Water Privatization: A Broken Promise

Case Histories from Throughout the United States

A special report by

Public Citizen's
Critical Mass Energy and Environment Program

Washington, D.C.

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Water Privatization: A Broken Promise

Case Histories from Throughout the United States

Rising rates, increased shortages, legal and legislative battles, source depletion and crumbling infrastructure have drawn attention to a resource that the United States has long taken for granted — water.

We expect an unending flow of clean water every time we open the tap. We also expect this life-giving resource to be available to everyone at affordable prices because our health and our survival literally depend on it.

Today, over 80 percent of Americans receive their water from public utilities. Many of these public providers, however, find themselves in a very difficult position. The nation's water and wastewater infrastructure — with its leaky, decades-old pipes and pumps — is in desperate need of repair and upgrading.

The Water Infrastructure Network estimates that an additional $23 billion a year would have to be spent to adequately improve the infrastructure over a 20-year period.[1] Without the help of the federal government, which has not placed water projects high on its priority list, cities and counties are in a bind.

Coming to the rescue of local governments, or so they say, are private corporations. Fully aware that elected officials are averse to raising taxes, corporate executives are seeking to parlay public financing problems into profit opportunities. Corporations are promising local government officials the world: They'll buy or operate their water or wastewater systems and, in the process, save taxpayer money, comply with ever-enhancing environmental standards, and eliminate the headaches associated with operating these increasingly complex systems.

Even though the historical record supplies evidence that privatization is not a panacea for ailing water and wastewater systems, more and more municipalities are beginning to consider handing over their systems to the private sector.

Backers of privatization — which also goes by the names of public/private partnerships, outsourcing, procurement, and operation and maintenance contracts — like to highlight their successes.

The U.S. Conference of Mayors, for instance, champions privatization as an innovative solution to the country's water challenges. In a study of 20 local governments that privatized water/wastewater utilities, the organization's Urban Water Council portrays private companies as their saviors.[2] The study, however, carefully steers clear of communities that had negative experiences with privatization.

The Conference of Mayors' glowing assessment of privatization comes as no surprise, given that the membership of its Water Development Advisory Board includes major private water companies American Water Works (the largest in the U.S.), Severn Trent, OMI, United Water, U.S. Filter and U.S. Water.[3]

The Conference of Mayors had good reason to leave out the negative. There are more than enough cases that expose the opposite side of water privatization.

No matter what form privatization takes, there is always a risk it could backfire.

A government agency can hire a private company to complement or replace its engineering department to perform repairs or new construction. San Francisco, for example, last year hired a Bechtel-led alliance for consulting services that some argue overlaps with the city's management. Public officials can also decide to outsource management alone, as did Pittsburgh this past March.

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The contracting out of operations and maintenance (O&M), and often management, is becoming a very popular form of privatization. Under such a structure, the community retains ownership of water and sewer systems and continues to set the prices, but a private company effectively operates and manages the system for a fee. Atlanta's privatization is an example of such arrangement. Design-Build-Operate (DBO) contracts often include the operation component because public officials believe that they encourage private companies to construct high-quality infrastructure. Under this arrangement, the public generally retains ownership of the new facilities.

Concession is a form of privatization that is more common abroad. Under such an arrangement, which usually has a duration of 20-30 years, a government agency concedes operations of its water systems to a private company for a number of years. The company becomes responsible for maintaining the system, performing capital improvements, providing customer service and setting rates. As a rule, the company also makes a one-time payment to the government.

This type of privatization is more popular with communities whose water systems are in need of capital infusions they cannot afford. Concession is not a complete transfer of ownership. Once the concession expires, however, transferring responsibilities back to the public sector may prove difficult. As in the case of O&M, by the time the contract expires, the government would likely have lost both the expertise and the employees necessary to run the system.

Finally, the sale of public water and sewer system to a private company is the most extreme form of privatization. This option is much more popular among communities that serve small populations, because local governments in such cases rarely have the expertise, resources or incentive to operate water and sewer systems. Without consolidation, public operation can prove rather costly. Private operators could reduce these costs through economies of scale. Privatization, however, is not the only way save money; connecting to a larger public provider can be a sensible alternative.

