

OUTLINE

The Manila Water Privatization Fiasco and the Role of Suez Lyonnaise/Ondeo

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Brief history of water privatization in Metro Manila

In 1997, the privatization of Metro Manila's waterworks and sewerage system was the largest water privatization project in the world, affecting a population of 11 million individuals or around 2 million households.

In 1995, only 75% or 8.25 million of Metro Manila's 11 million residents had water connections, 3.6 million had none. The MWSS was a hugely inefficient, unpopular government agency under the Department of Public Works and Highways, generally considered the most corrupt department in the Philippine executive branch.

>From 1993 to 1995, MWSS needed \$253 M or 7 B pesos to replace its pipe network. Only IFIs could fund that at the time, with the Asian Development bank providing \$249M of MWSS's \$307M long-term loans as of 1995.

The failure of MWSS to provide universal access and efficient service, coupled with the lack of resources to finance waterwork systems made privatization seem like a promising alternative at that time. It was aggressively pushed by the World Bank and readily undertaken by the Philippine national government. (In 1996, the World Bank sent a Philippine contingent to study the privatization project in Buenos Aires. The contingent reported that the Argentinians seemed to be "very happy" with the privatized water project.)

The French government gave the Philippines a \$1M grant to hire SOGREAH as consultant.

B. Metro Manila was divided into two zones: the East Zone, which went to the Manila Water Company Inc. and its foreign partner, Bechtel. The larger West Zone comprising 60% of Manila's pipeline network, was awarded to MAYNILAD Water Services Inc., owned by a prominent Filipino business clan, the Lopez family. Its business partner is Suez Lyonnaise de Eaux subsidiary ONDEO (and will be referred to in this presentation as Suez/Ondeo).

Maynilad covered 6.5 million residents, only 4.3M of whom had water connections.

Manila Water-Bechtel covered 4.5M people, only 3M had connections.

>From pre-privatization level of 8.78 pesos per cubic meter, the average rate for

Maynilad-Ondeo's customers fell to 4.96 pesos or by 43% in August 1997. Initially, therefore, the privatization project was considered "successful". Future price increases were to be determined through procedures specified in the Concession Agreement-the contract between Maynilad-Ondeo and the Philippine government (MWSS). The concession was to be regulated by a Regulatory Office (RO) created by the contract for this purpose.

Other promises of Maynilad-Ondeo as stipulated in the Concession Agreement:

Water supply coverage of 87.4% by 2001, 97.1% by 2006.

Sewer coverage : 16% by 2001, 20% by 2006.

Sanitation coverage target of 43% by 2001.

Reduce Non-Revenue Water (leaks, stolen, unbilled water) to 42% by 1999.

Main points:

Metro Manila had a very bad experience with state-run water utility, hence the positive political climate for water privatization.

Privatization promised better service, more connections, cheaper water, less wastage.

The initial price drop made privatization look like a success.

The Philippine government had no resources to finance the enhancement of its water systems. Only the IFIs could afford to finance such a project before privatization.

II. PERFORMANCE OF MAYNILAD-ONDEO FROM 1997-2002

The Concession Agreement was amended in October 2001, upon heavy lobbying by Maynilad-Ondeo and collusion with key officials of the Regulatory Office.

The Amendment authorized a series of price increases to cover foreign exchange losses of Maynilad-Ondeo due to the Asian financial crisis of 1997-98, which resulted in the devaluation of the Philippine peso by 100% to the American dollar. The Amendment also authorized the lowering of expansion targets, relax performance targets, including NRW targets. In other words, the parameters of the original bid were altered; Maynilad-Ondeo was allowed to raise prices, but reduce service. Both the Lopezes and Suez/Ondeo refused to put in more equity for capital investments and debt payments, relying instead on dramatic price increases to bolster their financial standing.

Basic price of water in Maynilad-Ondeo areas is now 19.92 pesos per cubic meter or an increase of 500% from 1997. (Take note that Maynilad-Ondeo cannot therefore claim that all it is only recovering losses from the peso devaluation. The Philippine peso devalued by 100%, while the price increases have added up to 500% since 2001.)

Basic water tariff is not all. Plus extra charges to cover forex losses: 8.28 pesos per cubic meter. An average family consuming about 20 cubic meters per month pays about 600 pesos a month, 40 % of this is for the extra charges, not for the water they actually consumed. A single-income household in a Maynilad-Ondeo area earning 6,000 pesos a month or about \$120 US (a generous estimate) will therefore pay 10%

of its income for water costs. Those who do not have water connections must allocate about 20-30% of their income for water costs, since the price of water sold by water vendors is 300-500% higher.

Poor service: weak water pressure, a few hours of flowing water in a day. Families in Maynilad-Ondeo areas wake up at midnight or at dawn to store water because supply is not continuous, especially in populous and elevated areas.

Slow expansion of water supply coverage: 577,492 individuals in Maynilad-Ondeo areas will not have water connections because expansion targets were deferred for 3-5 more years. (This is not counting those who have connections, but have no water flowing from their pipes.)

