

# Replacing failed private water contracts<sup>1</sup>

by

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January 2010

A report commissioned by Public Services International (PSI) [www.world-psi.org](http://www.world-psi.org)  
for a seminar in Jakarta 20<sup>th</sup> January 2010



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<sup>1</sup> This version contains minor revisions to the paper as originally published.

## 1. Introduction

This paper sets out a global overview of trends in the public and private presence in the water sector, to help assess the options facing cities which still have problematic private water contracts, such as Jakarta.

The first section presents a general overview of the public-private mix; the status of the private companies, including the so-called ‘local’ companies; and the growth of public-public partnerships supporting municipally-run water services.

The next section examines the process of termination of private contracts around the world, and the negotiating positions and tactics used by companies and public authorities.

The final section examines the problems of the Jakarta contract, and the possible strategies for the city, in the light of global trends and experience.

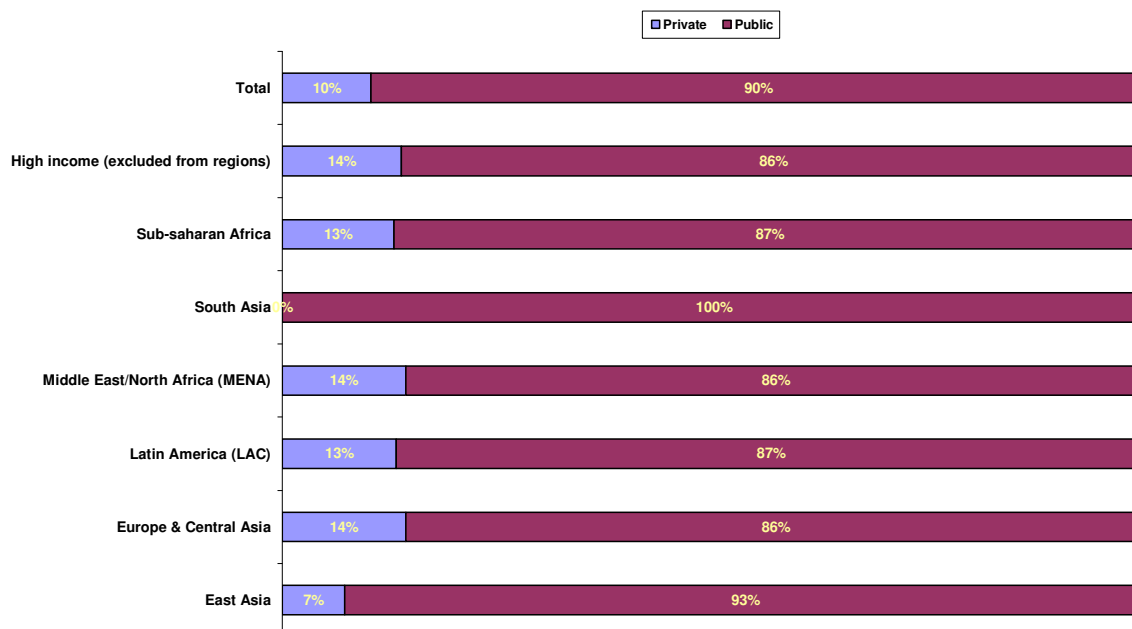
## 2. Global overview of public and private sectors in water

### 2.1. Public and private water services in largest cities in the world

Water services are owned and run by the public sector in about 90% of the largest 400 cities in the world (those with populations over 1million). The proportion run by the private sector is about 14% in high income countries – including the EU, USA, and Japan - and similar in developing countries in Latin America, Africa and Middle East. In south Asia there are no examples of privatised water, and in east Asia (excluding China) there are only 3 cases, Jakarta, Manila and Kuala Lumpur. The proportion privatised has fallen slightly since 2006, the year in respect of which the analysis was carried out, due to the return of public sector operators in cities such as Buenos Aires, La Paz, and Paris.

**Chart A. Public and private water operators in 400 largest cities in the world**

Private or public water operators in cities with population over 1 million (October 2006)



Source: PSIRU

### 2.2. Multinational retreats and the myth of ‘local’ companies<sup>1</sup>

As noted below, the large water multinationals – which effectively means Suez and Veolia – have pulled back from the aggressive international expansion which they were pursuing 10 years ago. The companies themselves now emphasise that their interest is restricted to certain types of contract – for example engineering contracts, especially BOTs – and certain areas, notably the EU, USA, Middle East/North Africa,

and China. There remains some activity by these companies in other countries, but nearly all of this is the legacy of the earlier years, rather than new contracts.

A PPIAF paper published in 2009<sup>2</sup> claims that there is ‘a new breed of investors’, private water companies which are local and not multinationals based in northern countries.<sup>3</sup> But its list of ‘local’ companies fails to survive examination, on a number of counts:

- it includes a number of companies which no longer own or operate the water services listed
- It includes one 100% public sector company (ONEP, Morocco) and a company which has only invested in water in the UK, not in developing countries
- Some companies are historical oddities which cannot be imitated, such as the Tata ‘company town’ in Jamshedpur, India, or WSSA, the company set up in South Africa under the apartheid regime
- a surprising number are owned by companies or rich individuals based in tax havens thousands of miles from the contracts e.g. the Antofagasta contract in Chile

