

Redefining the Process of Engagement in Delegated Management Contracts in Water Supply and Sanitation

By

Jan G. Janssens (Vatten Infrastructure Inc.)

Mounir Zouggari (Consultant)

Alexandre Brailowsky (Suez Environment)

Claude Jamati (Consultant)

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Summary

The performance of the public sector in its delivery of services to the population, including water supply and sanitation (WSS) services,, depends on the development level of the following factors and on their degree of coherence and interdependence:

- ◆ Governance structure and institutional organization of the sector
- ◆ Political stability, legal status and behavior of the public authorities responsible for service delivery
- ◆ Organization of the civil society, including consumers
- ◆ Economic and financial enabling environment, including tariffs
- ◆ Level of service
- ◆ Integration of water resources management, water conservation and demand management
- ◆

When a public-private partnership (PPP) is envisaged to ensure service delivery, three main categories of situations – or market segments - can be distinguished, based on the combined development level of the above factors: s

- ☐ Category A, corresponds to situations where all or most of the conditions are already in place to allow sustainable PPPs)
- ◆ At the other end of the spectrum, category C comprises situations where the combined development level of above criteria is too low to allow most forms of commercial arrangements. PPPs are not considered a viable solution.
- ◆ An intermediary category B which regroups situations in between the two ends of the spectrum.

The paper focuses on this intermediary category and develops the idea that in such situations, progress toward sustainable service delivery can be achieved over the medium/long term by following a roadmap that typically includes three successive steps:

- ◆ The first step consists of (i) a diagnostic (baseline data) of the situation of the sector and the utility), including performance gap and root causes analysis, (ii) the initiation of a participatory reform and change management process, and (iii) the implementation of urgent measures and investments
- ◆ The second step typically consists of (i) the consolidation of reforms at the sector and utility levels, and (ii) the implementation of investments in order to attain a satisfactory level of service
- ◆ The third step consists of reaching economic and financial sustainability and autonomy, , moving gradually towards full cost recovery through tariffs and targeted subsidies where needed.

Overall, these successive steps constitute a progressive and continuous process of reform and improvement, toward the overarching objective of reaching a better, reliable, affordable and sustainable service to all. From the point of view of a public-private partnership, each of these steps implies different obligations of the parties and evolving risks, which are cumulative and/or interrelated. For instance, the first step will usually generate the most uncertainties, at least until a reliable baseline has been established.

Of course, a public authority can choose to initiate and implement such a process with various degrees of involvement of the private sector: however, continuity is a key element of success and it can be argued that mistakes have been made in the past when focusing too much on the design of contractual arrangements or models for each step of the process and paying too little attention to the transition points between these steps and to the well structured dialogue between stakeholders that these transition points require.

In line of the preceding the authors propose the following approach in Category B situations, based on a logic of process and of continuity:

- ◆ Initiate operations at the utility level under a delegated management contracts¹ in three steps, which correspond to the above identified three steps of the roadmap for sustainable WSS sector development,
- ◆ Implement this contract within the context of, and preferably in parallel with, a broader WSS sector reform in order to create the enabling environment conducive for sector growth and sustainable improvement of WSS services, particularly in un-served and low-income areas.
- ◆ Design the contract of delegated management in an evolving format following the three successive steps, moving from a Technical Assistance (step 1, contract of means, input based), to a Performance-based Management Contract (step 2, results contract, output based), to a Enhanced Affermage/Lease or Subsidized Concession (step 3).
- ◆ Customize each step and tailor to local circumstances, with appropriate investment obligations and allocation of risks between the operator and the delegating authority, based on each entity's ability to manage these risks and rewards to each party based on the risks they have assumed.
- ◆ Facilitate the process in full transparency and with the active consultation and participation of all stakeholders (government and public authorities (central and local), sector professionals, unions, and civil society including the NGO community and consumers) in particular at the decision/transition points between the successive steps of the process

The above approach has been developed based on the observed needs and demands in the water supply and sanitation sector, and the sincere conviction among the authors coming from across public, private, civil society and international environments that delegated management contracts (public-public or public-private) are an efficient and effective tool to achieve good quality service to all.