Here, then are 13 case histories that should give any public official pause before handing over a public resource to a private, for-profit corporation. Some of these experiences have made local governments second-guess the wisdom of privatizing.

Operation and Maintenance

Lee County, Florida

In 1995, ST Environmental Services, a subsidiary of the British company Severn

Trent, won a contract to operate and maintain the water and sewer systems in Lee County, Fla., after underbidding employees by some $6.8 million. ST promised to save money by increasing efficiency and cutting almost half of the workforce, from 91 people to 52.

Some county officials questioned whether the company could operate the systems with so few employees. Among the doubters was the county's public works director, J.W. French. He did not anticipate big problems, however, because "the company would have to perform at the cost it bid, even if it has to hire people not specified in the proposal."[5]

Privatization proponents celebrated the company's performance: The number of employees reduced dramatically, the amount of pipe inspected increased, and old gas-guzzling vehicles were replaced with newer, more fuel-efficient models.[6]

Five years after start of the contract, however, a variety of problems began to surface. Paul Adams, a former ST vice president in Lee County, told the county that the company had neglected the systems. In a letter to county officials, Adams wrote that "critical facilities were in danger of imminent failure through lack of proper corrective maintenance."[7] He also alleged that when a superintendent was given a list of more than 500 meters that needed replacement, the company's direction was to "lose the list."[8] ST refuted the accusations.

ST sued Adams, claiming libel, interference with a business relationship and breach of contract. When he left the company, Adams agreed not to make comments that are derogatory or may damage the company in its business, or its public or private affairs.[9]

Notwithstanding the public benefit it may have brought, the breach of contract may create legal problems for Adams. Libel may be difficult to prove, however, because auditors indeed found problems with ST's operations, substantiating some of Adams' claims.

At the time ST was pursuing renewal of its contract, Azurix Inc. also submitted a bid. Contesting the county's intent to award the contract to ST, Azurix echoed some of Adams' allegations after its own investigation.[10]

In October 2000, Lee County's Internal Audit Department released a report on ST's contract performance. The findings included:

> Lee County's wastewater collection system was in poor to fair condition, and the maintenance level was inadequate to sustain the facilities in an acceptable operating condition.

- ST's flushing program was not as effective and efficient as it could have been, resulting in wasted water and lower than required chlorine levels, necessary for proper filtering.[11]
- ST did not perform required lime softening at the Olga Water Treatment Plant, even though the company was being paid do to the work.[12] At the same time, in its monthly reports to Lee County Utilities (LCU), ST claimed that all requirements that involved lime softening were being met. According to LCU's former director, lime softening is "effective in removing heavy metals, radionuclides, dissolved organics, viruses and coliform."[13]
- The wastewater collection system was in poor to fair condition, and the maintenance level was inadequate to sustain the facilities in an acceptable operating condition.[14]
- ST was not operating one of the wastewater treatment plants according to Florida Department of Environmental Protection permit requirements, as required by the contract, for at least part of February 2000 and possibly several months prior.[15]
- Several operational errors occurred at

a wastewater treatment plant, including spills and contamination of re-use water in February and March 2000.[16]

◆ Preventive maintenance at a wastewater treatment plant was not always performed timely or to minimum manufacturer-recommended standards, as required by the contract.[17]

◆ ST failed to perform $108,310 worth of maintenance work on water meters.[18]

◆ A large number of monthly customer billings were delayed from April to July 2000, resulting in $596,614 not being billed in timely manner. The number of billing employees and meter readers may not have been sufficient for timely billing.[19]

◆ The Lee County Department of Natural Resources found concerns with the handling of hazardous materials in its assessments in 1998 and 2000, with conditions in the latter year being worse.[20]

In response to the problems with ST and to the battle between ST and Azurix, the county's Board of Commissioners voted in October 2000 to return the water and sewer to public control.[21]