The few cases of actual local or national companies are all, in effect, the various private companies which have collected stakes in the former multinational subsidiaries in Argentina, Brazil, or Colombia. They are descendants of the multinationals, with similar performance problems. The largest of them, Latinaguas (in Argentina), has been warned, criticised and or fined for underinvestment or poor customer service in 2 of its 3 concessions, and supported by public subsidies in the third. The private companies – mostly local construction companies originally taken on as partners by the multinationals – are not credible sources of investment finance, nor are they remotely comparable to the public sector operators of the region as a pool of expertise. A detailed presentation and discussion is set out in an earlier PSIRU paper.<sup>4</sup>

### 3. Terminations and renegotiations of private water contracts

#### 3.1. Problems with privatised water

Up to 1989 very few cities or countries in the world had privatised water supplies, outside France. The UK privatised water in England in 1989, then the World Bank and others encouraged privatisation of water and other public services in developing and transition countries. In the early 1990s a number of cities in former communist countries in Eastern Europe privatised their water to the English and French water companies, followed by cities in Argentina and other Latin American countries.

In the mid to late 1990s some African countries and cities privatised, together with a few Asian cities, notably Manila and Jakarta. By 2003, however, it was clear that privatisation was deeply unpopular, principally because of the price increases required by the companies. It was also clear that the companies were not making the expected investments in extending and improving the networks, nor making the expected improvements in efficiency, and the contracts and regulatory systems did not create sufficient incentives to do so.

The companies were also failing to make the profits expected by northern investors, and so the companies themselves wished to end or renegotiate most of these contracts. For example, Suez in January 2003 announced that it would withdraw from most developing countries unless they were protected from currency risk, financing all investment out of local profits, and providing a reliable short-term cash-flow – failing which the company would “prepare to depart”.<sup>5</sup>

As a result, many of the privatised water contracts were terminated, in most of these cases the service was renationalised, and some were renegotiated.<sup>6</sup> In some countries – Uruguay and Netherlands –water privatisation was made illegal.

#### 3.2. Continuing problems with privatised water

The problems with private water are not just a matter of poorly designed contracts or unsuitable regulatory mechanisms, as is sometimes argued. Very similar problems are seen in private water concessions and contracts all over the world. They include not only economic problems but public health problems, like the loss of piped water in parts of north Jakarta for 6 months in 2007, due to inadequate maintenance of an electrical system, caused an outbreak of diarrhoea in which 12 babies died and hundreds were hospitalised.<sup>7</sup> In a wide range of countries, the economic and public service problems continue.

### 3.2.1. Malaysia, Selangor privatised water concession to Syabas (Malaysian company)

Malaysia is in the process of renationalising its water network. In Selangor province, including Kuala Lumpur, the water concession is held by Syabas, owned by the Malaysian private company Puncak Niaga. In 2009 press reports noted ‘numerous irregularities’, involving accounting and financial devices such as non-tendered awarding of contracts, and large fixed management fees, as well as high levels of inefficiency:<sup>8</sup>

- Awarding 72 percent of contracts worth RM600 million [US\$180m.] without open tender;
- A discrepancy of RM325 million [US\$97.5m.] between the summary of contracts awarded in 2005, 2006 and 2007 and Syabas’ review document;
- Spending RM51.2 million [US\$15m.] to renovate Syabas headquarters, despite Selangor Water Regulatory Department (JKAS) approving only RM23.3 million for the exercise
- Syabas’ decision to source RM325 [US\$97.5m.] worth of pipes from Indonesia instead of locally in 2005, in breach of finance ministry instructions.
- RM5.1 million [US\$1.5m.] paid in allowances to its chairman Rozali Ismail (...the 32<sup>nd</sup> richest man in Malaysia)
- Syabas has a management fee agreement with its parent company Puncak Niaga. Syabas has to pay Puncak management fees, amounting to RM8.4 [US\$million annually and RM32 million [US\$9.6m.] since 2005
- Tariffs charged by Syabas are RM0.77 per cubic meter, more than double the amount of RM0.37 charged by the public sector water operator in Penang State

### 3.2.2. USA: Camden, New Jersey: leaking money and water

Camden County in New Jersey, population about 80,000, is officially the poorest city in the USA. Three mayors have been jailed for corruption, most recently Milton Milan in 2001.<sup>9</sup> In 2000, Camden privatised its water services under a 20-year contract with United Water, a subsidiary of Suez Environnement: the company is a major contributor to New Jersey politicians of both parties. In 2009 the state of New Jersey conducted a special audit into the water contract. Its findings, reported in November 2009, included:

- The loss of 45 percent of the water due to leakage, overflow, meter inaccuracies and billing errors
- Camden residents have long complained of poor water quality and brown water from their faucets, and inspections by state environmental officials found the potential for contamination in the water system is grave
- Most Camden customers have uncollected balances at least 90 days old, but the company’s account records are missing names and addresses, making collection impossible.
- The city paid \$2.2 million in connection with an amendment to the United Water contract, even though that amendment was never legally approved by elected officials.
- A review of 64 “add-on” charges worth \$8.3 million found problems with all 64 - including payments made without proper authorization.
- State auditors couldn’t locate 15 of 17 city assets that were supposed to be maintained by United Water. The two that it did find, including a water treatment plant with nine vehicles, was virtually abandoned and “left to rot,” according to the comptroller.
- United Water’s record-keeping is so poor that when Camden relied on the company’s list of properties with unpaid water bills to sell tax liens in 2003, it had to repurchase liens that should not have been sold. That cost the city nearly \$72,000.
- Twenty percent of the city’s fire hydrants need to be replaced, despite a contractual provision that all are operable.
- The company charged the city “administrative fees” not specified in the contract of 12.5 percent, even though the work was subcontracted to other companies.
- Water meters were not calibrated as mandated, causing inaccuracies and forcing the city to lose \$1 million in charges to public entities like the Camden County Jail and the Riverfront State Prison.
- United Water failed to refund \$550,000 owed to city customers.”<sup>10</sup>

