wastewater Service Needs

Local officials should first conduct a needs analysis. Officials will project the community's future water and wastewater services needs, determine whether they can be met by maintaining the status quo, and if not, develop a plan for bridging the gap. Typical needs include:

- Providing quality service to users, taking into account projected increases or decreases in the residential, commercial, and industrial base over a meaningful planning horizon
- Ensuring compliance with current and anticipated future environmental regulations, taking into account the capability of staff

"You need a good education program; you need to put articles in the local newspaper to explain all the partnership issues. The biggest problem is fear of the unknown on the part of the citizens and some of the council members. They think they lose control, but in actuality they gain control."

*David Carrothers, City Manager,
Karnes City, Texas, 2003*

to stay on top of changes in regulatory requirements, to keep up with new technology available to meet them, and to negotiate permit conditions with regulatory authorities

- Protecting the value of the assets, taking into account the need to repair aging infrastructure, the current value of the assets, and the costs of maintaining them at a desired level of functionality
- Ensuring stable and predictable user rates.

“We are not wastewater treatment experts; it is not our competency. The employees at the wastewater treatment plant know how to run the plant, but they are not people who know how to change the operation to make it more efficient. They do not understand new technologies and do not know how to come to the Board and say, ‘If we change this, we will see a five or ten year benefit in cost reductions.’”

Todd Rouse, Mayor, Canastota, New York, 2003

Meeting the first three needs can be straightforward if cost is no object. The challenge is to meet all of these needs while ensuring affordable service rates for the consumer.

Defining the Changes that Must Be Made

For many communities, system operating costs must be reduced if the community is to ensure stable and predictable rates, while at the same time maintaining quality service, staying in compliance with environmental regulations, and making the necessary investments to protect the value of the assets. Needs assessments for water and wastewater systems typically project over a time frame of 5 to 20 years all costs attributable to operating and maintaining the system, including labor (both salaries and fringe benefits), energy, chemicals, equipment, depreciation, and costs of borrowing to meet projected capital needs.

Because most public officials want their systems to be self-sufficient and not draw on subsidies from the general fund, officials can use the needs analysis to determine the user rates necessary to support the projected costs. A realistic assessment of needs usually means either raising rates or operating more efficiently or both. Therefore, defining how best to meet needs includes a determination of the optimum mix of cost reduction measures and rate increases.

Evaluating Options

Where municipalities and water districts have a record of unsatisfactory operation of water or wastewater systems, or where current

rates are not sufficient to meet future needs, then local officials face two choices other than raising rates. They may either partner with an experienced private entity or undertake an initiative to introduce a more businesslike approach to public operations. The latter is a daunting task.

“Managed Competition” Does Not Help to Evaluate Options

Some communities have used “managed competition” to “jump start” the change process. Under managed competition, public employees are given the opportunity to compete against private-sector proposers in a bidding scenario.

Managed competition can be wasteful of both time and money for the public employees, the private sector proposers, and the proposal review team. If local officials come to a consensus on the benefits of a public-private partnership, then the community should request proposals from qualified private firms. If local officials are convinced that continued public operation can and will become equally or more efficient than private operation in an acceptable time frame, then the public employees should be asked to develop an implementation plan. The choice is not easy. The community must decide between the proven benefits of a public-private partnership and the unproven possibilities of a public sector reinvention initiative. Managed competition delays the decision but does not make it any easier to make.

In a managed competition, all proposers respond to the same RFP. However, the proposal preparation process is so different for the public operators and the private firms that the proposals are not comparable. Since the public operators are inexperienced in preparing proposals and in reducing operating costs, they usually rely on consultants to develop their pro-

“North American water and wastewater services organizations should compare themselves to the most efficient, world-class organizations that can be identified. Within the water and wastewater services industry, there are a few, very large, multinational private sector companies that provide contract operation and maintenance (O&M) and support services to the water and wastewater industry world-wide. Through years of operating in a competitive private sector environment, not constrained by many public-sector rules and procedures, these firms have developed and refined business practices that usually result in the lowest cost of service delivery.”

Association of Metropolitan Sewerage Agencies (AMSA) and Association of Metropolitan Water Agencies (AMWA), Thinking, Getting, & Staying Competitive: A Public Sector Handbook, 1998, Page 35

“The public has to be included from day one. The general public, particularly the 20 percent that is against everything, can have trouble grasping the savings if it’s not explained carefully.”

Peter Alviti, Public Works Director, Cranston, Rhode Island, American City and County Magazine, May 1998

posal. The consultants typically propose cost reduction initiatives similar to those used in public-private partnerships, but the initiatives may not be based on experience, and the consultants will have no responsibility for implementing them. In contrast, the private proposers have experience to prove that they can reduce operating costs, and the same people who will have responsibility for managing facility operations also prepare the proposal. Moreover, private operators can guarantee performance through financial instruments and contract mechanisms designed to ensure accountability; public operators cannot.

An Effective Change Process Requires a Champion

Assessment of current and future water and wastewater needs almost always points to the need for change. Whether change is to be brought about through a public-private partnership or an internal competitiveness initiative, a champion is necessary to guide the process from conception through implementation.

A report published by the General Accounting Office (GAO) on lessons learned by state and local governments that have entered into public-private partnerships explains, “[A public-private partnership] can be best introduced and sustained when there is a committed political leader to champion it.”¹¹ Similarly, the American Water Works Association in discussing internal initiatives states, “If the utility needs to change, it must be led by a champion at a high level who has the full support of the governing body. The far-seeing manager will encourage staff participation at all levels to develop and implement a plan. The public must also be involved in this movement for change in order to win their approval and support.”¹²

The champion might be the mayor, a member of the city council, or an elected or appointed individual who has the respect of government decision makers and the community. The most effective champions are well versed in the issues that mandate change and are capable of presenting an argument for change clearly and per-

suasively to both stakeholders and decision makers. If the decision is made to form a public-private partnership, an effective champion will need to be enthusiastic about its potential benefits but remain sensitive to stakeholders' concerns.

Stakeholder Involvement

Time and money are often saved by involving key stakeholders from the start and throughout the change process. Stakeholders include representatives of municipal government, user groups (residential, commercial, and industrial), unions, non-unionized employees, and citizen activist groups. One approach to stakeholder involvement is to form a stakeholders committee. A few communities have used such committees to good effect, although smaller communities will typically take a less formal approach.

In successful situations, the stakeholders committee will advise on the change process, air concerns, and make recommendations for addressing them. A skilled facilitator is important to keep the committee focused on its assigned tasks and to guide it toward consensus. All meetings of the committee should be open to the public. The stakeholders committee should review the needs analysis, verify the objectives, and evaluate the pros and cons of a public-private partnership versus an internal strategic change initiative. A credible expert, with no stake in the outcome of the process, can be helpful in explaining the alternatives to the committee in detail. The committee may also find it useful to invite potential private partners to discuss their experience in other jurisdictions and their thoughts on how the community might go about developing a partnership.

Ideally, the committee can come to a consensus. If that is not possible, all committee members

“A relatively long-term contract, such as our 10-year agreement, puts a significant amount of responsibility and pressure on a contract operator to maintain the facility at a peak level. Since [our private partner] has a 10-year commitment to operate the plant, they have introduced a number of routine and preventative maintenance programs that reflect their desire to ensure that the plant and equipment will operate at maximum efficiency for that entire period. Since the City still owns the plant and equipment, we are ultimately the direct beneficiaries of the savings realized from those maintenance programs.”