The following spring, county utilities director Rick Diaz sent a memo to the county's new public works director, Jim Lavender, outlining ST's failure to properly maintain the infrastructure as required by the contract. The memo said it would cost more than $8 million to bring the neglected infrastructure up to par. According to Diaz, the contract required ST to clean more than 2.3 million linear feet of sewer lines over five years, but the company reported cleaning less than 1 million feet. The contract also obligated the company to make 23,000 manhole inspections, Diaz said, however less than 10,000 were actually completed.[22]

Lee County and ST are currently in post-contract discussions regarding the performance issues. Assistant county attorney David Owen anticipates that the two parties will evaluate their legal positions and options if the negotiations result in an impasse.[23]

Atlanta, Georgia

In 1998, the city of Atlanta awarded United Water, a subsidiary of the French water giant Suez Lyonnaise des Eaux, a contract to operate the city's water system. The company promised cost savings in exchange for a $21.4 million annual fee. Three years into the contract, the question of whether residents are benefiting from it continues to be raised.

> Last year, some Atlanta residents began to find debris in their water. Additionally, the water assumed brown tones, which usually signals high levels of iron oxide — rust.

In 2000, some Atlanta residents began to find debris in their water. Additionally, the water assumed brown tones, which usually signals high levels of iron oxide — rust. The company, however, did not initially acknowledge there was a problem.[24] Four months later, residents were still experiencing the same problems.[25]

Moreover, cases of dry or inoperative fire hydrants have been reported. Again, United Water did not promptly address the problem, even though inoperative fire hydrants could be a matter of life and death. And, in response to residents' inquiries, the company has said that testing the fire hydrants after they were repaired was the city's obligation — a claim city has rejected, holding that the company should ensure that fire hydrants are in working order after repair or replacement.[26]

Complaints of delays and slow service have also been registered. For example, when the Breakwater homeowners association paid $2,700 in March 1999 to have three meters installed, United Water told the group that the request would take 10 weeks to fulfill. Six months later the company installed the first meter. According to the contract, the company has one day to respond to leaks and 15 days to install a meter.[27] One reason for delays may be understaffing. Today, United Water has just 327 employees, down from 731 in 1997, a year before privatization.[28]

The city is currently conducting a comprehensive review and audit of the company's performance.[29]

New Orleans

The city of New Orleans has contracted out its sewage treatment operations and maintenance (O&M) since 1992. The original contractor, Professional Services Group (PSG), transferred its O&M operations to U.S. Filter, which was in turn acquired by the French conglomerate Vivendi.

This past July 26, an electrical fire interrupted operations at the East Bank Sewage Treatment Plant, which serves about 440,000 people, for two and a half hours.[30] Raw sewage backed up, covering the surrounding land and making its way through some of the plant's offices. The plant's operators diverted raw sewage into the Mississippi River for two hours before the plant was returned to operation.

> An electrical fire at a New Orleans sewage treatment plant led plant's private operators to divert raw sewage into the Mississippi River for two hours.

Joe Puglia, a spokesperson for the city's Sewerage and Water Board (S&WB), claimed it was not possible to estimate the amount of sewage diverted into the river.[31] Because sewage systems generally have flow meters, and because flow estimates are usually easy to calculate, this claim is open to debate. Interestingly, Puglia is an employee of a private firm, the Public Relations Group, which carries out a bulk of S&WB's public relations work.[32]

According to City Council member Jim Singleton, S&WB officials told him that U.S. Filter was aware of problems with equipment for several weeks and the dangers they could create, but failed to address them.[33]

The fire came only a few months after the sewage plant's two broken incinerators resulted in the trucking of excess untreated sewage sludge out of the plant through the neighboring Arabi Park and Carolyn Park communities of St. Bernard Parish. Residents there were exposed to the putrid odor for more than two months.[34]

Ironically, the fire took place just a day after the S&WB voted to invite bids to privatize the city's water and wastewater treatment systems, despite apprehensive citizens and the labor community. U.S. Filter is among several companies that have expressed interest in running the city's water.

