



October 18, 2002

Mayor Podesto and  
Council Members Johnston, Nickerson, Martin, Ruhstaller, Giovanetti, and Nomura  
City of Stockton  
425 N. El Dorado Street  
Stockton CA 95202

Honorable Mayor and Councilmembers:

I am writing to express concern about the City's possible decision to hire a private company to operate and maintain, make capital improvements to, and provide billing services for, water, wastewater, and stormwater utilities in Stockton. Before expressing those concerns, some information about my background and the Pacific Institute, my employer, may be helpful.

I am a licensed civil engineer who has worked with municipalities and special districts in California since 1984. I have been involved in procurement processes with similar size and structure to the one you are currently engaged in. For ten years, I was a consulting engineer with about 10 employees. During that time period, my firm performed the technical work necessary for several private companies to submit bids of the type you are now reviewing. In fact, my firm wrote the technical proposal for Western Waste Industries that helped them to win the contract for solid waste and recycling services in two-thirds of the City of San Jose. I am not opposed to private involvement or participation in provision of public services such as water, wastewater, stormwater, or solid waste management.

The Pacific Institute is a non-profit, non-partisan, independent environmental policy research organization founded in 1987. We strive to improve public understanding of resource issues and thereby promote higher quality, fact based decisions. For example, our February 2002 report ([The New Economy of Water: the Risks and Benefits of Globalization and Privatization of Fresh Water](#)) filled an important informational gap in the privatization area, and has been very well received, worldwide. Similarly, our [Economic Evaluation of the Cadiz Groundwater Storage and Dry Year Supply Project, Metropolitan Water District of Southern California \(July 2001\)](#) was quoted by many parties to the debate over the Cadiz project, including the Wall Street Journal. Both reports urge fact-based decision-making rather than decisions based on abstract ideology such as: "the private sector is more efficient" or "water must be publicly provided."

To put it plainly: neither the Institute nor I are for or against privatization. We are against hasty decisions that involve hundreds of millions of dollars of public funds, based on apples-to-oranges comparisons. Please consider each of these concerns:

## Hasty decision-making

I am unaware of any procurement of this size (about \$600 million) and duration (20 years) that has taken place in California in the time frame being employed in Stockton. Hundreds of pages of written proposals that took months of effort and tens of thousands of dollars to prepare were reviewed in weeks. This is unfair to the losing bidders as well as to the public. To make matters worse, the scheduled duration between a recommendation from the outside consultant and a decision by the City Council is less than a month. I wouldn't be surprised if the average public works street improvement contract in Stockton allows more time for staff review and public input than is being allowed here.

Furthermore, some issues have not been reviewed at all. CEQA requirements, for example, have not been addressed adequately or recently. The environmental implications of the three proposals and the "no action" alternative of continued public operation are probably different. The simplistic claim that all of the alternatives require the operators to meet regulatory standards is an incomplete and naïve response to the potential problem. There are numerous instances of public and private entities failing to meet their legal and environmental obligations due to mismanagement, short staffing, or other governance problems. But the review by City staff and consultants has not even touched on this concern. For example, might the lowest bidder's bid be as low as it is because they have underestimated what is required to satisfy regulatory requirements? Is the risk of environmental damage higher under one proposal than another, or under private operation as opposed to public operation?

The claim that contractor will be financially and legally responsible for any violations misses the point. CEQA requires that the potential environmental consequences of the project and its alternatives be investigated and discussed through a public process, no matter how responsibility for those consequences is allocated.

Given that the time allotted for review of technically and financially complex documents is far shorter than similar procurement processes elsewhere in the State, and that CEQA issues haven't been addressed properly, I respectfully suggest that the current course of action will expose the City and its citizens to costly and time consuming litigation if a contract is consummated at the pace currently anticipated. And even if litigation does not occur, or fails, the rapid pace creates an enormous risk that the City will have very expensive disputes with your contractor in the future. Such disputes have taken place in other instances where privatization decisions were made rapidly.

## Apples to Oranges Comparisons

The evaluation report prepared by Alternative Resources Inc. and Hawkins, Delafield, and Wood (hereafter, ARI), claims on page 7-1 that the proposal by OMI will save the City about \$154 million on a nominal dollar basis over 20 years, or about \$85 million on a present value basis, in comparison with improved efficiency of public operations. Potential savings of this magnitude are, understandably, attractive.