### 3.2.3. Gabon: typhoid, underinvestment

Water has been privatised in Gabon since 1997, under a joint energy and water concession to SEEG, which is 51% owned by Veolia. In January 2010 some districts of Libreville, the capital, still had no water at all,

while others faced cuts of up to eight hours a day. The Gabon government warned SEEG that failure to make improvements would result in a “sequestration” of the contract, and has ordered an audit of the company. The same problems of under-investment have existed for years, despite repeated government complaints: in 2004 there was an outbreak of typhoid in a town after months without a functioning water supply, and the government accused SEEG of “not wanting to invest in the short, the medium or the long term”. In 2005 SEEG got £25m from the World Bank’s private sector support arm, the International Finance Corporation, but in 2009 there were still repeated, lengthy interruptions to both water and energy services.<sup>11</sup>

#### 3.2.4. Brussels: Veolia releases sewage into river as bargaining tactic

Aquiris, a company owned by Veolia Water, has a PPP (technically a BOT concession) to operate a waste water treatment plant treating the sewage of the Belgian capital, Brussels. On 8th December 2009, Aquiris deliberately stopped treating the sewage and allowed it flow unchecked and untreated into the river Zenne, causing an environmental disaster. The action was described by the chief executive of the regional water authority as like releasing an atomic bomb. The action was taken because Aquiris were in a dispute with the responsible public authorities. Whatever the rights and wrongs in the dispute, it is hard to imagine that a publicly owned and operated company would have stopped the pumps like this.<sup>12</sup>

#### 3.2.5. Manila: no competition, no sewerage treatment, donor aid for private capacity

There is a constant process of renegotiation, even in supposedly stable contracts such as those in Manila. In the first week of January 2010, the concession of Manila Water, one of the two companies sharing the city’s water business, was extended by 15 years, without any competitive tendering, in addition to the original 25 year period which started in 1997. This means that Manila water’s monopoly in eastern Manila will last at least until 2037.<sup>13</sup>

In the previous month, Manila water and the other concession holder, Maynilad Water, were jointly fined P29.4 million [about US\$600,000] for failing to develop sewerage treatment plants despite this having been required by a law passed 5 years previously. In January 2010, both companies announced that they were appealing against this fine.

On the same day, Maynilad effectively admitted it had no skills or capacity in the field of sewerage, and needed public assistance to learn, when it announced that it would be using donor aid from the USA to pay Indah Water Konsortium (IWK) of Malaysia to teach Maynilad about this subject: “exchange best practices and learning experiences with the Malaysian firm and improve the Philippine company’s ability to develop and implement sewerage and sanitation projects. Another component of the program is to promote the health and environmental benefits of being connected to sewer lines. We also want to raise awareness on the consequences of indiscriminate dumping of domestic and industrial wastes in rivers and waterways in Metro Manila”.<sup>14</sup>

### 3.3. Extent of terminations and renegotiations

The table below sets out 34 known cases in which private water supply contracts have been terminated or renegotiated and then wholly or partly sold, (plus two ongoing disputes) together with comments on the process, in particular the use of compensation claims by the private companies. 21 of these cases concern Suez.

**Table 1. Water service contracts: terminated, renegotiated, sold**

Status: Expired, Terminated (and renationalised or re-municipalised), Renegotiated, Sold, Current