A. J. Damiano, Director, Administration & Finance, City of Cortland, New York, 2000

should at least feel that their concerns have been heard and taken into account in the final decision. Depending on the charter of the committee, its recommendations may be advisory only or may form the basis of the actions of the community.

Selecting the Best Contractual Arrangement

If the elected officials of a community decide that a public-private partnership is in the community's best interests, then the champion, with the help of the stakeholders committee, must consider the type and scope of the contractual arrangement most suitable for meeting the community's needs.

Many types of contractual arrangements are possible, although some may be prohibited or restricted by state law. The contract scope may be limited to the water or wastewater treatment facility or may cover a more comprehensive suite of services such as meter reading, billing and collection, maintenance and repair of the distribution system, and biosolids processing and disposal. A more comprehensive scope can result in lower costs through better labor resource utilization.

The table below introduces five optional contractual arrangements:

Option	Primary Application	Average Term (years)
Contract O&M	New or existing systems	1-5
Design-build-operate (DBO) or O&M with design/build	New or existing systems	15-25
Design-build-finance-operate	New systems	20
Concession/lease	Existing systems	10-20
Build-operate-transfer (BOT)	New systems	25

The two most common arrangements are contract operation and maintenance (O&M) and design-build-operate (DBO). O&M with design-build for capital improvements is becoming increasingly popular.

Contract O&M

The public entity contracts the day-to-day management, operation, and maintenance responsibility to a private partner—in whole or part—for its water or wastewater utility. Contract terms typically range from one to five years. Since the change in the tax law in 1997, longer term contracts, up to 20 years, have become more common. Close to a thousand local governments use this type of arrangement for wastewater treatment.¹³

The private partner may invest its own capital if it can improve the efficiency of operations over the life of the contract. The longer the contract term, the greater the opportunity for the private partner to recoup its investment through cost savings.

Design-Build-Operate or O&M with Design-Build

The public agency contracts with a single firm or a consortium of firms for the design, construction, and long-term operation of facilities. The public partner provides a set of performance specifications, and the private partner has considerable latitude in meeting them. DBO typically applies to development of new facilities, whereas contract O&M with design-build for capital improvements is a popular option for upgrading existing facilities. Contract terms average 15 to 25 years.

DBO arrangements yield the greatest cost savings. By providing single-point responsibility, such arrangements ensure that the design takes construction feasibility and operational efficiency of the system into account. Such arrangements minimize finger-point-

“In our view, because of our unusually high debt load and considering a company coming in to control the debt load and make the plant more efficient, the longer contract entices the applicant to give a good bid. They have a longer time to be able to amortize out their investment.”

Todd Rouse, Mayor, Canastota, New York, 2003

“Using a DBO method is the best way you can capture total life cycle costs. Our principal concern was when we do a classic design-bid-build scenario in the public arena, we are forced into a low bid type of analysis that frequently gives us a capital product that is less than what we want for long-term operations costs. We use the DBO method to try to improve the capital portion of the product we are acquiring. We know from our experience with DBOs that the teams will ... invest more capital upfront to lower long-term operating costs. As they do this, it accrues to both parties’ benefit.”

Jerry Maxwell, General Manager, Tampa Bay Water, Florida, 2003

ing between the designer, the builder, and the operator if the system does not function according to specifications. The private partner has powerful incentives to optimize life-cycle costs by striking the right balance between capital and O&M costs.

The savings resulting from the DBO model can be substantial. Because the private partner knows that it will be able to apply its operating expertise, it can size the facility and select technologies that it might be reluctant to employ if the plant were to be operated by a public agency. Under a conventional arrangement, where a public agency contracts separately for design, concern over potential liability often dictates that engineers design facilities that will perform regardless of the quality of operation. Historically, this has led to over-sized and over-designed facilities, resulting in both higher capital and operating costs.

Several states do not allow DBO procurements. Restrictive statutes force communities to rely on the traditional design-bid-build process that requires separate procurements for design, construction, and operation. These restrictions, however, are gradually being lifted.

Massachusetts law, for example, restricted the city of Taunton from using a DBO contract for making the necessary capital improvements to its wastewater treatment plant. Convinced of the many advantages of DBO, Taunton lobbied successfully for special state legislation that allowed the city to proceed.

The remaining contract options involve financing by the private partner.

Design-Build-Finance-Operate

The public entity contracts with a private partner for the finance, design, construction, and long-term operation, maintenance, and management of new facilities. The contract term is typically 20 years or more.

Concession/Lease

The public entity contracts with a private partner through a concession or lease arrangement. This contract type usually includes a payment by the private firm to the public owner for the right to manage the facilities. The private partner can be responsible for capital upgrades, expansion, and a broader range of functions.

Build-Own-Operate-Transfer

The public entity contracts with a private partner for the finance, design, construction, and long-term operation of facilities. In this case, the private partner owns the facilities and transfers ownership rights after a given period, typically 25 years.

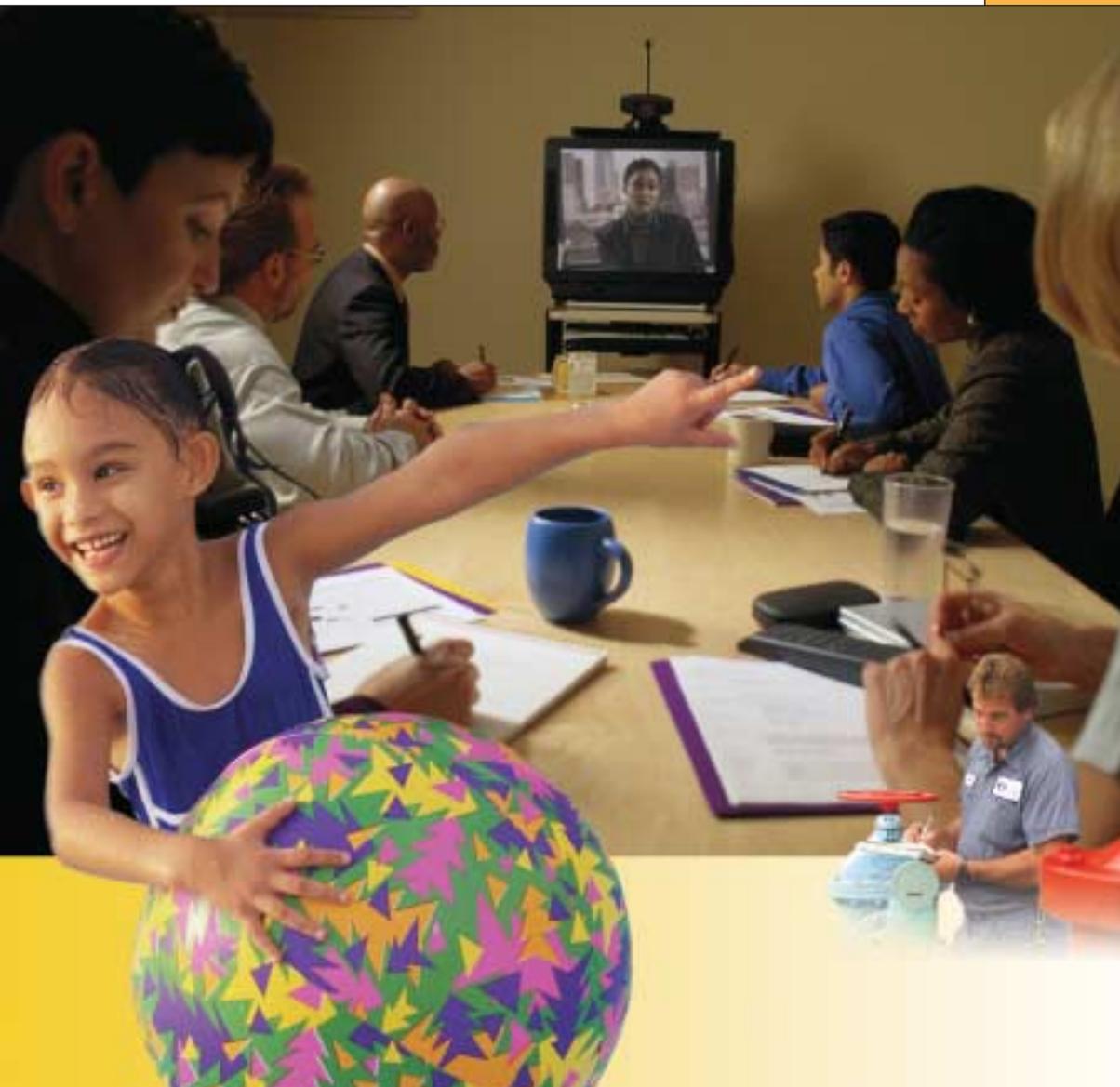
All options, except the last, have three characteristics in common:

