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The Water Barons

Hard Water: The Uphill Campaign to Privatize Canada's Waterworks

By [Bob Carty](#)

HAMILTON, Canada, February 13, 2003 — Determined to shed its image as a grimy steel town, this mid-sized city of hard hats and rough necks decided in 1995 to carve itself a niche in a purer, more refined line of work — water.

Investment gurus were predicting water would be the boom business of the 21st century. They called water a "commodity" and estimated the potential revenue flow at C\$4 trillion.

Hamilton councilors thought the city could get in at the ground level by creating an international private water utility business. It turned its waterworks and sewage treatment operations over to a local waste management company. The city encouraged the company to chase down water utility contracts around the world using Hamilton as a model of privatization. Councilors believed they could sit back and watch the company grow. They dreamed a river of jobs and money would flow into this industrial city located on the shores of one of the world's greatest freshwater lakes, Lake Ontario.

Barely a year later, on a cold January morning in 1996, the dream began to unravel when Bill Baldwin went to check on the home of his vacationing sister. Opening the basement door, he found three feet of stinking raw sewage.

"I said, 'Oh my God, what's this?' You could tell it was sewage because of the brownish color. Then I went out on the street and I saw the neighbors carrying furniture up from their basements to the driveway. They were flooded out too."

Hamilton had experienced sewage spills and backups before. But this was by far the worst on record — 182 million liters (48 million gallons) of untreated human waste, heavy metals and chemicals spilled into Hamilton harbor and then into Lake Ontario. More than 115 houses and businesses were flooded. The city would later place the blame for the spill on the operators of the city sewage system — private operators who had just taken control a year earlier.

"I expected as good or better service," Baldwin said of the privatization. He sighed as he recalled wading through the basement sewage to install a pump. "It didn't happen that way."

But that was only the beginning of Hamilton's troubled experience with water privatization. Over the next six years, residents would see more sewage spills, environmental fines left unpaid for years, and rising tariffs for water services. The city would also find itself dragged through the wreckage of two financial scandals, including the Enron meltdown.

The Hamilton experience heightened Canadian suspicions that profits and water mix no better than oil and water. Since Hamilton, there have been repeated protests against attempts to privatize water utilities in Canada. From Halifax to Vancouver, whenever word has leaked out that a city government might privatize its waterworks, the idea has been met with angry public meetings, intense lobbying campaigns and negative media coverage.

It has not been encouraging for the big water corporations. "Canada is a very strange country," said Gérard Payen, the senior executive vice president of [Suez](#), the Paris-based private water utility. "There are many people very vocal against private water companies; they do not know how it could work."

Still, private companies are making major inroads into the water sector. Payen's company, Suez, through its

subsidiaries Ondeo Degremont and United Water, recently won a C\$465 million (\$298 million) sewage treatment contract in Halifax. Payen sees it as a foot in the door: "I think this Canadian experience in Halifax will be viewed as a success and maybe private water operators will be more accepted in Canada. I hope so."

USF Canada, a subsidiary of the French giant Vivendi Environnement, is trying to win more contracts by showing off its treatment plant in Moncton, New Brunswick, where once unsavory water now runs clean. And American Water Works — a U.S. water company recently acquired by the third-largest corporation in the sector, Thames Water, owned by RWE AG of Germany — has captured a 10-year, C\$71.2 million (\$45.9 million) contract to manage and operate the water utility in London, Ontario, and several nearby municipalities.

"Canada is a vast untapped market for profits," said Judy Darcy, the national president of the Canadian Union of Public Employees (CUPE), Canada's largest public sector union, which represents many public utility workers. "In water, we could go down the road the Americans have in health care, where the access and quality of care you get depends on the size of your pocketbook."



CUPE National President Judy Darcy
(Photo: CBC)

Private water companies see profits in the C\$90 billion (\$58 billion) that cities need to invest over the next 20 years to maintain and expand water and sewage infrastructure and to keep up with new health threats from industrial pollution and factory farms.