It is also the conviction of the authors that innovative thinking should be revived on the process of competitive bidding for phased contracts with progressive obligations, addressing in particular issues of transparency and mitigating risks of under- and overbidding.

¹ The term «delegated management contract» is used here in a larger meaning than the term «public-private partnership », even though the factors of success and fundamental principles remain the same ; it encompasses the possibility of «public-public partnerships» as well, the key element being the existence of a contractual relationship between the public / delegating authority and a public, private or mixed public-private operator operationally in charge of service delivery.

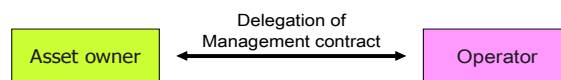
Redefining the Process of Engagement in Delegated Management Contracts in Water Supply and Sanitation

INTRODUCTION

The succession of initiatives inspired by the same objectives (drinking water decade, Millennium Development Goals (MDGs), etc.) in developing countries shows how difficult it is to reach rapid results at a large scale in the water supply and sanitation (WSS) sector.

In order to face this challenge, public private partnerships (PPP) were implemented in the 90s. (cf. Figure 1) The PPP model aimed at introducing the necessary professionalism in order to manage efficiently WSS services, but also possibilities of financing in a competitive environment and in a virtuous contractual framework, answering expectations of all parties (private operator, public authority, citizens benefiting from the services). One must admit today however that in many cases these expectations were not really fully satisfied.

A possible reform path: delegation of management



The asset owner (in majority of cases, public) can contract out or outsource service provision & operation of assets through a **delegation of management contract**.
Operators can be publicly, mixed, or privately owned

Figure 1

The 1990-2000 decade, contrary to the previous ones, has indeed brought important achievements (several tens of millions of people have been connected) through PPPs. However, it was observed at the same time, that several conflicts came to being. These conflicts led to the early termination of some contracts and the dissatisfaction of all parties involved.

The difficulty of exporting one model should also be emphasized. . It is indeed necessary to take into account local social, political and cultural conditions and to identify counterparts in civil society in order to optimize the dialogue between all concerned stakeholders. .

The above-mentioned dissatisfaction was fed by several factors, including:

- The lack of a planning and reform process that was developed in a participatory way and based on a consensus, built on a close and constant dialogue between all actors in the field and local communities
- The absence of shared sector diagnostics at the beginning of the PPP.
- The lack of preparation and training of transaction advisors and PPP managers to the needed societal approach of WSS services.

- ◆ The symbolic dimension of water: in countries facing an economic or political crisis, such as Argentina or Bolivia, the debate went away from any operational or public health reality to become an issue of political campaign. In these countries, water became the object of a political battle, very often evolving into an ideological “anti-privatization” debate. Paradoxically consequences of this politicization were often to the prejudice of the poorest population, despite the fact that the arguments put forward were based on social concerns.

It is important to recognize that the warning role of civil society is fundamental and should not be called into question. However on the specific subject of water, in a number of cases ideology has tended to come before the reality in the field. The situation today in Buenos Aires or La Paz for example is severely illustrating this point. (reference ?)

Based on these observations, it is necessary, but also a challenge, to develop new solutions and redefine the process of engagement in PPPs and more generally in delegated management contracts.