- The public partner retains ownership of the facility
- The public partner retains responsibility for setting or approving rates
- The private partner serves at the pleasure of the public partner within the terms of the contract.

CHAPTER 6

CONDUCTING AN EFFECTIVE PROCUREMENT PROCESS

You have defined your current and future operational needs. You have clarified objectives with the advice of stakeholders. You have decided to enter into a public-private partnership, and you have selected the type of contractual arrangement that best fits your needs. Now you need to attract potential private partners to participate in a procurement process that will result in a “good deal” for the community and its stakeholders.



Dos and Don'ts of Effective Procurements

Do:	Don't:
Clearly define the desired scope of services	Use the RFP as a fishing expedition to check prices or capture improvement ideas
Plan on awarding a contract at the end of the process	Expect proposers to spend time and money to participate in a procurement that may not result in the award of a project
Disclose the rules of the process in advance	Define the rules after the process is underway or modify the rules during the process
Establish a transparent proposal evaluation process	Keep proposers in the dark on how their proposals will be evaluated
Develop an RFP that invites innovative approaches to meeting performance objectives	Specify how objectives are to be met
Involve stakeholders in all aspects of the process	Allow stakeholder concerns to fester
Benefit from the advice of communities that have entered into partnerships	Allow private consultants and lawyers to delay the process unduly and increase costs unnecessarily
Establish a balanced, fair contract that shares risks and rewards	Shift all risks and liabilities to the private sector
Keep it simple	Introduce unnecessary complexity that can stifle competition, increase costs, or delay the process

The ABCs of Procurement

Each successful public-private partnership begins with a well-planned procurement process. Too often, procurement processes that are not well conceived result in unnecessary expenditures of time and resources for both the public entity and potential private partners.

After taking the actions discussed in Chapter 5, the next steps are to:

- Decide on the procurement approach
- Evaluate the proposals
- Award the contract.

Decide on the Procurement Approach

Communities can approach a procurement in several different ways. The simplest approach, if allowable by applicable state law, is a sole source or qualifications-based procurement. The most common approach is a two-step request for qualifications/request for proposal (RFQ/RFP) procurement. Alternatively, a request for proposal (RFP) may be issued directly without first requiring submission of a statement of qualifications from prospective proposers. Many variations on these basic approaches are possible depending on the specific needs of the community.

Qualifications-Based Procurements

If not prohibited by law, some communities negotiate a sole source procurement rather than conducting a formal RFP process. For example, public decision makers might discuss their needs with potential private partners in a series of meetings and work out contractual details with the one deemed to be most qualified. The practice is more common for one-to-five year O&M contracts in municipalities serving populations fewer than 20,000 than it is in larger cities with more complex needs.

“A successful procurement will attract competitive proposals from qualified parties, obtain attractive terms that meet procurement objectives and result in an equitable contract that fairly serves both parties.”

James J. Binder, President, Alternative Resources, Inc., New England Environmental Expo, World Trade Center, Boston, Massachusetts, April 29-May 1, 1997

“You need to make your specifications clear enough so that when you open your bids, you are getting comparable costs.”

*Larry Shelton, City Manager,
Chickasha, Oklahoma, 2003*

Many states allow sole source procurements for professional services and have ruled that contract operation and maintenance of water or wastewater systems is a professional service. The decision is usually made by local elected officials with the advice of internal legal counsel.

Two-Step RFQ/RFP Procurements

Many communities use a two-step RFQ/RFP process. Using an RFQ first has three potential benefits:

- It indicates the level of interest in bidding on the project
- It is far less costly to prospective proposers to prepare an RFQ than to respond to an RFP
- It allows the public entity to pre-select only the two-to-five most qualified firms to receive the RFP.

The process has greatest value if the submitted statements of qualification (SOQs) differentiate the private firms sufficiently to limit the number invited to submit proposals.

RFP Procurements

Whether the RFP is issued after evaluation of qualifications statements in a two-step process, or issued directly, it should be written in a way that:

- Attracts competitive bids
- Minimizes questions after the RFP has been published
- Creates a level playing field for evaluation of bids
- Minimizes the number of issues that need to be negotiated before awarding the contract.

Get it Right the First Time

The most efficient and effective RFP process starts with issuance of a draft RFP and invites prospective proposers to recommend additions, deletions, and points of clarification. If a stakeholder advisory

committee is involved (see Chapter 5), the committee may also want to participate in the development of the draft and meet with some prospective proposers to discuss ideas for how the RFP should be constructed. Communities can also gain considerable insight on how to prepare an RFP by obtaining copies of RFPs prepared by other communities that have successful partnerships.

Involving prospective proposers before issuing the final RFP enables communities to take advantage of their extensive experience with public-private partnerships. They bring a perspective to the RFP process that private consultants and lawyers, who have never operated treatment plants, do not possess. Prospective private partners are unlikely to take unfair advantage of the opportunity for input. If they try, the stakeholder committee and the public decision-makers should have no difficulty in identifying self-serving suggestions.

Extensive use of private consultants and lawyers is usually not necessary in order to get the RFP right the first time. Private consultants and lawyers bill by the hour and have been known to add complexity to the procurement process, to delay it unduly, and to increase the costs unnecessarily. Many communities have formed highly successful public-private partnerships relying entirely on in-house technical, managerial, accounting, and legal expertise. Existing RFPs and contracts from communities that have established public-private

“We go into every DBO project by having a draft of the actual water purchase agreement in the RFP. When we put the RFP on the street, the contract is in the package. If you have not written the actual terms and conditions of the partnership and put it into the RFP, you will be opening Pandora’s Box when you open the solicitations. Bidders have to understand how you are going to interpret their proposal and measure compliance with the RFP. We tell bidders that this is our expectation, and if you take exception to any of these terms or conditions, you need to notify us about these exceptions. This way you will eliminate a lot of arguments. They need to tell me about any of their concerns even if it is a definition of a word. We are not intimidated by a list of exceptions. We find that two-thirds are to make sure that each of us has the same definition or understanding as to what a word or phrase means.”

Jerry Maxwell, General Manager, Tampa Bay Water, Florida, 2003

“You need to have a strong background agreement, but you cannot have every single thing that you could possibly encounter during the life of the contract in the agreement. You need to have flexibility in the contract to address the issues that were unforeseen by the two parties.”

