

**The Future of Water and Wastewater in British Columbia:
The Case for Public-Private Partnerships**

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It's good to be back in Victoria. I am thrilled that what brings me here is the promise of sewage treatment for the Capital Regional District. Congratulations! That is great news.

When I started preparing for this talk, I was struck by the results of a poll of Victorians on their attitudes towards private-sector involvement in sewage treatment. The poll was conducted by Environics for CUPE. Pollsters asked 400 residents who they would trust to operate a new sewage facility. Seventy-six percent replied that they would trust the Capital Regional District more than a private corporation.

That figure astonished me. Why, I wondered? Why on earth would the citizens of this community place so much faith in the CRD? The CRD resisted calls to treat its sewage for years. It's been unwilling or unable to invest the necessary capital. It doesn't have much expertise in the area of sewage treatment. So why would the public have such confidence in it?

The poll provided some answers. Respondents explained that the CRD is not-for-profit. It would better serve the public interest. There would be more accountability. Those seem to be the issues that are dominating the debate about who should treat Victoria's sewage. The debate seems to be about trust, the public interest, and accountability. So those are the issues I want to focus on today.

I'll look at this from two different angles: First, I'll take a closer look at the wide-spread confidence in the public sector. Is it justified? Then, I'll turn my attention to the private sector. I'll review the ways in which private firms can serve the public interest. And I'll look at various mechanisms for holding private firms accountable for their performance.

Many Canadians have embraced what I call "the myth of public-sector accountability." Many believe that there is something inherently accountable in the municipal operation of utilities. Their thinking is as follows: Since municipalities aren't focussed on earning a profit, they can devote themselves to good performance. They can be responsive to the public and to regulators, rather than to corporate shareholders. They can be transparent without endangering some competitive advantage. And, should something go wrong, the political bosses can be held accountable through elections.

Regrettably, experience doesn't bear this out. Believe me, I wish it did. I would love to be able to say that municipal governments are doing a great job of treating water and sewage. I would love to be able to say that provincial governments are doing a great job of regulating them. And I would love to be able to say that voters are holding them all accountable at the polls. But it wouldn't be true.

Across Canada, public owners, public operators, and public regulators are falling down on the job. On the water side, Walkerton was a publicly operated system. North Battleford was a publicly operated system. Kashechewan – another publicly operated system. On the sewage side, all of our most notorious polluters – Victoria, Halifax, St. John’s – have publicly operated systems. There is nothing inherent in public operations that guarantees responsible performance. That is true for water, and it’s true for wastewater. BC is no exception.

BC’s water systems need a lot of work. There are currently approximately 500 systems under boil-water advisories. Although most are quite small, larger systems have had some spectacular failures. Vancouver’s lack of filtration left almost a million residents boiling their water last November.

Some communities have problems with water quantity rather than water quality. In Tofino, water levels got so low last summer that hotels and restaurants had to shut down just before the Labour Day weekend. The District knew that its storage capacity was inadequate. But it assumed that the rains would come. “I guess you get a little lackadaisical,” Mayor John Fraser said. “Lackadaisical” and “water” are two words that should not go together.

In February, Provincial Health Officer Perry Kendall released a report on drinking water. He noted that, historically, BC has under-treated its water, and has suffered more than its share of waterborne disease outbreaks. The good news is that progress is being made: Regulations are tougher, and funds are being invested to meet them. The bad news, he reported, is that many systems continue to struggle with aging infrastructure, with insufficient budgets, and with a shortage of certified operators running systems.

And what about sewage? Although Victoria gets most of the attention, inadequate sewage treatment is a problem elsewhere in the province, as well. Secondary treatment is considered to be the minimum standard for normal flows. But two of Vancouver’s plants still provide only primary treatment. The regional district isn’t planning to complete upgrades on those plants until 2030. Combined sewer overflows are another problem. So is the performance of plants. In the days when the province published non-compliance lists, municipal sewage plants made frequent appearances on them.

