The Privatization of Water Utilities: Supplementary Information
Submitted to the Walkerton Inquiry

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Increased private sector involvement: Ten years of support

Support for private sector involvement in the water and wastewater sectors dates back to the time of the NDP government. In 1991, the MISA Advisory Committee wrote that "there will be a need for the Province to support, as the U.S. EPA and the American States have done, revolving loan funds and public/private partnerships to give some flexibility in financing and to assure municipalities of a source of borrowing at reasonable rates."[1]

In 1993, the government amended the Municipal Act to enable municipalities to use public-private partnerships to provide public capital facilities. The province did not state a preference for partnerships, but in removing obstacles to them, it enabled local governments to make their own judgements about them.[2]

The following year, a draft report of the Interministry Committee on Local Government (in which MOEE participated[3]) noted, "Public/private partnerships are beginning to evolve as one approach to meeting infrastructure needs at both the provincial and the local government levels." The report identified water and sewage facilities as possible candidates.[4]

The Conservatives took up where the NDP left off, and went further. By 1996, increased private sector involvement was a central feature of provincial policy. Indeed, one briefing note referred to it as a key objective: "a key provincial objective is to provide municipalities with opportunities to achieve efficiencies in sewer and water services [and to] increase private sector involvement."[5]

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[1] Inquiry Document No. 1086446, Water Conservation in Ontario: Implementing the User Pay System to Finance a Cleaner Environment, Technical Report, Municipal/Industrial Strategy for Abatement (MISA) Advisory Committee, May 1991, p. v.

[2] Inquiry Document No. 1023084, Interministry Committee on Local Government, Innovative Financing Partnerships Phase I Report: Cost-Sharing and Other Finance Policy Clarifications, draft, hand-dated March 18, 1994, p. 1.

[3] Inquiry Document No. 1023095, Memorandum from Carl Griffith to Fausto Saponara, February 23, 1994, p. 1.

[4] Inquiry Document No. 1023084, Interministry Committee on Local Government, Innovative Financing Partnerships Phase I Report: Cost-Sharing and Other Finance Policy Clarifications, draft, hand-dated March 18, 1994, pp. 1, 2.

[5] Inquiry Document No. 1084343, Briefing Note regarding MOEE Cabinet Submission on the provincial role in sewer and water, Larry Clay and Satish Dahr, August 6, 1996, p. 1.

The policy of increasing private sector involvement retained its importance – in planning documents if not in reality – in the following years. “Enhancing private sector participation and competition” is listed as a policy objective in a May 1997 submission to the Cabinet Committee on Privatization.[6] In or after 1999, private investment was to be included in the government’s longer-term strategy: “The Ministry, along with SuperBuild, the Ministry of Finance, MMAH and others plan to develop a longer term strategy ... Such a strategy would focus on a number of principles and criteria, including: ... encouraging private sector involvement in investing in water and sewage infrastructure.”[7]

SuperBuild seemed to embody the policy. The program’s objectives included “increase the level of private sector and other non-provincial government capital investment.” Desired features of the organization model included “an organization that ‘opens doors’ to the outside to bring in new ideas, ways of doing things, and private sector expertise.”[8] Key design features of SuperBuild included “encourage public-private partnerships.” Evaluation criteria included “maximizes private sector and other partner contributions.”[9] The Cabinet Committee on Privatization and SuperBuild also hoped that SuperBuild would negotiate an infrastructure agreement with the federal government that “encourages public-private partnerships wherever possible.”[10]

Anticipated benefits of privatization

Initially, the drivers behind increased private sector involvement were financial. Although anticipated financial benefits remained central, a variety of other benefits soon emerged.

The magnitude of the required investment was key to the province’s wish for more private sector financing. The draft report of the Interministry Committee on Local Government explained the reasons for the 1993 changes to the Municipal Act: The “appropriate use of partnerships should help free up public capital ... There remains a gap between existing capital outlays and what is estimated to be needed to renew and upgrade Ontario’s local public infrastructure (additional $2 billion annual). Securing investment through forming partnerships with the private sector to

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[6] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], p. 11.

[7] Inquiry Document No. 1031775, Short and Medium Term Municipal Capital Funding Scenarios, undated, p. 2.

[8] Inquiry Document No. 1082929, Cabinet Committee on Privatization and Superbuild Proposed Mandate, Priorities, Policy and Communications Board, October 21, 1999, pp. 2, 10.

