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Joan Claybrook, President

Double Trouble

Thames Water and OMI—two companies Stockton could do without

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Mayor Gary Podesto and the Stockton City Council are in a rush to hand Stockton's water and wastewater systems over to a partnership between two giant impersonal corporations, OMI, Inc. and Thames Water. Sharing a passion for profits, a willingness to pollute, a reluctance to invest in system maintenance and a disregard for community interest, the companies appear to be very well-suited to each other. But they are unquestionably a very bad fit for the community. Entrusting Stockton's most vital public resource to one of these companies would be bad enough. The two of them acting in concert to rip off Stockton consumers makes for double trouble.

Thames Water

Debt-choked corporate parent targets Stockton

Thames Water is a giant British company, and is a subsidiary of an even larger German company, RWE AG. RWE is in the process of finalizing its acquisition of American Water Works, formerly the largest publicly water utility corporation headquartered in the U.S. On an acquisition binge in recent years, RWE has racked up nearly \$27 billion of debt.¹ The company has all but admitted that it spent too much for some of its acquisitions, including its purchase of the British energy company Innogy last year. Now the financial community is wondering if RWE's \$7.6 billion deal for American Water Works, a deal which includes several water systems in California, isn't similarly overpriced, and if the debt-loaded company isn't spread too thin.²

RWE acknowledges that it is paying a "premium" for American Water Works, which is to say RWE is shelling out more than the utilities' book value. And in state after state where RWE had to win regulatory approval, the company promised that customers would not be stuck with the tab. The company would cover the cost of the premium and grow future company revenues through expansion, not rate hikes to former American Water Works customers, RWE officials explained.

In fact, that's what RWE officials told the California Public Utility Commission in December, 2002. "Let's not worry about that," said Thames Managing Director James McGivern, referring to the premium. "That premium is for the shareholders. It will never, ever be passed down to the customers of California-American."³

"This transaction is predicated on growth," McGivern added, proceeding to envision the corporate takeover of water and wastewater systems throughout the United States.

In effect, the company is telling its current customers that they won't have to pay more, but future customers, especially customers whose rates aren't regulated by a state utility commission, will.

Or, as McGivern told the PUC, California customers subject to the American Water Works deal won't have to pay the premium, because the company will make up the costs of the premium elsewhere—"For example, we are the preferred bidder of a major project just up the road in Stockton, California where we will be working with the community there to run their water and wastewater services."⁴ Stockton is the first foray into long-term monopoly management contracts for the Thames-OMI partnership.

How the corporation will grow when it's already spread so thin—and given the substantial and growing public opposition to corporate control of water in the U.S.—is anybody's guess. Meantime, what McGivern appears to be saying is that California customers subject to PUC regulation won't be stuck with the cost of paying too much for American Water Works, but no such assurances are granted to customers in Stockton.

Thames, as RWE's water management arm in the United States, is going to be under tremendous pressure to fatten a bottom line for its debt-choked corporate parent. That could be a recipe for corner-cutting and customer-gouging in Stockton.

But then, Thames is already exceedingly familiar with cutting corners, gouging customers and neglecting its responsibilities to the communities it serves

United Kingdom

Late in 2002, Thames was taken to task by regulators for "failing to control leakage." The Environment Agency reported in December that Thames' leakage accounts for one-quarter of the total in England and Wales. The company's "unacceptably high" leakage put Thames customers at "greater risk of water shortages in times of drought than customers in the rest of England and Wales."⁵

Even accounting for Thames' gigantic presence in England, the company's leakage looks bad. A recent report from the Office of Water Services, the economic regulator of the nation's water and wastewater companies, found that Thames fared very poorly when compared to other companies, with leakage estimated at 250 liters per property per day, compared to an industry average of 145.⁶

In Stockton, Thames-OMI won't pay for the water, won't own the pipes, and will have little incentive to assure that water isn't leaking from the system. On the contrary, the whole point of the Thames-OMI partnership is to make money by holding down costs, not spend it on system

upgrades and maintenance that won't immediately enhance the partnership's profits. Thames' dismal record of leakage in the UK should alarm water-scarce Californians.