Argentina	Buenos Aires	2006	Suez	T	Compensation claim at ICSID was launched by Suez, then dropped to facilitate sale of its shares, now resumed. Lawsuits against Suez have been filed in front of Argentine courts by individual citizens, civil society organisations and local authorities for the poor level of service.
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Argentina	Buenos Aires Province 1	2002	Enron	T	Azurix withdrew from the contract accusing the regional government of "serious breaches". An ICSID Tribunal rendered an award in 2006 condemning Argentina to pay US\$ 165 million instead of the US\$ 565 million claimed by Azurix. The case is still pending and no payment made.
Argentina	Buenos Aires Province 2	2006	Impregilo	T	Impregilo filed a compensation claim in front of ICSID and the case is still pending. No payment made.
Argentina	Cordoba	2007	Suez	RS	Suez discontinued ICSID proceedings after renegotiating the contract with local authorities and transferring its shares to a local company.
Argentina	Mendoza	2009	Enron, SAUR	RT	The city council took over the company in 2009 on a 'temporary' basis, after failure to renegotiate. SAUR filed a compensation claim for US\$ 200-300 million to ICSID, suspended the claim and then reactivated it. The council is carrying out a financial, technical and environmental audit which could lead to compensation claims against SAUR and even prison sentences.
Argentina	Santa Fe	2006	Suez	T	After failing to sell its shares to private sector buyers, Suez withdrew from the contract. A compensation claim in front of ICSID is currently pending.
Argentina	Tucuman	1998	Veolia	T	Terminated after consumers stopped paying bills due to serious operational failures. An ICSID Tribunal rendered an award in 2007 condemning Argentina to pay US\$ 105 million instead of the US\$ 375 million claimed by Vivendi. The case is still pending due to appeal and no payment made.
Belize	National	2005	Biwater	TS	Renationalised by buying shares in BWS from Cascad/Biwater. Government then floated BWS for sale to Belize citizens only.
Bolivia	Cochabamba	2000	Bechtel	T	The concession was terminated following social unrest. Bechtel filed a compensation claim in front of ICSID demanding payment of US\$ 50 million. Due to pressure from an international civil society campaign, Bechtel decided to abandon the claim to protect its reputation. The claim was formally settled for a token payment of 2 Bolivianos (US\$ 0.30).
Bolivia	La Paz/El Alto	2007	Suez	T	The contract was ended after amicable negotiations providing for the Bolivian government to assume responsibility for loans, amounting to US\$ 9.6 million, and pay US\$ 5.5 million as compensation to Suez.
Brazil	Guariroba	2006	Suez	S	Suez left and sold its shares to a Brazilian operator. No reports of compensation.
Brazil	Limeira	2006	Suez	S	Suez left and the company is now wholly owned by a Brazilian operator. No reports of compensation.
Central African Republic	Bangui	2001	SAUR	T	The SAUR contract was terminated 5 years before its expiry. No reports of compensation paid.
Chile	Calama	2006	Biwater	TS	BOT. Regulator SISS stops payments to wastewater treatment BOT because of bad performance. Contract was terminated and plant taken over by water authority Essan.
China	Da Chang (Shanghai)	2004	Thames	W	BOT. Thames Water abandoned its Da Chang BOT treatment plant after the Chinese government declared that the municipal guarantee of a 16 per cent profit was invalid. No report of compensation paid.
China	Shenyang	2002	Suez	T	BOT. Terminated, council could not afford to pay
Colombia	Bogota	2004	Suez	T	BOT. The Salitre wastewater BOT was terminated after the city council calculated that the project was charging ten times too much, and that it was worth paying US\$ 80 million to buy out the contract.
Estonia	Tallinn	2009	United Utilities	C	City council refers profit rate of return to competition commission which rules it is double the acceptable level. Council seeks revision or termination.
France	Grenoble	2000	Suez	T	Operating contract renegotiated into joint venture with commune. Terminated after 2 court cases
France	Paris	2009	Suez, Veolia	TE	Re-municipalised at expiry by decision of Paris city council.



Gambia		1995	Veolia	T	The Veolia contract was terminated by government on grounds of poor performance. No reports of compensation paid.
Germany	Potsdam	2000	Suez	T	With agreed but undisclosed compensation and agreement to contract works to Suez
Hungary	Pecs	2009	Suez	C	Attempted termination 2004. Dropped after court case for compensation. New attempt October 2009.
Indonesia	Jakarta	2001	Suez, Thames	RS	Renegotiation protected payments to companies and rate of return. Partially sold by Suez, 98% sold by Thames.
Malaysia	states	2009		TR	Malaysian government policy to renationalise all water assets and revise or terminate existing concession agreements.
Mali	Bamako	2005	SAUR	T	The SAUR contract was terminated by government on grounds of poor performance. No reports of compensation.
Philippines	Manila	2005	Suez, United Utilities	TR S	Many conflicts with regulator. Maynilad Water (Suez) was bankrupt, bailed out by re-nationalisation, state funds, reduced targets, and higher prices, and then 84% sold to a new private equity/ construction joint venture. Manila Water (United Utilities) floated on stock exchange, now mostly owned by Ayala. Continuing problems over prices and investment.
South Africa	Amahthali (Stutterheim)	2005	Suez	T	Contract taken over by municipal water company
South Africa	Johannesburg		Suez	TE	Management contract, not renewed
South Africa	Nkonkobe (Fort Beaufort)	2002	Suez	T	City council won court ruling invalidating the contract.
Tanzania	Dar-es-Salaam	2005	Biwater	T	Terminated by government on grounds of poor performance. Biwater filed two compensation claims in front of two different international arbitration tribunals and lost both cases. It lost the case filed in front of the UK High Court under UNCITRAL rules (on grounds of early termination of the contract) and was condemned to pay GBP 3 million in damages, which Biwater refused to pay. It also lost the case filed in front of an ICSID tribunal on grounds of expropriation. The ICSID tribunal "found that while Tanzania's government had violated its bilateral investment treaty with the UK on four separate counts (including the unlawful expropriation of assets from Biwater's local JV City Water), the company is not entitled to compensation because the value of its investment in City Water was nil at the time of the expropriation".
Turkey	Antalya	2002	Suez	T	Suez subsidiary made bankrupt after price increase refused, municipality took over.
Uruguay	Aguas de la Costa	2006	Suez	T	Suez left after reaching an amicable settlement with the government and selling its shares.
Uruguay	URAGUA	2006	Urbaser	T	Urbaser and Aguas de Bilbao filed a compensation claim in front of ICSID and the case is still pending. No payment has been made.
USA	Atlanta	2003	Suez	T	Amicable settlement forbids Atlanta mayor and city councillors to criticise Suez in public and provides for a payment of US\$ 13.3 million to Suez, due to "transition costs". Technically, this is not paid as compensation.

In order to understand these processes, it is necessary to identify the objectives of the companies on the one hand, and of governments and cities on the other hand.

### 3.4. Company tactics: compensation claims and political pressures

For the companies, the objective is to achieve one of two results:

- either, to terminate the contract on the most favourable possible terms – i.e. with maximum compensation, or minimum payment of damages, and minimum damage to the company reputation;
- or, alternatively, to renegotiate the contract so that it delivers a return on capital which is both high and secure from various risks, including political and regulatory risk.

