

WATER FOR ALL



CAMPAIGNING TO KEEP
WATER AS A PUBLIC TRUST

HIDDEN COSTS: The High Cost of Water Privatization Even Before It Starts *January, 2004*

Advocates of privatizing municipal water and sewer systems say it will result in huge cost savings for cities. Opponents of privatization, on the other hand, predict higher rates, dismal service and environmental problems. But cities preparing to privatize must first pass on substantial costs to taxpayers long **before** a contract is ever signed. The city of Stockton, California is a good example of how high these hidden costs can be.

Stockton's Mayor claims the 20-year, \$600 million deal with the international corporate partnership of OMI/Thames Water-which went into effect on August 1, 2003-will save the city as much as \$97 million compared to continued public utility operation. However, a study by the independent Pacific Institute challenges those figures, showing that Stockton stands to **lose** \$1.7 million over the life of the deal instead.¹ Based on the track record of Thames and OMI in other cities worldwide, ratepayers and the city also stand a good chance of paying far more in utility rates from additional charges, change orders, automatic cost-of-living increases and independent audits.²

But neither of these two estimates includes the cost to taxpayers of **preparing** Stockton's water system for privatization. An initial estimate by Public Citizen puts that figure at a **minimum of \$4.9 million** between 2000 and the start of the contract in 2003 (see table, page 3). This figure includes millions of dollars to private consultants to evaluate bids and negotiate contracts, but does not include the **thousands of hours of city staff time**. The city also paid out \$2.1 million in severance pay to municipal workers. However, the estimate does not factor in the legal costs of negotiations with disgruntled public employee unions facing privatization of their jobs. Public officials who embark on the path of privatization without scrutinizing the hidden costs could be in for some unpleasant surprises.

Personnel Costs

According to Morris Allen, the former director of Stockton's Municipal Utility Department (MUD), the Department's professional staff was required to dedicate thousands of hours in preparing their efficiently run public utility for private takeover. Many staff members spent up to 50 percent of their time for more than a year on privatization-related work. As soon as the Request For Proposals (RFP) was released, MUD staff had to set up a data room with a dedicated data-processing specialist to catalogue data, answer requests and provide information. Each of the three corporations bidding on the contract made three to four visits to inspect the water system, and each of these tours required an entourage of at least 12 professional MUD staff for several days at a time to accompany corporate representatives. MUD staff dedicated significant amounts of time preparing data for ARI, Inc.-the consultant for the privatization contract-and in reviewing ARI's work. Allen conservatively estimates that close to \$500,000 in salary costs was expended in preparing for MUD privatization during 2001 and 2002.³

¹ Pacific Institute. January 2003. "*Independent Review of the Proposed Stockton Water Privatization.*" Oakland, California.

² Public Citizen. February 11, 2002. "*Double Trouble: Thames Water and OMI.*" Oakland, California.

³ Personal communication with Morris Allen, former director, Stockton Municipal Utility District. May 16, 2003.

Consultants, Reports and Legal Fees

As Stockton began to consider privatization, the city hired several consulting firms to lay the groundwork for the process. Boston firm Alternative Resources Inc. (ARI), Inc. was hired to advise the city on the costs and benefits of privatization, but critics contended that ARI was biased toward privatization from the start.⁴ With MUD staff's help, ARI later prepared a Request for Qualifications and Expressions of Interest (RFQEI) and a RFP, evaluated privatization bids, conducted an engineering evaluation, prepared contract specifications, and handled the negotiations between the winning bidder (OMI/Thames) and the city. ARI has so far invoiced the city for \$773,000 for these services.

A baseline study of the water system to define the cost of continuing municipal operation of the system compared to privatization, prepared by engineering firm HDR, Inc., cost Stockton \$343,000. Parsons-Engineering Science, Inc. and Carollo Engineers were hired to prepare a report estimating the cost of construction of mandated wastewater treatment improvements by MUD as opposed to turning this responsibility over to the privatizer. When that report showed MUD's proposed system would actually be cheaper to construct and operate, the report was sequestered under orders from the Assistant City Manager. Parsons-Engineering Science/Carollo was then directed by the City Manager to produce a second report utilizing a more expensive wastewater treatment technology, which formed the basis for the city's decision to go private. According to former MUD director Morris Allen, "All decisions are being made on the basis of that second report. The cost data in that report are not valid and should never have been used. The comparison is completely erroneous."⁵ Carollo Engineers was also hired to evaluate the feasibility of the privatizer's wastewater treatment proposals and provide an additional opinion. However, says Allen, "the City Manager didn't like those answers," and that report was discarded and Carollo Engineers was fired.

