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Problems with Public Private Partnerships in Ontario's Water and Wastewater Sector: Hamilton Wentworth as a Case Study

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The Drivers of Greater Private Sector Involvement in Water and Wastewater Operations

There are a number of factors that promote or facilitate the involvement of the private sector in the water and wastewater sector. The structural and policy changes include:

- Reduction or elimination of grants and funding to Municipalities
- Downloading of Services to Municipalities
- Desire by Municipalities to eliminate or avoid debt
- Desire to reduce costs and increase efficiency
- Ideology to reduce government and increase private sector role

There are also organizations and governments that are actively promoting greater private sector involvement. The Federal Liberal Government has been willing to promote a greater role for the private sector at the federal level while supporting private sector initiatives at other levels. However, the Ontario Government is among the greatest boosters of the turning public sector operations over to the private sector. The most vocal and influential non-governmental organization promoting greater private sector involvement in the delivery of public services and public infrastructure is the Canadian Council for Public Private Partnerships (CCPPP).[1]

What are Public Private Partnerships (P3s)

Public Private Partnerships are ventures where the private sector becomes a lead actor in the provision of public services. They may involve private-sector involvement in financing, designing, building, operating and owning public services, facilities and infrastructure. The term "Public Private Partnerships" is a clever and effective one because it has a disarming effect. Whereas privatization is clearly about the private sector takeover of services and infrastructure, P3 terminology suggests co-operation and mutual gain. Therefore, almost every form of private-sector intrusion into the public sector is called a P3.

The private sector has always been involved in the water and wastewater sector. It private sector has provided products, specialized services and consultation to public water systems. Private-sector design and construction of public

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[1] Its Chairperson is Michael Wilson, former Finance Minister in the Mulroney conservative Government. Its members include large corporations including the water corporations CH2Mhill, SAUR Canada Inc, Thames Water North America Inc and United Water, Azurix North America, EPCOR and USF Canada Inc. The Ontario Clean Water Agency and approximately 25 municipalities in Canada are also members including Cornwall, Guelph, Hamilton, Ottawa, London, Vaughan, Toronto, Regional Municipality of York, Goderich, Markham and Richmond Hill (The Canadian Council for Public Private Partnerships Directory of Members 2001.

infrastructure, something which we have always had and which CUPE has no objection to, is called a P3. Sometimes, straight forward contracting out of services are called P3s. Calling all of these P3s only confuses the issue and does not help us understand the expanding role of the private sector and the corresponding shrinking role for the public sector in the provision of services such as water and wastewater treatment and delivery.

There are three things that distinguish P3s from the standard contracting out of services and traditional private sector design and construction of public infrastructure.

1) P3s are longer-term agreements. The 3-5 year contracting out agreement is replaced by one that has a minimum term of ten years and extends to as much as thirty years.

2) P3s involve functions that go beyond operations, maintenance and management of services or infrastructure. They also involve the financing, leasing and ownership of infrastructure.

3) P3s are synonymous with the contracting or privatization of services and infrastructure that were unheard of before. Services like water that we never though they would privatise are now a target.

Promises of P3s

The advocates of P3s claims that they offer:

- Better financing for water and wastewater infrastructure
- Improved speed and efficiency in completing projects
- Improved operational efficiency
- Specialized expertise
- A transfer of risk from the public sector to the private sector
- Clear accountability
- Improved regulatory compliance and
- Protection of the public interest

However, there is evidence that P3s either do not make good on these promises or that these goals are ones that have been and can be achieved by the public sector. A brief examination of each promise with an illustration from the wastewater P3 in **Hamilton Wentworth** is used to make our argument. The

Hamilton Wentworth case is a useful one because it is the only water P3 in Ontario and only one of two in Canada.[2]

Better Financing with a P3?

It is widely accepted that governments can borrow money at lower rates of interest than can private corporations. When a private sector corporation borrows money for public sector projects it almost always pays more in borrowing costs, even when the loan is guaranteed by the government. It is also widely understood that the money borrowed by the private sector for public sector projects is an input that is a cost to the public sector and must eventually be repaid by the public or the users of the service.