The problems aren’t just with municipal performance: Problems also plague provincial enforcement. Regulators have been very reluctant to prosecute violators. They have also refused to let others do so. Environmentalists have tried to use private prosecutions to enforce the federal Fisheries Act. That act forbids the deposit of a deleterious substance in water frequented by fish, and the release of inadequately treated sewage violates it. Sierra Legal, representing various clients, undertook at least three private prosecutions in the 1990s – two against GVRD, and one (in 1999) against the CRD. In each case, the Attorney General’s office took over the prosecution, and then stayed the charges. It’s clear that the government hasn’t wanted anyone to crack down on sewage polluters.

The refusal of regulators to regulate shouldn’t come as a surprise. The provincial government is in a conflict of interest. It pays a substantial portion of infrastructure upgrades. If it gets tough with violators, it may have to cough up hundreds of millions of dollars to help them improve

their systems. Sierra Legal explains it this way: Cost-sharing arrangements put the provincial government in “a difficult position.” A government that prosecuted offenders “would be pressuring itself to fund improvements to the system.” And that, the organization acknowledges, may be “an unrealistic expectation.”

I hope that you’re beginning to see the flaws in the theory of public-sector accountability. Hundreds of publicly financed and publicly operated utilities are performing poorly. Indeed, many are breaking the law. Yet governments at all levels are either unwilling or unable to correct the problems. I don’t see a whole lot of accountability there.

What are the alternatives? How can the private sector help solve some of these problems? We know from limited experience in BC and in the rest of Canada, and from more extensive experience in other jurisdictions, that the private sector has much to offer. Private investors can bring capital to municipalities that desperately need it. Private operators can bring efficiencies, making limited funds go further. They can bring expertise and innovation. And the arrangements governing private investments or operations can bring far greater accountability than any we see in the public sector.

Let’s first take a look at capital investment. Here in Victoria, new sewage treatment plants are expected to cost over \$1 billion – perhaps as much as \$1.2 billion. If the federal government and the province each bear one-third of the cost, that still leaves Victoria facing a bill of \$400 million. The *Times Colonist* quoted one politician as saying that “chins are bouncing off desks” over the costs.

Victoria is by no means alone. In 1998, the Canadian Water and Wastewater Association warned that BC would need to invest \$15.5 billion over 15 years in water and wastewater infrastructure. Its estimates for the rest of the country were just as daunting – \$90.4 billion in all. Although there was a lot of guess work in those estimates, others have come up with similar figures. So we should take them seriously. And we should admit that our governments aren’t going to be able to provide that kind of money. If we’re going to make the investment required, we’re going to have to look at private sources of capital.

So far, Canada’s experience with private investment in water and wastewater systems has been limited. BC has 168 small, privately owned water utilities. But its *publicly* owned systems haven’t tended to seek private capital to upgrade or expand.

It’s an option that’s worth considering. Out east, Moncton built its water filtration plant with private capital, and it has been a great success. In the 1990s, the city was producing terrible water and was desperate for a filtration plant. But it couldn’t afford the upfront investment. Nor could it get provincial or federal funding. So it decided to find a private company that could finance, design, build, and operate a plant.

It held a competitive bidding process, which brought costs down. The total capital cost of the plant was \$23 million – almost \$10 million less than the city had planned to spend. Operating costs were also lower. All told, the city expects to save \$14-\$17 million over the 20-year lease. The city was also able to offload construction risks. The firm agreed to design and build the plant

within 500 days, to be responsible for cost overruns, and to forego payment until the plant was fully commissioned. Most important, the city has ended up with superb water. Not surprisingly, it is very happy with the arrangement.

If other communities decide to follow Moncton's example, they will find that considerable capital is available. Some water companies have the capacity to invest enormous sums. In England and Wales, the water companies have invested more than £50 billion. Infrastructure funds also have the capacity for large investments. Last year, globally, about \$100 billion in new money was raised for such funds. Water industry analyst Debra Coy explains that their managers "are now actively (some would say desperately) looking for deals where they can put all that new money to work for their investors."

Investors in water and wastewater will be winners, because the investments tend to be quite stable. And municipalities will be winners. They will offload some financial risks. They will get more for less, since private capital tends to be used more efficiently than public capital. And they will be able to put their limited funds to other uses.