Herb Mays, Executive Director, Exton, Pennsylvania, 2003

partnerships for water or wastewater provide a useful point of departure. Each community is in the best position to decide for itself whether it needs the advice of a private consultant or lawyer, and if so, what specific types of advice it requires. Contracts with private advisors are most cost-effective if the objectives, scope of work, schedule of deliverables, and fees are well-defined in advance, and if the public entity actively manages the contract.

Proposers must be given sufficient time to develop fully responsive proposals. Depending on the scope, proposers generally require six-to-eight weeks to conduct due diligence, visit the operations, develop an approach, and prepare a written proposal. For smaller communities, a shorter time may be adequate. For larger

communities, or situations where stakeholder complexities or project needs require longer time frames, complete procurement cycles may range from 6 to 12 months or more.

Contents of the RFP

The RFP usually includes:

- Background and objectives
- Description of the services desired
- Evaluation criteria and their relative importance
- Insurance and bonding requirements
- Financing responsibilities
- Responsibilities for obtaining and complying with permits
- Contract duration
- Equitable and balanced draft service agreement indicating mandatory and negotiable terms and conditions
- Instructions for submitting a bid.

Performance specifications are generally more effective than process specifications. In other words, the RFP should specify what is expected of the partnership, but not how the private partner is to meet those expectations. If the public-private partnership is intended to reduce operating costs and ensure compliance, the proposers should be given the flexibility to propose how they will meet the objectives. An RFP that specifies required plant improvements in detail could prevent the community from realizing the full benefit of the proposer's experience and expertise. The best solution may be considerably different and less expensive to implement than that specified by the public entity.

Bonding and insurance requirements should be based on a realistic analysis of what could go wrong and what damages the community might reasonably incur as a result. The requirements should provide the community with adequate protection, but public officials need to realize that the costs of excessive or unreasonable bonding and insurance requirements will significantly increase the contract price and may eliminate competition from small firms entirely.

Evaluate Proposals

The selection criteria must be transparent and specified in the RFP. Both proposers and other stakeholders need to know how each section of the proposal will be weighted and graded and what constitutes an "acceptable range."

Technical and cost proposals are generally submitted simultaneously, but some communities require that they be submitted in separate packages. Technical proposals generally include:

- The proposer's understanding of the objectives of the project
- The proposer's approach to meeting those objectives
- Background and credentials of key staff

"We have learned that the last dollar squeezed from a contractor's price or liability assumption can be the worst buy a municipality makes."

Brian F. Wolf, Infrastructure Management Group, Inc., consultant to municipalities, Public Works Financing, January 2001

- Description of the proposer's qualifications, including experience with similar projects.

Cost proposals generally provide the proposer's price and accompanying documentation. Since the term of O&M or DBO contracts is usually longer than one year, proposers incur significant risk in forecasting prices. Therefore, allowance is usually made for cost escalation based on an economic index such as the consumer price index (CPI) or the producer price index (PPI).

Some communities have the technical and cost proposals evaluated by different teams because the skills and background required to evaluate each component properly are different. The two teams then convene as a group to determine which bids fall within the acceptable range. In most instances, there will not be a clear winner. Finalists are invited to make oral presentations. All parties involved in the decision should be present at these interviews, including the mayor, the city council, and the public entity's engineering staff, legal department, and local technical advisor.

For both legal and ethical reasons, the proposal should be evaluated in accordance with the criteria stated in the RFP. The ratings of the proposals and the reasons for the ratings should be well documented to allow for a meaningful discussion with the proposers who were not selected.

Award the Contract

The contract should be awarded on the basis of best value to the community, generally measured in terms of net present value or life-cycle cost, balanced with the benefits and values offered by qualifications, experience, and technical/innovative approaches.

The practice of negotiating with more than one proposer simultaneously can be wasteful of time and resources for both parties. In the heat of competition, the finalists may lower their bids, but in the end the community may not benefit. Responsible proposers

will submit initial bids that reflect their best estimate of the costs they will incur to provide quality service. A community should be wary that going below that level could invite lower quality service and poor partnership relations.

CHAPTER 7

ADDRESSING KEY CONTRACTUAL ISSUES

The contract governs the relationship between the public and private partners. A well-crafted contract protects the interests of both partners and provides guidance to the private partner on expected standards of performance. A sound contract is the foundation of a successful partnership, and open discussion among all concerned parties is the best way to negotiate such a contract.



“Both sides have to be fair and understanding. Everybody comes to the table with what they want to gain. We wanted a good end product, and they wanted to make a buck. If you come in with an open mind, you can achieve a win-win situation.”

*Larry Shelton, City Manager,
Chickasha, Oklahoma, 2003*

Basic Contract Provisions

This chapter describes provisions that are often included in partnership contracts for water and wastewater systems. However, since every community is different, specific contract terms and conditions must address issues that are unique to the individual situation. As noted in Chapter 6, some public entities develop a draft contract prior to issuing an RFP and include that draft in the RFP.

Contracts for public-private partnerships are typically 25 to 50 pages in length. Highly complex contracts for large communities sometimes run several hundred pages. Elements that the contract may address include:

- Contract term
- Statement of work
- Performance criteria
- Employee issues
- Method and timing of payment to the private partner
- Changing situations including changes in the regulatory environment
- Risk allocation
- Contract termination
- Insurance and bonding requirements
- Contract management and oversight.

Contract Term

The typical term for an operations and maintenance (O&M) contract is five years, but contracts for 20 years or more have become increasingly popular since a January 1997 change in the federal tax law facilitated longer-term contracts. Most DBO contracts have a term of at least 20 years. Many variations are possible; one alterna-

tive is to have an initial contract of four or five years with options for multiple extensions.

A public entity is well advised to consider the longest-term contract allowable by law. A longer term not only demonstrates commitment on the part of both partners, it also reduces the annual costs to the community by allowing the private partner to amortize over a longer period any capital investment it may make to improve the system. The community also avoids the considerable expense of frequent procurements.

The community need not fear a long-term contract. The private partner has every incentive to meet the performance objectives of the contract, and the public partner always reserves the right to terminate the contract for unsatisfactory performance.

Statement of Work

A well-defined statement of work provides the basis for realistic expectations between the parties. Important considerations include:

- Will the private partner be responsible solely for operating and maintaining the water or wastewater facility, or will the private partner have additional responsibilities?
- What functions are encompassed by “operations,” “maintenance,” and “repair?”
- Who is responsible for environmental compliance, industrial pretreatment programs, permits, and license fees?
- What responsibility does the private partner have for supporting infrastructure, such as the water or wastewater delivery system and biosolids treatment and disposal?
- What responsibility does the private partner have for functions related to O&M, such as metering, billing, collections, and customer service?

“Anybody who is thinking about a partnership needs to make sure that you have a good contract and take the time to go through all of the ‘what-if’ scenarios and build them into the contract.”

*Kevin Shaffer, Executive Director,
Milwaukee, Wisconsin, 2003*

“We wanted the contract long enough so that we had the opportunity to make changes to get things stabilized. The council did not want the contract too long in case they didn’t like the process. We ended up with a ten-year contract for water and wastewater O&M. Last year we extended the contract when we added the distribution system.”

*David Carrothers, City Manager,
Karnes City, Texas, 2003*

- Who is responsible for equipment replacement costs?
- Which partner will be responsible for capital improvements?
- What are the design parameters and system capabilities required for new construction or major upgrades of the existing facility?

In some instances, specifying what is not included in the statement of work may provide additional clarity and prevent misunderstandings during the contract term.

Performance Criteria

What gets measured gets managed. Conversely, what is not measured tends to be forgotten. Therefore, the contract should state the criteria for satisfactory performance explicitly and, if possible, quantitatively.

