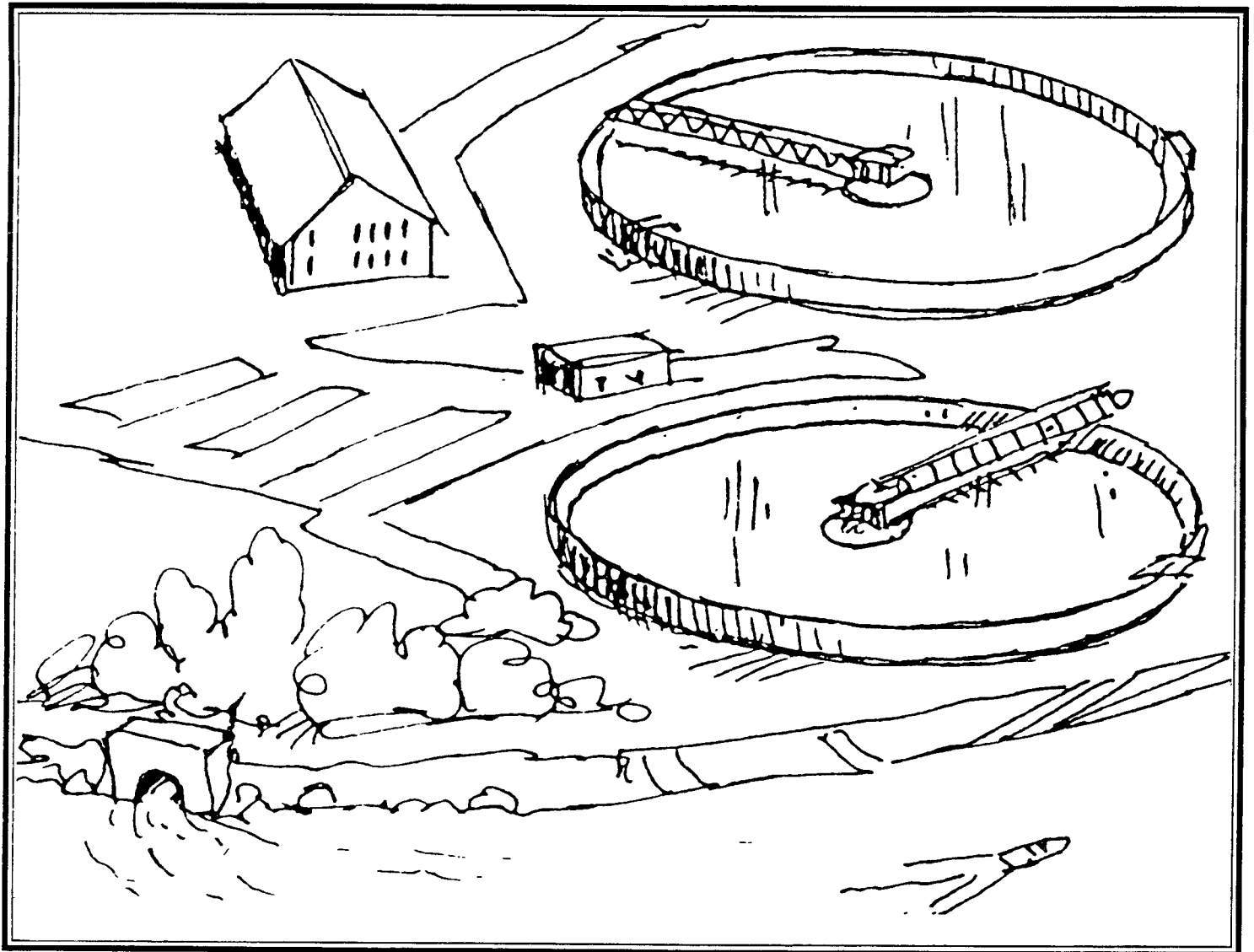




Response To Congress On Privatization Of Wastewater Facilities



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I. Introduction

For approximately 40 years, the federal government has been a full partner with the states and local governments in meeting the Nation's wastewater treatment needs. Since 1972, more than \$67 billion of federal funds have been invested in wastewater treatment works through the Environmental Protection Agency (EPA) Construction Grant Program. In 1987, Congress phased out the construction grants program, replacing it with the Clean Water State Revolving Fund (SRF) program.

The SRF program provides low-interest loans to communities for the construction of water pollution control infrastructure projects. Federal and state investments to date of more than \$20 billion ensures that the SRF program will play an important role in funding water pollution control projects into the future. However, even with continued capitalization, the SRF program will not address all local government water pollution infrastructure needs, now estimated to be about \$137 billion, of which \$47 billion is for wastewater needs. As a result, it is important to fully explore other approaches to meet funding needs at the state and local level.

One approach to consider is the use of public private partnerships that utilize private sector resources to finance wastewater treatment needs. The private sector has historically been involved in providing wastewater-treatment-related services to local governments. Whether providing basic wastewater treatment supplies (e.g., chemicals), maintaining a portion of the collection or treatment system under contract or providing contract operation and maintenance for all of the municipal facilities, the private sector has served a role in the effort to control water pollution across the country.

In 1992, a Presidential Executive Order (E.O. 12803) increased interest in using private sector financial resources to meet local government wastewater funding needs. E.O. 12803 directed federal agencies to remove regulatory or procedural obstacles to privatization that were under their control. At the same time, the Executive Order protected the existing public wastewater investment by requiring that (1) privatized federally funded facilities continue to serve their original purposes, (2) user charges remain reasonable and (3) lease or transfer prices be reviewed by federal agencies to help determine that they are fair and reasonable.

Although the vast majority of municipal wastewater facilities are publicly owned and operated, there are many examples of successful privatization arrangements. Privatization should be viewed as an option for providing wastewater treatment services that will work in some communities and not in others. The decision to privatize should be made by local governments and reflect a balanced evaluation of the financial, non-financial, and other issues and the needs of the community. However,

when federal funds were used to construct the wastewater facility, EPA is required under E.O. 12803 to review and approve lease and sale privatization arrangements of states and local governments.

A. Purpose of Response

This response was developed to address a U.S. House of Representatives, Appropriations Committee's request to examine the use of public-private partnerships as a source of funds to meet current and future wastewater infrastructure needs. The Committee was concerned about the significant costs that local, state, and federal governments must finance to meet projected wastewater needs and the potential of the private sector to play a significant role in accomplishing this task:

"Therefore, if qualified and experienced private sector entities can finance, build, own, operate and/or maintain wastewater treatment facilities in an equal or more cost effective manner and with the same or better environmental results, the Committee strongly urges the Agency to do everything it can administratively to remove impediments to such public/private partnerships and encourage the state and local governments to look to the private sector instead of the Federal government as a financial source of choice." (Omnibus Consolidated Recissions and Appropriations Act of 1996)

B. Summary of Potential for Public-Private Partnerships

The private sector has the potential to be a significant partner in the development of wastewater infrastructure in this country. Theoretically, the private sector has ready access to financial markets which could be made available for wastewater infrastructure needs when a local government enters into a private partnership arrangement to lease or sell its public wastewater facilities. Financial markets may find these investments attractive because the local government guarantees that it will pay its private partner a fixed service fee for wastewater treatment. The local government's guarantee also provides a form of assurance to the private lenders that their loan will be repaid by the borrower.

The decision by the local government to privatize its wastewater needs involves an evaluation of many financial, non-financial, and other factors. A primary consideration is that any wastewater capital funds obtained through either government or private sources must be repaid by the wastewater users. Privatization is simply another source of capital funds available to local governments that must be repaid to the lenders. Thus, privatization is never a source of "free" capital.