Capital is just one of the things that the private sector has to contribute. Another very important contribution is expertise. Most established water companies have far greater expertise than any municipality. These guys are the pros. They have had more experience meeting a wider range of challenges. They have greater capacity. The director of public works in Indianapolis summed things up well when he said, "It's just a different league. These guys have resources our guys could only dream of." Often, the desire to share in those resources convinces a municipality to find a private partner.

A perfect example of this is the town of Sackville, New Brunswick. It has been having a lot of trouble with its water system. The province told it that it needed two fully-certified treatment plant operators. But it would have taken at least four years to train its own workers. And so, as of yesterday, it turned over operations to a private firm. This firm can easily provide the necessary expertise and training – right away, and for less money. Its parent has more than a century of experience. Globally, it serves more than 80 million people. It runs several research centres, with 350 researchers working to improve treatment methods and technologies. It has more than 600 patents. There is simply no comparison between its resources and Sackville's.

The union was furious at the town's decision to go private. When the decision was made in March, union members shouted "shame, shame" and booed the council. But there is nothing shameful in a town seeking the best water for its residents.

Walkerton recently did the same thing for the same reason. Mayor Charlie Bagnato explained, "In the name of safety, and to keep everyone happy, we have to get someone we can rely on." He and his council didn't think that they could afford to keep specialized expertise in house. So they turned to the pros.

And so did Kashechewan. After E. coli contaminated its water, the federal government called in a small firm that operates plants in Northwestern Ontario. The firm's technician flew into the community, and repaired the malfunctioning chlorination system in less than six hours. The firm

now operates the plant.

Expertise is certainly important. But for many systems, operations are fairly straightforward. The managers of those systems may not need extensive resources behind them. What they do need is incentives to do their job well. One of the reasons I'm enthusiastic about the contracting process is that it makes it easy to create those incentives. Municipalities can write incentives into their contracts. They can structure contracts to reward good performance and to penalize bad performance.

Milwaukee did this. Its sewage contract has provisions for performance payments. Such payments, it explains, are intended to "prevent the Company from profiting from poor performance and to encourage the Company to spend additional funds to achieve good performance." The first thing the contract does is set a range of standards that are considerably stricter than those set by federal regulators. Then it specifies that if the operator, on average, exceeds the upper limits for certain pollutants, it will have to pay steep fines – between \$50,000 and \$100,000 for each increment in excess of the limits. Conversely, if the pollutants in effluents, on average, fall below the lower limits of the range, the company is paid generous bonuses – an additional \$50,000 annually for two different components. That system of penalties and bonuses gives the operator a real incentive to perform well.

Incentives also inhere in the competitive process itself. Competition for contracts creates incentives to design and operate systems efficiently. A bidder will be more attractive if it can bring its price below its competitors'. So it looks for smarter ways of doing things. It may find them in design changes, in technological innovations, in the elimination of waste and duplication, in staff reductions, or in economies of scale.

The efficiencies that have emerged from competitive bidding processes have brought impressive savings. Some examples from the US are striking. In Houston, contracting out water plant operations brought savings of 43 percent. In Seattle, the contract to design, build, and operate a water filtration plant was priced at 40 percent below the city's benchmark. In Indianapolis, hiring a private operator for sewage treatment reduced costs by 42 percent. Milwaukee will save about 30 percent – \$140 million over the 10-year contract.

Those efficiencies can mean that there is money left over to upgrade the system. Or they can translate into lower costs for consumers. What they don't mean is that corners are being cut. As long as the quality of service is regulated, efficiencies don't come at the expense of good performance.

To this point, I've argued that the private sector can provide capital, and that it has the expertise and the incentives to operate our systems effectively and efficiently. I want to turn now to the other major advantage of privatization: accountability. This may be the most controversial thing I'll say today, but I believe that it's the most important thing: A private operator is inherently more accountable than a public operator. It is more accountable to municipal governments, to the public, to the market, and to provincial regulators.

The most obvious accountability mechanism is the contract. Enforceable contracts, with specific

performance criteria, provide municipalities with powerful tools to compel compliance. Contracts can guarantee water or effluent quality, monitoring and reporting procedures, maintenance levels, and customer service levels. They can guarantee schedules and costs. As I mentioned earlier, they can include financial penalties for non-compliance. And they can include provisions for contract termination.