The criteria should be tied to the statement of work and will generally include measures for:

- Quality of goods and services provided
- Safety
- Customer satisfaction
- Community relations
- Compliance with applicable laws and regulations
- Cost control
- Adherence to schedule.

The contract might include incentive or award fees for performance that exceeds expectations, if that can clearly be defined, and penalties for performance that falls below the established criteria. Any penalty clause should be carefully considered and clearly documented because it may require the private partner to build in a contingency fee to cover events with a very low likelihood of occurrence.

To ensure mutual understanding and to minimize subsequent disputes, the contract should provide definitions of all legal and technical terms. Terms that can lead to confusion if not defined explicitly include: “unsatisfactory performance,” “uncontrollable circumstances,” “force majeure,” “consequential damages,” “equivalent compensation,” and “indemnification.”

Employee Retention

The contract must protect the interests of existing employees without hampering the ability of the private partner to operate the facility efficiently and effectively. Most contracts limit staff reductions to attrition or cause. Private partners are usually willing to accept such limits because they value staff who know the facility well. In addition, contracts typically provide some protection regarding compensation, including salary and benefits. Providing for equivalent rather than identical compensation allows the private partner to reward good performance.

Method and Timing of Payment to the Private Partner

Most public-private partnerships for water or wastewater are fixed price with an annual increase based on one or more economic indices and adjustments for unforeseen changes in load or flow. The private partner receives periodic service payments (monthly or quarterly) over the term of the contract. Payments for the design-build phase of a DBO contract are usually geared to milestones. In developing an approach to paying the private partner, local officials should be mindful of start-up costs, the purchasing of materials and supplies, and repair costs incurred by the private partner.

“The negotiations were very easy. It all boils down to how much of a relationship you make with the people you are dealing with. A lot of trust was developed because the contractor came in a sincere way. You need to feel a great level of trust with the people you are negotiating with. If you have any concerns about how genuine are the people you are negotiating with, you should talk to some other company. They presented a draft contract to us and our city attorney worked with the contractor to make adjustments. It was a common sense type document and was not one of these legalistic documents that are 800 pages long. It had common basic language: This is what we will do and this is what you will do.”

Robert Bass, Mayor, Long Beach, Mississippi, 2003

“Documentation is the key to a successful partnership contract. If anything occurs to you during contract negotiations, which is not in the draft contract, you need to document this item and provide copies to all parties.”

Herb Mays, Executive Director, Exton, Pennsylvania, 2003

Start-up Costs

Costs to the private partner are generally higher immediately after assuming operational responsibility. The start-up costs may include planning, installation of equipment to improve the efficiency of operations, implementation of more efficient work processes, and training of personnel. A private partner occasionally loses money in the first year or two of the contract.

Private Partner as Agent

The contract usually specifies that the private partner is acting as the agent for the public partner in purchasing materials and supplies used at the facility. Otherwise, the private partner pays

state sales tax on purchases, and the added cost is passed on to the community.

Repair Costs

The responsibility for repair costs needs to be defined in the contract. Many contracts require the private partner to pay for repairs or equipment replacement costing less than a specific amount, such as \$2,500 per occurrence. Since the vast majority of equipment components may fall into this category, the private partner has a strong incentive to maintain equipment properly and to perform preventive maintenance. Equipment replacement costing more than the specified amount is usually the responsibility of the public partner.

Changing Situations

Changes may occur over the term of the contract that are outside the control of either partner but that have an impact on the contract provisions. Examples include changes in law, regulatory requirements, and demand for services. Since the specific changes cannot reasonably be anticipated or controlled, the contract generally should include a procedure for resolving such situations.

Risk Allocation

Under public ownership and operation, the public bears 100 percent of the risks associated with operations. Under public ownership and private operation, many of these risks are transferred to the private partner. How risks are shared is typically based on the principle that risk should be borne by the partner better able to manage or prevent that risk from occurring or in a position to recoup the costs associated with that risk.

The first line of defense for balancing risks between the partners is a relationship of trust. Contract terms and conditions based on a realistic assessment of risks provide added protection for both parties,

Risks and Responsibilities in a Typical Partnership for O&M Services

Risks	Responsibility		
	Private Partner	Public Partner	Shared
“As Is” Condition of the Plant	X		
Non-performance	X		
Deterioration of asset value	X		
Costs in excess of budget	X		
Non-compliance with environmental regulations	X		
Quality and quantity of influent		X	
Owner-mandated change orders		X	
Uncontrollables		X	
System repairs and replacements			X
Indemnification			X

“The municipality has to be very clear as to their goals and objectives, and what the break point is. What is the point that makes this a good or bad deal? If you can’t get to the point that is realistic for both sides it won’t work. If you beat up on price, there is no way out; the partnership will fail.”

Todd Rouse, Mayor, Canastota, New York, 2003

but risks by definition cannot always be anticipated. Highly complex contracts based on an unrealistic assessment and apportionment of risks inevitably lead to unnecessary added costs and the creation of unrealistic expectations. Agreements built on trust are critical to resolving unforeseen issues that arise during the contract term. O&M contracts typically address the risks and responsibilities shown in the table on page 71.

Risks Assumed by the Private Partner

“As-Is” Condition of the Plant

The private partner assumes the risk that the design and existing (as-is) condition of the treatment plant are adequate for purposes of meeting contract obligations. However, any risks resulting from latent defects caused by prior operational practices customarily remain with the public partner.

Non-Performance

The private partner assumes the risk of operating the facility in accordance with performance criteria for service quality, safety, employee and community satisfaction, and community relations. The private partner also assumes the risk of operating and maintaining the facility within its design capacity and capability.

In a DBO contract, the private partner assumes the risk for completing the project on time, on budget, and in accordance with contract specifications. Failure to complete the project on time may trigger liquidated damages since actual damages might be difficult to estimate. Failure to complete the project on budget and the resultant loss of profits would be the sole responsibility of the private partner. Exceptions generally would be made if late delivery or exceedance of budget were due to unforeseeable events beyond the private partner’s control.

Excessive Deterioration of Asset Value

The contract may require the private partner to perform preventive maintenance over the contract term and to return the assets in good operating condition except for normal wear and tear. Apart from contractual obligations, private partners have powerful incentives to initiate timely capital repairs, even as a contract is coming to an end. Preventive maintenance is invariably in the best interests of the private partner who is usually responsible for repair or replacement of equipment costing less than a specified amount. Preventive maintenance also reduces the risk of equipment failure. Addressing such failures on an emergency basis is more expensive, generates community dissatisfaction, and reduces the chances for contract renewal.

Costs in Excess of Budget

The private partner guarantees the costs of meeting contractual obligations. Apart from adjustments for inflation, loadings, flow, and other changed conditions as specified in the contract, a private operator accepts the risk that its costs may exceed its proposed budget. A public operator cannot offer the same guarantee.

Non-compliance with Environmental Regulations

The private partner is clearly responsible for conducting operations in compliance with applicable laws and regulations. The private partner also should pay any fines or penalties imposed for non-compliance, provided that the failure to comply is due to the private partner's negligence. The private partner typically is not held liable if the fines result from circumstances that are beyond its control, but the burden of proof rests with the private partner.

Risks Retained by the Public Partner

Risks over which the private partner has no control should be shouldered by the public partner.

Quantity and Quality of Influent

The quantity and quality of water or wastewater that enters the treatment plant has a significant impact on operating costs and efficiencies.

"We hold each other harmless for our own actions. We have developed a trust relationship. We support their efforts, and they support ours. We accept the responsibility that the plant is ours and are willing to make the investment to maintain it in proper working condition. They have to make sure they take our investment and make it work all the time."