The problem is that Canada's top 10 cities contribute half of the country's economic output, but collect only 7 percent of all tax dollars. Canadian cities lack a sustainable tax base. They've been hit hard by cutbacks in financial allocations from provincial and federal levels of government. So more and more of them are open to private sector claims that they can breach the gap. "You don't have the cash and we do," Darcy said.

Hamilton was the first privatized large water utility in Canada. In a country where waterworks historically have been overwhelmingly a public affair — and where most people like it that way — the Hamilton experience was supposed to demonstrate an alternative, free-market model. It was supposed to change public opinion. It has. But not as expected.

The water baron

By 1994, Stuart Smith had logged a handful of previous careers. Starting out as a professor of psychiatry, Smith turned to politics becoming leader of the Liberal Party of Ontario in the late 1970s. His professorial manner and nerdy appearance were not the stuff of political populism, however, and he never progressed further than leader of the opposition.

But the political connections of those years proved useful. In 1982, the Liberal Party, then in power federally, appointed Smith head of the Science Council of Canada, the federal government's policy advisor on science issues. After that, he launched a company that turned public research centers and laboratories into private operations.

By 1994, Smith was looking to make some money. "I had this idea of creating a Canadian water company. The main notion wasn't to save Hamilton money on their water — that was a good effect too. But the main idea was so we could then go and get contracts all over the world. Economic development in Hamilton — that was the whole notion."

Smith went to the city managers and sold them on the idea of using Hamilton as a demonstration of what the private sector could do. But the city bureaucrats insisted on bringing in one of the city's major companies, Philip Services. With 12,000 employees and annual revenue of about US\$1.5 billion, Philip Services was the local corporate star. The Hamilton company had acquired scrap metal and waste processing companies, largely in the United States, and by 1997 had become North America's biggest recycler of industrial waste, with annual revenue approaching U.S. \$2 billion.

So Smith put his idea into the hands of Philip Services. They set up Philip Utilities Management Corporation (PUMC) in 1994, with Philip Services controlling a 70 percent interest, and the rest held by the Ontario Teachers Pension Plan Board. Stuart Smith was named president of PUMC.

And then in December 1994, without tendering the contract and with no public consultation, the city awarded a 10-year, C\$180 million (\$115 million) contract to PUMC. They then sat back and waited for it to put Hamilton on the world water map.

PUMC promised to create an export-oriented water company with its head office in Hamilton, providing jobs to Hamilton workers while providing cost-effective water and wastewater services. The company also promised to build an international training center for water technicians and engineers and an environmental enterprise center, which was to be a sort of business mall for environment companies. PUMC would operate, manage and maintain 14 municipal water treatment facilities, three wastewater treatment plants and 129 pumping and outstations. Water rates and investment in the system remained the responsibility of the city. At the time, the deal was the largest public-private partnership (PPP) of its type in North America.

PUMC's owners, through Philip Environment and Philip Services, were major contributors to candidates in municipal elections in Hamilton, ranking among the top 10 contributors in the elections of 1994. According to John Anderson, a university economist contracted by the union to analyze the donations, the Philip companies made C\$100 to C\$600 contributions to 12 different candidates for a total of C\$3,700. "It was not a lot of money," Anderson said, "but a majority of all the candidates got something from Philip companies."

The new private entity also hired senior managers from both the former public utility and the city government, including five people who helped the city put the original deal together. PUMC had become Canada's largest private water and wastewater services company.

Seven months after taking over operations, the layoffs began. PUMC initially cut 60 of the 128 workers. There were also 19 vacant positions at the waterworks when PUMC took over that were never filled. "The problem with big cities," Stuart Smith explained, "is that they end up with four or five times the number of employees than they really need."

Then, the environmental problems began. The city moved to hold PUMC liable for the January 1996 spill of millions of liters of sewage, and 115 victims claimed C\$2.5 million in property damages because of the spill. The company refused to accept responsibility for the damages for more than three years.

