

LEARNING FROM PRIVATISATION OF WATER SERVICES IN TRENCIN, SLOVAKIA

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INTRODUCTION

In Slovakia, almost 85% of inhabitants are connected to public water supply systems, but only 55 % of them live in houses connected to public sewerage. In the past, the reconstruction and renovation of water infrastructure was neglected, which resulted in a high rate of drinking water leakages, estimated at 30 % but reaching almost 50% in some networks. In order to comply with regulations of the European Union, there is a need to invest more than €3 billion in public water services by the end of 2015.

Since the mid-1990s, the Slovak Republic government has been preparing for transformation of state waterworks and sewerage enterprises with the aim of transferring infrastructure ownership from the state to municipalities. The way the property would be transformed and results of the transformation process remained unclear for a long time. One option considered included privatisation of a part of the state waterworks. Privatisation of the Trencin Water Company (following the public-private partnership model – PPP) was supposed to serve as a transformation pilot project and learning model. In 2002 the government decided to transform formerly state-owned water utilities into seven joint stock companies and hand over their shares to municipalities according to the number of inhabitants.

PRIVATISATION OF THE TRENCIN WATER COMPANY

The first steps toward privatisation of the state-owned Trencin branch of the Western Slovakia Waterworks and Sewage Company (known as the Trencin Water Company – TWC, serving around 150,000 inhabitants in the city of Trencin and surrounding municipalities) were made in the summer of 1997. At that time, the government's plan for transformation of the state water companies assumed that municipalities would acquire the property, including water distribution systems, sewerage systems, sewage water treatment plants and the related operational property. Other relevant property - buildings and machinery - would be accessible in the process of privatisation, and municipalities would be able to buy it for the price equal to its current book value.¹ Remaining property - mainly water distribution systems of strategic importance and big potable water resources, such as water reservoirs - would remain state-owned.

In 1997, the municipalities supplied by TWC asked for the ownership of water infrastructure property (including water distribution and sewerage systems) and they acquired it in several steps. In March 1997, the municipalities established the Trencin Waterworks and Sewage Company (Trencianske vodarne a kanalizacie - TVK), and the property they acquired was deposited into this company. The operational property (mainly buildings, machinery and related devices) as well as laboratories and a water dispatching centre that were essential for operation of the system, were designated for privatisation in the form of “direct sale to the applicant appointed in advance”.²

¹ “New private waterworks and sewerage company begins to operate in Trencin”. Trend No. 46, November 11, 1998.

Privatisation of TWC was, according to the official documents, to serve as a model for transformation of other state water enterprises in Slovakia. However, it was obvious that from the start that the driving force of privatisation was managers of TWC, with close political ties to HZDS (the leading political party), wanting to acquire property that had been generating profits for a while. As early as 1993, the management of TWC had established a firm called Trencianska vodohospodarska spolocnost (TVS) which was not active; but was in preparation for privatisation.

Its time came in 1998 when the government coalition, including the HZDS, was afraid of losing power and political influence in the upcoming elections. Since the municipalities already owned the infrastructure property, there was just one last step needed to privatise the operational property and to gain control over future profits from the water business. Private TVS had strong support from state officials which, significantly, simplified the privatisation process.

TVS was the only corporation running for privatisation of the operational property of TWC. Only this firm received the so-called “acceptation letter” issued by the Ministry of Agriculture which guaranteed TVS operation of the public water company. This is why TVS had no competitors and it was clear in advance that TVS would win this “competition”. The transfer of state property to TVS was then just a matter of time and relevant government institutions hurried to finish the privatisation before elections. The contract was signed on 23 September 1998, two days before the parliamentary elections in which the ruling coalition lost its power.

² This form of privatisation was introduced into the Act No. 92/1991 on Conditions of the Transfer of State Property to Other Entities during the authoritarian government of V. Meciar in 1993. At that time, this method was used mainly to privatise the state property to people loyal to the government.

The property of TWC was divided in such a way that municipalities in the Trenčín region had to sign an agreement for the operation of municipal waterworks and sewerage systems with TVS if they were to fulfil their legal obligation to ensure continuous delivery of water services. Any other approach by the municipalities would result in a collapse of water supplies in the region.