Jersey City, New Jersey

In 1996, the city contracted United Water Resources to operate and maintain its water system. Five years later, the city no longer expresses as much enthusiasm about the arrangement. According to Kathleen Deely of the Municipal Utility Authority (MUA), the city has learned that the private operation is "no worse, no better." United Water did improve bill collection, but overall the quality of water service did not change.[35]

Though still set by the MUA, rates are greatly influenced by operation fees paid to United Water. According to a senior MUA official, a lack of financial transparency prevents the city from evaluating whether the price commanded by the company is reasonable. The company is not required to open its books for a municipal review. Instead, it just sends a bill. The contract does not prevent the company from overcharging because no review process is built in.[36]

According to the same MUA official, United Water's customer service is in need of improvement. Customer service representatives often direct citizen complaints to the

MUA, even though in many cases the company is responsible for the problems triggering these complaints, and some of the problems are preventable. And, United Water contracts out meter reading to another company. A combination of broken meters and underpaid readers often leads to erroneous billing.[37]

The MUA official does not believe that the "public/private partnership" is a bona fide partnership. The company's goal is to make a profit, regardless of the consequences. It has little concern, the officials said, for public good and is resistant to doing work unless it is compensated for it.[38]

Private Ownership and the Move to Deprivatize

Charleston, West Virginia

In the Year 2000 Water and Wastewater Rate Survey of 194 U.S. cities and counties performed by a leading consulting firm, Raftelis Financial Consulting, Charleston stood out due to its exceptionally high rates.

Monthly water charges for an average customer using 7,480 gallons of water were $46.21, some $31.84 — or 221 percent higher than the $14.37 average for cities of comparable size. This amount was augmented by an additional $12.69 monthly fee — once again, the highest in the category. Finally, the affordability index showed that the cost of 7,480 gallons of water amounted to 1.65 percent of the median income in Charleston. The city was the only one in its category with an index of more than 1 percent. The cost of water as a percentage of median income was more than 3.5 times higher than the amount for like-sized cities.[39]

Charleston residents get their water from West Virginia-American, a subsidiary of American Water Works Co., the largest private water company in the U.S. According to the West Virginia Public Service Commission, average bills increased by 66.5 percent for the company's customers over the last decade.[40] West Virginia-American has increased its rates 15 times during that period.[41]

Roy Ferrell, the company's rates and revenues director, attributes the skyrocketing rates to West Virginia's mountainous landscape that makes it difficult to lay pipe and new construction. According to Ferrell, the company has consolidated its plants, reducing the number from 26 to nine. Eight of the remaining plants were either refurbished or replaced. To provide remote locales with access to water, extensions had to be built. The company claims to have spent $240 million on construction.[42]

> West Virginia - American forces its customers, already paying some of the highest rates in the country, to finance its own expansion.

Billy Jack Gregg, director of the Consumer Advocate Division in West Virginia's Public Service Commission, sees the picture a little differently. Gregg agrees that infrastructure construction is very costly, but he believes West Virginia-American is forcing existing customers to finance its own expansion. The company has extended its water service to areas where operations are not cost-effective. The investment required for such areas can be twice as high. Single tariff pricing, however, shifts costs to present customers. New service areas not only receive access to new infrastructure built with existing customers' money, but they also receive service at prices lower than real costs, thanks to higher rates paid by existing urban customers.

Earlier this year, West Virginia-American filed for yet another rate increase, which would translate into an additional $1 million in annual revenues. Gregg says the company is seeking to recover $750,000 it spent trying to acquire the water system in Parkersburg, West Virginia.[43]

Ferrell pledged that the company would not request another rate hike for the next 20 years, because after the current request is approved all major construction will be finished.[44] Given that American Water Works depends on rate increases for higher profits and dividends, it remains to be seen whether this is a promise the company can keep.

In extending water lines to remote regions, West Virginia-American is mainly driven not by a sense of civic responsibility, but by the simple desire for higher profits. Single tariff pricing allows the company to expand to non-profitable areas, knowing it can easily increase rates statewide to maintain existing profit margins.