1. PERFORMANCE FACTORS OF PUBLIC SERVICE DELIVERY

The performance of public services (including WSS services) is characterized by the following non limitative list of factors:

- ◆ Governance and institutional organization: do existing structures have the capacity to represent all stakeholders and to efficiently allocate responsibilities and resources, thus allowing the implementation of a sector development strategy, in order to meet the population needs ?
- ◆ Level of service, which includes the technical and managerial performance of operators, the availability or not of basic data characterizing the service, of monitoring tools, and of an internal auditing system to monitor the performance of operators.
- ◆ Integration of water resources management, water conservation and demand management. Water allocation between competing uses calls for integrated water resources management that transcends compartmentalized sector concerns. Actively integrating water conservation into water supply planning remains a challenge. Social and community benefits are also directly related to maintaining or increasing environmental protection by reducing water demand.
- ◆ Political stability and legal status and behaviour of the public authorities in charge of the service: do these authorities have the capacity to select and manage a delegation model, to manage, monitor and regulate potential delegated management contracts ? Do they have the power to decide on adjustments to these contracts ?
- ◆ Organization of civil society: is there a local civil society capable of playing its role as a stakeholder in the reform and delegated management process ? Does this civil society have the required tools to participate to the achievement of its expectations in accordance to the capacity of the population to pay for WSS services ?

- ◆ Organization of the economic and financial environment: does this environment allow the implementation and financing of the required technical performance targets with the appropriate tariff structure and level ?-

The overall performance of the sector will depend on the level of development of each of these factors, and on the degree of coherence and complementarities between these factors. This in turn will depend in large part on the existence and of the outcomes of an effective dialogue between all stakeholders and on the consensus reached amongst them regarding strategies, changes and reforms, actions, and programs.

2. MARKET SEGMENTATION OF MANAGEMENT DELEGATION CONTRACTS

The delegated management market can be schematically divided into three types of markets:

The first segment (Category A) comprises situations where the development level of the above factors is sufficient to ensure good conditions for sustainable public-private partnerships (PPPs) or delegated management contracts. For this segment, the traditional forms of PPPs that have been implemented so far are usually well adapted (implementation models, contractual framework, operator remuneration, investment financing).

At the other end of the spectrum, category C comprises situations where the combined development level of above criteria is too low to allow most forms of commercial arrangements. PPPs are not considered a viable solution.

An intermediary category B regroups all situations in between the two ends of the spectrum. Most cities in middle and low income developing countries fall in this intermediate category, and it can be argued that this is where most of the progress toward reaching the Millennium Development Goals can be achieved. This paper focuses on this intermediary category and develops the idea that in such situations, progress toward sustainable service delivery can be achieved over the medium/long term by following a roadmap that typically includes three successive steps:

3. ROADMAP FOR SUSTAINABLE DEVELOPMENT OF WSS SECTOR: towards logic of process

A roadmap for sustainable development of the WSS sector will typically include three steps: (cf. Figure 2)

From a menu of contractual models towards a logic of process

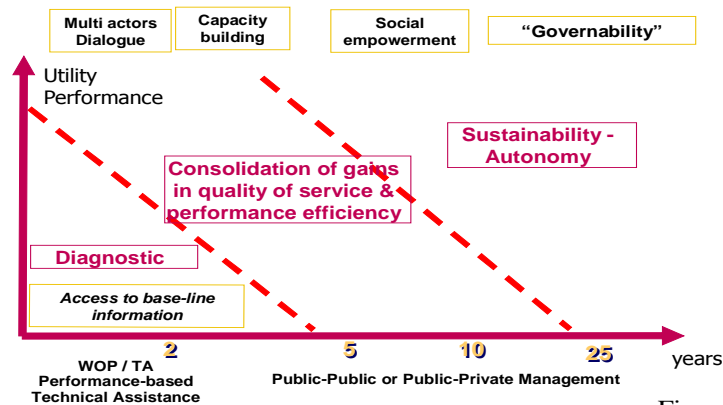


Figure 2

- ◆ The first step consists of a diagnostic of the existing situation, a performance gap and root causes analysis, the initiation of a participatory reform and change management process, and the implementation of urgency measures and investments (including management information systems). This step introduces significant changes and measures to start restoring operational efficiency at the technical, commercial and managerial levels. The duration of this step should not exceed two to three years in order to maintain the momentum of the reform process. Central and/or local government political championship for sector reform should exceed the duration of the first step.