Fred Pocci, Executive Director, North Hudson Sewer Authority, Hoboken, New Jersey, 2003

Performance and cost guarantees proposed by prospective private partners assume that the raw water input to the water treatment plant or the sewage that enters the wastewater treatment plant will fall within specified quality and quantity parameters. The contract should address what will happen if the influent falls outside of that range and leads to increased operating costs.

Owner-mandated Change Orders

Under ideal circumstances, the contract establishing the public-private partnership would be so well crafted that no change orders would be needed. Realistically, unforeseen changes in regulatory requirements or community concerns might lead the public partner to seek amendments to the contract. In the spirit of the partnership, such changes and their reasons should be discussed with the private partner to determine the cost implications. The private partner may also be able to suggest minor operational adjustments and other less expensive approaches to accomplishing the change objectives.

Uncontrollable Circumstances

Some risks fall into the category of uncontrollable circumstances, in the sense that they are not under the control of either partner. Examples are loss of power, floods, storm damage, earthquakes, and unforeseen subsurface conditions that affect the ability of the private partner to meet the contract terms. Uncontrollable circumstances typically are covered by a force majeure clause that excuses the private partner if its failure to perform could not be avoided by the exercise of reasonable care.

Shared Risks

Some risks cannot be assigned wholly to one or the other partner, since both are partially responsible.

System Repairs and Replacements

Assets deteriorate over time if not properly maintained. System repairs and replacement are a shared responsibility. The public partner may want to retain liability for major capital expenditures to take advantage of its lower cost of capital. The private partner assumes responsibility for the performance and reliability of capital

equipment under its control. The private partner may also bear the costs of system repairs and replacements that pay for themselves over the course of the contract. If the partners agree that certain capital improvements are necessary to prevent future damage, and the public partner agrees to make them but fails to do so, payment for any resulting damages should be the responsibility of the public partner.

Indemnification

Neither partner should be expected to indemnify the other for its own negligence. Indemnification often is proportionately shared based on the negligence of each party in a given situation and is often limited by a monetary cap.

Contract Termination

Contract termination is usually not a desirable outcome for either partner, but it is a contingency that virtually all contracts address. Typically, the public partner wants the option of terminating the contract under two different sets of circumstances:

- Termination for cause
- Termination for convenience.

Termination for Cause

Termination for cause occurs when the private partner's performance is unacceptable as measured by the established performance criteria. To prevent prolonged dispute, the contract should explicitly state the circumstances that could lead to termination for cause.

Questions to consider include:

- Does unsatisfactory performance on a single criterion for a single day constitute sufficient cause?
- Should the private partner be given the opportunity to take corrective action? If so, how much time should be allowed?
- How will actual damages to the public partner be determined?
- How will the issues be resolved if the private partner challenges a termination decision?

In the event of termination for cause, the public partner needs to be compensated for:

- The costs of correcting the damages resulting from non-performance by the private partner
- The costs of transitioning back to public operation or to another private partner
- The net present value of the incremental costs of operations by the new provider.

To ensure adequate compensation, the public partner might require a performance bond, a letter of credit, a parent company guarantee, or other types of surety. For over 75 percent of existing public-private partnerships that require a form of surety, a performance bond is the sole surety. Reasonable upper-bound estimates can be developed for damages that could result from contract termination. Requiring multiple layers of surety such as combinations of performance/payment bonds, letters of credit, and corporate guarantees adds unnecessary costs to the public partner and can eliminate competition from otherwise capable and qualified firms.

Requiring proposers to assume unlimited liability greatly in excess of upper-bound estimates can increase the cost of the contract without providing any additional benefit to the community. Furthermore, no responsible private partner can agree to unlimited liability because no company has unlimited resources. All liability is effectively limited by a company's net worth. Even insurance firms, whose business is risk assessment and risk management, do not accept unlimited liability.

Termination for Convenience

When the public partner wishes to end the contract for reasons other than poor performance by the private partner or for no expressed reason whatsoever, the termination is considered to be for convenience. The public partner indemnifies the private partner in the event of termination for convenience, just as the private partner indemnifies the public partner in the event of termination for cause. In both cases the contract should specify the standards that will be applied and the process to be followed to reach a financial settlement.

In the event of termination for convenience, the public partner ordinarily pays the private partner for:

- Demobilization costs
- Costs of assistance with transition, if requested by the public partner
- Repayment of the private partner's outstanding debt for capital improvements and start-up costs paid for by the private partner
- Compensation to the private partner for lost revenues and profits.

If the public-private partnership is based on trust, the chances of having to invoke a termination clause are greatly diminished. Even in the unlikely event that termination proves necessary, a relationship of trust can expedite agreement on the financial terms. Ideally, the partners will be able to settle between themselves. If not, mediation or arbitration is preferable to litigation.

Insurance and Bonding

Insurance requirements included in the contract should be based on how risk is to be allocated between the partners. As owner of the facility, the public partner typically carries property and casualty insurance. The private partner usually posts a performance bond. Performance bonds are well-established surety mechanisms that are available at reasonable cost. Communities should be aware that letters of credit are expensive, and requiring them as an additional form of surety will unnecessarily increase service fees.

Contract Management and Oversight

A public partner cannot delegate operations and maintenance to a private partner and then walk away. The public partner never surrenders its responsibility to ensure that residents receive an adequate supply of clean, fresh water and that wastewater is adequately treated prior to discharge. Therefore, the contract should specify the reporting requirements of the private partner and allow for the public partner to visit the facility at any time, unannounced.