There are two principle tactics used by multinational companies in

Companies use compensation claims to courts or arbitration tribunals as tactical bargaining moves. The tactic is most often used when governments (or city councils) attempt to terminate a contract (e.g. Buenos Aires, La Paz/El Alto, Dar es Salaam), or alter a contract, or impose regulatory sanctions (e.g. Arezzo, Italy). The company objective is to deter the government/city from taking the proposed action, or to negotiate a better deal than they could without the threat of arbitration. The tactical nature of these claims can be clearly seen in cases where claims have been submitted, then dropped or suspended while negotiations take place, and then reactivated if companies think that negotiations are not going well for them (e.g. Buenos Aires and Mendoza, both in Argentina).

In the majority of cases, however, even when an arbitration award is made, this does not invariably result in a government paying compensation. One reason for this is that companies do not always win arbitration cases e.g. Dar-es-Salaam where Biwater lost in two cases, under both UNCITRAL and ICSID arbitration rules. Another factor is that countries do not always accept the rulings e.g. Argentina has refused to recognise any ICSID awards, and in May 2007 Venezuela, Bolivia, Nicaragua, and Cuba decided to leave ICSID. Companies may do the same: in the Dar-es-Salaam case, the Tanzanian government said it would refuse to recognise an UNCITRAL award; when the government won the case, the multinational Biwater said it would not pay damages to Tanzania because the subsidiary company had been liquidated.

One tactic is exaggerating claims to scare and to maximise possible return. The actual amount of compensation awarded varies; even when an arbitration tribunal finds in their favour, the award may be less than 30% of the original claim (e.g. Tucuman, Argentina; Azurix in the Province of Buenos Aires, Argentina) or a token amount (in Cochabamba, it involved no more than 2 Bolivian pesos) or nothing (in Dar-es-Salaam, even the tribunal which awarded in Biwater's favour said that it was not entitled to any compensation because the company was worthless).

Arbitration claims (and even awards) are normally dropped as part of a negotiated settlement involving termination of the contract. The only cases where companies continue to pursue compensation claims regardless of negotiations are those where the company no longer operate in the water sector and so has nothing to lose (e.g. Vivendi in Tucuman, Enron/Azurix in Buenos Aires province). Companies are likely to want to negotiate a settlement if they want to retain operations in the region or country (e.g. SAUR in Mendoza, Argentina); or if they can sell the company more easily without a pending arbitration case (e.g. Suez in Cordoba, Buenos Aires and Santa Fe, Argentina); or if they want to protect their international reputation, to end damaging campaigns by international civil society (e.g. Bechtel in Cochabamba, Bolivia). In other cases compensation has been agreed without arbitration proceedings even starting: e.g. the Salitre BOT in Bogota, Colombia; Grenoble, France; Potsdam, Germany; Belize.

The other main category of company tactics is political pressure, through mobilising the embassies of the home countries of the multinationals. In Argentina, for example, the companies mobilised the EU to warn Argentina against introducing new tighter regulation, on pain of damaging diplomatic relations with Europe. In Indonesia, the British ambassador successfully intervened by asking the president to authorise price increases requested by the British water company Thames Water. In Hungary, the French, British, German and other ambassadors pressured the Hungarian prime minister to denounce the attempt by Pecs to re-municipalise the water service in 2009.

### 3.5. Governments and cities

For governments and cities, the objectives normally include satisfying citizens and consumers that prices are not excessive, that the quality and extent of services are being improved, and that there is little or no cost to public finances in terminating or renegotiating the agreement.

It is also possible to identify initiatives and tactics used by governments and citizens.

- Governments or public authorities also withhold payments, refuse price rises, or impose fines as a response to persistent non-performance. Refusal to permit price increases was a key measure in Buenos Aires, Dar-es-Salaam, Manila and many other cities. The effect of this was not only to make the service more affordable to citizens, but also to make the business less profitable and less



attractive for the companies, thus triggering re-negotiations or terminations. This was done in Antalya, for example, where the private company was then liquidated, and the service taken over by the municipality. In Chile, in the case of a badly performing wastewater treatment contract at Calama, the regulator simply suspended that portion of the user charge which financed the payments to the operator. The company appealed, but lost: the court stated that it would be absurd to support the company's appeal because then "it could provide a bad service at a very low cost [to itself], charge full price to users as if it had been paid in good condition.... gaining huge profits".<sup>15</sup>

- A similar approach is to insist on rewriting the contract to ensure that it is 'well-balanced' between the interests of the public authorities and those of the company, and/or to insist on introducing 'performance-related' provisions that provide real incentives and penalties for the private company. This has been done recently in a number of contracts in Russia, where existing lease contracts were rewritten in this way, supported by the European Bank for Reconstruction and Development, which made these revisions a condition of its loans.<sup>16</sup>
- Independent audits have been used in a number of cases, for example La Paz, as a way of both confirming and publicising a government's criticisms of a company, supporting fines or price reductions, countering a company's claim for compensation. Similar audits are now being commissioned by the government of Gabon in Africa,<sup>17</sup> and the provinces of Mendoza and Santa Fe in Argentina.
- Regulatory bodies played a significant role. In La Paz, Buenos Aires and Manila they published or commissioned reviews of performance, imposed fines for non-performance and/or recommended against price rises. In Paris, reform of the regulatory body to establish public accountability was the first stage in the process.
- Consumers and other groups have been key players in terms of making public complaints about performance (e.g. in Dar-es-Salaam), participating in demonstrations and other action (e.g. in La Paz), bringing court cases against the private operator (e.g. in Buenos Aires, Manila), and campaigning and making submissions to the ICSID cases (e.g. in Cochabamba, Buenos Aires, Dar-es-Salaam).