Many of these households are located in urban poor areas. They are forced to buy water from water vendors who sell water 300%-500% higher than Maynilad-Ondeo prices. Or else, they pump water manually from communal/private pumps that are usually located some distance from their houses. (Plus 314,550 individuals in the Manila Water-Bechtel areas, means nearly 1 MILLION individuals in Metro Manila still have no water connection. Again, this is not counting those who have water connections, but only get 3-5 hours of water flow in a day. This is a substantial part of the population but no exact documentation exists.)

Huge operating costs, mismanagement and inefficiency: Maynilad-Ondeo had very expensive dollar-denominated consultancy contracts between the local Lopez controlling company (Benpres) and the French side (Suez/Ondeo) for start-up and enhancement operations: 1) Management Consultancy Contract with Lyonnaise de Eaux Philippine (LDEP) 2) Interest-bearing advances from Benpres Holding Company (BHC) and LDEP for bidding and start-up costs 3) Technical assistance and service agreement with BHP and LDEP 4) Charges for guarantee fees related to loans and standby letters of credit guaranteed by BHC and Suez Lyonnaise de Eaux (SLDE) 5) Interim program management with Safage Consulting and Montgomery Watson, an affiliate of SLDE 6) Technical assistance agreement with Lyonnaise de Eaux Services Association (LYSA) for the revenue-enhancement program to reduce Non-Revenue Water (NRW). The costs of these contracts inflated as a result of the peso devaluation due to the Asian financial crisis of 1997-98.

The Filipino side of Maynilad controlled by the Lopez clan, is notorious for the high salaries and perks of its upper management elite: the Maynilad president earns 1 million pesos a month (about 20,000 USD).

Maynilad-Ondeo spent 80% more on computers per employee vs. Manila Water-Bechtel. They bought computers from IBM France, a company affiliated with Suez. All these contributed to the ballooning operating costs of Maynilad-Ondeo.

This, while Maynilad-Ondeo's NRW averaged at 68.1% during the last five years, actually increased from pre-privatization levels. That means that it doesn't earn from nearly 70% of its water, although it spends to extract, purify and deliver that water. High inefficiency.

This information is important, in the light of the so-called internal conflict within between the French and Filipino partners in Maynilad-Ondeo. Both cannot deny their role in the mismanagement of the firm, even given majority Filipino control of the corporation. Both decided to allocate their capital towards management and technical consultancies with their subsidiaries. Suez/Ondeo cannot say now that it did not have a part in that decision. Their collaboration failed to remedy critical problems that contributed to its financial standing (such as the NRW).

Other performance standards:

Actual sewer coverage of 19% as of 2001, compared to 16% target.

Actual sanitation coverage of 6% as of 2001, compared to target of 43%.

Main points:

The amendment of the Concession Agreement in October 2001 undermined the whole premise of privatization by 1) erasing the agreed-upon standards by which to evaluate the performance of the two water companies 2) violating the processes that should have governed price increases.

The amendment process itself was tainted with corruption. Of the 5 Regulators consisting the Regulatory Offices, two Regulators complained about the irregularities that were apparently actively abetted by the Chief Regulator himself. These two Regulators were harassed, their salaries withheld, because they dared to do their jobs independently and honestly.

The Regulatory Office has little capacity to 1) evaluate the actual performance of the concessionaires. They are dependent on the numbers submitted by the water company. 2) Hold the water companies accountable for failing to comply with the performance standards.

The RO is a creation of the contract. In this arrangement, consumers have no legal personality to intervene in regulatory processes, no provisions for transparency except for token public consultations before price hikes where consumer inputs have no bearing at all on decisions made by the RO.

The Philippine government approved the changing of the contract to accommodate the demands of the Lopez clan, whose bankruptcy threatens to affect the Philippine economy and the political fortunes of our leaders. For sure, the desire to please foreign companies such as Ondeo and Bechtel is also a factor in our government's decision to let the water firms get away with everything.

Regulation is therefore hardly independent. It is based on political decisions of the national leadership.

The horrible performance of Maynilad-Ondeo shows that all the promises of water privatization have not been fulfilled: 1) Water is 500% more expensive. In the Manila Water-Bechtel areas, it is 700% more expensive. 2) Service is still lousy. 3) There are

new connections, true, but far from the rate of expansion it promised. 4) "Market forces" are not at work. Maynilad-Ondeo's water is far more expensive than the other concessionaire, but other than serving as a benchmark, it has no consequence on the demand levels of its consumers (because they have no choice but to use water) or on the standing of Maynilad-Ondeo. In a privatized set-up, poorly performing concessionaires should be axed.

MAYNILAD-ONDEO WALKS AWAY BUT WANTS CASH

In mid-2002, Maynilad-Ondeo petitioned for a 100% increase in water rates and asked for government guarantees on its loans. It has not been paying its concession fees since April 2001 and now owes the MWSS over 5.5 billion pesos (\$ 100 M); it also wanted to defer further payment until 2007. When such demands were rejected by the MWSS and the Regulatory Office, it terminated its contract in December 2002. It then filed an arbitration case before the International Appeals Panel seeking 19 billion pesos (\$365 M) in compensation from the Philippine government which it blames for its failures.