At this stage it is also often necessary to envisage a new distribution of roles and responsibilities among key stakeholders and hence a change in prior practices. This new distribution consists in systematically giving a voice and participation in the decision making process, to the stakeholders who are not directly responsible and accountable for the reform implementation. Finally, due to the risks inherent to this development phase, it seems logical to expose actors directly involved in the first step to an obligation of means rather than to an obligation of results.

- ◆ The second step consists of the consolidation of reforms at the sector and utility levels, and, the implementation of sector investments in order to attain a satisfactory level of service and of operational performance. Its duration can be estimated typically between three to five years. This step includes two main objectives: the first one dedicated to the consolidation of the achievements of the first step, the second one to the implementation of deep reforms in order to strengthen sector and utility development. The consolidation period is an intermediate period at the beginning of which performance targets can be set and during which development plans and programs can be adjusted according to results effectively achieved.
- ◆ The third step consists in reaching economic and financial sustainability and autonomy, reaching optimal quality standards, and ensuring the long term availability of to put local competences capable of taking full responsibility for services delivery. Its duration can be estimated between ten and fifteen years. This step can be considered as a “cruising period” during which sector performances are improved to satisfy quality standards and the level of service reaches its final configuration. During

this step full cost recovery is gradually introduced through tariffs and targeted subsidies where needed.

Each step is fundamentally different from the others in its content and corresponds to a specific work plan. They are also sequential: their order of occurrence is compulsory and the success of one step is conditioned by the success of the former one. Overall, these successive steps constitute a progressive and continuous process of reform and improvement, toward the overarching objective of reaching a better, reliable, affordable and sustainable service to all.

It must be noted that each of these successive steps includes its own risks. These risks can be cumulative and/or interrelated over the duration of the overall sector and utility reform process. The risks of the first development step are those which generate the largest uncertainties, for all sector stakeholders, at a time when the contractual relation is not yet fully established and is the most unstable. Therefore these risks are very high and require a shared action between in order to be faced. This gives particular importance to the first development step and to the need for a well-structured dialogue among all parties in order to achieve joint ownership of and commitment to the overall reform process.

Of course, a public authority can chose to initiate and implement such a process with various degrees of involvement of the private sector during the different steps: however, continuity is a key element of success and it can be argued that mistakes have been made in the past when focusing too much on the design of contractual arrangements or models for each step of the process and paying too little attention to the transition points between these steps and to the well structured dialogue between stakeholders that these transition points require.

4. A PROPOSED THREE-STEP ENGAGEMENT

In line of the preceding the authors propose the following approach in Category B situations, based on a logic of process and of continuity: (cf. Figure 3)