The Raftelis survey shows that the median sewer charges for the cities of comparable size are 20 percent higher than the water rates . However, in Charleston the situation is reversed. The sewer charges don't amount to even a half of the water rates level.[45] The solution to this paradox may lie in the fact that the sewer service is provided by the city, and not by a private company.

Unwilling to sell its water system to Chattanooga, Tennessee-American launched a multimillion-dollar public relations and legal fight that included a background check on the mayor.

Chattanooga, Tennessee

In 1998, the city of Chattanooga moved to buy out Tennessee-American, also a subsidiary of American Water Works, which has owned the utility for 130 years.[46] Chattanooga's Mayor Jon Kinsley, who spearheaded the takeover effort, projected that public ownership would result in a 25 percent rate reduction and some $100 million overall savings for customers over 10 years.[47]

Kinsley was also responding to the company's exorbitant fire hydrant fees and to the possible export of city water to Atlanta without public approval. Tennessee-American Vice President Richard Sullivan admitted discussing supplying water to Atlanta with officials there.[48]

Unwilling to sell, the company launched an extensive public relations and legal fight as the city filed a condemnation suit. In its quarterly earnings report, American Water Works acknowledged spending $6 million on costs incurred by the subsidiaries fighting takeover attempts in Chattanooga and Peoria, Illinois.[49] According to the company's officials, most of these pre-tax costs were in Chattanooga.[50] Tennessee-American hired Burson Marsteller, a New York-based public relations firm, and Baker Donelson, Tennessee's largest law firm, to fight the takeover attempt.[51]

Among other firms used by the company in the public relations offensive were Wirth Worldwide, which handled opinion polling, National Media, which handled advertisements, Moriah Group, which provided political insight, and a temporary agency, Special Counsel, which performed background checks on Mayor Kinsley and Ken Hays, his former chief of staff.[52]

The public relations effort succeeded. In October 1999, the city reached a settlement with Tennessee-American under which the company agreed to lower its fire hydrant fees from $301.50 to $50 per hydrant, or from about $1.2 million to $200,000 a year.[53] Such a significant drop raises the question whether the city was paying reasonable fees in the first place. The agreement also requires Tennessee-American to ask permission from local citizens before exporting water.[54]

Duval, Nassau and St. Johns Counties, Florida

This past August 1, United Water Resources (UWR) accepted a $219 million offer from the Jacksonville Electric Authority to buy out the company's Florida holdings in Duval, Nassau and St. Johns counties. JEA is a municipal authority serving residents of Jacksonville and surrounding areas. JEA's operations are expected to lower average water and sewer bills of former UWR customers by 25 percent.[55]

The rate cut will be welcomed by many county residents. In 1997, when UWR was providing water and sewer services for the three counties, residents saw their rates increase by an average of $9.44 per month. Many residents expressed indignation with the rate hike. Richard H. Harlan, Jr., who was among the affected ratepayers quoted in the local media, called the company "the biggest bunch of highway robbers." [56]

In 1998, the company requested yet another rate increase, which the Florida Public Service Commission granted the following year. Water rates then increased by 12.5 percent and sewage rates by 5.4 percent. When reviewing the rate hike request, the PSC found that United Water overestimated its expenses by $1.05 million.[57]

The Florida Public Service Commission found that United Water Resources overestimated its expenses by $1.05 million.

Hingham and Hull, Massachusetts

Massachusetts-American, another American Water Works subsidiary, owns the water system in the communities of Hingham and Hull. In 1996 the company doubled water rates[58] in the face of many objections. Massachusetts-American justified the hike by the need to build a new water treatment facility. Meanwhile, American Water Works profits grew by 10.4 percent that year.[59]

This year yet another rate increase was approved for the company, which relied on claims of higher infrastructure spending and increased operation costs.

When approached with a request for rate schedules in effect before the 1996 increase and those currently in effect, Connie Chapman of Massachusetts-American provided information on rates immediately after the increase, but not those preceding it. When asked again, she claimed that the 1995 rate schedules would be difficult to locate, even though locating the rate information just one year later apparently did not pose a problem.[60]

According to James Lampke, Hull's town attorney, the two communities have some of the state's highest water prices.[61] Lampke said the city understands that rates have been influenced by construction of the new plant. He believes, however, that the company chose a process that augmented the costs by spending millions of dollars that could have been avoided.