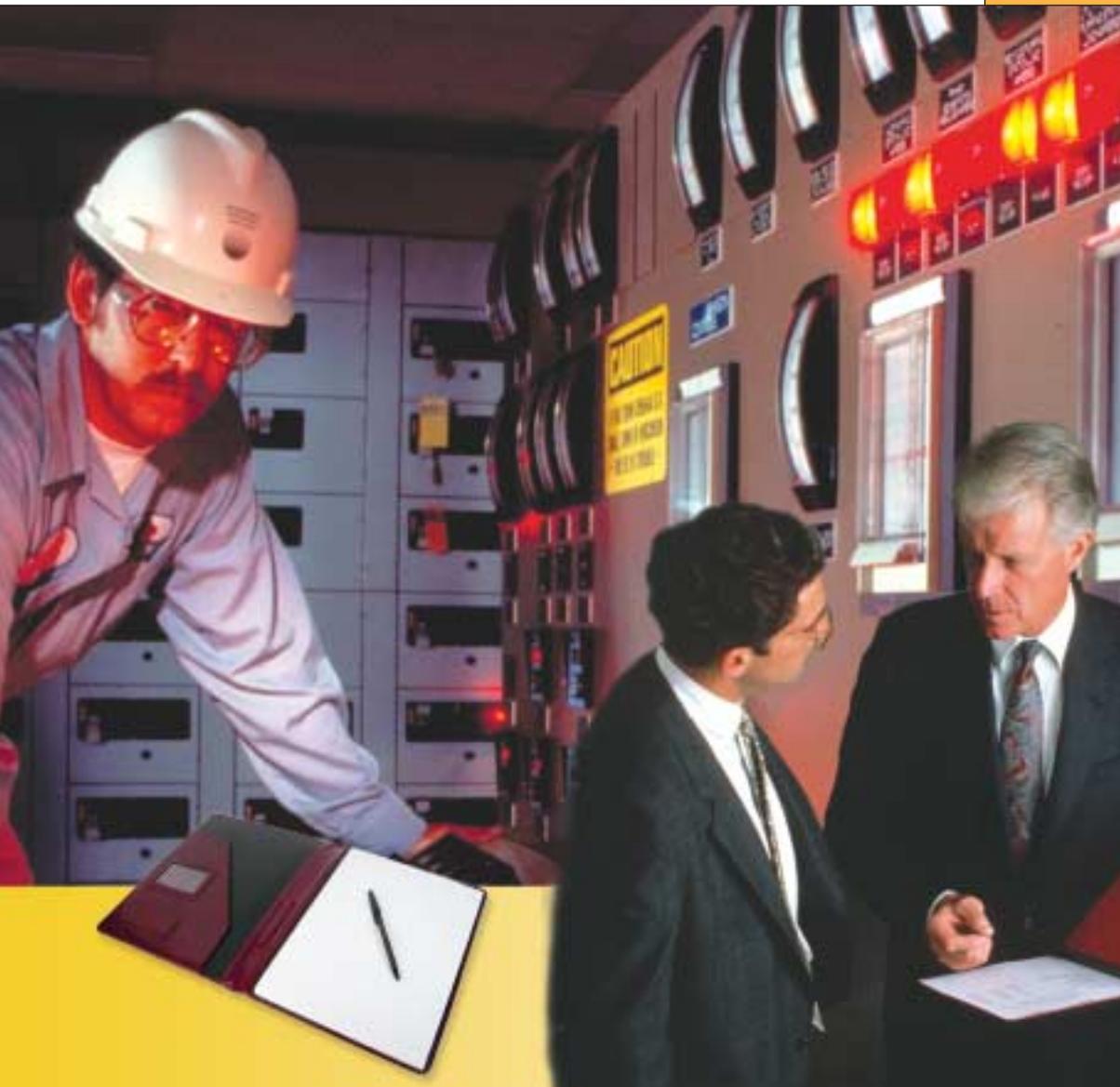
"I firmly believe that the most important part was finding somebody who was sincere, concerned about our problems, and we could work with and trust. They went out of their way to help us manage some of our tough financial situations. If somebody is interested in a public-private partnership, they must realize that it is all about trust and relationship building. It is a momentous decision for any city administration to make."

Robert Bass, Mayor, Long Beach, Mississippi, 2003

CHAPTER 8

PROVIDING EFFECTIVE MANAGEMENT AND OVERSIGHT

Citizens hold their local government responsible for providing them with safe drinking water and effective sewage treatment. Local government can never relinquish that responsibility, but in a public-private partnership, government fulfills its duty in a new way. Rather than managing the day-to-day operations, government ensures that its private partner operates in the public's best interests by monitoring and enforcing adherence to the terms of the partnership.



“What you do after you sign the contract is a very critical area. You don’t want to put the partner who is saving you money out of business, but you don’t want them to do anything they please. You need a balanced approach that protects the government interest, the public, and the contractor. You can’t just look at it from only a financial basis, trying to squeeze every nickel possible out of the private company. You can’t monitor without a well written contract.”

Anne Spray Kinney, Former Executive Director, Milwaukee Metropolitan Sewerage District, Milwaukee, Wisconsin, 2003

“The design of the deal can make an enormous difference in the future success of monitoring the contractor. Strategic thinking on monitoring needs to begin at the time a deal is structured, not after.”

Tom Olsen, Director, Enterprise Development, City of Indianapolis, 1996

Develop the Plan for Managing the Contract Along With the RFP

The RFP articulates the program objectives and defines explicit performance standards that the successful proposer must meet. During the development of the RFP, the public partner must also give serious consideration as to how it will meet its obligation to ensure that the partnership functions as intended. Questions that the public partner must address include:

- What information do we need in order to evaluate whether the private partner is performing in accordance with our standards?
- How will we obtain that information?
- Who will manage the evaluation process?
- What actions will we take if we discover instances of non-conformance?
- How will disputes be resolved?
- What resources will be required to monitor the program effectively?

The answers to those questions may suggest changes to the RFP, such as clarifying the objectives or performance standards. The answers may also suggest a need to enhance the contract management skills of the public employees who will manage the public-private partnership effort.

For large communities, a stakeholder advisory committee, discussed in Chapter 5, can provide valuable assistance in the simultaneous development of the RFP and the plan for managing and monitoring the private partner’s performance. All stakeholders, both advocates and skeptics of public-private partnerships, have a vested interest in ensuring that the pub-

lic partner will manage the contract effectively. Even though public-private partnerships are not privatization, stakeholders must be reassured that the public partner will not relinquish control *de facto*. A good way to provide that reassurance is to involve stakeholders in the design of the post-contract monitoring and management system.

A public-private partnership is indeed a partnership. The most important feature of a good partnership is trust. The contract is an agreement between the partners that reinforces trust. The public partner monitors and manages the contract, not in an adversarial manner but in a way that seeks to maintain that trust.

Appoint a Qualified Contract Manager

In a public-private partnership, the role of responsible public officials changes from service provider to contract manager. Experts have observed that managing a contract requires different skills and abilities than providing the service. Managing O&M or DBO contracts for water and wastewater facilities is particularly challenging because the contracts are long term.

In successful public-private partnerships, the public partner designates an individual who will have lead responsibility for managing the contract, and who will be the primary liaison with his or her counterpart from the private side.

Criteria for selecting the lead person to represent the public entity include:

- No vested interest in returning the facility to public operation
- Familiarity with facility operations
- Detailed understanding of the contract terms and conditions

“Communication is the key to making it work. You need to constantly communicate with the partner’s manager and have a good relationship with that person. I am aware that other communities have had bad experiences but in my judgment it boils down to having good communication. You can resolve a lot of issues by just communicating. The biggest impediment on the city side is micro-management. They want to continue to run the plant after the partnership is formed. When you have a personality mismatch with the partner’s manager you can easily get a new manager; it is very hard to replace the director of public works who is protected by the civil service system.”

*David Carrothers, City Manager,
Karnes City, Texas, 2003*

“I manage the partnership by having monthly meetings with the plant personnel. The meetings are broken down into two facets – operations and maintenance, and need for capital improvements. For capital requests, they provide justification and if I agree, I phase it into the city’s budget so that it is not a shock to the city council. Our private partner also submits a monthly report. The partnership has been a life saver; they have the expertise that I cannot afford to have on my staff.”

Nick DeSantis, Director of Public Works, Glen Cove, New York, 2003

- Experience in contract monitoring
- Expertise in negotiation
- Ability to assess performance objectively
- Knowledge of cost estimation techniques
- Ability to apply methods of financial analysis
- Good communication and human relations skills
- Experience in strategic and tactical planning and organizational design.

Candidates who meet all of the criteria are rare. Managers from the department who had been providing the service may be intimately familiar with facility operations but may lack the necessary skills to work in partnership with a contractor, assess contract performance, and resolve misunderstandings of contract terms. The lead individual from the office that arranged and awarded the contract may be intimately familiar with the contract provisions but may lack familiarity with the facility operations.

The private partner has the advantage of greater experience in contract negotiation and execution.

To ensure a level playing field, the public partner may want to take steps to enhance the skills and confidence of its managers. Possible steps include formal training, executive coaching, and visits with public officials in communities that have experience with public-private partnerships.

Employ a Variety of Tools to Monitor the Contract

An effective monitoring program has three basic components:

- Private partner reports
- Field inspections
- Citizen feedback.