The financial value of the operational property of Trenčín was officially stated to be 93,318 million Sk (€2,3 million). TVS had to pay only half of the price divided into 15 annual instalments, while the rest was to be invested by TVS until 2007.³ Taking into consideration the net financial profit, which Trenčín generated before privatisation, TVS was in a situation where it could easily repay these sums from profits of the privatised operational property.⁴

SUEZ LYONNAISE DES EAUX TAKES OVER TVS

The municipalities transferred at the end of 1998 the infrastructure waterworks property, which they gained from the state, to TVK - whose shareholders are municipalities of the Trenčín region. Then, in October 1999, TVK and TVS signed a contract for operation of the water services that became effective on 1 July 2000.⁵ The operational contract turned out to be very disadvantageous for TVK.

³ “Proposal to issue the decision on privatisation of a part of the Western Slovakia Waterworks and Sewage Company Bratislava, enterprise Trenčín - the operational property.” A document submitted for session of the Slovak government, August 18, 1998.

⁴ In the last three years before privatisation, the Trenčín water company made a surplus of respectively 35,081 million Sk (1995), 16,742 million Sk (1996) and 39,436 million Sk (1997). 1 Sk = €0,025.

⁵ The contract on renting and operating waterworks and sewage infrastructure in the Trenčín region and on providing services related to general repairs and investments dated on October 7, 1999.

Before signing the privatisation contract, TVS signed a memorandum on a potential future collaboration with Suez Lyonnaise des Eaux (SLDE). Apparently, for a long time before privatisation, SLDE had been negotiating with TVS about its future participation in operation of water companies in the Trenčín region. In October 1999, SLDE purchased the majority of TVS shares and gained control over decision-making of the company. At present, SLDE occupies three of five seats in the TVS board of directors, including the post of company president.

EUROPEAN COMMISSION EXPERT TEAM INVESTIGATES PRIVATISATION CONTRACT

At the beginning of 2001, TVK was awarded almost €4 million grant from the European Commission (EC) programme, ISPA, for the construction of wastewater treatment plant (Trenčín Right Bank Waste-Water Treatment). The grant represented 50% of the total project costs and was accompanied by co-financing from Slovak government amounting to 12,5 %. In May 2002, however, the EC published a report by an EC team that looked at the privatisation contract to evaluate “whether there is scope for making undue profit”.⁶ The report’s conclusions clearly indicated that the Trenčín Right Bank Waste Water Treatment project represented a real risk in terms of undue

⁶ Final report of the expert team of the European Commission “PPP/SK/01/TR, Framework Contract for Provision of TA for Analysing and Monitoring PPP Operations in ISPA Countries Review of 6 WWTP ISPA Measures in Slovakia” May 2002 (<http://www.vlada.gov.sk/phare/finalreport.pdf>). The aim of the expert team was to evaluate preparation and implementation of the ISPA-funded wastewater treatment projects. The team had focused on an examination of the legal status of final beneficiaries in relation to transformation of the state water utilities and their institutional and professional capacities. One of the main goals of the expert team was “the terms and conditions must be summarised and an estimation given as to whether there is scope for making undue profit” in case operation of water companies was or may be given to a private company.

profit for TVS, the private provider of water services. The EC's report pointed out several provisions of the operational contract between TVK and TVS that privileged the private corporation at the expense of the municipal company and consumers.

By this contract, TVS acquired exclusive rights to operate the water infrastructure owned by TVK for 20 years.⁷ According to the expert report, the most problematic provisions of the contract were connected with the amount of the rent, the guarantee of minimum TVS profits, the management and organisational fees, planning and performing of repairs and investments, accountability for damages, and protection of TVK in case of violation of the contract by TVS. These provisions enabled TVS to increase its profit at the expense of TVK and consumers.

The contract guaranteed that fees for water services paid by consumers would cover not only TVS's expenditures for repairs, new investments and all organisational expenses - including full annual inflation, but they would also guarantee 15 % profit. Profit guaranteed in this way is unusual, according to the authors of the report: "Allowing recovery of a 15% profit margin on unregulated operational costs may open up opportunities for TVS to make unreasonable profits, and is not in the best interests of the consumer."⁸ In the first few years after privatisation, TVS made constant profits, while TVK lost major amounts. This was due to flaws in the operational contract and the fact that the rent for using the infrastructure was calculat-

⁷ For using this infrastructure, TVS pays rent equal to depreciation of rented property. The contract has several annexes, one of which was an agreement on the loan that TVS provided to TVK. The interest rate, the payback period nor any other details about the credit have ever been published. According to the TVK 2001 Annual Report, the loan of 45,5 million. SKK was spent in 2001.