For example, the company spent excessively to obtain approval for a site that was an unlikely location for the plant. According to Lampke, the state Department of Telecommunication and Energy, which regulates private water providers, has agreed with the city that the plant could have been built with less money.[62]

Huber Heights, Ohio

In 1993, Florida-based Avatar elected to sell its water holdings, including Ohio Suburban Water, a small outfit that provided water for 40,000 customers in Huber Heights and parts of the Mad River Township. American Water Works expressed its desire to buy the utility.

The city voiced concerns about the New Jersey-based water giant controlling its water. It feared the company would raise rates and extend service to areas beyond the city limits without annexation, thus impairing the city's ability to grow.[63] Water services are an important incentive that municipalities use to expand. As a rule, outlying areas have to become part of a city before obtaining access to municipal water.

The city attempted to acquire the water

system from Avatar but was outbid by American Water Works. The Ohio Public Utilities Commission simultaneously approved the transfer and denied the city a hearing to plead its case.[64]

The city's fears soon materialized. In 1993 the company increased its rates by 30 percent.[65] At the same time the company moved to contract with Industrial Water to deliver up to 2 million gallons of Huber Heights' water a day to the Wiley Industrial Park, located outside the city.

In an effort to prevent further rate hikes and to reclaim control of economic development, the city initiated proceedings to take over the system through the power of eminent domain.

Once again, American Water Works unleashed a public relations campaign to prevent the takeover and collected enough signatures to put the issue on the ballot. The effort collapsed when city residents voted overwhelmingly in support of the city's efforts to acquire the system.[66]

> Because of American Water Works questionable actions, the city of Huber Heights, Ohio is now under a legal obligation to act against its own interests.

While the city continued to fight the legal battle to reclaim control of the water system, the company continued its efforts to export Huber Heights water outside the city. The city protested, arguing that water pipes should be extended only in the event of annexation.

However, in pursuit of additional profits, the company disregarded the city's pleas and began piping Huber Heights water to the industrial park. Because the park used only 10,000 gallons a day, county officials wanted to make excess water available to the remainder of Bethel Township.[67]

In March 1995 the city avoided a lengthy legal battle by negotiating an out-of-court settlement with the company and proceeded with the buyback. Even after the buyback, however, American Water Works continued to cause problems. Industrial Water, through which water was channeled to the industrial park, had subsequently sold its contract to neighboring Miami County, which claimed rights to two million gallons of water per day. Under the settlement, the city would continue piping water to the park "until Ohio Suburban's obligations, if any, are resolved."[68]

Because of American Water Works questionable actions, the city is now under a legal obligation to act against its own interests, due to the fact that Bethel Township is unfairly reaping benefits of the water infrastructure funded by Huber Heights' ratepayers and taxpayers, while avoiding paying city taxes. The city continues to argue that the township must be annexed to Huber Heights in order to have access to its water. The conflict remains unresolved.

Pekin, Illinois

In 1982, Illinois-American, another subsidiary of American Water Works, acquired Pekin's water system from a local private owner. In the 18 years that followed, rates increased by 204 percent. At the same time the company failed to keep infrastructure up to date.

According to Pekin City Manager Dick Hierstein, pressure problems have plagued several parts of the city, especially those experiencing commercial growth. However, the company hesitated to construct the water tower it promised to build, while failing to upgrade undersized mains.[69] The company's behavior negatively impacted the city's economic growth and added to its expenses.[70]

In response to soaring rates and questionable quality of service, the city chose to consider acquiring the local water company from Illinois-American through its eminent domain powers. A report by the Water Study Committee, commissioned to evaluate feasibility of the acquisition, made a strong case for purchasing the water system. The committee found that the company's service record left much to be desired.