Greg Hoath witnessed it all from the inside. Hoath worked at the PUMC water treatment plant and is the business agent for the International Union of Operating Engineers, which represents the workers. "I'm not saying the spill would not have happened if the water was not privatized," Hoath explained. "But when you cut staff, people are not there to catch things. Anything can go wrong. Privatization affected the scale of the problem."

The company blamed the spill on malfunctioning pumps and not on reduced staffing. It also claimed the spilled wastewater was very diluted and had minimal impact on the harbor.

But Hoath said sewage spills were the norm, with one spill continuing for 16 days. In the summer of 1996, university students studying Hamilton harbor found raw sewage floating around their boat. A regional government report that same year estimated that 4.33 billion liters (1.14 billion gallons) of untreated sewage flowed into the harbor each year.

The pattern would continue. In late 1998 and early 1999, there were at least three serious sewage spills — in one case, the equivalent of 15 truckloads of sewage bubbled up through manhole covers at King Street and Olympic Drive in the nearby town of Dundas. By 1998, some raw sewage was still bypassing the treatment plant completely, on average one hour a day. A provincial report showed that in 1998 the wastewater treatment plant often exceeded limits for discharges of suspended solids and phosphorous, a nutrient that can deprive water of oxygen and light and kill fish. Environmental fines against the operation began to mount.

Meanwhile, Stuart Smith's big idea had started to grow. In 1996, PUMC won a major design-build-operate water project in Seattle. At the time, it was the largest municipal water-wastewater project of its kind in the United States. The competition was fierce and included Compagnie Générale des Eaux (now Vivendi) and Lyonnaise des Eaux (now Suez). PUMC had teamed up with Camp Dresser & McKee Inc. (CDM) of Cambridge, Mass., to place a bid of US\$101 million — a bid 30 percent below its closest competitor and 40 percent below the city's independent estimate of the cost for a traditional design-bid-build construction and public operation for 25 years.

PUMC had made it into the big leagues. Then it started to implode.

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"In terms of water services to people, it went fine," Smith insisted. "As far as being part of a stable relationship with a trustworthy company — that's a different matter."

Smith admits that he is more than a little bitter about what happened next. PUMC's parent company, Philip Services, would later admit that in 1995 and 1996 company earnings in its copper-trading business were far less than its audited financial statements claimed. The Ontario Securities Commission took note. It issued a Notice of Hearing to Philip Services regarding one of the largest alleged frauds in Canadian history — estimated at US\$363 million.

After years of legal wrangling over access to documents held by Philip's accountants, the case is still under investigation and unresolved. For Stuart Smith, it meant a great personal loss. His remuneration was largely in stock options. "I ended up with a lot of worthless paper that I can paper my walls with — it was supposed to be my pension. If anybody is bitter about the Philip experience, I am."

And then the musical chairs began.

Embroided in fraud allegations, Philip Services was also in serious financial difficulties in 1998 with a corporate debt of US\$1.1 billion. On the verge of bankruptcy in May 1999, Philip Services sold its stake in PUMC to Azurix Corp., an affiliate of Enron Corp. of Houston Texas, for C\$70 million (\$44.8 million). As a condition of the sale, PUMC agreed to resolve all existing claims from the 1996 sewage spill. The final cost remains a secret to this day; the city has always declined to divulge the details.

Then came the Enron meltdown.

Like Philip Services, Enron also had been maintaining fraudulent financial records. Desperate to stay alive, it sold Azurix to American Water Works Co. Inc. of Voorhees, N.J. In order to clinch that deal, in 2001 Azurix settled its accumulated environmental fines with the city of Hamilton, pleading guilty to 18 charges and paying C\$168,000 (\$109,000) and an additional C\$33,600 (\$21,869) to residents affected by various spills. The Hamilton water management contract passed into the hands of American Water Services Canada.