Legal fees also represent a large chunk of Stockton's pre-contract privatization costs. Law firm Hawkins, Delafield and Woods billed the city for over \$1 million for negotiating the contract between Stockton and OMI/Thames, and for legal counsel during the privatization process.⁶

Costs Not Included

Beyond the significant costs mentioned above, several items were not included in the cost estimate for water privatization in Stockton—either because data are not publicly available or because they are difficult to estimate. Top city officials, including the mayor and city manager, dedicated thousands of hours of paid time to aggressively promoting privatization, at city council meetings and elsewhere. Nor does the estimate include the salary cost of numerous city council meetings, committee hearings and work sessions dedicated exclusively or partly to the privatization plans. Sizeable printing, copying, travel and other costs were also difficult to estimate or not available. One of the biggest unknown bills will likely be submitted by Kay & Stevens, the firm hired by the city to handle five lawsuits filed by unions representing MUD Blue Collar, Middle Management, Engineering and Professional staff, whose jobs were threatened by privatization. After months of negotiations, Thames/OMI and Stockton settled with all unions in May 2003, but the costs of these negotiations are not publicly available.

The city's legal costs continue to soar in the battle to defend the flawed privatization process against a lawsuit filed in March, 2003 by the Concerned Citizens Coalition, League of Women Voters and the Sierra Club. The city is now appealing a district court decision that found the city had clearly violated the California Environmental Quality Act by not conducting an assessment of the risks posed by privatization. In December,

⁴ Personal communication with Dale Stocking, Concerned Citizens Coalition of Stockton, June 3, 2003.

⁵ San Francisco Chronicle Magazine, "Profit on Tap?" February 9, 2003, p. 13.

⁶ Water Industry News, "Judge Voids Stockton Deal," December 6, 2003.

the judge ordered the city to rescind the contract. A new law approved by voters last March requires any future water utility contract over \$5 million to be put to a citywide vote.

It is also difficult to estimate the opportunity cost of pursuing privatization. Planned upgrades to the sewage treatment plant and other innovations and proposed cost savings by MUD staff were put on hold while privatization was heralded as the panacea. The city could be fined millions of dollars if they fail to meet the environmental quality standards imposed by the regulators because of these delays.

The Bottom Line

Water corporations are promoting privatization as **the** solution for cash-strapped local governments. However, cities that embark on the path of handing their water systems over to corporate management can find themselves on a slippery slope of hidden costs, long before a contract is ever in place.

At the start of the privatization process in Stockton, city officials assured the city council that it would cost between \$600,000 and \$800,000 to evaluate the benefits of privatization for the city and prepare the system to be privatized, if that was the best option. City officials persuaded council members they would be “derelict in their duties” not to spend a modest sum evaluating the benefits of private operation. Now, approximately \$3 million later, Stockton has signed a 20-year privatization contract with Thames/OMI, a deal predicted to **cost** the city an additional \$1.7 million.

The personnel, legal and administrative costs involved in privatizing a large municipal water utility can mushroom far beyond predictions-as they have in Stockton-and can only partly be quantified. Stockton’s experience is a cautionary tale for other cities being approached by corporations touting the economic benefits of private utility management. Elected officials would do well to closely scrutinize the hidden costs and risks involved in privatization before taking even initial steps to put their public water utilities out to bid.

PRE-PRIVATIZATION COSTS AS OF JULY, 2003 Stockton, CA Municipal Utility District

Entity	Purpose	Cost
ARI, Inc.	Prepare RFQ/RFP; engineering evaluation; contract negotiation	\$ 773,566
Hawkins, Delafield, Woods	Legal costs; contract negotiation	\$1,000,000+
HDR, Inc.	Engineering baseline study	\$ 348,000
Parsons-Engineering, Inc.	Wastewater cost comparison study	\$ 134,000
Carollo Engineering, Inc.	Evaluation of feasibility of privatization proposals	\$ 99,037
Stockton Municipal Utility District	Staff time dedicated to privatization	\$ 471,250
Kay & Stevens	Labor negotiations with MUD unions	\$??
City of Stockton	Severance pay to MUD workers to settle lawsuits	\$2,100,000
City of Stockton	Staff time, other expenses such as travel, CEQA lawsuit	\$??
MINIMUM ESTIMATED COSTS		\$ 4,925,853