For example, there was an instance of street flooding for over 24 hours before any action was taken. In another case, water service to two schools was interrupted for a week. Company workers taped a message to school doors just before the students arrived for classes, instead of notifying the school officials in advance.[71]

Citizens For Locally Owned Water (FLOW), a group that advocated public ownership of the water system, projected that with the present rate of infrastructure upgrades, it would take Illinois-American some 268 years to replace all city mains. Given that some water mains were over 75 years old, FLOW found this rate of improvement unacceptable. The group also pointed out that in 1990 a local business was destroyed by fire after firefighters were confronted with broken fire hydrants and low water pressure.[72] Hierstein also argued that the city could obtain financing for infrastructure improvements at lower interest rates than the company.[73]

To remedy the problems, some city officials, including the city manager, began to advocate a buyout.

Yet another elaborate public relations campaign by American Water Works sought to convince residents that the city did not have enough expertise to run the system properly. PR firms hired by Illinois-American conducted surveying and placed television, newspaper and radio ads to fight the takeover efforts.[74] Even the company's president was invited pay a visit in an effort to convince residents to support private ownership of the water system.[75] The city estimates the company's public relations offensive cost about $1 million. Meanwhile, the city spent $30,000 on public outreach.[76]

Illinois-American then hired a firm to collect enough signatures to put the issue on the ballot. The company narrowly won the election, 54 to 46 percent,[77] but the referendum was advisory, not binding.

As a result of the close outcome and the battle preceding the referendum, Illinois-American did become more responsive to the public. The buyout question remains on hold, but Hierstein believes it will inevitably be raised again because of the stark differences in priorities of a "profit-driven national company versus a service-oriented and cost-conscious local government." Having been the city manager in communities with both private and public providers, Hierstein is convinced that citizens and the government are served "far better" by publicly-owned systems.[78]

> Public relations firms hired by Illinois-American placed television, newspaper and radio ads to fight attempts by Pekin, Illinois to purchase its water system.

Peoria, Illinois

In October 1998, the Peoria City Council voted to buy back the city's water system from American Water Works subsidiary Illinois-American Water. The city believed that public ownership would stabilize rates and reduce operating costs.[79]

According to Terry Kohlbuss, coordinator of the takeover effort, Peoria's rates at the time were among the highest in the rate survey prepared by Raftelis Financial Consulting.[80] (The company has since stopped providing Peoria information to Raftelis, and in the 2000 survey the city is not listed).

Takeover proponents estimated that public ownership would result in a 31 percent rate reduction over the first 10 years.[81]

The city also argued that the buyback would place the much-needed control over economic development back into the city's hands. City officials have characterized the company as being less than cooperative in economic development initiatives. In fact, a group of business leaders offered to lend the city up to $1 million for the takeover attempt.[82]

Moreover, a financial analysis prepared by Raftelis showed the city would have $6 million a year in excess revenues if it owned the company itself.[83]

City officials argued that the 1889 franchise agreement allowed Peoria to buy local assets of Illinois-American. The company disagreed and challenged the city's position in court.[84] Soon thereafter Illinois-American, requested an 8.2 percent rate increase,[85] just three years after an 8.8 percent increase.[86]

Earlier this year, the U.S. Environmental Protection Agency fined Illinois-American $168,488 for failing to promptly report a release of chlorine vapors in 1998. The company waited 20 hours before reporting it. According to EPA spokesperson James Entzminger, the notification should have been made within 15 minutes of the spill. A Peoria firefighter was hospitalized after breathing the fumes.[87]

The EPA fined Illinois-American $168,488 fine for failing to promptly report a release of chlorine vapors in Peoria. A firefighter was hospitalized after breathing the fumes.

The buyout effort is now on hold pending the outcome of the legal battle.[88]

Washington Court House, Ohio

In 1991, Washington Court House, decided to take over its water system from Ohio Water Service Co. The city believed it could operate the utility more efficiently and at a lower cost.