But that was still not the end of the musical chairs. In September 2001, the German corporate giant RWE, owner of Thames, began the process of taking over American Water Works. The deal, recently finalized, means that residents of Hamilton will have had five water companies in the course of eight years.

It has all left residents of Hamilton a bit dizzy. "It's a moving target," complained Gus Olivera of the Hamilton section of the Canadian Union of Public Employees. "First it's one group, then the next group. It's changed hands so many times."

"You don't know who you are dealing with," concurred City Councilor Sam Merulla. "When you deal with the private sector on behalf of the public sector, you need stability. In Hamilton, it has been a revolving door of international corporate owners dealing with one of the most precious things we have — water."

Another troubling part of the PUMC privatization was its lack of accountability to the public. As a union representing some of the former utility workers, CUPE had to wait more than a year to receive an access-to-information request simply for the terms of the original contract — and even then parts of the contract were omitted. PUMC was late in filing at least one of its financial statements. And while city managers received audited financial statements from PUMC, these were not made public. As a result, neither elected officials nor the public had any sure measure of how their money, some C\$18 million per year, was being used.

The original contract called for the city to conduct an annual performance review of PUMC. But only one was done, in 1995, and it was highly critical. "The relationship has been consistently confrontational, tense and frustrating," the city review said. It went on to complain that PUMC was slow in responding to city requests for information and action. "There seemed to be a consistent attempt to redefine (i.e., renegotiate) the contract" and far from being dedicated to a cooperative spirit of economic development, PUMC wanted to focus on "profitability only."

Elizabeth Brubaker, author of a book advocating privatization of Canada's water utilities, has argued that the Hamilton case brought limited savings and investment and permitted the city to dispense with labor relations problems. Brubaker contended that the private company "lived up to approximately one-half of their promises."

The company never built the training center or the enterprise center.

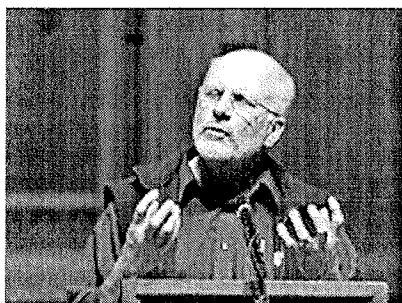
Like many Canadian cities, Hamilton faces huge water investments in the years to come. According to the director of water and wastewater, Lou DiGironimo, in the next 10 years the city will have to invest C\$1.1 billion (\$709 million) — largely in new sewage systems and repair of underground water pipes. As a result, the cost of water services in Hamilton has gone up 8 percent to 15 percent a year since 1999.

DiGironimo says that when the privatized contract comes up for renewal in 2004, it most likely will be put out for competitive bidding. The current operators, American Water Services Canada, expect to continue on the job. "We will bid, and we will win," said AWS President Dave Clancy.

But there is another option. The management of Hamilton's water could be taken back by the city. City Councilor Sam Merulla would like that.

Merulla said he doesn't have problems with the current operator — AWS has been responsive to his inquiries, better than previous owners of the contract. But philosophically, Merulla wants water to be retained in the public realm. "Corporations are more accountable to shareholders than to the citizen," he said. "My objective would be to make sure that water is retained in the public realm."

Just another commodity



Blue Gold co-author Tony Clarke (Photo: CBC)

At the core of the debate is whether water should be treated like just any other commodity. "Water is being carved up and parceled out according to what people have the ability to pay," Tony Clarke, the co-author of *Blue Gold: The Battle Against Corporate Theft of the World's Water*, told ICIJ.