The Agency believes the decision to privatize should be made by the local government based on its circumstances. In anticipation that some local governments will choose privatization, the Agency has worked closely with the Internal Revenue Service and the Office of Management and Budget to remove federal administrative impediments to the privatization process. In addition, the Agency has streamlined its administrative procedures to assist wastewater construction grantees in complying with grant and E.O. 12803 requirements by delegating its review and approval authority to the Agency's Assistant Administrator for Water.

C. Organization of Response

This response provides an overview of the wastewater public-private partnership process. It presents the most common partnership arrangements, the financial and non-financial and other issues associated with privatization, the impediments to privatization, and several case-studies of public-private partnership arrangements. The major sections of the response are:

- Overview of privatization - discusses the history, the current industry position, the benefits, privatization's increasing popularity, and the most common public-private partnership options.
- Analysis of the factors affecting privatization arrangements - discusses the financial, non-financial, and other factors encompassing public-private partnership arrangements.
- Federal requirements affecting privatization - discusses the impacts of tax regulations, Executive Order 12803, and NPDES regulations on public-private partnerships.
- Impediments to public-private partnerships - provides observations about the factors that influence the decision to privatize wastewater facilities.
- Public-private partnership case studies - provides actual examples of communities that have successfully implemented public-private partnerships or are currently negotiating them. It also presents one case of a community that used a public employee contract.

II. Overview of Privatization

The term privatization encompasses a broad range of private sector participation in public services. Partnerships between the public and private sectors in the water and wastewater industry range from providing basic services and supplies to the design, construction, operation, and ownership of public water and wastewater facilities. The primary focus of this response is local government's use of the private sector to finance and operate their wastewater facilities. The basic reasons that the public sector historically privatized services were to realize cost savings, utilize expertise, achieve efficiencies in construction and operation, access private capital, and improve the quality of wastewater services.

As the pace of constructing water pollution control facilities escalated in the 1970s, due to federal and state environmental legislation and EPA's Construction Grant program, so too did the interest of the private sector in wastewater operations. In the 1980s the availability of tax incentives (tax-exempt debt and tax-deductible interest payments) for private investment stimulated interest in privatization of publicly owned treatment works (POTW). However, the Tax Reform Act of 1986 removed many of the tax incentives for public-private partnerships and reduced interest in certain types of privatization.

Executive Order 12803 was issued in 1992 to simplify federal requirements related to the sale or lease of federal grant-funded infrastructure facilities. Among its more important features, the Executive Order allows state and local wastewater treatment investments to be recovered from the proceeds of a lease or sale prior to any claim by the federal government for funds provided by EPA construction grants. Repayment of federal grants only occurs to the extent that the transfer price under a sale or concession fees under a lease is higher than the total state and local investment in the facility. Also, grants are recouped at their depreciated value. So in the event that all EPA construction grants are fully depreciated, there would be no federal grant recoupment.¹

Other Executive Orders that affect privatization include E.O. 12875, which directs federal agencies to review their regulatory requirements with respect to wastewater privatization, and E.O. 12893, which encourages agencies to seek public-private partnerships and for agencies, in conjunction with state and local governments, to remove regulatory and legal barriers to privatization.

¹The 1996 Water Resources Development Act included a provision that allowed EPA to forgive federal grant repayment for five lease arrangements.

This response discusses the sale or lease types of privatization that are addressed by the Executive Orders. The response also examines contract operations of local wastewater treatment facilities, which is currently the most common type of privatization.

A. The Privatization Process

Historically public wastewater collection and treatment services have primarily been provided by local governments. However, small subdivisions and trailer parks have traditionally used privately owned and operated wastewater services since their inception. Unlike utilities such as electricity or natural gas, which have been viewed by the public as necessities to every household and local business, the demand for water pollution control most often reflected a region-wide need to address the threat of water pollution to public health. As a result, while the private sector often provided the utility services for gas and electric to the public, local governments provided wastewater services to ensure health protection for its citizens from municipal and industrial pollution.

Over time the participation of the private sector in directly providing water-related services has grown within the United States. Public drinking water systems are frequently owned by a private company (over 40 percent of drinking water systems are private systems). Privatization of public wastewater treatment has been less common. It is somewhat difficult to obtain exact growth estimates for wastewater privatization because much of the information is proprietary. Recent industry newsletters and reports give a general indication that growth is occurring. One report indicates that in terms of dollars spent, less than 2 percent of the wastewater industry is privatized.² Reports indicate that there are 280 small to mid-size (1 to 10 mgd) facilities and 40 large facilities (over 10 mgd) now using private partners for wastewater operations.³ Public-private contract operations are reported to have grown annually at a rate of 15-20 percent, and produced revenues of \$0.4 billion out of the \$23 billion expended for POTWs.⁴ Nearly all of the privatization has been in the form of contract operations. While many communities have explored the outright sale of facilities to private entities as allowed under E.O. 12803, this option has not been used in the wastewater area primarily because of discharge permit and tax-related issues. These issues are fully discussed in this response.

² William Reinhardt. *Public Works Financing*, "Special Water Issue," 1996, page 24

³ David Sherman and Michael Stayton. *Infrastructure Finance*, "Better Than Expected," October/November 1995, vol. IV, No. 5, pages 13-14

⁴William Reinhardt. *Public Works Financing*, "Special Water Issue," 1996, page 24

B. The Appeal of Privatization

In recent years, there has been increased interest in public-private partnerships. Local governments are becoming more focused on the benefits of privatization at the same time that the private sector is anxious to expand markets and revenues. Reasons for the increase in local government interest in privatization include the desire to increase efficiency of local government operations, reduce costs of providing services, improve environmental protection, and access private capital for infrastructure investment.

Increased efficiency

Private companies may be able to operate facilities more efficiently than public entities that have limited expertise or resources. The private companies often will employ innovative operation and maintenance methods and equipment for wastewater treatment that often require significant capital investment. Also, the private sector is able to draw on substantial experience in the operation of treatment facilities and take advantage of wholesale prices of supplies and materials needed for a facility's successful operation. The private company can frequently use its management expertise to stabilize user fees for the time period of the privatization agreement.

Cost reduction

Often the opportunity to realize cost savings is the primary reason that local governments are attracted to privatization. In many cases, private ownership/operation makes sense because it lowers costs. Depending on the type of privatization selected, surveys indicate the private treatment systems can operate at costs savings compared to public treatment systems. Capital cost savings can be substantial when the private partner uses advanced technology coupled with streamlined procurement and construction practices.

However, local governments that are able to identify and implement the cost-saving management techniques that would be undertaken by a private company may be able to reduce costs as much or more than the private sector. This can occur because the public sector has several cost-related advantages over the private sector. First, the public sector does not have to make a profit on operations and capital investments. Second, the public sector has better access to tax-exempt debt financing that results in lower borrowing costs for capital projects. The Charlotte, NC case included in Section VI of this response illustrates this point.

Environmental benefits

Some government facilities may have problems complying with discharge permit limits because of needed capital improvements, maintenance costs that exceed budgetary allocations, or difficulty in maintaining skilled personnel. Where local governments have had difficulty meeting permit limits, privatization may result in real environmental benefits. Private companies can readily make capital investments under the conditions of the service contract and dedicate highly skilled personnel to ensure efficient operation and compliance with facility discharge permit requirements.

Access to capital

One of the major benefits of privatization is that it provides access to private sector capital. This may be an attractive feature of privatization for communities with limited access to capital markets. However, as with public financing, the use of private capital will require that user fees are increased sufficiently to recoup the capital investment plus interest. When privatization arrangements include capital investments in the form of an up-front transfer of funds (e.g., transfer price in an asset sale or concession fees in a lease arrangement), it can be viewed as a loan from the private sector to the public entity comparable to the "home-equity" loans popular with home owners across the country. Up-front fund transfers from the private sector, or "facility-equity" loans, that are part of a privatization arrangement mean local wastewater users must repay the up-front funds plus interest to the private firm. An increase in user fees can result when the transfer price or concession fees exceed the outstanding local debt on the wastewater treatment facilities because of the "equity" that is taken out from the facility.