Private Partner Reports

Monthly private partner reports, submitted in an agreed-upon format, provide a good basis for face-to-face discussions of progress and problems between the public and private partner. The report should be simple and straight-forward. Contents may include:

- A comparison of costs versus budget for the month, year-to-date, and contract inception-to-date.
- Information about lost-time accidents, employee grievances, customer complaints, and instances of non-compliance with environmental regulations by month, for the current year, and annually since contract inception.
- A brief narrative on problems encountered and how they were or will be resolved.

Written documentation is essential, but the written word can also be misinterpreted. For the public partner, the report should serve as an agenda for monthly meetings with the private partner. A face-to-face meeting adds a great deal to the written communication and promotes mutual understanding.

Field Visits

The public partner should visit the facility on a regular basis. The purpose of the visits is not to police the operations but to ensure conformance with the contract terms and to identify potential issues before they become difficult problems. The review should be based on the performance standards written into the contract. Many communities schedule frequent, short, and informal visits while some schedule formal quarterly visits.

“They give us monthly reports and come to all the Board meetings. They keep the Board totally informed on what they have done and what is happening at the plant. They have weekly contact with me and their doors are always open for me or the Board members to visit the plant to find out what is going on.”

*Ruth Ann Ritter, General Manager,
Lewes, Delaware, 2003*

“I meet with our private partner’s supervisor at least once a week, and frankly I don’t have to worry that the plants are not being operated properly and complying with all of the current regulations. If I have any questions about anything, they are very responsive and I never have a difficult time getting ahold of anybody.”

*Patricia Spaide, Borough Manager,
Boyertown, Pennsylvania, 2003*

"I am especially impressed with the level of communication the [private partner] maintains. Through their extensive reporting system, the City is informed of all phases of their operations, including water quality, system maintenance and customer service. In addition [our private partner's] regional vice president and senior members of his staff are readily accessible for discussion and resolution of both routine and emergency matters. [Our private partner's] quality of service and communication give me the level of comfort I demand from a municipal contract. I can focus my time and attention on other pressing matters of City business, knowing that water and wastewater systems are in very capable hands."

A. J. Holloway, Mayor, Biloxi, Mississippi, 1998

A typical formal visit may begin with a brief meeting between the public partner's representatives and the facility's key staff. The reviewers usually explain the purpose of the visit and what the review will entail. Usually the visit includes a tour of the facility.

The site visit may include:

- Interviews with a representative sample of operating staff
- Observation of key operations
- Review of records, such as discharge monitoring reports, inspection logs, repairs, training logs, standard operating procedures, employee complaints, customer feedback, and financial data.

Before leaving the facility, the review team usually summarizes its findings at a meeting of key operations staff. Generally, findings will focus on documenting areas of non-conformance with the terms of the contract. These reports should explain for each relevant contract requirement the factors that led to a finding of non-conformance. The on-site staff is usually given the opportunity to challenge the findings they believe are incorrect. If a finding is indeed valid, both partners can collaborate on a remedy.

The public partner usually sends a written report to the facility to recap the findings discussed at the meeting with key staff and usually the private partner responds with a description of the corrective measures under way and a timetable for completion.

Customer Complaints

The private partner should keep a log of all customer complaints and the actions taken to resolve them. In some partnerships, the public partner receives customer complaints and passes them on to the private partner for response. This approach provides the public partner with first-hand information on customer dissatisfaction but may delay the response by the private partner.

Some communities conduct customer satisfaction surveys in addition to documenting complaints. For water and wastewater services, the benefits of customer satisfaction surveys may not justify the cost. If the water has an objectionable odor, taste, or color, if a sewer overflows, or if invoices are incorrect, complaints will be immediate. If apparently clean water flows when the tap is opened, and if the toilets flush, customers give little thought to how the service is provided or who provides it.

Dispute Resolution

Considering the complexity of water and wastewater systems, not all contingencies can be adequately addressed in the partnership contract. Over the period of the contract, new regulations may go into effect. New technology may become available. Accidents may occur. Even without major external changes that can affect operations, disagreements can arise on the interpretation of contract language. Therefore, the contract must include a mechanism for dispute resolution. Where the intervention of a neutral third party is required, mediation or arbitration is preferable to litigation.

“I get a monthly report, but I pay very little attention to it. By the time it comes, the information is old and has already been taken care of. We do not have any formal meetings. We are a family; we talk to each other all the time. Typically, I meet with our partner’s project manager, but occasionally with the whole staff.”

Fred Pocci, Executive Director, North Hudson Sewer Authority, Hoboken, New Jersey, 2003

“I make frequent visits to the facility to make sure everything is being accomplished efficiently and correctly. You still need a monthly report, but you also need to have some technical person who understands the operation overseeing the contract on a frequent basis.”

Herb Mays, Executive Director, Exton, Pennsylvania, 2003

CHAPTER 9

STAYING THE COURSE

You have learned about the benefits that over 2,000 municipalities and water districts are enjoying from their public-private partnerships, and you have decided to create a partnership for your community. You may encounter opposition. If you do, this chapter counters myths with facts that will help you stay the course.



Opposition to public-private partnerships can come from many different corners for many different reasons. The following table summarizes some of the myths that opposition groups have advanced and compares them to the facts.

Myths	Facts
Since water is a basic human need, water and wastewater services should not be provided by a private, profit-making entity.	The public partner retains responsibility for safe drinking water and adequate wastewater treatment but fulfills that responsibility through a partnership.
Public-private partnerships invariably lead to rate increases.	The public partner retains responsibility for setting rates, and future rate increases can be minimized because the private partner guarantees cost savings. (See Chapter 2)
Massive layoffs often follow in the wake of public-private partnerships.	There is no evidence of this. Public-private partnerships protect jobs of existing employees. (See Chapter 3)
Impacts on labor are always negative.	Transition from public to private employment usually increases opportunities for training, continuing education, and career advancement. (See Chapter 3)
At times, service and water quality are put at risk due to understaffing.	Most contracts require the private partner to meet or exceed levels of service and quality of water and wastewater set by the public partner.
Since corporations care more about profits than about the public interest, partnerships usually result in decreased environmental performance.	Many communities enter into partnerships to remedy chronic non-compliance with environmental regulations. (See Chapter 4)
Checks and balances are missing at every step in the process, from bidding to service delivery.	Most communities solicit input from all stakeholders when they form a partnership, and the partnership contract provides for continual community oversight.
The private partner gets exclusive water distribution rights for 20 years or more.	The private partner rarely has any rights to the water or its distribution.

Myths	Facts
<p>Once a water or wastewater system is handed over to a private partner, withdrawing from the agreement borders on the impossible.</p>	<p>Most partnership contracts allow the public partner to resume operations at any time. Mechanisms are both legal and practical.</p>
<p>Even if the private partner does not fulfill its contract obligation, proving breach of contract is a difficult and costly ordeal.</p>	<p>Most contracts include two termination clauses. Breach of contract (termination for cause) is one, but the municipality can terminate for convenience at any time without any stated cause. (See Chapter 7)</p>
<p>Very little can be done to ensure that the private partner will work in the best interests of the community.</p>	<p>The performance measures specified in the contract actually provide the municipality with more control than it has over public operations.</p>
<p>The private partner will pay higher interest rates for capital improvements than the public partner. The higher interest costs will be passed on to the rate payers.</p>	<p>If the public partner has access to tax-free and low-interest financing, there would be no need for the private partner to fund capital improvements.</p>
<p>Since private firms care only about making money, the private partner may decide to export water to areas willing to pay more.</p>	<p>The municipality always owns and controls the water.</p>
<p>The private partner may take too much water resulting in ecological imbalance and destruction.</p>	<p>The municipality monitors and regulates water extraction.</p>

The Water Partnership Council is available to assist local governments considering the formation of public-private partnerships.

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