The work of Professor John Loxley has demonstrated, through a series of case studies, that P3 capital financing is indeed more expensive than public financing. These studies of P3s in a variety of sectors show that P3 financing is often not shown as public sector debt, even though its repayment by the public sector is a financial commitment. Several provincial auditor generals have even raised serious concerns about the manner in which such financial commitments are hidden.

Finally, with many P3s there is no private capital committed to the project. In the case of the **Hamilton-Wentworth** Wastewater operations the private corporation, Philip Utilities Management Corporation (PUMC), was awarded a ten-year management contract. The corporation did not have to provide capital for the operation. However, [3] The Municipality was responsible for all capital expenditures, although PUMC would benefit from any improvements from capital expenditures as will be discussed later. PUMC is responsible for maintenance of the facility, a responsibility that is limited to $10,000 per year.[4]

Improved Speed and Efficiency in Completing Projects?

The private sector advances the idea of having the design/build stage completed by a single private sector partner, thus optimising the design, materials and construction and thereby reducing costs. This integrated design/build approach has merit, but there is nothing that prevents the public sector from using it by contracting a private sector corporation to implement the approach. This benefit is

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[2] The other one is a Design, Build, Operate and Transfer P3 for the water tratment facility in Moncton, NB. It has only been operating for a little over a year.

[3] John and Salim Loxley, *An Analysis of a Public-Private Sector Partnership: The Hamilton Wentworth-Philip Utilities Management Corporation PPP: A Report Prepared for the Canadian Union of Public Employees*, September, 1999. This is a revised and edited version of a report by David Anderson entitled *Privatizing Water Treatment: The Hamilton Experience*, January 1999.

[4] Ibid., p.14.

not relevant to the **Hamilton-Wentworth** case as there was no design-build phase in the P3.

Improved Operational Efficiency?

The big claim by the private sector is that it is more efficient that the public sector. For sure, the private sector has achieved operational efficiencies in some cases where it has taken over public water and wastewater facilities. However, very often these efficiencies are not achieved through any kind or innovative technology or creative reorganization. Instead, they are often achieved by dramatically reducing the workforce and having fewer people do more work.

This was the case at the PUMC-operated facilities in **Hamilton-Wentworth** where the workforce was reduced by almost 50% by the end of 1999, from a staff of approximately 120 to about 60. The wage, salary and benefit bill of approximately $7 million in 1995 was the biggest item in the $18 million per year budget and it became the principal way in which PUMC achieved cost savings. Any savings were to be shared by the Region and PUMC. PUMC was to make a payment of $500,000 annually to the Region and then it would receive 60% of savings until savings reached 20% of the $18 million annual budget, after which the PUMC's share was increased to 80%.

As for operational efficiency through investment in new plant and equipment, PUMC did not have to pay for capital upgrades as the contract specified that the Region was responsible for them while PUMC only has to pay up to a maximum of $10,000 per year in maintenance costs. However, PUMC expected that it would benefit from cost savings due to capital improvements. Indeed, in October 1995, annual savings of approximately $2.5 were realized as a result of a proposed energy transfer from the Region's solid waste incinerator to the sewage treatment plant. PUMC laid claim to this amount, but the Region argued that the savings were a direct result of its $8 million expenditure to make the energy transfer possible.

Another instance of PUMC benefiting from measures taken by the region was in 1996 when the Region closed down a sludge incinerator at a PUMC-operated plant because it required $10 million in repairs. PUMC began trucking the sludge to landfill site saving $60 per ton on a daily production of approximately 150 tons. The savings were split 60%-40% in favour of PUMC. If the Region had operated the wastewater system, they would have retained all of the savings.[5]

More Specialized Expertise and better Quality?

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[5] Loxley and Loxley., p.12.

The private sector does not have a monopoly on specialized staff and expertise. The public has dedicated and highly knowledgeable managers and operators who have been doing an extraordinary job under very demanding circumstances. In fact, it is not at all uncommon for the private sector to recruit public sector people. PUMC recruited five high-level people with the Region after it had won the contract. These same people had been involved in negotiating the initial contract with PUMC.[6]

The public sector has always and still utilizes private sector technology and expertise in performing certain functions related to the upgrading and or maintenance of their systems. However, Ontario has tremendous wealth of public sector experience and experience in operating and managing water and wastewater systems.

Transferring Risk from the Public Sector?