Maynilad-Ondeo has been collecting extra, illegal charges that consist of 40% of the bill of each household. The MWSS and the Regulatory Office have ordered it to stop collecting and refund these charges but it has refused to comply. The over-collection now amounts to about 3.3 billion pesos (\$ 63 M). The MWSS is also trying to collect on Maynilad-Ondeo's Performance Bond of \$120 million USD, to no avail. Maynilad-Ondeo has brought all these issues, including the matter of over-collection, to the International Appeals Panel. It is defying duly constituted government agencies and is trying to remove all these issues from Philippine jurisdiction into international commercial courts. Philippine courts, Filipino taxpayers and consumers are being stripped of any capacity to intervene in these matters.

While the formal arbitration process unfolds, Maynilad-Ondeo is still trying backdoor negotiations with the Philippine national government to stay on as concessionaire, despite its very poor performance. It is also asking for: 1) steady price increases over the next 6 years 2) further deferment of its concession fee payments until 2007 3) further relaxed expansion and performance targets 4) sovereign guarantees on its loans. In sum, Maynilad-Ondeo is asking for an out-of-court settlement and a bailout.

This bid is backed by a strong lobby from the French Embassy in Manila and will be partly financed by the World Bank's International Finance Corp. (WB-IFC). Suez/Ondeo has washed its hands of the horrible performance of Maynilad and proposes to ease out its Filipino partner and take over the concession. This is illegal. The Philippine Constitution mandates 60% Filipino ownership of corporations operating in the Philippines. However, it is backed by high officials in the Philippine national government, which is afraid that if Maynilad-Ondeo leaves the concession for good, its privatization policy will be construed as a failure.

Main points:

If the Philippine government loses the arbitration case, it will pay Maynilad-Ondeo 19 B pesos or \$365M. It will also have to shell out \$530M in loan payments to MWSS creditors. It will have to fund pending water and sewage improvements left

hanging by Maynilad-Ondeo.

But we think this is still preferable to an out-of-court bailout package which will let Maynilad-Ondeo stay for another 18 years and granting all its demands.

The IAP is also a creation of the Concession Agreement and it has several drawbacks. 1) It makes local agencies and institutions such as the RO useless. If the concessionaires are not content with an RO decision, they can always take it to the IAP. Even the jurisdiction of Philippine courts on water issues such as contract interpretation, technical disputes on price-settings and loss-recovery mechanisms are being challenged by Maynilad-Ondeo when it brings all these matters to the IAP. 2) It costs a lot to convene the IAP and part of the costs is borne by Filipino taxpayers. In 1999, the convening of the IAP due to a dispute between the MWSS and the Manila Water-Bechtel cost 40 million pesos or \$800,000, split between the concessionaire and MWSS. Since big water companies have the resources for litigation, they can always take issues to the IAP.

The IAP set-up has implications on Philippine sovereignty itself, as Filipino consumers and taxpayers, Philippine government agencies, as well as Philippine courts lose the right to intervene in water utility issues.

THE PHILIPPINE WATER VIGILANCE NETWORK (Bantay Tubig)

The Network is composed of Akbayan Citizens' Action Party, the Alliance for Progressive Labor, Citizens' Battle Against Corruption, Focus on the Global South (Philippine program), Freedom from Debt Coalition and the Institute for Popular Democracy. It is linked up with 5 members of the Philippine Congress. The Bantay Tubig Network conducts campaign and public information work, policy advocacy and legislative lobbying and research on public sector and community-based alternatives.

Main advocacies:

1) The ouster of Maynilad-Ondeo from the water utility and government takeover of the Maynilad-Ondeo areas. We must not allow this company to make Manila its milking cow for another 18 years so that it can make up for its failures in other parts of the world.

When the Water Vigilance Network started out two years ago, we concentrated on pricing and regulation issues. We now realize that this campaign is far larger than our local target, the Lopez business clan. Help us show the international dimensions of this issue so we can form a truly global picture of the privatization project has failed in many cases at great cost to millions of people and how Suez/Ondeo played a role in these failures.

2) Stop the replication of water privatization experiments in other areas of the Philippines.

3) Study alternatives to privatization. Study regulation and craft water policy.

The Philippine experience with government-run utilities is equally dismal. We cannot go back to previous public sector models, so if we have no choice but to do so, we must be able to improve on it. How do we contest the dogma that only profit-oriented organizations can be efficient providers of water? Are there any other models? We are currently studying water cooperatives, other community-based water systems and how to finance such initiatives.

As for regulation, it appears that we have to take this more seriously, as we will need regulation even for publicly-owned and managed utilities.

4) Water as a human right. Universal right to adequate water.

Even as we reject the notion that water is a commodity, we have to contend with the costs of extracting, purifying and distributing water. How can resources be mobilized towards these costs so that each human being can have access to water?

end

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