C. Types of Privatization

Municipalities seeking public-private partnerships have a range of options to consider from the status quo of continued municipal ownership and operation to complete private ownership and operation. Often a local government will evaluate the expected cost of continued public operation with various privatization proposals. Currently the most widely discussed types of wastewater privatization include contract operations, leases, and asset sales.

The specific application of each privatization type will vary by location, since local governments do not have the same conditions and requirements. For example, some communities may find privatization attractive because they are having difficulty meeting permit requirements due to lack of skilled personnel or extremely challenging water pollution treatment conditions. Other communities may wish to evaluate privatization when undergoing major facility expansions or rehabilitation in hopes of

achieving greater economies, by attracting competitive facility design, construction and operation bids from the private sector. Because privatization situations are not identical, this response focuses on a presentation of the general structure of widely used types of privatization and the factors leading to the selection of a privatization type.

Contract operations

For many years municipalities have used the flexibility of contracting out selected governmental functions ranging from janitorial services to vehicle fleet or equipment maintenance. Municipalities have found that contracting can be a good way to obtain services needed for a limited period of time, tap into specialized skills not available in the local pool of employees, or as a way of introducing competition into the governmental services arena.

In the area of water pollution control, municipalities have employed different levels of contract operations. In full contract operations, the private entity operates and maintains the wastewater treatment facility in its entirety, whereas, in partial contract operations, the private company operates only certain areas of the facility.

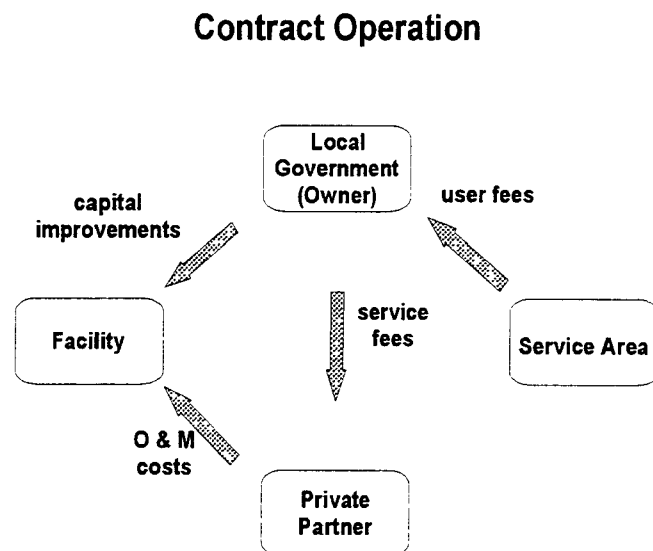
Under contract operations, facilities are operated for a fixed length of time. Until recently, Internal Revenue Service "management contract" rules for wastewater facilities financed with tax-exempt municipal bonds allowed a maximum of five years for contract operations without affecting the status of the bonds. Private companies and local governments generally viewed this term as too short and limited the economies that could result from long-term contract arrangements. For example, with the assurance of a longer term contract, private companies are able to make a long-term commitment of expert staff to operate and maintain a facility. Recent rule changes from the IRS (January 1997) have addressed this concern by allowing "management contracts" for wastewater treatment facilities of up to 20 years.

Longer term contracts make it more attractive for private companies to invest in capital improvements in a facility, since the investments can be recouped in the form of cost savings. Such investments may result in the private company having partial ownership in the facility or an encumbrance on the facility. If this occurs, local governments will need to obtain approval for the privatization agreement under the EPA construction grant regulations and E.O. 12803.

The contract operations approach is the most prevalent form of wastewater privatization. Since 1987, reports indicate that contract operations of the entire wastewater facility has increased fourfold with approximately 86 percent of these contract operations occurring at facilities with flows of 1 to 10 mgd.

Under contract operations a local government maintains ownership of the facility (Figure 1). The local government retains control over and responsibility for capital investment in the wastewater facility, setting rates, collecting user fees, and enforcement of the municipal industrial pretreatment program. The local government maintains primary responsibility for interaction with the public and state regulators. The private partner is paid a service fee to cover operation and maintenance. Performance is maintained through close monitoring by the public partner and strict contract clauses that stipulate actions taken in the event of nonperformance including financial penalties.

Figure 1



Leases

Historically, leases have been popular tools for local governments. The most common form is generally called an operating lease. Operating leases have provided governments with a way to obtain long-term use of equipment ranging from office equipment such as copying machines and desk top computers to heavy machinery for public works departments. Under this form of a lease the private leasing company, the lessor, purchases equipment and leases it to the government, the lessee. The lessor receives tax benefits related to depreciation of the equipment while the lessee is not required to treat the lease payment as debt, as would occur if the equipment were purchased.

In addition to operating leases, tax-exempt leases, have been widely used by state and local governments. Tax-exempt leases are used by local and state governments as a way to purchase equipment or buildings. Several of the key reasons

cited for use of tax-exempt leases are: 1) leases are a way to purchase equipment when local debt restrictions or need for local voter approval make it cumbersome to obtain required equipment or facilities, 2) leases do not have transaction costs that are experienced when issuing local bonds. Under the tax-exempt lease, the local government makes lease payments that are defined as principal and interest to the lessor. Under federal tax law the interest portion of the payment is viewed as tax-exempt so lessors are willing to charge a lower interest rate to lessees. This tax advantage results in lower costs for the local or state governments.

The lease concept currently being applied to privatize wastewater treatment facilities differs from operating and tax-exempt lease structures. The wastewater lease structure being proposed in several locations across the country calls for the local government, the owner of the facility, to enter into an agreement to lease the facility to a private partner. The private partner, as the lessee, pays a lease payment for the right to operate the facility for a specified period of time. The lease payment may be one up-front payment referred to as a concession fee, or it may be periodic payments over the life of the lease. The local government then pays the private partner an annual service fee to operate and maintain the facility. This annual service fee is comparable to the service fee paid under contract operations, however, the service fee under a lease includes an annual payment on the debt incurred by the private partner for concession fees and capital improvements. The lease arrangement can allow the local government to retain responsibility over wastewater rate setting, collection of user fees, and the municipal industrial pretreatment program. However, the private company may have the responsibility for capital investments under a lease arrangement, as illustrated in Figure 2.

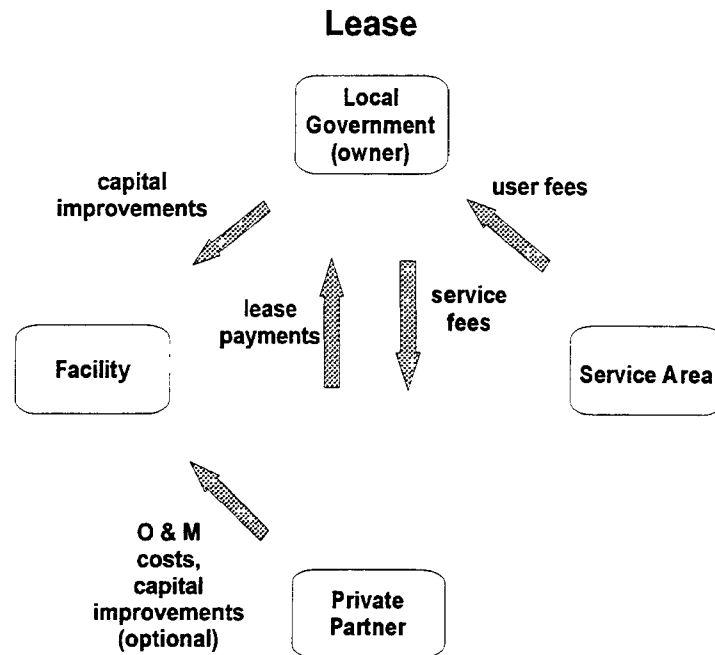
An arrangement involving lease payments and, or private capital investments must undergo formal review by EPA to determine compliance with the specific requirements and overall intent of Executive Order 12803. A lease arrangement of this type was approved in May of 1997 for Cranston, Rhode Island (see section VI)

The duration of the lease may be affected by the presence of outstanding tax-exempt municipal debt on the wastewater treatment facility. If the local government used tax-exempt municipal bonds to finance any portion of the leased facility, then the term of a service contract may be restricted by federal IRS tax regulations just as they limit the term under a contract operation.