[Listen to Tony Clarke]

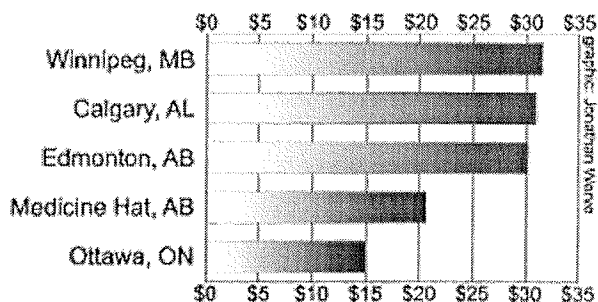
There are also serious treaty implications for cities. "Under trade treaties like the GATS [General Agreement on Trade in Services], the water companies would have been allowed to set up shop in other countries without restrictions. It gives them the legal tools to pry open public water systems around the world." Clarke is most concerned that international trade treaties could penalize cities that might want to reverse privatization. "It's a way to

make privatization irreversible."

If water is a commodity, then it could be subject to provisions of the North American Free Trade Agreement (NAFTA), forcing municipalities to open management, or even ownership, of public waterworks to private corporations and to compensate them for lost future revenue.

This trade angle of the water debate was at the heart of a decision in 2001 by the Greater Vancouver Regional District (GVRD) to reverse its intention to turn its water treatment and distribution system over to a public-private partnership. The private water industry asserted that local governments are exempt from international trade treaties. But former GVRD chair, George Puil, says the city could not get strong enough assurances of that from Canada's Department of Foreign Affairs and International Trade.

The cost of Canadian water



Note: monthly vaues based on average use of 7480 gallons
Source: Raftelis Financial Consulting, 2002

"The deciding factor was the legal uncertainly," Puil acknowledged. He initially favored private sector involvement, but changed his mind when he started to examine the trade implications. "There are uncertainties in trade treaties. Some action is needed from the Canadian government to correct that or to indemnify local governments from the possible unintended consequences of trade treaties. Without that, public-private partnerships will need to be looked upon with great caution by local governments when considering areas as sensitive to the public as water."

Trying to soothe Canadian nerves over privatization is the Canadian Council for Public-Private Partnerships

(CCPPP).

"It's an emotional issue, and it gets a lot of attention," said the lobby group's executive director Jane Peatch. Water delivery, she said, is misunderstood and misrepresented.

Created in 1993, the CCPPP has powerful political figures on its board. It has been chaired by two former Canadian finance ministers, and its members include many of the international water players: American Water Works, now a subsidiary of RWE; [Bechtel](#) of the United States; and USF Canada Inc., owned by Vivendi. "They preach for the industry," said Dave Clancy of American Water Services Canada. "And they do a good job at it too."

Union president Darcy called CCPPP "the single biggest and most powerful lobby in this country that is pushing water privatization." [[Listen to Judy Darcy](#)]

It's not large and has a staff of only two, according to Peatch. But she said they find well-known people to sell privatization. "We have gone out to find people with very distinguished public sector backgrounds as well as very distinguished private sector backgrounds — we have heads of very large companies that also sit [on our board]."

The CCPPP runs an annual conference, as well as smaller ones, on privatization of almost all government institutions. They submit briefs and arrange speakers for conferences and municipal meetings. The CCPPP gives out annual awards "to honor governments and/or public institutions and their private sector partners who have demonstrated excellence and innovation in the establishment of public-private partnerships." (See www.pppcouncil.ca).

The CCPPP's main arguments for private delivery of water are efficiency and access to new sources of capital to pay the estimated C\$90 billion (\$58 billion) required in water infrastructure over the next 20 years.

"Numbers this large are staggering," said former Canadian Finance Minister Michael Wilson, the chair of the CCPPP. "They are also not addressable by public spending alone. We will never tax to this extent, nor should we."

Privatization proponents like to point to the example of Moncton, in eastern Canada. The residents used to joke that they weren't sure if their daily showers were making them cleaner or dirtier. For years, the city had experienced discolored, bad-tasting, substandard water. High bacteria counts led to repeated summer boil-water orders.