It is claimed that P3s by definition transfer most of the risk of operating water systems to the private sector. Specifically, it is argued that financing and operating risks are shifted to the private sector. However, the experience with **Hamilton Wentworth** shows how liability and risk tends to stay with the public sector.

PUMC was responsible for maintenance of the facility, but the responsibility was limited to $10,000 per year. Thus the Region maintained considerable responsibility for maintenance of the facilities as well as for any upgrades to the facilities. Because private companies are much more unstable than municipalities the latter are at risk if the private company develops serious financial problems. The financial problems of Philip Services Inc, PUMC's parent company, were in the news regularly as it fought off bankruptcy.

The **PUMC-Hamilton-Wentworth** experience makes clear that it is also difficult to hold a private sector partner liable when there is an accident. In January 1996, 180 million litres of raw sewage were spilled into the harbour and area and more than 115 houses and businesses were flooded in the Stoney Creek area. A Report by Rand Rosell of the Region's legal department aid PUMC was responsible for the spill and outside consultants put the blame on mechanical and operational failure caused by PUMC.[7] Yet, the Region had to pay for all damages, an amount that has not been published.

Public Accountability and Transparency

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[6] Loxley and Loxley, p.25-26

[7] Ibid., p.15

The advocates of P3s contend that they make the private sector responsible for problems over systems they operate and manage and for remedying these problems. The key to this system of accountability is the contract between the municipality and the private sector since the contract defines the outcomes expected and the framework within which the private sector must achieve these outcomes.

The reality is that contracts do not anticipate every possible situation and conflicts can arise between the municipality and the private sector partner. The conflict in **Hamilton Wentworth** over responsibility or the wastewater spill is a case in point. Also, there was a conflict over who should receive the savings from changes that reduced energy costs in the wastewater system. As both sides claimed the benefit, the legal costs mounted.

Private companies are not required to be transparent about their financial situations, many aspects of which they see as proprietary or competitive issues. The PUMC's reporting criteria to the Region was very vague and there was no monthly or quarterly reporting to the Ministry of the Environment. The contract between the Municipality and PUMC had no provisions related to public access to information. While there was a provision for an annual performance review, there was no stipulation that this should be made public. The 1995 review was obtained by the International Union of Operating Engineers only after a freedom of information request and even then they did not receive it until 1998. The Region's contract coordinator noted in the review that PUMC obtained a grade of "1" on most issues on a scale of 1 to 4 where 1 is inadequate.[8]

Accountability and Transparency are also compromised by corporate influence over the political process. The PUMC contract was suspect because it was not tendered through a competitive process. PUMC owners had roots in the local community and it is thought by many that this is why the contract was "sole-souurced". The parent company of PUMC made donations to various municipal election candidates; an activity that is completely legal but one that does not foster a democractic transparent process.

Accountability is further compromised when a locally based company such as PUMC is taken over by a foreign concern since decisions about the **Hamilton Wentworth** operation could be made by corporate representatives in another country. This is what happened in 1999 when PUMC was taken over by Azurix, a subsidiary of Enron Corporation based in Houston, Texas.

Under full public service delivery, almost any problem can be quickly addressed since politicans, administrators, supervisors and front-line employees are all part of the

[8] Loxley and Loxley, p.22

public system. For instance, a member of the public can call a municipality or government department with a complaint and the department can directly respond to the problem.

Also, when people have problems with their service under a P3, it is not the private contractor they contact, but the municipality. The public sector has to go to the private sector to obtain a remedy, if indeed the contract makes clear that the private sector is obligated to provide one. Such a system does not present clear lines of accountability between the municipality and the residents or the taxpayers and the residents. The private sector becomes an obstacle to effective accountability.

Improved Regulatory Compliance

It is argued that the public sector should not be both operator of a water system and the enforcer of regulation. Such an arrangement where the province regulates and enforces a municipality is a conflict of interest, since enforcement may result in financial penalties that the Province may end up paying for through its financial arrangement with the municipality.