⁸ According to the report, it is not common practice that inflation is fully reflected in water prices. Usually, it is possible to cover a part of annual inflation in order to increase effectiveness of the services.

ed wrongly. Only in 2002, when the rent was doubled, this situation was corrected.⁹

Repairs and investments in the rented property were to be covered by a major part of the rent as well as from a loan provided to TVK by TVS. According to the operational contract, TVS prepares a long-term plan that includes repairs and investments necessary for providing water services and operating the infrastructure. In addition, repairs and investments can be made directly by TVS, which raise the risk of hidden financial flows between repairs and operation of the services. In this way, the contract allows for easy abuse of public resources: TVS, itself, suggests what repairs and investments in the property of TVK are necessary and TVS, itself, sets the price and the same company also carries out the work.¹⁰

The contract provides TVK with no possibility to sanction TVS in the case of a material breach of the operational contract, for example, in the case of delays in repairs or investments. TVK has limited power to control the activities of TVS. TVK can execute only annual inspections of infrastructure, and TVS has to submit annual reports to TVK. According to the operational contract, TVK is supposed to prioritise repayment of debt to TVS, for instance by taking additional loans if

⁹ The operational contract was defined by the amount equal to depreciation of the rented infrastructure property. This is why TVS made constant profits, while TVK lost more than 5,6 million Sk in the first year after the contract became effective. The amount of rent was improperly calculated. The loss was repeated in 2001 as well. Only when the rent was almost doubled, did TVK profit.

¹⁰ According to the operational contract, and apart from direct expenses for repairs and investments, the budget for major repairs and investments includes the organisational fees of TVS, interest from the loan provided to TVK by TVS (or from any additional loans of TVK) as well as an additional 10% of total expenditures as a reserve. Since the residence of TVK is located in the building of TVS (part of the privatised property), TVK pays TVS for renting their offices as well.

¹¹ At the same time, TVS is supposed to facilitate such loans. From these new loans, TVK is supposed to invest in infrastructure property, and subsequently, the property is to be rented to TVS so that the debt can be repaid from the TVK revenues generated by rent.

it is unable to pay the loan to TVS.¹¹ The EC's experts pointed out that the operating guidelines and performance standards for TVS, annexed to the contract, have been to a large extent defined by TVS. The European Commission report concluded that "there is a risk that ISPA contribution is perceived as inducing undue profits to the private partner, and/or that benefits for the local population induced by the ISPA contribution are not evident". The experts recommended that "TVK, as final beneficiary, should renegotiate the contract with TVS in order to reduce the current advantages of TVS that may increase to a point where profits could be considered undue."

STRUGGLING FOR TRANSPARENCY

After the expert report was published, negotiations between representatives of the EC and the TVK company were held to address concerns of the expert team. The EC made it a condition of the release of the second instalment of the ISPA grant that there was a change in the operational contract between TVK and TVS. The result of the negotiations was the annex to the contract between TVK and TVS, signed in January 2003.¹²

The Center for Environmental Public Advocacy (CEPA), a Slovak NGO, requested the Commission to tell them how the contract was changed. An officer at the EC said "the contract was re-negotiated and clearly improved to the advantage of TVK. The commission has endorsed the result."¹³ For any other information he referred CEPA to the Slovak authorities.

The Slovak government's agency responsible for implementation of ISPA projects confirmed that the EC made several

¹² Minutes from the fifth meeting of the ISPA Monitoring Committee, March 13, 2003, Bratislava.

¹³ The letter of Carsten Rasmussen, European Commission, DG Regio, dated April 10, 2003.

improvements to the contract and that all deficiencies that were criticised by the EC's expert report have been resolved. As a result, the contract as a whole was amended to reflect a more balanced division of risks. But it refused to disclose the contract between TVK and TVS because TVK declared it a trade secret and, instead, recommended passing a request for disclosure of the contract either to TVK or TVS.¹⁴ In February 2003, the TVK refused such a request, and TVS responded likewise.

Therefore, on April 24, 2003, CEPA submitted a request for copies of the contract between TVK and TVS to the Ministry of Environment according to Act No. 211/2000 on Free Access to Information. CEPA requested access to both original as well as amended versions of the contract. The ministry denied the request arguing that the content of the contracts is subject to trade secrets. Therefore CEPA, in January 2004, filed a complaint to the Supreme Court of the Slovak Republic against the Ministry of Environment. In November 2004, the court cancelled the decision of the ministry and confirmed the contract should be revealed.

