Opportunities for the Development of Municipal Water in Mexico

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MISCONCEPTIONS ABOUT PRIVATE SECTOR PARTICIPATION
IN THE WATER INDUSTRY

First, private sector participation has to be differentiated from "privatization." The term "privatization" was coined after the successful experience conducted in the United Kingdom (UK) under Margaret Thatcher's leadership. This consisted in the sale to private investors of most of the UK water companies. As we will see this represents a very special type of arrangement whereby those companies were sold forever to private operators that were entrusted, at the same time, with the management rights of those companies and the obligations of providing the service to the final clients within the constraints imposed by a regulation authority. This is not the sort of arrangement that Suez Environment is promoting as it does represent only one of the multiple solutions offered.

Second, private sector participation is not a new way of intervention born in the UK in the 1980s. Early examples of this type of operations were introduced in France in the middle of the eighteenth century in order to build canals to improve trade conditions throughout the French territory. Private operators were given the rights, through concession contracts, to build and operate the relevant infrastructures and to receive tolls from the users of those canals.

Third, private sector participation is not an asset driven contract. It is true that, in order to provide a certain service to the end users, certain infrastructures have to be built or purchased. More particularly, in the case of water related services, the operator has to make sure that the proposed infrastructure will procure the appropriate level of treatment to provide either potable water or to treat effluents whether domestic or industrial sources, but it should be clarified that design and construction of the necessary infrastructures are not the goal of the private operator, as its aim is and remains the provision of an adequate service at the lowest possible price.

Finally, private sector participation is not a financial agreement. It is true that the private operator might help in finding and securing the most advantageous sources...
of financing but, once again, this is not the driving force nor the main objective of the private sector participation.

The main driver for the private sector participation in the water sector is the provision of an efficient service to the final consumer providing access to a reliable source of potable water and/or an adequate treatment of wastewater at acceptable prices throughout the years.

Therefore, what private sector participation brings along is an injection of efficiency and productivity in this public sector activity, as those are what private companies are good at. It is also a way to introduce competition as, in most cases, a private operator is retained after a competitive selection process which is bound to lower costs and charges to be paid by the final consumers and, in certain cases, to make the water and sanitation available to parts of the city population which are deprived of it.

**Two Basic Approaches to Public/Private Partnership: The Contractual Agreement or Ownership Agreement**

In the contractual agreement, a municipal government entrusts a private operator with the provision of certain services, which could encompass all of the water and waste water services or only part of those for a specified duration, at an agreed price which could be paid either directly by the final consumers or by the municipal government. The price depends on the scale of the agreement and/or local legal constraints. Predefined indicators cover the extent and quality of the services provided so that the municipal government or any other public body may regulate the performance of the private operator.

In the ownership agreement, on top of defining the services to be performed and the way to evaluate the performance of the private operator, the municipal government requires it either to invest in the purchase of the existing assets, to invest in the upgrading and/or replacement of some of the facilities and/or to design and build new facilities, to improve the treatment and provision of the service, or extend the coverage of the services. The most radical option is the full "privatization," in the UK sense, where the ownership is transferred forever to private operators.

Most of contracts stand in between those two extremes and are tailored to cater to local constraints or financial constraints or any other considerations not directly linked to the provision of the services per se. It can then be seen that between service contracts at one end of the spectrum and full privatization at the other end, several types of contracts may be considered by the municipal government and the private operator to better address the local environment.

In between these two solutions stands the concession agreement which is the most common in France. It is at the same time a contractual Agreement, whereby the municipal government and the private operator define jointly the nature and extent of the services to be provided, and an ownership agreement, whereby some of the existing assets are transferred to the concession company while the government retains ownership of remaining assets. The agreement also defines the new facilities and/or improvements to the existing facilities which will be owned, operated, and financed by the concession company.
In any case it should be stressed that whatever type of agreement is considered suitable for a given city the control remains firmly in the hand of the public sector due to the nature of the service provided. In this respect, to achieve a successful contract it should include and provide: (i) clear objectives; (ii) clear regulation; and (iii) clear standards. As already mentioned ownership may remain with the municipal government or be transferred to the private operator. New facilities may be financed by the government or by the private operator, without substantially affecting the nature of the obligation of the private operator with respect to the provision of the service. To this end, the private operator has to be assigned clear goals and standards to comply with and to be able to rely on a consistent, unbiased regulation. As we will see these aspects may have repercussions on the way private operators and municipal governments will structure the local company to be formed to provide the services.