If the local government has no outstanding wastewater facility tax-exempt debt, or pays off wastewater facility debt prior to entering into the lease agreement then the term of the lease can be longer since the IRS requirements do not apply. It may be possible for a local government to retire outstanding debt out of available financial

resources or a lease/concession payment that is used to retire debt. The result, is essentially refinancing of outstanding debt; by swapping tax-exempt debt for payments to the private partner that reflect the private "investment" in the local

Figure 2



government. This approach may be beneficial to the local government if the private partner is able to guarantee lower annual costs for the long-term than could be expected under continued governmental operation.

Asset sales

Asset sales have received a great deal of attention as a result of E.O. 12803 - Infrastructure Privatization. Under an asset sale (Figure 3), a local government sells a wastewater facility to a private partner. Revenue from the sale of the facility can be used to retire outstanding wastewater facility debt, for infrastructure investment, or for general property tax relief. In combination with the sale transaction the private partner and the local government enter into a multi-year service contract under which the private partner is paid an annual service fee for treatment of the wastewater. The private partner has control over the facility and is free to modify the equipment or treatment processes as necessary to reduce costs and/or improve performance. If the costs for capital expansion are passed on to the public in the form of higher fees, the services contract will stipulate a process to determine the selection and implementation of facility modifications. A partial asset sale occurred in June of 1995 under E.O. 12803, when the Franklin Area Wastewater Treatment Plant (Franklin, Ohio) owned by

the Miami Conservancy District was sold to Wheelabrator EOS, Inc. (see section VI).

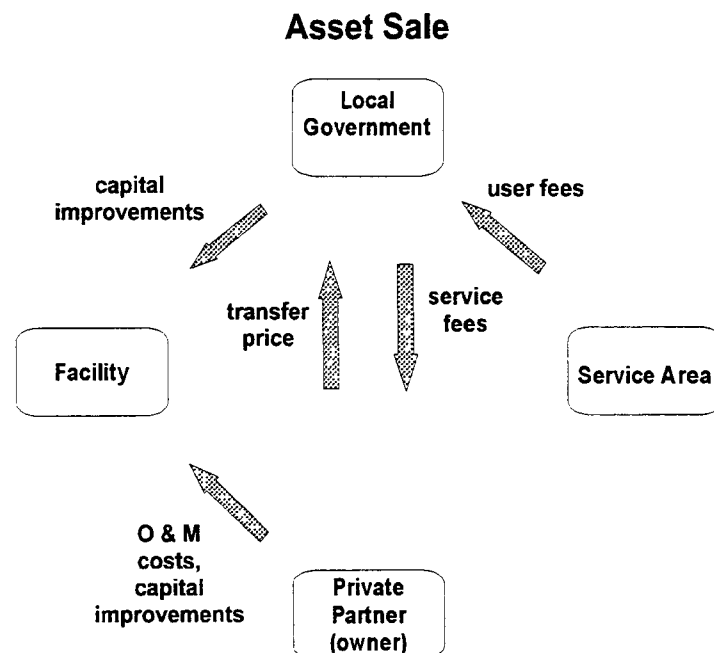
The transfer price paid for the facility represents an investment in the facility by the private partner. The partner will need to recoup its investment plus interest through the service fees it charges to

operate the facility. As a result it is inappropriate to view an asset sale as a way to free capital for other investments. It is, in fact, another financing source available to local governments comparable to individual homeowners borrowing against the equity in their home.

A simplified example helps to illustrate this point. If a local government sells a wastewater facility for a price of \$1,000,000 and has the facility outstanding debt of \$400,000, the government will receive net cash of \$600,000 from the sale. However, a private partner will require repayment of its total \$1,000,000 investment plus interest. So as part of the annual operating fee payment, the private partner will receive repayment of the \$1,000,000 investment plus interest.

In summary, any payments a local government receives from the sale or lease of a wastewater infrastructure asset represent a loan from the buyer or lessee which must be repaid with interest by the wastewater users in the form of additional user fees. Thus, the value of any concession fees or sales price which exceeds the current debt on the wastewater infrastructure represents additional debt the wastewater users must repay.

Figure 3



If a local and state government wants to recoup all of its investment in a facility and sets a transfer price or concession fee to reflect that amount, the resulting annual service fees to the buyer or lessee could be very large and result in significant increases in user fees for all the wastewater treatment users.

III. Factors Affecting Privatization

This section presents a discussion on the financial and nonfinancial factors that affect a decision to privatize. A review of these factors helps to clarify what incentives and disincentives local governments have to privatize their wastewater facilities. Financial factors address issues of cost savings, tax status of debt, capital improvements, economic risks, and local/regional economic impacts. The non-financial factors include regulatory compliance, labor, response to capital improvements, municipal control, accountability, and rate stability.

A. Financial Factors

For any public-private partnership to be successful, a number of financial issues must be resolved to the satisfaction of all participants. Specific financial concerns including outstanding municipal debt, user fees, and the cost of private capital have important implications on privatization agreements. Each participant in the arrangement, the local, state and federal governments and the private operator, has a different perspective on the financial structure of public-private partnerships.

Cost savings

The ability of the private sector to reduce operating costs beyond what is practically achievable by the local government is a critical factor affecting the privatization decision. Private companies reduce costs by applying their expertise to all areas of engineering, construction, operations, and maintenance. Frequently, private companies can construct new treatment facilities at lower costs than is possible for local governments since the companies can streamline design, procurement and construction practices. Private companies may be able to apply advanced operating skills to reduce the use of chemicals and electricity in a facility while meeting or exceeding permit requirements. Private companies also may be able to lower operating costs by expertly maintaining the facility and, as a result, find it possible to operate the facility with fewer workers. In some circumstances local governments can use the same techniques to reduce operational costs.

User Fees

The attraction of lower or stable user fees over the period of the privatization contract is one to the main reasons local governments explore privatization. Often privatization will result in a reduction in user fees with a guarantee that service charges from the private partner will remain stable with increases occurring only to reflect inflation or to reflect increased costs stemming from changes in regulatory requirements, treatment processes, or facility upgrades/expansions. Contract

conditions that clearly state why and how changes in service fees will occur are important to the privatization process.

Capital costs

The tax status of existing and future wastewater debt is a factor in determining the ultimate costs and benefits of any privatization agreement. The ability of the existing wastewater debt to remain tax-exempt will depend on how the specific conditions of the privatization arrangement relate to IRS tax rules. In developing a privatization agreement, the parties must carefully follow IRS tax rules to avoid changing the status of existing tax-exempt municipal bonds to taxable private activity bonds. The IRS has defined very specific types of action local governments must meet to maintain the existing tax-exempt status of municipal bonds.