### 3.6. Outcomes: re-municipalisation or nationalisation

The public authorities have nationalised or municipalised in the great majority of cases. In four of the five capital cities - Buenos Aires, Paris, Dar-es-Salaam, and La Paz - this was the final result. In the case of Manila one of the companies, Maynilad, was renationalised, restructured with extra state aid and a contract more favourable to the private company, and the government then sold its shares in the company to new investors (a similar process happened in Belize). The act of nationalisation sometimes happens as the first move in the sequence of events – for example in Dar-es-Salaam, Atlanta and La Paz; sometimes as an initiative during the bargaining processes – as in Buenos Aires; but usually as the final step, either implementing an agreed termination or as a way of imposing a termination. In Malaysia, the government policy is to systematically renationalise all the assets of the state water services, terminating existing private concessions, reducing allowable price increases, and negotiating compensation, financed by a RM20 billion sukuk bond issuance (USD \$5.9billion).<sup>18</sup>

The creation of a new public water service can involve a long process of preparation. In particular, there is a need to address issues of staff transfer, organisational capacity, and economic benefits:

It involves transferring existing staff of the private contractor to the new public operator, which may involve detailed negotiations, as was the case in Paris, for example.

The new organisation may need technical assistance to develop capacity: in Dar-es-Salaam, this was provided through a public-public partnership (PUP – see next section) with Uganda's NWSC, which provided training and consultancy, resulting in an immediate improvement in performance.

The creation of a new public sector service out of a terminated private concession clearly involves costs, but an assessment of the overall economic impact invariably shows that these costs are far outweighed by the savings on tendering and monitoring, lower costs of capital, and the developmental and democratic advantages of the flexibility in a directly controlled service. This cost-benefit analysis was central to the decision by Paris to re-municipalise rather than renegotiate.

### 3.7. Public-public partnerships (PUPs)<sup>19</sup>

Water operators need to be efficient, accountable, honest public institutions providing a universal service. Many water services however lack the institutional strength, the human resources, the technical expertise and

equipment, or the financial or managerial capacity to provide these services. They need support to develop these capacities. A growing number of public sector water companies have been engaged, in a great variety of ways, in helping others develop the capacity to be effective and accountable public services. These supportive arrangements are now called “public-public partnerships” (PUPs). A public-public partnership (PUP) is simply a collaboration between two or more public authorities or organisations, based on solidarity, to improve the capacity and effectiveness of one partner in providing public water or sanitation services. They have been described as: “a peer relationship forged around common values and objectives, which exclude profit-seeking”.<sup>20</sup> A great advantage of PUPs is that they avoid the risks of private partnerships: transaction costs, contract failure, renegotiation, and the complexities of regulation, commercial opportunism, monopoly pricing, commercial secrecy, currency risk, and lack of public legitimacy.<sup>21</sup>

PUPs are not merely an abstract concept. In the last 20 years there have been over 130 PUPs in around 70 countries, in all regions of the world. This means that far more countries have hosted PUPs than host PPPs in water (according to a report from PPIAF in December 2008, there are only 44 countries with any kind of private participation in water). The earliest PUPs date to the 1980s, when the Yokohama Waterworks Bureau first started partnerships to help train staff in other Asian countries. Many of the PUP projects have been initiated in the last few years, a result of the growing recognition of PUPs as a tool for achieving improvements in public water management.

From 2010 the European Commission will provide up to €40 million Euros to finance PUPs involving EU public sector water operators and partners in developing countries. For further information on PUPs see <http://www.psiru.org/reports/2009-03-W-PUPS.doc>.

#### **4. The Jakarta water contract**

The preceding sections show that the problems of private water concessions are widespread; that public sector operation is normal; that many private contracts have been terminated, or are subject to continuing bargaining processes over economic and public health issues; and that public-public partnerships are often used to develop public sector provision.

Against this background, this section examines the problems associated with the Jakarta water concession, sets them in the context of global trends and experience, and considers possible courses of action by the city. The review of the issues draws on two major source documents.<sup>22</sup>

##### **4.1. Problems with contract and performance**

The contracts originated as political acts of the Suharto regime. The process started with a letter from President Suharto in 1995, and ended with two companies being appointed in 1997, without any competitive tendering. The corruption in this process was visible in the original share allocations: the British firm Thames Water allocated shares to a firm owned by the son of the president, the French company Suez Lyonnaise des Eaux allocated shares to a firm owned by a crony of Suharto. After the fall of Suharto in 1998, these allocations were rapidly reduced. (CR pp2-3)

Like many privatised water contracts, the Jakarta contracts were revised in 2001 in order to make it easier for the companies. This was because the private companies were unable to make sufficient profits and achieve the targets of the original contracts. The revisions reduced the targets for coverage and non-revenue water to levels below what was achieved by PAM Jaya in 1995, and even the new targets are weakened by various exceptions and flexibility clauses. (FTY pp. 54-66; CR pp. 9-10).

The 2001 revisions also created a new system for payment of the companies, which can best be described as a ‘cost-plus’ contract with guaranteed profits. The companies are paid according to their costs, protected against inflation, interest rates, foreign exchange rate and even tax changes (FTY p.94). These include a ‘know-how’ fee, or management fee, which is typical of water concessions; a World Bank paper noted that the effect of these ‘management fees’ is to provide a guaranteed dividend for the owners of the operating companies. In addition, the charge is calculated to provide a guaranteed return on capital of 22% (CA clause 27.1, schedule 6: CR p.13, FTY pp. 54-66). The tariffs paid by customers are effectively determined by these

charges, so that if these tariffs are held down to make them affordable, the deficit has to be covered by the public authorities, not by the operators.