However, there are number of reasons to believe that the claimed savings were not accurately estimated. The ARI report and other bid-related documents contain apples-to-oranges comparisons that must be resolved before an accurate estimate of savings can be made. We describe a few of the apples-to-oranges comparisons that stand out, below. However, our very limited review of the documents suggests that many other such problems exist; problems that should be addressed one by one before the Council is called upon to take action. "Sample" inappropriate comparisons:

1. The labor cost comparison between public and private operation assumes that the current MUD staffing level for policy and planning and regular regulatory compliance will remain at the current level of effort. But common sense and experience show that regulating a private entity is more time consuming than planning and performing regulatory compliance for another “department” within a public entity. Regulating a private entity involves legal and procedural steps not required internal to a single entity. Consequently, the MUD staffing assumption unfairly favors the private alternative. As a historical fact, this “level of regulatory effort” issue was an enormous problem during the first five years of privatization of water services in England and Wales. The British regulatory agency overseeing the newly privatized companies (OFWAT) was overwhelmed during those years; and staffing for it needed to be and eventually was increased significantly.
2. The capital cost estimates differ enormously between private and public operations. For example, OMI price proposal form 3 and Table A-2 of the HDR baseline analysis, suggest that capital repair and replacement costs for essentially the same facilities are about \$0.8 million more per year for the public operation. Total capital cost estimates essentially the same facilities are about \$63 million in the OMI proposal and about \$112 million in the HDR estimate of public operations.

These differences are simply too large to reflect “efficiencies of the private sector.” More likely, they reflect inappropriate comparison of City planning level estimates for budget purposes, versus competitive bid numbers. Those familiar with the budget process know how much pressure exists to be certain that planning estimates are not “too low.”

Also, an inappropriate comparison is being made between the traditional public works approach of separate contracts for design and construction and the combined design/ build contract approach. Or put another way, if it is feasible for OMI to design/build facilities for \$63 million, then it is also feasible for the City to hire a design/build team to do the same for a similar amount. So why didn’t HDR estimate public operations using the apparently more effective design/ build approach? Regardless of why, an apples-to-oranges comparison now exists.

3. Similar problems may underlie the chemical cost line items (\$1.81 million per year, public operation; only \$1.16 million per year under private operation), and electricity (\$3.40 million per year under public operation; only \$1.74 million per year under private operation). Either the private contractor is underbidding these items grossly and will press to recoup their losses later, or HDR’s “MUD Efficiency Initiatives” cost estimate (Table A-2) is too high.

I suspect, based on experience, that chemical usage by City staff is higher than necessary. This is a common problem in municipal operations. But it can and has been solved in numerous cases without privatization.

4. Finally, the “miscellaneous and other costs” line item estimates differ dramatically (\$2.25 million per year under public operations; only \$1.11 million per year under private operation). Again, either OMI is unaware of numerous such cost items, and will attempt to recoup their losses later, or the City operation has greater potential for efficiency improvements than shown in the HDR efficiency evaluation.

Correcting the discrepancies mentioned could eliminate the supposed financial benefit of \$154 million nominal dollars over the 20-year contract term. They might even reverse the outcome, with public operation (but much more efficient than present) being less expensive than the lowest private company. This is what the City of Phoenix found out a few years ago – they could save more by “re-engineering” public operations than they could save by privatizing. Until appropriate comparisons are made, the claim that the OMI bid represents \$154 million of savings compared with continued public operations is premature and could lead the City into a more, not less, expensive course of action than continued public operation.

In summary, privatization is a decision with many potential risks and benefits. I believe that any independent, professional observer would agree that the risks and benefits in the Stockton situation are not fully understood. Until they are understood, the water, wastewater, and storm water management alternative that is in the best interests of the citizens and businesses of Stockton can't be identified, much less selected.

I believe that all of you care deeply about your City. Please seriously consider doing the following:

- Dramatically slow down the decision process.
- Perform CEQA review.
- Ensure that ambiguities in the technical and financial documents and proposed contracts are carefully and fully resolved, and that citizens and business representatives are satisfied that the ambiguities have been resolved. Similarly ensure that apples-to-oranges comparisons are not taking place.

Please note that the current public advisory committee is not the right vehicle for this purpose. We are NOT urging more advice from citizens and businesses. Instead, we urge a process that leads to wider understanding among citizens and businesses of the facts of the situation and of the alternatives that exist. Not everyone will agree about a final decision; but clarity about key facts and alternatives is achievable and well worth the effort.

Please feel free to call me with any questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'GHW', written in a cursive style.

Gary H. Wolff, P.E., Ph.D.  
Principal Economist and Engineer