When private companies must acquire capital to fund improvements to the wastewater facilities, lease payments, concession fees, or transfer prices, the debt is usually acquired in the form of taxable private activity bonds. However the IRS has defined certain limited situations where private companies can finance wastewater treatment facilities with the proceeds of tax-exempt "qualified private activity bonds".

Even though the nominal interest rate differential between tax-exempt and taxable bonds may be significant, the actual costs of the capital may not have a great impact on the privatization decision. The private party may be able to offset the higher capital costs by the tax deductibility of interest costs and depreciation expenses.

Up-front payment (concession fee, lease payment, or transfer price)

Up-front payments from a private partner to a local government may occur in privatization. In a lease arrangement it is usually called a "concession fee." It could be an initial payment or installment payments made as part of a lease arrangement or, in an asset sale, the transfer price provided up-front to complete the privatization transaction. Municipalities may use these up-front payments for other infrastructure investment, to refund outstanding debt, or for general tax relief under E.O. 12803 privatization arrangements.

As discussed in the previous section, it is important to note that the transfer price, lease payment, or concession fee are equivalent to loans from the private partner to the local government. Any funds provided by the private partner would be recouped through future user fees. Simply stated, up-front payments (transfer price or concession fees) are analogous to the home equity loans that are used across the country today. A private company provides a payment that reflects some level of the municipal investment in a facility and then the private company recoups the payment

plus interest as a part of annual service fees charged to the municipality. As a result, privatization should not be viewed as a way to obtain sources of “free” capital. Instead, privatization should be viewed as one more source of capital financing for municipal wastewater investments.

Tax-exempt status of local debt

Most municipal wastewater debt is in the form of tax-exempt general obligation or revenue bonds, SRF loans, and other bonds or loans received to build and maintain the wastewater facility. As long as a municipality maintains ownership of the wastewater facility and the privatization agreement meets the conditions allowed by IRS “management contract” rules, government issued debt can remain tax-exempt over the repayment term. Tax-exempt public debt is repaid at attractive interest rates, currently around 6-8 percent.

The IRS rules that have recently been released provide additional flexibility to communities that wish to have their facilities operated under contract for an extended period of time while maintaining the tax-exempt status of their wastewater bonds. The new rules allow certain management contracts for “public utility property” (including wastewater treatment plants) of up to 20 years without endangering the tax-exempt status of outstanding municipal debt under certain operations arrangements.

Capital improvements

Capital improvements usually represent modifications to the wastewater facility to meet new discharge requirements, replace old infrastructure, provide services to a growing residential area, or meet economic growth needs by expanding the service area. Capital improvements are often costly and impose a financial burden on the local government. In privatization, depending on the terms of the privatization agreement, capital improvements may become the responsibility of the private sector. The private partner recovers the costs of its investment in capital improvements through increased service fees paid by local governments. The private partner’s ability to use tax-exempt financing plus different engineering, procurement and construction practices can have a significant influence on capital improvement costs. The overall costs that result from capital improvements under privatization are important to consider and compare to costs that would result from financing and construction under continued public ownership and operation.

Economic impacts

The local/regional impacts will vary depending on the type of privatization agreement. Overall impacts can include potential increases in local unemployment and loss of local government control over hiring of operations personnel. Privatization has often resulted in a reduction in the staffing levels because the private firm is able to efficiently manage the facility with fewer workers. This action will potentially affect union relations, local income levels, and the local businesses that the local labor forces patronize. However, to address this concern, the private partner will normally agree to hire most of the current employees, cooperate with labor organizations to secure job training and placement for the workers, and reduce the workforce through attrition. Frequently, the private partner has the ability to lower and stabilize wastewater rates which can contribute to the ability of the community to encourage economic growth.

Performance and liability

There are economic risks associated with meeting National Pollutant Discharge Elimination System (NPDES) permit standards and the costs resulting from unexpected wastewater flow and loading variations. When a private partner assumes operating responsibility, they assume responsibility to meet permit limits under typical operation conditions. Often this responsibility is reflected by making the private partner a copermittee with the local government on the NPDES permit.

When a facility is privatized, the interests of both the local government and the private partner can be protected by defining normal operating conditions and stipulating what actions are taken to adjust service fees under different conditions, such as floods, atypical pollutant levels, or amendments to environmental regulations that increase operating costs.

B. Non-Financial Factors

In addition to financial factors, there are non-financial factors that affect the privatization decision. These factors include: regulatory compliance, local control, accountability, personnel impacts, and response to capital improvements.

Regulatory compliance

When evaluating privatization, local governments must determine if private firms can operate the wastewater facility in as legal manner that maintains the facility's publicly owned treatment works (POTW) status. This is achieved when the local government retains ownership and the private operator is a copermittee on the NPDES permit. Under these conditions, the service contract would clearly assign performance

responsibility to the private operator. In the event of nonperformance, the contract would specify financial penalties to the private firm that would escalate in the event of continuing nonperformance.

In the circumstances of an asset sale, where all components of the facility are sold to a private partner, the facility and any industrial dischargers to the facility would be regulated under the Clean Water Act and may be subject to requirements under the Resource Conservation and Recovery Act (RCRA). The private ownership status means that industrial pretreatment requirements under the POTW status of the Clean Water Act may be replaced by RCRA requirements. In such a situation, higher treatment costs may occur if the wastewater treatment facility is designated as a RCRA hazardous waste treatment, storage or disposal facility. When an asset sale occurs the private partner will have to apply for a new NPDES permit under its own name. The permit limits under private ownership will likely be similar to those of the previous POTW's permit. In the only asset sale/lease that has occurred to date under E.O. 12803, the facility retained its POTW status by the local government retaining ownership of a portion of the wastewater treatment process under a lease arrangement.

Local control

Under a public-private partnership, local governments yield control over the facility's daily operations to the private partner. However, through the service contract local governments can maintain control over important local issues such as user rates, industrial pretreatment programs, capital improvements/expansions, and modifications to the service area. Local control will vary depending on the type of privatization. Under an asset sale the local government yields ownership to the private partner and relinquishes control over the facility except in the event of a failure of the owner to perform as required. One significant issue that may affect an asset sale is the potential for oversight from state Public Utility Commissions (PUCs). PUCs often regulate investor-owned utilities such as privately-owned public water systems. PUC oversight governs a variety of cost related activities including user rates and debt issuance. The local government's control will be significantly reduced if the facility is subject to PUC oversight.

The level of oversight for the private partner will vary to reflect the level of concern that local governments have about the private partner's performance. Oversight activities such as periodic performance reporting to the local government or use of an oversight board consisting of local authorities are negotiated as part of the privatization service agreement.

Public accountability

When a private company operates a local wastewater facility, there may be concern or a perception that they will not be as accountable as a public operator. Communities that have opted for privatization of their wastewater facility indicate that contract requirements with specific performance levels for the private operator in all areas of operations have worked to protect the public interest and to assure a high level of accountability. All service contracts established with private companies need to incorporate specific performance assurances that protect the environment. Local government may require a performance bond from the private partner to add additional assurance of performance. Under an asset sale, where PUCs have jurisdiction over privately owned public wastewater facilities, the private operator would be regulated and held accountable for PUC requirements.

Personnel impacts

The private company and local government need to consider how privatization will impact current wastewater plant personnel. Any expected reduction in staff, including the timing of the reductions and out-placement activities must be included in contract negotiations. Because of the potential for significant personnel impacts, local governments have found it important to involve workers and unions in deliberations about privatization to explore any plans for personnel adjustments including new hires, salary and budget changes, and staff reductions. Current privatization arrangements have generally used attrition or transfers as the primary way to reduce the work force.