The overall objectives of the contract still refer to ‘comprehensive coverage...substantial extension...increase efficiency.... ensure the quantity, quality and continuity of supply of clean water and potable water... to meet the technical target and service standards.... to reduce the quantity of unaccounted for water.....’ (CA2001 art 2.2; CR pp6-7). But the actual performance of the companies is very poor. There has been little extension of the network, with the lowest level of coverage of major Asian cities; the price per cubic meter of water is the highest of any major Asian city; in terms of quality, the water coming out of the taps must be boiled; in terms of efficiency, non-revenue water remains over 50% (FTY pp. 5, 105-137).

#### 4.2. Problems in context

The contract revisions of 2001 created a distinct set of problems. There are no effective incentives, as the company’s payments and indeed their rate of return are effectively guaranteed under the contract. The companies’ poor performance record has certainly not been helped by such a contract.

It is therefore tempting to address the problem by trying to reform the contract. However, there are three factors which must be borne in mind.

Firstly, the performance problems are not unique to Jakarta. As the section on terminations shows, many other cities which have privatised water have also experienced the same combination of high prices, low investment, no efficiency improvements, and poor performance on leakage, and it is now recognised even by former supporters of water privatisation that it is ‘an experiment which failed’.<sup>23</sup> The experience of many cities is that solving the performance problems requires replacing the private contractor with a public sector operator.

Secondly, as many of these cities found, it may not be possible to revise contracts so that they are profitable enough for the companies, and at the same time deliver the public interest objectives – lower prices, greater investment in extensions and efficiency. In any case, companies will demand compensation for an unfavourable revision of a contract as much as they would for termination.

Thirdly, if a contract is terminated, a public sector operation needs to be re-established. This should be planned for at an early stage, as the necessary capacity-building may take some time. The growth in PUPs is of potential assistance in this process.

#### 4.3. Possible actions by the city

Five broad types of action are clearly worth considering:

- Commission an independent audit on technical, financial, social, economic, environmental and accountability impact of the concessions. This should assess how much the Jakarta water concession is actually costing, including the costs of receiving a poor service. This assessment is vital for assessing the city’s potential claims or liabilities in negotiation with the companies.
- Examine the possible legal grounds for challenges in court by governments or consumers to the provisions of the contract or the actions of the companies
- Announce termination for breach of contract/unsatisfactory performance, or unilateral insistence on revision or termination
- Encourage public campaigns, both national and international, both to put pressure on the companies and demonstrate political responsiveness
- Plan to create a public sector operator, identifying capacity needs and staff transfer issues, potential PUP partners, and potential sources of finance for such a PUP
- Develop a new business plan, including investment and connection targets, and identify potential/optimal sources of finance.