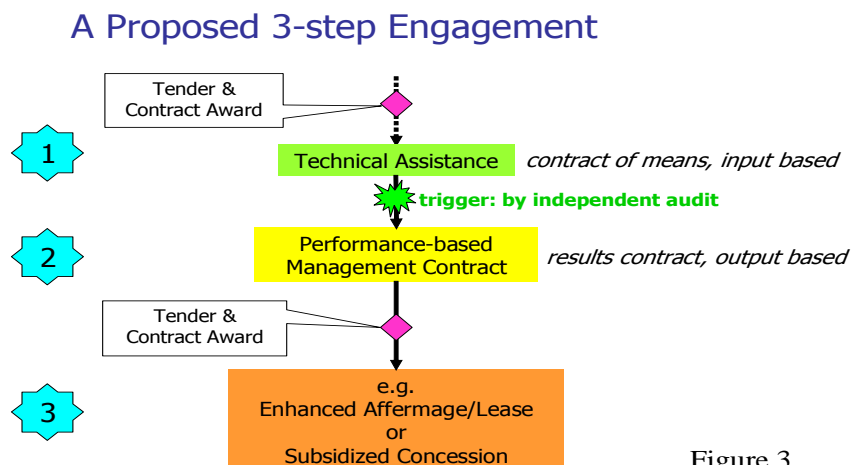


Figure 3

- ◆ Initiate operations at the utility level under a delegated management contract² in three steps, which correspond to the above identified three steps of the roadmap for sustainable WSS sector development,
- ◆ Implement this contract within the context of, and preferably in parallel with, a broader WSS sector reform in order to create the enabling environment conducive for sector growth and sustainable improvement of WSS services, particularly in un-served and low-income areas.
- ◆ Design the contract of delegated management in an evolving format following the three successive steps, moving from a Technical Assistance (step 1, contract of means, input based), to a Performance-based Management Contract (step 2, results contract, output based), to a Enhanced Affermage/Lease or Subsidized Concession (step 3).
- ◆ Customize each step and tailor to local circumstances, with appropriate investment obligations and allocation of risks between the operator and the delegating authority, based on each entity's ability to manage these risks and rewards to each party based on the risks they have assumed.
- ◆ Facilitate the process in full transparency and with the active consultation and participation of all stakeholders (government and public authorities (central and local), sector professionals, unions, and civil society including the NGO community and consumers) in particular at the decision/transition points between the successive steps of the process

4.1. First Step: a Technical Assistance Contract (duration 2 to 3 years)

During the first period:

- ◆ The operator, in addition to taking charge of day-to-day operation of the service, will also act as a technical assistance consultant advising the public authority on all key aspects of the reform process and participating in the dialogue between stakeholders.
- ◆ He will have an obligation to provide all operational informations_-needed for this dialogue.
- ◆ He will perform a full diagnostic of the initial situation at the sector and utility level, including a performance gap and root cause's analysis
- ◆ The delegating authority and the operator will build jointly a monitoring system with performance indicators quantifying results of reforms undertaken. This system will then be piloted by the operator.
- ◆ The operator will have like other stakeholders an obligation of means (the lack of initial data making it impossible during this first period to set viable performance objectives and obligations of results); however, -minimum levels of performance indicators could be defined. Should performance fall below these minimum levels, early termination of the contract could be triggered by either party without financial consequences.

² The term «delegated management contract» is used here in a larger meaning than the term «public-private partnership », even though the factors of success and fundamental principles remain the same ; it encompasses the possibility of «public-public partnerships» as well, the key element being the existence of a contractual relationship between the public / delegating authority and a public, private or mixed public-private operator operationally in charge of service delivery.

- ◆ Remuneration of the operator will be a lump sum based on an estimated budget allowing him to conduct the required studies and technical assistance work . This budget will be financed by the delegating authority, possibly with external funding from multilateral or bilateral development agencies.
- ◆

This first period of work will end with a contractual meeting which will allow parties to review the progress achieved and prepare the action plan of the second step. Graduation from Step 1 to Step 2 will be triggered based on an independent audit of the performance of all parties.

4.2. Second Step: a Performance-based Management Contract (duration 3 to 5 years)

At the conclusion of the first step, all parties are provided with a reliable diagnostic of the situation and with a reliable baseline; institutional reforms have also been implemented, and the notion of performance risk can realistically be introduced in the contract between the delegating authority and the operator.-

However this should concern only performance indicators regarding service delivery. Risks related to the financing of investments and to possible delays in the institutional reforms should continue being borne by the delegating authority.

During this period:

- ◆ The operator will work according to a management contract with operational performance targets and obligations of results. He will also continue to act as a consultant to help consolidate sector reform .
- ◆ He should provide all information allowing the comparison of his results with the contractual figures included in the business plan established at the end of step 1.-
- ◆ The monitoring system put in place during the first period will be updated in order to integrate the performance and service extension objectives corresponding to this step.
- ◆ The operator's remuneration will be the combination of a fixed remuneration (as in the first period) and of an incentive payment related to the business plan of the period.
- ◆ Covenants will be included in the contract regarding the achievement of reforms and the financing of investments (as obligations of the delegating authority). If reforms and investments are not implemented, the contract may be interrupted without financial consequences for the operator. These reforms and investments will be included in an annex to the contract.