Thames' doesn't operate its wastewater infrastructure any more efficiently than its water infrastructure, with results that stink—literally. Thames ranked as the worst polluter in England and Wales for two of the past four years, according to the Environment Agency in England.

A Public Citizen profile of Thames' recent environmental performance found that dating back to 1999, Thames has been convicted of environmental and public health violations 24 times and fined approximately \$700,000.⁷ In case after case, regulators found that the company was aware of conditions that led to raw sewage discharges and could have prevented the pollution. It appears, however, that Thames' corporate strategy is based on the notion that paying fines is less expensive than paying to maintain and operate water and sewer systems cleanly and safely.

In 1999, Thames was successfully prosecuted by the British government for pollution eight times. No company was prosecuted more often. In 2000, Thames was fined nearly \$450,000 for pollution—more than any other company in England and Wales. The company was repeatedly criticized for ignoring warnings, failing to respond appropriately and unnecessarily endangering public health and the environment. Some examples:

- In Dartford, England, in 1998, Thames was fined roughly \$70,000 for failing to promptly and competently stop sewage that was discharging into the River Cray. Officials later characterized the violation as “unique” in that the company admitted to in “knowingly permitting the discharge to the Cray.”
- In 2000, a pumping station failure in southeast London resulted in raw sewage and toxic industrial waste overflowing into a street and flooding nearby homes. Residents suffered headaches, nausea and vomiting, and many were treated in hospitals. Ten houses were rendered uninhabitable. An estimated 22.5 million liters of raw sewage and waste was pumped into the River Thames. Thames was fined \$400,000, the largest fine ever under the waste management law Thames had violated, and the court harshly criticized the company for its “complete disregard for human health and the environment.”
- In 2001, a blocked sewer in Hampshire caused sewage to flow into the River Wey and lakes in the area. While Thames' contractors arrived on the scene quickly, their shift ended before they fixed the problem, and they did not clear the source of the discharge until the following day. Hundreds of fish died as a result, and Thames was fined more than \$30,000. Magistrates said they were stunned at Thames' “exceptional levels of incompetence.”

Thames' failure to adequately maintain water and wastewater infrastructure in the UK should be all the more alarming to residents of Stockton in that Thames has inflicted enormous rate hikes on its customers—in the name of infrastructure investment. Water bills levied by the company rose by 99 percent in actual pounds during the decade following the 1989 privatization of England's water systems. And in 1995, Thames slashed investment in infrastructure by £350 million, but that reduction in expenditures did not translate into lower rates during that period of time.

Australia

As part of a consortium operating a water and sewer system in South Australia in the mid 1990s, Thames was involved in slashing maintenance expenditures, leading to the failure of a primary sewage treatment plant in April 1997. For the next three months, the entire Adelaide metropolitan area was subject to, as the media dubbed it, the “Big Pong,” a rotten stench that created “universal annoyance and widespread health problems.”⁸ A subsequent audit commissioned by the government of South Australia laid the blame clearly at the feet of the private consortium’s efforts to reduce costs. The Big Pong was the result of “failure of the operators over several years to properly monitor the performance of the processes within the plant,” a failure “associated with a policy of minimising expenditure.”⁹

Indonesia

Thames has been criticized for striking deals with the regime of President Suharto in Indonesia, a reign marked by human rights abuses and cronyism. Thames’ Indonesian operations have been marked by repeated strikes by Jakarta water workers, and court cases alleging excess profiteering and contracts obtained through corruption.¹⁰

Closer to Home – Felton, California

In Felton, California, one of the communities where RWE’s consolidation and acquisitions have placed a community’s water and sewer service under Thames management, the company is trying to immediately increase revenues by 57 percent, and follow with 9 percent and 2 percent rate hikes over the ensuing two years.¹¹

Felton is just one example of Thames’ expansion in the US. In addition to bidding for and winning contracts to operate various U.S. cities’ water systems in its own name, Thames will soon be responsible for all of RWE’s water operations – including those purchased separately by RWE, like American Water Works, as was the case in Felton. Wherever it goes, Thames seems to take its general business philosophy with it – profits above all, regardless of the cost to communities and the environment.

OMI Inc.