## Notes

- <sup>1</sup> This section is based on section 3 of our paper on private companies for the World Water Forum, see <http://www.psiru.org/reports/2009-03-W-companies.doc>
- <sup>2</sup> Stephan von Klaudy, Apurva Sanghi, Georgina Dellacha 2008 Emerging Market Investors and Operators - a New Breed Of Infrastructure Investors PPIAF Working Paper No. 7, 2008 [http://www.ppiaf.org/documents/working\\_papers/emerging\\_investors7.pdf](http://www.ppiaf.org/documents/working_papers/emerging_investors7.pdf) ; PPIAF 2009 Public-Private Partnerships For Urban Water Utilities: A Review Of Experiences In Developing Countries.
- <sup>3</sup> Stephan von Klaudy, Apurva Sanghi, Georgina Dellacha 2008 Emerging Market Investors and Operators - a New Breed Of Infrastructure Investors PPIAF Working Paper No. 7, 2008 [http://www.ppiaf.org/documents/working\\_papers/emerging\\_investors7.pdf](http://www.ppiaf.org/documents/working_papers/emerging_investors7.pdf) ; PPIAF 2009 Public-Private Partnerships For Urban Water Utilities: A Review Of Experiences In Developing Countries.
- <sup>4</sup> E. Lobina and D. Hall 2007 Water privatisation and restructuring in Latin America, 2007 <http://www.psiru.org/reports/2007-09-W-Latam.doc>
- <sup>5</sup> See PSIRU 2003 Water multinationals - no longer business as usual <http://www.psiru.org/reports/2003-03-W-MNCs.doc>
- <sup>6</sup> For a detailed account of water privatisation see a number of PSIRU reports including 'Water privatisation' by D. Hall and E. Lobina April 2008 [www.psiru.org/reports/2008-04-W-over.doc](http://www.psiru.org/reports/2008-04-W-over.doc)
- <sup>7</sup> The First Ten Years of Implementation of the Jakarta water Supply 25-year concession agreement. By JWRSB.2009 (referred to as FTY) <http://www.jakartawater.org/images/stories/unduh/10tahunbrEng.pdf>
- <sup>8</sup> Selangor can lower water rates if... Andrew Ong [Malaysiakini](http://malaysianheartbeat.com/yourmp/2009_02_archive.html) Feb 26, 09 [http://malaysianheartbeat.com/yourmp/2009\\_02\\_archive.html](http://malaysianheartbeat.com/yourmp/2009_02_archive.html)
- <sup>9</sup> [http://www.economist.com/world/unitedstates/displaystory.cfm?story\\_id=14974307](http://www.economist.com/world/unitedstates/displaystory.cfm?story_id=14974307) ; <http://www.nytimes.com/2001/07/16/nyregion/metro-briefing-new-jersey-camden-milan-begins-sentence.html>
- <sup>10</sup> State faults Camden water management Philadelphia Inquirer 12/16/2009 by Matt Katz [http://www.philly.com/philly/news/20091216\\_State\\_faults\\_Camden\\_water\\_management.html](http://www.philly.com/philly/news/20091216_State_faults_Camden_water_management.html) . The official press release is available at [http://www.state.nj.us/comptroller/news/docs/camden\\_pr\\_final12-16-09.pdf](http://www.state.nj.us/comptroller/news/docs/camden_pr_final12-16-09.pdf) The audit report itself is available at [http://www.state.nj.us/comptroller/news/docs/camden\\_audit\\_report12-16-09.pdf](http://www.state.nj.us/comptroller/news/docs/camden_audit_report12-16-09.pdf),
- <sup>11</sup> [Gabon warns Veolia unit on water contract | Reuters](http://www.gaboneco.com) Sunday, January 3rd, 2010; [gaboneco.com - Gabon : Le gouvernement va réviser ses accords avec la SEEG](http://www.gaboneco.com) ; Sunday, January 3rd, 2010; Pipe Dreams 2006 <http://www.psiru.org/reports/2006-03-W-investment.pdf>
- <sup>12</sup> See <http://www.epsu.org/a/6071> .More information is available at: <http://www.demorgen.be/dm/nl/989/Binnenland/article/detail/1044008/2009/12/18/Zware-dwangsom-voor-Aquiris-en-Brussels-gewest-in-Zenne-dossier.dhtml> (Dutch); and with an interesting chronology of events: <http://www.elsampe.be/pdf/artikel%20ds%2017122009%20zennevervuiling%20ab.pdf> (Dutch); for more information on Hill & Knowlton: [http://en.wikipedia.org/wiki/Hill\\_&\\_Knowlton](http://en.wikipedia.org/wiki/Hill_&_Knowlton)
- <sup>13</sup> [Manila Water's contract extension approved | ABS-CBN News Online Beta](http://www.abs-cbnnews.com) Monday, January 4th, 2010
- <sup>14</sup> [MAYNILAD, MANILA WATER APPEAL WASTEWATER FINE](http://www.philly.com/philly/news/20091216_State_faults_Camden_water_management.html) Monday, January 4th, 2010 [Philippine Daily Inquirer](http://www.philly.com/philly/news/20091216_State_faults_Camden_water_management.html) December 12, 2009 Saturday; [Maynilad partners with USAID, Malaysian company](http://www.philly.com/philly/news/20091216_State_faults_Camden_water_management.html) Monday, January 4th, 2010 [Manila Times \(Philippines\)](http://www.philly.com/philly/news/20091216_State_faults_Camden_water_management.html) December 12, 2009 Saturday
- <sup>15</sup> See <http://www.siss.cl/article-5247.html> and <http://www.siss.cl/article-5259.html>
- <sup>16</sup> OECD 2009 Status paper on key trends in private sector participation in water supply and sanitation in the EECCA region p.26
- <sup>17</sup> [Gaboneco](http://www.gaboneco.com/show_article.php?IDActu=16071) Sunday, January 3rd, 2010 [Gabon : Le gouvernement va réviser ses accords avec la SEEG](http://www.gaboneco.com/show_article.php?IDActu=16071) [http://www.gaboneco.com/show\\_article.php?IDActu=16071](http://www.gaboneco.com/show_article.php?IDActu=16071)
- <sup>18</sup> The Edge Financial Daily, January 4, 2010. 2009, a volatile year for water industry <http://www.theedgemaalaysia.com/in-the-financial-daily/156697-2009-a-volatile-year-for-water-industry.html>
- <sup>19</sup> This section is based on the PSIRU paper on PUPs for the WWF5 in Istanbul March 2009 <http://www.psiru.org/reports/2009-03-W-PUPS.doc>
- <sup>20</sup> Lobina, E., Hall, D. (2006) Public-Public Partnerships as a catalyst for capacity building and institutional development: lessons from Stockholm Vatten's experience in the Baltic region. *PSIRU Reports*, August 2006 (<http://www.psiru.org/reports/2006-09-W-PUPS.doc>), p. 16.
- <sup>21</sup> Lobina, E., Hall, D. (2006) Public-Public Partnerships as a catalyst for capacity building and institutional development: lessons from Stockholm Vatten's experience in the Baltic region. *PSIRU Reports*, August 2006 (<http://www.psiru.org/reports/2006-09-W-PUPS.doc>), pp. 5-7.
- <sup>22</sup> The First Ten Years of Implementation of the Jakarta water Supply 25-year concession agreement. By JWRSB.2009 (referred to as FTY) <http://www.jakartawater.org/images/stories/unduh/10tahunbrEng.pdf> ; CRITICAL REVIEW OF JAKARTA WATER CONCESSION CONTRACT by Wijanto Hadipuro and Nila Ardhianie 2007 (referred to as CR)
- <sup>23</sup> For example, two new reports published by the World Bank's PPIAF acknowledge that these problems are widespread. For references and a critique of those reports see <http://www.psiru.org/reports/2009-03-W-companies.doc> ; also [www.psiru.org/reports/2008-04-W-over.doc](http://www.psiru.org/reports/2008-04-W-over.doc)