[9] Inquiry Document No. 1078541, 2000 Superbuild Partnerships Initiatives – Key Design Features, hand notation: PPCB, Aug 8, 2000, pp. 1, 2.

[10] Inquiry Document No. 1019221, Record of decision of the Cabinet Committee on Privatization and SuperBuild, no author, undated, p. 1.

procure and finance public infrastructure can help to meet this need."[11]

A later consultants' report likewise stressed the gap between public expenditures and capital requirements: "It is estimated that, over the next 10 years, Ontario will require about $2 billion per year for capital spending for water and wastewater systems.... Obviously, there is a substantial gap between present capital spending levels and anticipated future requirements, a gap that the province cannot and likely will not fill."[12]

However, the private sector would not just be an outside source of funds. Private operations, driven by competition to achieve new efficiencies, could reduce operating costs. This would free up existing municipal funds for new capital investments. As the consultants explained, "the operations of the existing infrastructure may become more efficient as a result of increased competition for maintenance and operation contracts and continued fiscal pressures, so that reductions in operating costs may provide some of the fiscal capacity for municipalities to finance the capital requirements."[13]

Greater private sector involvement would also free up municipal and provincial funds by encouraging consumers to bear more of the costs of providing water services. A Minister briefing noted that privatization objectives include "institute user-pay principles for commercial services (eg. water delivery) to link consumer price with the cost and level of consumption."[14]

While numerous reports, studies, presentations, and other submissions likewise pointed to both the availability of new private funds and the freeing up of existing public funds as benefits of partnerships, they generally included other benefits as well. A September 1995 presentation on public-private partnerships reviewed partnerships' contributions as follows: "Access to private financing for public capital investments; Allow government to undertake a level of capital investment which would not have been otherwise possible; Private sector efficiencies (i.e. faster delivery, lower costs, innovation, maintained or improved service quality and level); More effective value capture via user fees instead of taxes; Risk sharing/transfer – construction, market, operating, financing."[15]

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[11] Inquiry Document No. 1023084, Interministry Committee on Local Government, Innovative Financing Partnerships Phase I Report: Cost-Sharing and Other Finance Policy Clarifications, draft, hand-dated March 18, 1994, pp. 1, 2.

[12] Inquiry Document No. 1052122, Public Private Partnerships and the Financing of Water and Sewer Investments in Ontario in an Era of Fiscal Restraint, A. Donner and F. Lazar, undated, pp. 13-14, citing George G. Powell, "Financing municipal water and wastewater services – what needs to be done," Environmental Science and Engineering, May 1995, p. 28.

[13] Inquiry Document No. 1052122, Public Private Partnerships and the Financing of Water and Sewer Investments in Ontario in an Era of Fiscal Restraint, A. Donner and F. Lazar, undated, p. 15.

[14] Inquiry Document No. 1084808, Privatization Opportunities and Process, Minister Briefing, July 11, 1995, p. 4.

[15] Inquiry Document No. 1074383, Capital Investments & Public-Private Partnerships, Capital & Crown Corporations Branch, Management Board Secretariat, September 28, 1995, p. 6.

A December 1995 consultants' study reviewed other benefits of public-private partnerships: "partnerships bring together different sets of skills and expertise, and so, by increasing the quantity and quality of resources available, should result in productive synergies due to specialization, economies of scale, piggy-backing on learning/experience curves and economies of scope." The study listed a number of specific strengths that the private sector could bring to partnerships: "performance-oriented incentive structures; flexibility and speed in decision-making; ability to develop on-going relationships based on trust and mutual benefit; flat organizations and low overheads; and ability to assess risks and efficiently allocate/handle risks."[16]

In an April 1996 document on public-private partnerships, Michele Noble, Secretary of the Management Board, summarized the province's objective as "to improve service to people and to decrease costs to taxpayers."[17] The following year, the Alternative Financing and Public-Private Partnership Working Group drafted a framework for partnerships that discussed a number of reasons why involving the private sector can result in improved service. The private sector, it said, may: "have access to resources, technology or expertise that is unavailable in the public sector; have experience in delivering a particular type of service that is similar to the public service that is needed; be subject to competitive pressures that motivate it to deliver a high level of service; bring disciplines and management skills to service that result in increased efficiencies and improved service management; accept a payment system that provides incentives for maintaining high service levels and penalizes poor performance; and be motivated to improve the method of delivering a service through better use of technology and other innovations."[18] Another insight into how privatization would improve service appeared in a July 2000 correspondence briefing note: "When services are delivered by the private sector, one of the most powerful incentives to maintain or exceed Provincial standards is the possibility that one's contract may be terminated if those standards are not met."[19]