Capital improvements

Capital improvements or wastewater capacity expansions contribute to the continued economic success of the wastewater facility. The privatization agreement may address specific scheduled capital improvements during the life of the contract, including responsibility and financing arrangements. The contract negotiations determine who has the lead on capital improvements and it will vary according to the specific situations.

State laws and regulations

State laws and regulations often have significant impacts on the form and conditions of privatization agreements like the type of service, term of contract, and contracting entity. These laws and regulations vary significantly across the country but most appear to be oriented toward allowing privatization of wastewater facilities. In cases where the form of privatization desired is not explicitly allowed under state laws, local governments will find it necessary to seek the necessary legal opinions on the

feasibility of the specific desired privatization arrangement.

Overall administrative complexity of the transaction

One of the overriding issues that affect privatization is the overall complexity of designing a privatization arrangement, negotiations between public participants and the private partner, and execution of the formal contract. In cases where there are multiple facility owners or participants in a wastewater treatment system, the privatization process is likely to take a longer period of time to accomplish. In the case of extremely large regional facilities with many participating communities the process may become so complex that it would be difficult to implement.

IV. Federal Requirements Affecting Privatization

Although many of the factors affecting privatization are local in nature, there are certain federal requirements that impact those decisions. IRS regulations, NPDES permit requirements, and Executive Order 12803 come into play in choosing the type of privatization. Some of the federal regulations restrict certain privatization activities. For example, tax law restricts the use of tax-exempt debt for privately owned facilities. Other federal requirements present a challenge because they require that local governments seek approval for changes to ownership/operation of their POTW. EPA requirements apply only if the local government received federal wastewater construction grants. For example, sale of a facility that received construction grants through the Clean Water Act requires the local government to apply for a deviation from the EPA grant regulations and E.O. 12803. Various federal requirements can potentially add additional time for the local government to complete the privatization agreement. As a result they are often cited as impediments to privatization. Each of the requirements and their influence on decision-making are discussed below.

A. IRS Regulation/Tax Law Affecting Use of Tax-Exempt Municipal Debt

In 1986, the Tax Reform Act influenced private investment in public infrastructure by removing or limiting many tax incentives. Specifically, the amendment eliminated the investment tax credit, scaled back accelerated depreciation and limited the use of tax-exempt debt financing. These changes virtually eliminated several "lease-buy" privatization arrangements and severely restricted the duration of management contracts under contract operations to five years. The main reason generally cited for these changes was that the financial incentives given to the private sector represented a very significant loss of tax revenues to the federal treasury.

As previously mentioned in Section III, recently released IRS rules provide additional flexibility to communities that wish to have facilities operated under a contract arrangement without the loss of the tax-exempt status of the wastewater bonds. The new rules allow certain "management contracts" for wastewater treatment plants of up to 20 years without endangering the tax-exempt status of outstanding municipal wastewater debt. For example, a 20 year "management contract" is allowed if at least 80 percent of the compensation provided to the private partner is in the form of a periodic fixed amount. This has the effect of limiting the amount of net profit that may be provided to the private partner.

The new rule, which was released in February 1997, substantially extends the time limits placed on "management contracts" in previous IRS rules. In the past, "management contracts" were only allowed for up to a five-year period. The availability of longer contract terms provides local governments and private partners with

additional flexibility to determine the contract length that meets the needs of both parties.

B. EPA Regulations and Procedures

The Clean Water Act established the regulatory structure for local governments that received EPA grant funds to construct water pollution control facilities under the Agency's construction grant program. Through the Clean Water Act, local governments have received billions in federal construction grant funding to build POTWs that meet wastewater discharge permit limits established under the NPDES. The NPDES requirements of the Clean Water Act establish pollutant limits for discharges from POTWs and privately owned wastewater treatment facilities.

NPDES Permittee Designation

NPDES regulations require that a local government obtain an NPDES permit to discharge water from its wastewater treatment facilities. Under privatization, the private operator may be a copermitttee or the permittee of record. If the facility becomes privately owned, it will no longer be a POTW and the owner will be required to obtain a new NPDES permit under its own name.

POTW Designation

An important privatization consideration is the POTW status of the wastewater treatment facility. When a wastewater treatment facility loses the POTW status it is classified as a privately owned treatment works that is no longer subject to the requirements of a municipal industrial pretreatment program. A privately owned treatment facility may also be designated as a hazardous waste treatment, storage or disposal facility under RCRA and subject to more strenuous treatment standards. Local governments and private companies have indicated that the threat of losing the POTW status has been a significant concern when evaluating asset sale and lease arrangements.

Grant Deviation Procedures

EPA's construction grant regulations specify that when a grantee sells or encumbers ownership by leasing a facility that received grant funds, the grantee must request a deviation from certain grant regulations and possibly repay the grant funds. The grant deviation process is used to manage the federal interest in facilities after the award of the federal construction grant.

C. Executive Order 12803 - Infrastructure Privatization

In 1992, Executive Order 12803 on infrastructure privatization establishes a framework for privatization of facilities funded with federal grants. The order has five purposes: (1) assist local privatization initiatives; (2) remove federal barriers to privatization; (3) increase the financial incentives for state and local governments by relaxing federal repayment requirements; and (4) protect the public interest to ensure reasonable user charges and (5) that the facility will be used for its intended purpose.

E.O. 12803 significantly modifies the federal construction grant recoupment process. Under E.O. 12803 the local and state governments are the first to receive proceeds from an asset sale or lease concession fees. If the transfer price or concession fee for the facility is higher than the state and local investment, then federal construction grants are repaid at their depreciated value (to maximum of the transfer price or concession fee). Federal grants are depreciated using IRS accelerated depreciation schedules. The Executive Order results in repayment of federal grants at a much lower level that would have resulted under construction grant regulations.

When an EPA construction grantee decides to pursue an asset sale or lease under the Executive Order, it will be necessary to submit a request to EPA for approval under E.O. 12803 in combination with a grant deviation request as described above. Submissions for approval under E.O. 12803 and the grant deviation request address:

- Proposed privatization arrangements - ownership structure, permit status
- Responsibility for the industrial pretreatment program
- Current and proposed user fee rate structure and arrangements for future increases
- Federal construction grant history and depreciated value of grant
- State and local investment in facility
- Facility transfer price and proposed distribution of proceeds
- Assurance that facility will be used for its original intended purpose in the event that the purchaser/lessee becomes insolvent
- Assurance that user charges will be consistent with any current federal conditions that protect users and the public by limiting the charges

There has been one partial asset sale and one lease that has occurred to date under E.O. 12803. The sale of the Franklin Area Wastewater Treatment Facility (Franklin, OH) was completed in 1995. The lease of the Cranston, Rhode Island wastewater treatment system occurred in 1997. The experience gained through the Franklin and Cranston cases will be important as other requests are submitted to EPA for approval. Several local governments are in various stages of seeking EPA approval for their privatization arrangements.

V. Impediments to Privatization

This response describes the wastewater privatization arrangements that are available today and the financial, non-financial, and federal regulatory factors that affect a local government's privatization decision. An examination of the factors that influence current privatization activities leads to the following observations about potential impediments affecting privatization of wastewater facilities.

A. Financial

In many situations, financial factors may provide the biggest incentive for local governments to implement a privatization agreement. As illustrated in several case studies presented in the next section, there are numerous examples of communities realizing significant operational cost savings and obtaining new sources of capital from privatization arrangements. However, financial factors may also be impediments to privatization in cases where a private partner simply cannot achieve operational cost savings over efficient public operations. The private partner needs to make a return on its investment, and may incur higher capital borrowing costs when tax-exempt financing is not available for new infrastructure needs.

Another financial impediment can be encountered in circumstances where communities receive large sums of money when they sell or lease a facility. Such large up-front payments may require the private partner to charge higher service fees in order to recover its investment.