In the last few years, OMI has signed contracts ranging in length from three to twenty years with dozens of cities and towns around the U.S. to provide a variety of water services. For a number of these cities, what looked like a good deal at first has turned out to be nothing but trouble – in the form of pollution, rising costs, and unfavorable long term contracts. Below are just a few examples.

East Cleveland, Ohio

In November 2001, the city of East Cleveland, Ohio signed a three-year contract with OMI for the operation of the city’s drinking water and wastewater services. The contract, which was negotiated primarily by the mayor and to a lesser degree the rest of the City Council, went into effect in March 2002. The mayor pushed hard for the contract, arguing that it would cut costs and help lift the city out of a state of fiscal emergency, where it had been for more than a

decade. OMI optimistically projected that under its contract the city's water operations would run at a profit within five months and would bring the city's water fund to a positive balance within 17 months.¹²

As part of East Cleveland's efforts to improve the city's fiscal situation, the mayor requested a performance audit from the Ohio State Auditor. This audit was completed in September 2002, and contained a number of surprises for the city with regard to its new water contract. Rather than save the city money, the auditor concluded that the new contract would cost the city more than double what it had been spending to run the water systems itself – or else it would suffer a substantial decrease in quality of service, if not both.

OMI was irresponsible in its projections, significantly underestimating its costs and overestimating its revenues, while simultaneously making several highly dubious assumptions in its calculations. The budget OMI provided for the contract also contained several questionable items that drew the auditor's attention, including "bank charges for a lockbox and telecheck" even though the city would continue to do the bill collection, "transportation and lodging expenses for OMI start-up personnel," but with no details on how much travel would be permitted and no specified limits on the expenses, and "\$322,600 for outside services with no explanation."

The performance audit recommended that East Cleveland try to revisit the terms of the contract with OMI but recognized that since the contract was already signed this would probably be impossible during the course of the contract. It further suggested that the city either significantly revamp the contract when the time came for renewal or that it seek other options altogether.

Shortly after the performance audit was completed, the mayor of East Cleveland and several City Council members publicly voiced severe doubts about they had made the right decision in selecting OMI to operate their water systems. An October 2002 article in the *Cleveland Challenger* reported that the mayor and City Council members publicly voiced severe doubts about their decision, and that former Councilmember Nathaniel Martin believed they had all made a mistake.¹³

Norwalk and New Haven, Connecticut

In June 2000, OMI began operating Norwalk, Connecticut's wastewater and sewage treatment plants under a 20-year contract. The company also operates plants in nearby New Haven, whose 16-year contract began in 1997.¹⁴

A few years later, OMI is facing a federal criminal investigation regarding pollution of the Norwalk River and the falsification of federally required records regarding pollutants released into the river. In October 2002, EPA officials entered wastewater treatment plants in Norwalk and New Haven with search-and-seizure warrants. The EPA simultaneously subpoenaed the company for documents related to sludge handling, lab tests, and discharges from the plants, among other things. Although OMI has denied releasing sludge into the river,

Norwalk's mayor says the city has photographic evidence from the summer of 2002 that either sludge or some other relatively solid material was released and formed a layer on top of the river.

The city of Norwalk has also retained Robinson & Cole, the law firm that originally helped set up the contract with OMI, to collect nearly \$300,000 in penalties that the company owes for violating performance standards specified in the contract. After a year of complaints to the company and back-and-forth discussions, the city had been unable to get the company either to pay the penalties or to make the requested improvements. The city was also planning to hire at least one outside firm to perform independent tests of OMI's discharges and to verify testing done by OMI, at an additional expense to the city of tens of thousands of dollars.