However, in the five-year history of the operation of the **Hamilton Wentworth** system by PUMC, the Province has not shown a readiness to enforce regulations. PUMC has often failed to meet governmental or remedial Action Plan (RAP) standards for discharge of effluent.[9]

Nor does the P3 set up another level of enforcement through the contract. P3 contracts, it is argued, contain provisions for monitoring the compliance of the private sector on a regular basis. However, the example of **Hamilton Wentworth** shows that municipalities will fail to closely monitor or rigidly enforce regulations. Operators have repeatedly brought problems before elected officials within **Hamilton Wentworth**, usually only to have them ignored.

Impact on Workers and the Community is Positive?

The private sector often claims that its involvement in the water sector will create opportunities for workers and the community. PUMC initially promised to create 100 new jobs in the Region over a five-year period. It also promised to pay $1 million, or $10,000 for each job it did not create. Workers were also offered a 10% share in any expenditure reductions. Instead, PUMC laid off almost sixty workers, paying them the minimum of one week's pay for one year's work. The sharing of expenditure reductions with the work force soon went by the boards and the promise of more jobs in the Region remained just that.[10]

Further evidence of the intentions of the private sector is the legislative and policy changes proposed by the Canadian Council for Public Private Partnerships (CCPPP). The CCPPP has lobbied the Ontario Government for Changes to Collective Agreements in Municipal Sector, the Labour Relations Act, Employment Standards Act, Municipal Act and the Development Charges Act.[11] They say these

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[9] Ibid., 16
[10] Ibid., 26-27
[11] Canadian Council for Public Private Partnerships, "A Response to the Ministry of Municipal Affairs and Housing in regard to the Draft Municipal Act", October 1999. This document also contains comments on the Development Charges Act, Employment Standards Act, Labour Relations Act and the Municipal fair wage policies.

changes are needed to encourage P3s and provide a level playing field for the private sector.

The Changes to Labour legislation and contracts proposed by the CCPPP include:

- Eliminate successor rights as under the Crown Employees Collective Bargaining Act;
- Municipalities remove all contracting out language from collective agreements;
- Restrictions on contracting out language should include provisions on advance notification of employees and consultation with them on planned P3s or contracting out;
- Permit private sector partners to introduce pay for performance and profit sharing and;
- Eliminate the need for a successor employer to recognize an employee's length of service.[12]

These changes would amount to an overturning of the rights that workers have fought to win and maintain since the late 1930's.

The proposed changes to Ontario's Municipal Act and Development Charges Act by the CCPPP are clearing designed to allow municipalities to subsidize and promote the private sector in delivering public services. They include allowing municipalities to:

- Give or lend property or money
- Guarantee Private Sector Borrowing
- Lease or sell property below fair market value
- Provide total or partial exemption of fees, charges or levees
- Exempt private sector partners from taxes
- Exempt private sector capital costs under a lease agreement
- Form corporations and hold securities
- Move beyond service contracts to incorporated partnerships
- Be more flexible in accumulating or showing debt
- Empower private sector partner to collect development fees
- Allow private sector to access portion of reserve fund

Such changes would not enhance the public sector and the services it delivers to communities; instead it would undermine the public sector for the benefit of the private sector.

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[12] Ibid.

Private Sector Monopolies Result

PPP's are almost always promoted in the name of competition. Private sector partners claim that they want to break the public-sector monopoly on service delivery and thereby improve service and reduce costs. However, their real objective is to achieve a very profitable monopoly for themselves. Many services to the public are "natural monopolies" because they can only be delivered by one organization or agency. Water and sewage treatment services are a case in point. If a "natural monopoly" situation applies, it makes sense that democraticaly-controlled and accountable public organizations fulfil this need, not a foreign-controlled trans-national corporation.

PPP's are Privatization by Stealth.

Full privatization, the sale of public assets to private investors with some public-sector regulation, is considered by most to be outside the PPP framework. However, there is a connection between full privatization and Public Private Partnerships. Public Private Partnerships may represent a phase or stage in the privatization process. Once a corporation plays a significant role as a service provider within the public sector organization, it can more effectively promote privatization of a service. Partnerships can be considered privatization by stealth. For example, Toll Highway 407 in the Toronto area is a case in point. Soon after the highway was completed and operational under a 35-year design, build, operate and transfer contract it was fully privatised by the Ontario Government.[13]

[13] For a further explanation and examples of these problems see CUPE's "Behind the Pretty Packaging: Exposing Public Private Partnerships".