In May 1997, a submission to the Cabinet Committee on Privatization noted, "Increased private sector involvement is attractive for a number of reasons, including: (i) ability to access capital for investment; (ii) opportunity to increase operating efficiency; (iii) prospect of diversifying risk away from the public purse; (iv) maximizing service delivery options for municipalities; and (v) the ability to drive the introduction of new technologies and new solutions, which should result in increased efficiencies."[20]

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[16] Inquiry Document No. 1022565/1040459, Financing Water and Sewer Infrastructure Investments: Policy Considerations and Options, Prepared for MOEE by Arthur Donner Consultants, December 1995, p. iv.

[17] Inquiry Document No. 1021779, Public/Private Partnerships: Models for our Times, Ontario Public Service Partnership Network and the Institute of Public Administration of Canada, Toronto Regional Group, April 12, 1996, p. 1.

[18] Inquiry Document No. 1090315, Framework for Partnerships, Alternative Financing and Public-Private Partnerships Working Group, Draft for discussion only, September 17, 1997, p. 15.

[19] Inquiry Document No. 1090604, Correspondence Briefing Note, Shaun Young (staff contact), July 3, 2000, p. 2.

[20] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], pp. 11-12.

A September 1997 report by the Alternative Financing and Public-Private Partnerships Working Group discussed the objectives of alternative financing in greater detail. Taking a rather unusual approach, it placed lower financing costs at the top of its list. It explained that although the province may be able to borrow at lower interest rates, these costs might hinder the province in other ways. It described the financial benefits of transferring risks to investors, freeing up credit capacity for other capital projects, and reducing general obligation debt and the interest rates paid on debt.[21]

The advantages of transferring risk to the private sector were also noted in a Price Waterhouse study on the outsourcing of public services. Outsourcing, it said, "could be a mechanism to transfer risk to the private sector, where a private operator could manage those risks better than government." The report identified an even more important benefit of outsourcing, especially if done in a competitive manner: "The key reason for outsourcing is to enable innovative approaches to service delivery. Competitive private and/or public sector operators will tend to generate innovative ideas about program design, technology, operating procedures and organization when they are offered the opportunity to bid competitively to deliver a service." The report highlighted a related advantage. Outsourcing, it said, offers the potential "to achieve significant cost reductions as quickly as possible."[22]

The magnitude of cost reductions was discussed in another consultant's presentation, in April 1996, on the outsourcing of government activities. The Serco Institute summarized the findings of the most comprehensive study to date on the benefits derived from competitive tendering. According to this "survey of surveys," which represented 200 estimates of cost savings published between 1977 and 1995, "75 percent of [the] studies found that competition reduced the ongoing costs of service provision" and that "savings ranged between 10 percent and 30 percent in over half of the services studied."[23]

Other documents from Ministry files confirmed that cost reductions could indeed be considerable. One discussed the sale of the wastewater plant in Franklin, Ohio, which made possible 23 percent lower sewer rates.[24] Another indicated that in Indianapolis, private management of the wastewater treatment plants reduced costs by 40 percent, saving taxpayers $65 million over five years. The private operator not only reduced costs but also improved service. In part, the improvements were attributed to the operator's expertise: "WREP has

[21] Inquiry Document No. 1029035, Framework for Alternative Financing, Report by the Alternative Financing and Public-Private Partnerships Working Group, Karen Prokopec, September 5, 1997, p. 1.

[22] Inquiry Document No. 1021794, Best Practices for Outsourcing of Public Sector Services, Price Waterhouse, pp. 1-3.

[23] Inquiry Document No. 1090410, Outsourcing of Government Activities – An International Private Sector View, Presentation to the Centre for Leadership, Province of Ontario, Richard Nicholls, Serco Institute, April 18, 1996, slide 19.