B. Non-financial

Some communities may believe that providing wastewater treatment is an important service that should remain under direct government control to assure responsiveness to changes in environmental regulations or local conditions. Some governments may be concerned about potential staff reductions that could occur under privatization. Others may feel that because there are multiple facility owners or participants, the process to evaluate options and conduct privatization contract negotiations would be prohibitively complex and time-consuming.

C. Federal requirements

Federal requirements including IRS regulations, NPDES regulations, EPA construction grant regulations, and E.O. 12803 compliance influence the privatization process but do not represent an impediment to the successful implementation of privatization arrangements. The recent changes in the IRS regulations facilitate long term contract operation arrangements by maintaining the tax exempt status of local

debt. EPA and delegated states have extensive experience in addressing permit requests under the NPDES and deviation requests under EPA construction grant program. This experience translates into such requests being processed as normal operational events. The Executive Order 12803 process will be improved and streamlined to facilitate privatization activities as local, state and federal governments gain additional experience.

The Agency has delegated final approval of privatization arrangements from the Administrator to the Assistant Administrator for Water and established a privatization coordinator within the Office of Wastewater Management to expedite approval of privatization requests. The coordinator will interact with EPA decision-makers and OMB as necessary to shorten the time to review proposed privatization arrangements under E.O. 12803. The coordinator will also serve as an important point of contact for state agencies, local governments, and private companies that are seeking information on requirements related to E.O. 12803 and the privatization process.

VI. Privatization Case Studies

To illustrate the successful application of privatization arrangements this section presents five case studies that summarize the experience of communities that have used different forms of privatization. The Cases studies include:

- Indianapolis, IN (contract operations)
- Miami Conservancy District (Franklin, OH) (asset sale/lease)
- Cranston, RI (lease)
- Dale City, VA (private ownership)
- Charlotte, NC (contract public operation)

Each case study description describes the privatization agreement, the benefits realized by the community and the barriers to privatization experienced by the participants.

INDIANAPOLIS, INDIANA

Contract Operations

Wastewater Treatment Plant

Public Partner	Indianapolis, Indiana
Private Partner	White River Environmental Partnership
Service Population	850,000
Treatment Plant Facts	Advanced Wastewater Treatment Plants, 180 mgd (average daily flow)
Initiated	January 31, 1994
Contract Cost	\$14 million annually

Synopsis

Indianapolis entered a partnership with the White River Environmental Partnership (WREP) to improve the wastewater services offered to the community. The WREP consists of the following corporations: Lyonnaise des Eaux-Rumey, Indianapolis Water Company Resources Corporation, and JMM Operational Services. Under the five-year contract the municipality pays an annual service fee of approximately \$14 million in exchange for a more efficiently run treatment facility.

Public-Private Partnership Agreement

After a year of negotiations and selection, Indianapolis signed a five-year contractual agreement with WREP for the O&M of the Advanced Wastewater Treatment (AWT) plants. WREP is responsible for the maintenance, personnel, and daily operational costs. The City retains ownership of the facilities, pays an annual service fee, is responsible for capital improvements, funds corrective maintenance, and sets rates. WREP and Indianapolis negotiated with the Association of Federal, State, County, and Municipal Employees to make arrangements for those employees displaced by the partnership agreement and train other personnel on the new system. The arrangement did not require the submission of an E.O. 12803 approval request or a grant deviation request to EPA, since the agreement did not involve any lease

payments or additional capital investment by WREP.

Outstanding federal grants and municipal bond debt were not affected by the privatization agreement. Tax-exempt bond issues did not become an issue because municipal bond obligations are the city's responsibility and are paid by the collection of property taxes and industrial fees.

Effects of Public-Private Partnership

The municipality projected savings of over \$65 million as a result of the partnership. After two years of operation, Indianapolis reported over \$21.5 million in cumulative savings for facility operations, and the savings for capital project expenditures was over \$13.3 million. Permit exceedances decreased by 86% and worker complaints decreased from 38 to one. The labor force was reduced from 328 to 176 workers. Displaced personnel experienced 100% placement within eight months after privatization occurred. The service area experienced no initial rate increases due to the cost savings associated with the partnership. The partnership also exposed the AWT facilities to innovative technological advances that increased the plants' efficiency.

The city cited the following impediments to privatization: (1) IRS restriction of use of tax exempt debt, (2) union acceptance, (3) resistance within the city council, (4) fear of change, (5) bureaucratic resistance, (6) media antagonism and (7) federal requirements for grant recoupment under the E.O. 12803.

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MIAMI CONSERVANCY DISTRICT, FRANKLIN, OHIO

Asset Sale/Lease

Wastewater Treatment Plant

Public Partner	MCD, Franklin, Ohio
Private Partner	Wheelabrator EOS
Service Population	25,000
Treatment Plant Facts	Franklin Area Wastewater Treatment Plant, 4.5 mgd
Initiated	July 21, 1995
Transfer Price	\$6.85 million

Synopsis

The Franklin Area Wastewater Treatment Plant (FAWWTP) owned by the Miami Conservancy District (MCD) has a service area that includes Franklin, Germantown, and Carlisle and sections of Montgomery and Warren counties. Wheelabrator operated the plant under contract since 1987 and offered to purchase the facility in 1992 for \$6.85 million. The MCD-Wheelabrator transaction has been the only privatization agreement approved under Executive Order 12803. The sale/lease required two years of negotiation followed by a one year (eight months - state, four months - U.S.EPA) government approval process. The \$6.85 million, paid to the communities of Franklin, Carlisle, and Germantown, was used to retire outstanding local debt pertaining to the wastewater facility.

Public-Private Partnership Agreement

Wheelabrator purchased the facility at the fair market value of \$6.8 million in July 1995. The private operator signed a 20 year sale/lease agreement which provides MCD with the right to repurchase the facility at the end of the contract. All municipal approved plant expansions and upgrades are financed by Wheelabrator. Since Wheelabrator operated the plant since 1987, all current personnel were retained under the contract. As a municipal asset sale/lease, the MCD-Wheelabrator transaction was

subject to E.O. 12803 review and grant deviation requirements. The E.O. 12803 review involved approval for the MCD asset sale/lease from the local, state, and federal governments (EPA and OMB). Due to the financial terms of the sales/lease, recoupment of federal grant funds was not required under E.O. 12803. Since the FAWWTP received construction grants totaling \$1.15 million from EPA, MCD was required to obtain a deviation from EPA's grant regulations to accomplish the transaction. The OMB had to concur on the transfer price because it was a negotiated price rather than a competitively bid price. MCD used the sale/lease proceeds to retire outstanding local debt and had over \$2 million remaining for dedication to community infrastructure projects.

Although, this privatization agreement is described as an asset sale/lease, the FAWWTP is still considered a POTW. This was accomplished by leaving a portion of the facility that is integral to the treatment process in public ownership. MCD maintained ownership of the collection system, interceptors and a portion of the treatment process. Wheelabrator owns the remainder of the facility and operates the entire wastewater treatment process. MCD and Wheelabrator are NPDES co-permittees. Wheelabrator is responsible for all O&M, monitoring and sampling for the industrial pretreatment program, and regulatory reporting, while MCD is responsible for enforcing the municipal pretreatment program.

Effects of Public-Private Partnership

The privatization of the facility reduced rates from a projected \$1.85 per 1,000 gallons to \$1.34 per 1,000 gallons (a 28 percent decline). Any future rate increases would only reflect inflationary adjustments. The project was successful because of local, state, and federal government support, Wheelabrator's familiarity with the plant and community, and the use of an independent contractor to facilitate negotiations.