Rialto, California

In late 2001, the Rialto Public Works Director stated that the costs to operate a sewage treatment plant contracted to OMI had increased substantially over the amount initially agreed upon. OMI was seeking – and receiving – the additional money from the city of Rialto. He also stated that the facility had been served with Notices of Violations in the summer of 2001 and that the city and OMI were still working out who would pay the fines.¹⁵

In December 2002, the *Stockton Record* reported that Rialto considered OMI to be “in default of its long-term contract” with “19 alleged violations.” The city was continuing private discussions with the company, but had “invited other companies to submit bids to take over wastewater operations.”¹⁶

Conclusion: Don't blow it

As the fiasco in Atlanta demonstrated, communities should be very wary of private operation and maintenance contracts. Companies make promises they can't keep, in the hope that by cutting costs through cutting corners and sticking communities with extra charges above and beyond those in the contract, the company will be able to ultimately make a huge profit. And the companies are emboldened to pursue such an anti-consumer strategy by virtue of a long-term monopoly contract. Monitoring a company's performance can be complicated and costly—Atlanta ended up paying an independent consultant \$1 million just to double check the company's data.

Are privatization's shortcomings going to surface in Stockton as they did in Atlanta? Thus far, Stockton's mayor and other officials have taken their cue from corporate executives and privatization apologists, attempting to brush aside the Atlanta debacle as an anomaly.

But other cities' experiences with Thames and OMI suggest a high probability of cost overruns, environmental damage, failure to maintain infrastructure, poor service, and rising rates. The partnership has publicly stated that it plans to cut staff and services, which cannot help but lead to more accidents, more leakage, and poorer service. Both OMI and Thames have a history of environmental damage as an acceptable cost of doing business, and as for-profit corporations, they have no incentive and no plans to encourage conservation. Combine Thames' corporate parent's \$27 billion debt—and the accompanying intense pressures on the company's bottom

line—to the shoddy performance record of Thames and OMI, and Stockton is, to put it charitably, needlessly taking a big gamble. Less charitably, Stockton officials are on the verge of a truly colossal blunder.

Notes

¹ “RWE issues warning on net profits for 2003,” *Financial Times*. Dec. 17, 2002.

² “Is RWE paying too much in U.S. deal?” *Wall Street Journal*, Nov. 18, 2002.

³ James McGivern statement to California Public Utilities Commission, Dec. 12, 2002.

⁴ *Ibid.*

⁵ “Thames Water must act now on London’s water supply,” Environment Agency release, Dec. 19, 2002.

⁶ “Security of Supply, Leakage and Efficient Use of Water,” Office of Water Services report, October 2002.

⁷ All information on Thames Water in the U.K. comes from Public Citizen, *Corporate profile: RWE/Thames Water*. Public Citizen. (Oct. 21, 2002). Available online at www.citizen.org/documents/RWE%20Profile.pdf.

⁸ Quiggin, John, “Contracting out: promise and performance”. Australian National University, April 2002. Quoted in Public Citizen, *Corporate profile: RWE/Thames Water*. Public Citizen. (Oct. 21, 2002).

⁹ K. J. Hartley, *Independent Audit of the Bolivar Wastewater Treatment Plant to Determine the Causes of a Major Odour Event*, Uniquet Limited, St Lucia, July 10, 1997, p. 56-7; excerpted and cited in Christopher Sheil, “Adelaide’s Big Pong,” and extract from *Water’s Fall*, Pluto Press Australia Ltd, Annandale, 2000, www.plutoaustralia.com. Referenced in Public Citizen, *Corporate profile: RWE/Thames Water*. Public Citizen. (Oct. 21, 2002).

¹⁰ Public Citizen, *Corporate profile: RWE/Thames Water*. Public Citizen. (Oct. 21, 2002).

¹¹ *Ibid.*

¹² Ohio State Auditor, *City of East Cleveland Performance Audit*. State of Ohio Office of the Auditor: Columbus, OH. (September 26, 2002). This report is the source for all details on the East Cleveland situation.

¹³ Brewer, Eric J. “Mayor, council failed to do homework.” *Cleveland Challenger*. Page 4. (October 4-17, 2002)

¹⁴ Breslow, Matt. “Knopp: Probe does not involve city or its employees.” *Stamford Advocate*. (Oct. 18, 2002); “Federal authorities investigate Norwalk plant,” *Associated Press*, Oct. 18, 2002.

¹⁵ Rialto City Council. *Minutes of City Council Meeting*. City of Rialto, Calif., Dec. 4, 2001.

¹⁶ Miller, Cheryl. “Stockton council set for key privatization vote.” *Stockton Record*, Dec. 2, 2002.