[24] Inquiry Document No. 1021790, Privatization 1996, Reason Foundation, first page.

brought an expertise to the plants it is unlikely the city could have provided."[25]

Confident of privatization's many and varied benefits, the government believed that more municipalities would begin competitively contacting out the operations of their water and wastewater works in 1998. The May 1997 submission to the Cabinet Committee on Privatization predicted that Bill 107, which transferred ownership of facilities to municipalities, would "prompt many municipalities to take a fresh look at their water and sewage management arrangements." Municipalities' increased fiscal restraint would also play a role: "This concern toward generating new savings will likely lead to more municipalities competitively tendering water and sewage management arrangements." The submission noted that the private sector was poised to meet the challenge: "Vigorous competition from private sector firms can be expected.... Several large British and French firms have recently established operations footholds in Ontario.... Large American firms are also looking to expand into Ontario.... Several Canadian gas utilities are also looking to enter into the water and sewage facilities operating business."[26]

Why privatization has not happened

Despite such predictions, and despite almost ten years of interest in privatization, very little has happened. In January 2000, the Ministry was aware of only about a dozen municipalities with private sector operators.[27]

While there is no single explanation of what has prevented more municipalities from privatizing, a number of potential factors emerge. Several reflect omissions rather than commissions: They reflect the province's failure to implement policies or to undertake reforms that would have facilitated privatization.

The government's failure to eliminate grants and subsidies and to encourage full cost pricing

Two such omissions were the province's failure to implement its policy to phase out grants and subsidies and its failure to promote full cost pricing. The province was aware that implementing these related policies would hasten privatization. In 1995, consultants had advised MOEE that "Private participation is more likely when facilities are legally and financially autonomous."[28] A 1996 briefing note made the link even clearer: "The elimination of provincial funding will hasten the transition to a system of full cost pricing. This would ... enhance the attractiveness of systems

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[25] Inquiry Document No. 1021706, Privatization of Wastewater Treatment Plant Reduces Costs by 40%, Mark Maxwell, July 31, 1995, p. 1.

[26] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], pp. 7-10.

[27] Inquiry Document No. 1083518, The Ontario Clean Water Agency, John Lieou, January 18, 2000, p. 2.

[28] Inquiry Document No. 1022565/1040459, Financing Water and Sewer Infrastructure Investments: Policy Considerations and Options, Prepared for MOEE by Arthur Donner Consultants, December 1995, p. vii.

to the private sector."[29]

The government's failure to establish an economic regulator to oversee private utilities

A third omission was the province's failure to establish a regulatory regime that could oversee utilities if they were privatized. It is generally understood the privatization of a monopoly – especially full privatization, or the sale of assets to the private sector – requires regulation. A document on water privatization in the United Kingdom noted that a key consideration was that a new regulatory regime would be required.[30] Regulation would likewise have to be a consideration in Ontario. In a 1995 Minister briefing on privatization, under economic policy considerations, the first item listed was "Post-privatization regulatory framework (ie. regulated utility)."[31]

Environment Minister Norm Sterling recognized that privatization would require new forms of regulation. In April 1997, he appeared before the Standing Committee on Resources Development, which was holding hearings into Bill 107. He told the Committee: "If they [water and sewer systems] are privatized by the municipalities then the government would have to take another step, and that would be introduce a method of regulating charges, as we do with natural gas at the present time. Once you're into a monopoly kind of situation then you have to move to a regulatory regime. There hasn't been any privatization in the province to speak of – there may be some minor services provided and some private systems in relatively small communities – but if that happened, then you would have to move to the next step and have a regulatory regime that would be there."[32] The province never moved to that next step.

The government's discouragement of private ownership

The province's failure to establish a regulator to oversee private utilities may have been linked to a fourth factor: its discouragement of private ownership of utilities. Cabinet opposed the full privatization of water and wastewater facilities. Its framework for water and sewage services included the stipulation that "Municipal ownership of transferred works will be encouraged."[33] Bill 107 brought this policy into effect with its requirement that municipalities selling their water or sewage facilities would have to repay grants received since 1978.

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[29] Inquiry Document No. 1084343, Briefing Note regarding MOEE Cabinet Submission on the provincial role in sewer and water, Larry Clay and Satish Dahr, August 6, 1996, p. 2.

[30] Inquiry Document No. 1086447, Water Utility Privatization: The U.K Experience, no author, undated, p. 1.

[31] Inquiry Document No. 1084808, Privatization Opportunities and Process, Minister briefing, no author, July 11, 1995, p. 4.

[32] Hansard, Standing Committee on Resources Development, April 14, 1997, 1620.

[33] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], p. 2.