A CUPE ad warns that “The provincial government wants to hand control of our sewage treatment to private corporations.” Nothing could be further from the truth. A good contract gives a municipality meaningful control over a privately operated utility. There is no parallel in the public sector. Indeed, a handbook put out in 1999 by BC’s former NDP government recognized this: “It can be argued that local government has more control, in that it has well-defined contractual remedies in a PPP that it may not have with its own management and staff.”

Another aspect of accountability is legal liability. Liability is different in public and private systems. One major difference is that governments are often immune from tort liability for the consequences of policy and budget decisions. Private firms don’t enjoy that kind of immunity from liability. The consequences of liability are also different for public and private suppliers. They tend to be more serious in the private sector. The individuals who are responsible are more likely to lose their jobs. The companies are more likely to lose their profits. In other words, private providers are more likely to bear the costs of bad decisions. Because of this, liability has a great deterrent value.

In a private system, the market itself provides yet another form of accountability. Investors don’t want to invest in a company that performs poorly. Nor do clients want to work with such a company. Private firms may well be put out of business if they provide unsafe water. As the president of Azurix once said to me, “If you are negligent, you are history.” He should know. Azurix was Enron’s water company.

Last, but by no means least, is regulatory accountability. I spoke earlier about how conflicts of interest prevent regulators from doing their jobs. Involving private partners in financing and operations helps resolve that conflict. It puts some distance between utilities and regulators. It helps free up regulators to regulate. A review conducted by the federal Policy Research Initiative last year put it this way: “Privatization is not a simple retreat of the state, but rather a redefinition of its role as a regulator in a market-oriented economy.”

Experience confirms this. Enforcement improved dramatically during Hamilton’s ten-year experiment with private operations. The Ministry of Environment laid charges for violations it had happily ignored when operations were public. The same thing happened in England and Wales. Privatization, as they said, separated the “poacher” from the “gamekeeper.” One regulator identified as the most significant gain of privatization. UBC’s Karen Bakker has pointed out that “Despite having been privatized, the water industry in England has been re-regulated rather than de-regulated.” The system of water regulation in the UK has become one of the toughest in the world.

Capital. Expertise. Efficiency. And accountability. These are the factors that explain why the owners of water systems across Canada are increasingly turning to the private sector for help.

This has been more controversial in BC than it has been in most provinces. Opposition to private-sector involvement thwarted Vancouver's plans for the Seymour filtration plant and Whistler's plans for sewage treatment. Regardless, BC is making progress.

Port Hardy has a new water treatment plant, thanks to a public-private partnership. There used to be a joke: How do you get a suntan in Port Hardy? Easy! Take a shower. Kids growing up today won't even get that joke. They have clean water now. Likewise, Sooke, thanks to a partnership, has a new sewage system. Its new sewers and treatment plant were completed ahead of schedule and on budget. Langford has a new sewer system, paid for in part by private capital. And now, because of the new provincial rules announced by Premier Gordon Campbell in October, Victoria must at least consider a partnership if it is to be eligible for provincial funding. That's progress.

I don't want to leave you with the impression that public-private partnerships are a magic bullet. There have certainly been failures. We're still learning what works and what doesn't. We're still learning how to get the best out of the private sector. We're still perfecting contracts. And let's face it, even the best contracts won't solve all of our problems. We also need pricing reforms, and we need regulatory reforms.

No, partnerships are not a panacea. But a competitive bidding process and a well-drafted contract do hold great promise. If you can get them right, you'll be well on your way to ensuring that you get the most possible out of your investment – that you get the best available expertise at the best possible price.

I started this talk with a reference to an Environics poll that was conducted for CUPE. I want to wrap it up with a reference to another poll. This poll was also conducted by Environics. But the results were strikingly different. The poll was commissioned last year by the Canadian Council for Public-Private Partnerships. It found that in BC, 58 percent of those polled would support public-private partnerships for sewage treatment. There were caveats: The support rested on the assumption that access to services remained the same, that the quality of services was the same or better, and that the cost was no more than if the government were providing the services.

Experience has demonstrated that private water providers can and do meet these criteria. As the public learns more about these private successes, its confidence can only grow. As this happens, I do believe, the public will start *insisting* that we tap into private-sector capital, expertise, efficiencies, and accountability mechanisms.