LEARNING FROM THE PRIVATISATION "PILOT PROJECT"

The case of privatisation of water services in Trenčín is clear evidence that the main goal of so-called public-private partnerships for private providers is to make a profit at the expense of the public owner of the water infrastructure or consumers. The Trenčín case has become a poor example for municipalities in the rest of Slovakia.

By handing over the shares of water companies to municipi-

¹⁴ A letter from Radoslav Liptak, ISPA project manager at the Implementing Agency of the Ministry of Environment, dated April 11, 2003.

palities, the government practically dumped all problems connected to water supply and sewerage onto municipalities. Now it is clear that municipalities did not have enough expertise or experience to exercise public control and management of water services. There are real risks that municipalities that do not have the capacity or management abilities will not be able to responsibly fulfil their obligations, which might lead to privatisation of water services in different forms (sale of shares, sale of property, operation contracts with private providers etc). For example, the city of Bratislava (capital of Slovakia with approximately 550,000 inhabitants) was already preparing its water utility in 2002 for privatisation, with the French company Vivendi/Veolia among the strongest candidates. With a new municipal council elected at the end of 2002, the city changed the plan and stopped the privatisation process. This decision however cannot prevent attempts by water TNCs to privatise in the future.

In 2002, a new way of regulating prices was adopted. The regulation office sets the top limit of prices for each water company. According to the law, regulated prices in the water sector should reflect eligible expenses and reasonable profit of each provider. Unfortunately the regulation office has only a limited ability to verify of data presented by providers. Also it isn't clearly defined what "reasonable profit" means, which allows for different interpretations. However, the rates have grown since 2002 by about 30% every year and it is expected that the increment in 2005 (also projected at 30%) will not mean the end of price increases.

Another difficult issue for municipally-owned water utilities is investments for reconstruction, upgrade and building of new infrastructure. The only finances from public sources currently available come from cohesion and structural funds of the EU, supplemented with co-financing from a European

Investment Bank loan (€30 million) and a small amount from the state budget. Unfortunately, this cannot satisfy all requirements, which need to be fulfilled in order to comply with EU regulation by 2015. The government refuses to increase the state's share. Instead, it uses insufficient public financial support as an argument to promote private involvement in water services provision.

VISION FOR PUBLIC-CENTERED WATER SERVICES MANAGEMENT

Currently, the main challenges for water services are environmental standards, finances, effectiveness, affordability for marginalised communities as well as socially weak citizens and public participation in decision-making.

Water companies must comply with environmental standards, related to both drinking water and wastewater, set by the EU regulation at latest by year 2015. Required investments are estimated at €3 billion, but the government now relies only on financing from the European Union's cohesion and structural funds. Water companies and municipalities learned how to apply for grants from this source but now they will have to look for other sources. It is inevitable that the government's financial contribution will increase, otherwise the goals will not be met. Development banks (EIB, EBRD, World Bank) should also increase their financial involvement without any conditions on private or public modes of operation.

There is room for increased economical effectiveness of water utilities. For a long time water services were provided in a strictly centralised and non-flexible system, unable to accommodate possibilities for cost saving. On the other hand, the function of public water utilities as important employers must also be taken into consideration.

Affordability of water services for socially weak groups is a

problem. Water companies have already disconnected several Roma communities where people are unable to pay for water. Not having access to clean water represents a potential threat for inhabitants' health.

The former centralistic management of water services practically excluded effective public participation in decision-making. Even now, municipalities, management of water companies and other public authorities often doesn't allow the public to "interfere with their competence". It's crucial for public control that all information related to management of water services, as well as decisions on strategic planning processes, are open to the public. Municipal councils, officials and water companies' representatives have to understand that public control can help them to provide effective services.

Currently, there is not enough strong social pressure to initiate these changes. But possibly, with continuous increases in water prices, the awareness and activity of different groups will also grow. Consumers, trade unions, environmental and social NGOs will have to articulate their positions on public water services and initiate public dialogue with municipalities, water companies and other relevant public authorities. Many citizens' groups have experience in how to involve media in this dialogue and how to attract the attention of politicians at all levels. The international water justice movement can support this dialogue by providing examples of successful, publicly-operated water utilities abroad and by facilitating communication between Slovak institutions and foreign municipal water utilities, which may result in public-public partnerships emerging.

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