The Association of Municipalities of Ontario objected to Bill 107's grant repayment provision. In a Policy Report on the bill, it noted that "it does not take into account the depre-ciated value of past grants and the depreciation of the value of the facilities" and recommended that "any recovery initiative must fully account for the depreciated value of the facilities being sold." It also objected that "these provisions also serve to limit the options available to municipalities to take advantage of a full range of management strategies once they assume ownership of facilities. The provisions should be recognized as a potential impediment to public-private partnerships and amended to provide greater flexibility for municipal governments."[34]

In a draft discussion of barriers to partnerships, the Alternative Financing and Public-Private Partnership Working Group identified Bill 107's grant repayment provisions as a legislative limitation and "recommended that the Province consider the implications of this legislation with respect to the ability of municipalities to form partnerships with the private sector in respect of these works."[35]

Critics were right to point out the problems with the grant repayment scheme. Conceivably, the grants could be greater than a facility's value – especially if they were used to overbuild the facility, and if the facility served an insufficient number of customers to fully support its new, larger self. Repaying such grants could be economically unfeasible and could make the acquisition of the facility unattractive to a private firm.

In an April 1997 letter sent on behalf of the Minister, MOE's John Elstad wrote that the grant repayment provision "would strongly encourage continued public ownership." He went further: "Our Minister shares your concern about inappropriate privatization of water and sewage infrastructure ... The government's position is very clear – ... the infrastructure should remain publicly owned.... Ontario's approach is exactly the opposite of England's approach to water and sewage services."[36] (Under England's approach to water and sewage services, "The ten public sector authorities were restructured and sold to private investors concurrently in December 1989."[37])

When discussing Bill 107 with the Standing Committee on Resources Development, Norm Sterling likewise contrasted England and Ontario. He claimed that full privatization "doesn't make sense in Ontario." He explained, "I just don't think it's going to happen in this province. The sewage and water systems in this province are in very good shape. Most of the need to do that kind of thing, as was the case in Britain ... was that their systems were terribly deficient and

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[34] Bill 107: Water and Sewage Improvement Act, 1997, Presentation to the Standing Committee on Resources Development, Association of Municipalities of Ontario, April 1997, p. 2.

[35] Inquiry Document No. 1090315, Framework for Partnerships, Alternative Financing and Public-Private Partnerships Working Group, Draft for discussion only, September 17, 1997, p. 24.

[36] Inquiry Document No. 1085513, Letter to Eleanor Hart from MOE's John Elstad, on behalf of the Minister, April 11, 1997, pp. 1-2.

[37] Inquiry Document No. 1086447, Water Utility Privatization: The U.K Experience, no author, undated, p. 1.

there was a huge need for an injection of capital into their systems."[38]

Mr. Sterling's explanation was disingenuous. Ontario's systems were, in fact, not in very good shape, and there was here, as in Britain, a huge need for an injection of capital. The Minister's next comments were more forthright. He told the committee, "I don't think that any municipal politician would choose to do that it they wanted to get elected again."[39] It is likely that political concerns, rather than more substantive considerations, discouraged full privatization in the province.

The government's support of the Ontario Clean Water Agency (OCWA)

A fifth factor discouraging private sector involvement was the province's support of OCWA. A 1996 briefing note warned, "The private sector has been critical of OCWA because they perceive OCWA having an unfair competitive advantage in operating sewer and water facilities by virtue of its financing responsibilities and its close relationship with the province. It will be important that any future role for OCWA address these concerns and, if it is to continue, that it be on an equal footing with private sector competitors."[40]

The May 1997 submission to the Cabinet Committee on Privatization acknowledged the potential impacts on privatization of the government's policies regarding OCWA: "The Government's decision on the future of OCWA's facility operations and management business will not only have an impact on firms seeking to operate and maintain water and sewage facilities, there will also a trickle-down effect on the entire domestic water and sewage industry."[41]

In an interesting twist, the submission also expressed some concern that, just as OCWA might threaten the private sector, the private sector might threaten OCWA. Municipalities that had historically looked to OCWA now had more alternatives. "[T]here is a risk that competitors will cherry pick OCWA's most lucrative clients." Competition from the private sector might destabilize OCWA, diminish its profitability, reduce its attractiveness to potential investors, and threaten the province's realization of its investment in it.[42] Presumably the government would not have discouraged greater private sector involvement in order to protect its Crown agency, but it is nonetheless apparent that it did have conflicting interests in this matter.

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[38] Hansard, Standing Committee on Resources Development, April 14, 1997, 1620.

[39] Hansard, Standing Committee on Resources Development, April 14, 1997, 1620.

[40] Inquiry Document No. 1084343, Briefing Note regarding MOEE Cabinet Submission on the provincial role in sewer and water, Larry Clay and Satish Dahr, August 6, 1996, p. 2.

[41] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], p. 10.

[42] Inquiry Document No. 1017286, Submission to the Cabinet Committee on Privatization, no author, undated [May 1997], pp. 7, 11, 13.