The issues encountered by the privatization partnership were categorized as federal and local in nature. The federal requirements which had to be resolved included the IRS regulations pertaining to municipal bond repayment once the treatment is no longer publically owned, NPDES permit status, and the implementation of the Municipal Industrial Pretreatment Program. Local issues were related to contract negotiation, specifically user rates and the valuation methodology selected for plant repurchase at the end of the contract. Participants in the process indicate that the E.O.

12803 review and grant deviation requirements were not impediments to privatization, but did require time to first understand the process and then to prepare the materials for the request for approval under E.O. 12803 and the construction grant deviation.

Contact

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CRANSTON, RHODE ISLAND

Long-Term Lease

Wastewater Treatment Plant

Public Partner	Cranston, Rhode Island
Private Partner	PSG-Poseidon
Service Population	78,000
Treatment Plant Facts	12.5 mgd
Initiated	May 1997
Lease Payment	\$48.1 Million

Synopsis

The need for capital improvements motivated the City of Cranston to pursue a public-private partnership. Cranston selected the Triton Ocean State L.L.C. organization that included the Professional Services Group, Inc. and Poseidon Resources Corporation to operate and maintain the wastewater facility under a lease arrangement for 25 years.

Public-Private Partnership Agreement

The City of Cranston chose Triton Ocean State as its private partner for the operation and maintenance of its wastewater facility for a 25-year period. Triton Ocean State agreed to provide an up-front lease payment which was used to retire debt and establish a working capital fund. Because leases are included in E.O. 12803, Cranston had to comply with E.O. 12803. The City had to obtain a federal construction grant deviation since they received EPA grant funds to construct the facility. Cranston will pay Triton Ocean State an annual service fee based on defined flow components and amounts. The service fee will be adjusted in accordance with established inflation indices.

The City of Cranston received a \$48.1 million lease payment as part of the agreement with Triton Ocean State. The decision to obtain \$48.1 million was made

after extensive public discussion and a consensus of the rate payers. The lease payment did not result in an increase in existing user fees. The average future user fees will be equivalent to six tenths of one percent (0.6%) of Cranston's local median household income. This level represented a low financial burden on local households. Of the \$48.1 million provided to Cranston as a lease payment, approximately \$31 million was used to repay wastewater treatment-related debt. About \$12 million was used to eliminate general City debt and approximately \$5 million was used for a working capital reserve fund to enhance the City's future credit standing.

Under section 3(c) of E.O. 12803, the city was required to repay \$5 million of its EPA construction grant funds to the federal government. The EPA forgave repayment of the \$5 million under the authority granted the Agency by section 586 (a)(2) of the Water Resource Development Act of 1996

Effects of Public-Private Partnership

The City expects the project will accomplish three significant objectives:

- Providing capital funds for up-grading the facility to tertiary treatment.
- Provide a cost-effective means of upgrading the facilities to advanced wastewater treatment by allowing the private partner to manage the design, construction and operation of the new treatment system at an estimated total cost savings of \$96 million over 25 years.
- Provide lower wastewater treatment user fees and long-term rate stabilization.

The City described its greatest hurdles to accomplishing the privatization agreement as satisfactorily resolving the concerns of rate payers, the city council, and regulatory agencies that water quality would be protected and wastewater user fees would remain reasonable. Negotiation with the private partner to achieve the City's privatization objectives in a contract acceptable to all parties, completed in March 1997, was very lengthy and complex process.

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DALE CITY, VIRGINIA

Design, Build, Operate

Wastewater Treatment Plant

Public Partner	Dale City, Virginia
Private Partner	Dale Services
Service Population	40,000
Treatment Plant Facts	Dale Service Treatment Facility 4 mgd (average flow)
Initiated	1965
Operating Cost	\$2.8 million annually

Synopsis

Since the 1965 inception of wastewater treatment services in Dale City, VA, the wastewater treatment system has been privately owned and operated by Dale Services. Therefore, many of the issues affecting public-private partnerships today are not applicable to this situation.

Public-Private Partnership Agreement

Dale Services is responsible for all activities pertaining to the treatment of Dale City's wastewater. Dale Services must obtain all permits, set rates, and fund all capital improvements. The municipality has no responsibility in the provision of wastewater treatment services to the public. However, the municipality does have the option to purchase the treatment facility from Dale Services at market value at any time. Dale Services is the NPDES permittee for the wastewater treatment facility. All of the dischargers to the wastewater treatment plant are either residential or commercial. There are no industrial wastewater dischargers located in Dale City. Dale Services was not required to have a RCRA permit. Currently Dale Services has not found it necessary to implement a wastewater pretreatment program.

Effects of Public-Private Partnership

When Dale Services began providing wastewater services in the Dale City area in 1965 it served only a small population. The local government provided only minimal municipal services at the time, so Dale Services provided a desired service to an area. Since 1965, Dale City, a community outside Washington, D.C., has grown in population. Dale Services has also grown over time to respond to the needs of the area. Because of the success of the public-private partnership between the City and Dale Services, the local government has not been interested in providing wastewater treatment services.

The local government views the current wastewater system as very efficient with stable user rates. Dale City is pleased with the Dale Service's operation of the treatment facility. Any required capital improvements are completely financed by Dale Services with private sector funding and all capacity expansion must be approved by the State Corporation Commission. Dale Services has no access to public sector funding and it is subject to taxation for tap fees as a result of changes in tax laws.

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CHARLOTTE, NORTH CAROLINA

Contract Public Operation

Wastewater Treatment Plant

Public Partner	Charlotte-Mecklenburg Utility Department
Private Partner	NA
Service Population	540,000
Treatment Plant Facts	Irwin Creek Wastewater Treatment Facility, 15 mgd
Project Approved	July 1, 1996
Operating Cost	Approximately \$1.1 million annually

Synopsis

To counter the ever increasing costs of wastewater treatment, Charlotte decided to pursue a five-year contract operations privatization arrangement. However, after extensive evaluation of various contract proposals, the city opted to continue ownership and operation of the treatment facility. Its rationale was that continued municipal ownership and operation over the five-year period, should result in a significant cost savings over the contracts proposed by the private sector.

Public-Private Partnership Agreement

In January 1996, the Charlotte-Mecklenburg Utility Department (CMUD) announced a request for proposals for a five-year contract operations agreement. Of the six bidders, one was a separate accounting unit formed within CMUD. Known as CMUD Contract Operations or ConOp, this group of employees bid against the private firms and won. Using an outside firm (HDR Engineering) ConOp successfully bid for contract operations by taking the approach that they should think and bid as a private entity.

Contract operations provided by ConOp will produce cost savings in operations and maintenance of more than \$4 million over the five-year term. The savings is a consequence of staff reduction, automation, oxidation-reduction potential technology, a new head works, a plant-wide supervisory control and data acquisition system, improved digester operations, and a predictive maintenance system. ConOp has a memorandum of understanding (MOU) with the city that is similar to a contract service agreement. This MOU provides a measure of ConOp's performance, and if the conditions are not sufficiently met, the city can terminate the agreement. Due to increased facility automation, some staff reduction has occurred, which resulted in a current staff of more technical, highly specialized personnel. Other operational services which include grounds maintenance, janitorial services, electrical and instrumentation maintenance, laboratory service, and vehicle maintenance are provided on a contract basis to ConOp.

This contract operations arrangement did not require the submission of an E.O. 12803 approval request or a grant deviation request, since it involved only internal units of CMUD. Outstanding municipal bond debt was not affected by the agreement.

Effects of Public-Private Partnership

Charlotte's case differs from the other examples because in this situation, it was decided that the treatment facility was best left under the operation of the municipality. Charlotte was prepared to handle the environmental, economic, labor and financial challenges of retaining control over the treatment facility. The fact that ConOp was familiar with the facility's operations worked to its advantage.

Contact

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