As usually has been the case, the company mounted legal and public relations campaign, collecting enough signatures to put the issue on the ballot. Residents voted to retake control of the system and, after a two-year legal battle, the city purchased the water system for $10 million.[89]

City operations proved to be a true success story. One of the conditions of the bond issued by the city to raise money for the purchase required the city to collect approximately 20 percent more in revenues than it spent to operate the system. Yet just two years following the takeover, the city was collecting 60 percent more and enjoying $500,000 annual surpluses. Not only did the city live up to its promises not to raise rates in the three years following the takeover, it was actually able to issue rebates to local ratepayers.[90]

Consulting and Management

San Francisco, California

San Francisco is among a large number of U.S. cities whose water systems require intensive repairs and upgrades. The century-old Hetch Hetchy water system, which provides water to 2.3 million people in San Francisco, San Mateo, Santa Clara and Alameda counties, needs as much as $8 billion worth of seismic upgrades.[91]

The city hired a private consulting firm as it embarked on this ambitious project. Last year, after much controversy, the city awarded a $45 million contract to an alliance led by Bechtel Corporation, the world's largest engineering firm and an emerging player in private water market. The city's Public Utilities Commission (PUC) claimed that hiring Bechtel would produce as much as $45 million in savings over four years and allow access to the necessary expertise.

Many spoke out against the contract, including city budget analyst Harvey Rose, who disagreed with the claim of prospective savings because no supporting evidence had been provided.[92] Supervisor Tom Ammiano questioned the alliance's ability to produce cost-savings and suggested that the contract would eventually lead to further privatization.[93] Nevertheless, the city Board of Supervisors approved the deal.

Almost a year into the contract, many have voiced concern about its value. According to David Novogrodsky, the executive director of the Professional and Technical Engineers Local 21, Bechtel has so far done very little other than charge “outrageous” fees. Bechtel’s workers do not work closely with the city engineers. Additionally, there are a few “higher-ups” who go beyond their contractual role as consultants and often attempt to manage PUC staffers. And, there are many Bechtel support staff with no knowledge or experience unique to Bechtel.

Moreover, said Novogrodsky, most staff members are not qualified, and it is not unusual to see Bechtel employees sitting down studying for their engineering exams, instead of performing actual work.[94]

> The *Bay Guardian* found that most of Bechtel’s work in San Francisco was either “unnecessary, duplicated work that city staffers had already done, or wasn’t specialized enough to require a highly paid outside consultant.”

According to the *San Francisco Bay Guardian*, many city workers feel Bechtel is not aiding them in their work, and is actually slowing progress because the company has to approve certain in-house jobs. City workers also feel that instead of acquiring valuable skills from Bechtel’s engineers, as was originally intended, they have to explain even basic operations to them. Finally, staffers feel the city is being billed for work already performed by city employees.[95]

The city’s first semiannual audit found the Bechtel consortium’s performance to be satisfactory, although many tasks were not evaluated because they were in the start-up phase.[96] The auditor did find that of the $75,943 in reimbursement requests submitted by the consortium, $2,766 was not identified as allowable under the contract. These costs included refreshments and lunches, telephone charges, and relocation and travel expenses.[97]

The auditor also found that the consortium did not inform the PUC about changes in staff work locations, which is essential in order for the city to determine whether the consortium is charging correct rates.[98]

Additionally, a *Bay Guardian* investigation documented many instances of wasteful spending. Bechtel, for instance, was paid nearly $500,000 to restore and change the format of data already prepared by the city. Most of Bechtel’s work, the newspaper said, was either “unnecessary, duplicated work that city staffers had already done, or wasn’t specialized enough to require a highly paid outside consultant.”[99]

Conclusion

Not every private company provides poor service, and not every operation and maintenance contract is a failure. In their marketing efforts, however, companies exploit their successes while carefully concealing their failures. And, analyses conducted by financial consultants are often biased in favor of privatization.

As a result, the debate over the merits of transferring operations or ownership of public utilities to the private sector tends to be biased. The case histories in this report are intended to bring much needed balance to the debate, while helping government officials better assess the risks involved.

Not every public utility has a satisfactory performance record. However, the solution lies in more government accountability and more investment in aging systems not in signing them away and admitting defeat. The risks that privatization brings are simply too great to be dismissed.

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