During the second step, the delegating authority will analyze options and make initial plans for the implementation of institutional measures needed during the third step. The second step will end with a contractual meeting and dialogue with stakeholders to determine the objectives and the operational/contractual model for step 3.

4.3. Third Step: Enhanced Affermage/Lease or Subsidized Concession (duration 10 to 15 years)

During the third period the operator will typically work under an enhanced affermage or subsidized concession scheme, that will possibly include a combination of public and private

financing of the investments needed. The final PPP framework will be customized at the end of step 2 and tailored to the local needs and circumstances.

4.4. First thoughts on the need to adapt procurement methods to the specificities of the W&S sector in emerging countries

One of the main difficulties in terms of implementation of the proposed three-step approach resides in the design of the tendering process..

It is proposed that at the beginning of the process, the delegating authority call for tenders covering the first and the second steps together; the basis of the incentive payment of the second period would be determined by the delegating authority in the bidding documents. The financial evaluation of the offers would be based on the first lump sum payment required during the first step.:

At the end of the second step, second call for tenders would be prepared in order to select the third step operator. The incumbent operator of the first and second steps works in full transparency and with an “open book” in order to allow fair competition for the third step. The incumbent operator would be allowed to participate in this tender.

Possible variations, depending on local circumstances, could be to allow the option of a negotiated contract with the incumbent operator at the end of step 2, or to require tendering in between steps 1 and 2.

Overall, various procurement choices have to be made by the delegating authority at the beginning and during the implementation of the three-step road map: for the sake of efficiency and continuity, will it prefer finding from the beginning a long term private partner with the capacity to accompany it during the three steps of the process (with appropriate safeguards to control costs and with clear exit clauses in case the partnership does not work)? Will it desire hiring an experienced international operator for steps 1 and 2 with a built-in program of knowledge transfer that would facilitate a smooth transition to public management during step 3? Shouldn't these various options remain open at all times during the reform process ? What should be the optimal balance between the expertise of the private partner and its cost during the three steps, and the corresponding quality/price evaluation mix at the time of tendering? Etc. Each case will obviously be different, and a degree of anticipation and flexibility will be needed in order for the delegating authority to make at each transition point the choices it considers the most appropriate, in consultation with the other stakeholders.

4.5. Dialogue with stakeholders: key role played in the reform process and guiding principles.

As mentioned earlier, dialogue between the stakeholders involved in the reform process is a fundamental element of the continuity and long term success of the process. Unfortunately, too often in the past this aspect has been overlooked or handled informally (with more formal emphasis placed on technical, legal or financial issues) and the conditions for a fully effective dialogue have not been met.

In order to be effective, this dialogue must be institutionalized: in practical terms, this means that it must formally be a component of each step the reform process, with operational objectives and guidelines included in all project implementation documents (tender documents, contracts, etc.). Dedicated structures must be put in place, with adequate resources (for instance a project or reform “Steering Committee” where all stakeholders are represented).

The dialogue must be organized in a professional manner, following internationally recognized practices. If needed, specialized facilitation institutions or firms should be used to ensure that the appropriate methodological principles are respected, and that the dialogue process has the required sincerity and credibility in the eyes of all stakeholders.

It must also be a continuous activity in support of the reform process, with increased intensity at the key transition points, as defined previously. The organization of a public audience at the end of step 2 is an example of such increased intensity at one of the key moments of the process.

5. CONCLUSION

The proposed approach has been developed based on the observed enormous needs and demands in the water supply and sanitation sector, and the sincere conviction among the authors coming from across public, private, civil society and international environments that delegated management contracts (public-public or public-private) are an efficient and effective tool to achieve good quality service to all.

It remains to (i) define the criteria to trigger the transition to the different steps and the optimal timing of the sequence, (ii) the appropriate remuneration at each step to motivate professional operators, and (iii) the financial mechanisms adapted to the proposed logic of process

It is finally the conviction of the authors that innovative thinking should be revived on the process of competitive bidding for phased contracts with progressive obligations, addressing in particular issues of transparency and, mitigating risks of under- and overbidding.

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