The city was unable to secure provincial or federal funding to build a new water treatment plant, however. It turned to the private sector instead. In May 1998, after competitive bidding from nine firms, the city signed an agreement with Greater Moncton Water — a company owned by USF Canada (85 percent, subsequently taken over by Vivendi) and the Hardman Group Limited (15 percent) — to finance, design, build, and build and operate a water treatment plant for 20 years.

The mayor and city manager claim the private arrangement relieved the city of having to make any up-front capital investments. They also claim there were substantial cost savings with the private company building a treatment plant for C\$23 million (\$15 million) — between C\$8 million and C\$10 million less, they claimed, than a publicly designed and built plant would have cost.

Darcy, the president of the Canadian Union of Public Employees, concedes the public sector water management may need to be made more efficient. "Let's develop that expertise," she said. But she takes issue with the private sector's claims that only it can deliver expertise, competitiveness and efficiency.

If the public sector is so incompetent, Darcy said, why is it that one of the first things private companies do when they take over a waterworks is to hire public officials?

Darcy concedes that the people of Moncton are happy with their new water service. "The water was very bad before — water is good now, nobody disputes that." But she questions whether the private sector really saves money. In Moncton, the capital cost savings were fictional, CUPE contends, because the higher estimate for a public plant was one with three times the water capacity than the one actually built.

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Darcy pointed out that private companies have to make a profit to satisfy their shareholders. And the cost of capital is greater for them than for a municipal government with a strong municipal bond rating. Her union estimates that, over its life, the contract will actually cost the taxpayers of Moncton some C\$14.5 million (\$9.3 million) more.

Nor does competitive bidding always guarantee the taxpayer gets the best deal. Peter Spillett, the head of Environment, Quality and Sustainability for Thames Water, told ICIJ that all too often in water bidding around the world the winner isn't necessarily the best price and the best design. Sometimes it's a matter of which company is better at politicking and wining and dining city council members and other city officials.

Spillett said he was not happy with the recent C\$465 million (\$300 million) sewage treatment contract in Halifax. The bidding came down to two of the world's water giants Suez of France and Thames Water of Britain. Thames lost and doesn't understand why.

"We were gobsmacked," said Spillett. "We lost out even though both technically and financially we were easily the best, and we undercut the price considerably."

Halifax city officials, however, said the bidding competition was conducted in a transparent and professional manner and that the best company won. Suez echoed that sentiment in a statement to ICIJ: "These are transparent procedures, everyone goes through the same evaluation, and the best player wins."

Dealing with the competition isn't the only challenge for private water companies. Across Canada they often face hostile public opinion. When it comes to water "people feel unsafe in the hands of the private sector," Stuart Smith conceded. Reluctant to raise public alarm, water companies have been operating largely through "cold calls" followed by private meetings with municipal leaders.

Toronto began last year considering privatization, or "commercialization," of its water utility after meeting with officials from USF Canada and United Water.

The plan was met with public outcry and protests. Residents of Toronto made thousands of phone calls to councilors, sent e-mails and faxes, and then hundreds packed city council chambers to oppose the proposal.

The city council voted to retain control of the waterworks and passed a motion against privatizing water operations in the city of Toronto.

About the same time, a union campaign against privatization erupted in North Battleford, Saskatchewan. The spark was an informal meeting between a city official and USF Canada to solve water quality problems. When union members got wind of the meeting, they campaigned against it by distributing anti-privatization brochures door-to-door.

"It's very frustrating," said Wallace MacKinnon of USF Canada, who initiated the meeting and who said there is still no formal proposal on the table. "We just want to inform people of the merits of public-private partnerships and the capability of our company."

CUPE's Judy Darcy fears that because of the public opposition the water companies are changing their tactics. On the one hand "they are trying to use wastewater treatment to get a toehold. Canadians care less about what leaves their homes in their toilets than the water that comes in the house through their taps," she said.

Darcy's other concern is what she calls "privatization by stealth." She contends that the private companies are meeting with city officials behind closed doors "because if Canadians were asked in an open and transparent manner, they'd say we're absolutely against having water taken over by private corporations."