In most cases water and sanitation services are provided by a municipal government department that does not enjoy an independent legal existence. In very few cases, the provider of the service has been structured as a company fully owned and controlled by the municipal government. Generally, there is no contract between the municipal government and the provider of the service nor between the provider of the service and the final consumers. In many instances, the only contractual document between the consumers and the service provider is the invoice that reaches the mailbox of the end user. Considering this quite fuzzy environment, the first possible solution to introduce private sector participation is to form a joint venture between the existing public body and the private operator. This is a solution which has been used very successfully in China. There, municipal governments, first, were to create local companies to which all assets and obligations of the previous departments were transferred and, second, to from a joint venture between those newly formed water companies and the private operators. In this form of association, the only documents that rule the association are the joint venture contract and the shareholders agreement, where the extent and nature of the services to be provided are described. This form of association is mostly used in developing countries where the legal framework does not contemplate or allow for more sophisticated type of contractual agreements.

A second option would be to complete the formation of the joint venture with the signature of a formal contract between the joint venture itself and the municipal government where all the obligations of the joint venture, as far as the provision of the services is concerned, are documented and spelled out. The mere existence of this contract, directly between the municipal government and the joint venture, is the basis for regulation which is to be conducted directly by the municipal government. In this scheme a weakness comes from the fact that the beneficiary of the service, the municipal government is also the one to check the performance of the private operator. This may lead to some difficulties as the municipal government may have objectives that are incongruent with the objectives of the operator leading to unsurpassable difficulties when assessing the effectiveness of the operation.

A third option would be another one between the joint venture and privatization, where the management of the joint venture is entrusted to the private operator. This strengthens the private operators' obligations and rights with respect to the joint venture. In this new set up, it would also be beneficial to have a regulatory authority defined independently from the municipal government so as to ensure that the
monitoring of the performance of the private operator is conducted in a fair and unbiased way.

This last sort of agreement resembles the French "affirmage" contract, which is an agreement whereby the municipal government entrusts a private body with the provision of a public service while retaining the ownership of the existing assets and committing itself to own and finance all new required facilities. Ondeo Services refers to delegated management to characterize contracts where the relationship between all stakeholders is defined clearly. Rights and obligations of the municipal government, the private operator, the local operating company and the end users are clearly defined. The regulation of the contract is performed by a public entity apart from the above parties. This sort of set up which can be embodied in concession or "affirmage" contracts are the ones which appear as the most effective and the less prone to conflicts over the long life of these operations.

In this respect, strong regulation is vital to success. The operator needs to have periodical assessment of its achievements so that there are no doubts about what has been achieved and what remains to be completed. It also allows reformulation of the objectives that may evolve with the passage of time and the evolution of the city.

It also is very important to mention that self-regulation by the private operator itself is also a very strong regulation mechanism. A private operator will always try to find ways around the difficulties he may encounter and find with the municipal government the best possible solution, under given circumstances, to continue to provide the service and find acceptable compromise with all stakeholders. All major companies around the world in this business take pride of their success, fear failures and are willing to devote all efforts to overcome possible difficulties. In this respect, it should be remembered that private operators are very much aware of their responsibilities vis-à-vis their clients and expect the same sort of commitment from municipal governments and regulators with respect to the contracts by the fulfillment of their obligations and responsibilities.

Last, I would like to say a few things about tariffs which are a very sensitive issue. It is our strong belief that tariffs should cover the real economic price of the service. It is true that pricing those services at their economic value might hurt either the consumers or the municipal government and that under certain circumstances it might not be achievable. But it is also our belief that if a municipal government has to subsidize the provision of a certain service to the consumers, it has to do so in a conscious and informed way rather than through cross-subsidizing out of its general budget services, not sustainable if deprived from subsidies, should not be offered to private operators because the biased structure of the tariffs will ultimately impair the provision of the service.

In conclusion, I hope that the benefits of public sector participation and delegated management are clearer. First, there is a clear distinction between the municipal government functions and the provision of a service to the consumers. This provides a clear separation between regulation and operation. It brings competition and, in turn, lower costs to the final users. It brings also efficient financing and private sector efficiencies so that focus can be on the service and the customer satisfaction.