

Case Study

**BUENOS AIRES WATER AND SEWERAGE
CONCESSION**

Water Supply and Sewerage

CASE OVERVIEW

Country: Argentina

ULB: Federal capital area of Buenos Aires city and 17 suburbs (4 added later)

Sector: Urban Basic Services **Sub-Sector:** Water Supply and Sewerage

Award Date: May 1993

Type and Period of concession: Operations and Maintenance (O&M) Concession for 30 years

Stakeholders:

Contracting Authority National Government of Argentina

Concessionaire Aguas Argentinas

Oversight Arrangement Independent oversight body - the Tripartite Entity of Sanitation Works and Services, ETOSS

Present Status of Project: The Argentine Government revoked the concession in 2006.

PROJECT TIMELINE:

1989	<i>Enactment of Law empowering the President to privatize public utilities under the National Government</i>
1991	<i>Advisory Technical Assistance (TA) by World Bank and appointment of transaction advisors</i>
1992	<i>Creation of ETOSS as a regulatory body for the period of the concession</i>
1993	<i>Concession agreement with Aguas Argentinas as the private operator</i>
1997	<i>Contractual amendment introducing tariff related and output related revisions</i>
2002	<i>Argentine Economic Crisis and enactment of an Act abolishing contractual provisions for periodic adjustments of tariff to accommodate Forex fluctuations</i>
2003	<i>Commencement of Arbitration proceedings by the International Centre for Settlement of Investment Disputes (ICSID) based on petition by Aguas Argentinas</i>
2006	<i>Termination of the contract through a Presidential Decree</i>

1. PPP CONTEXT

1.1 ENABLING ENVIRONMENT

In order to address the economic crisis plaguing Argentina in the late 1980s, the National Government adopted several reforms for reducing public expenditure and successfully privatized several erstwhile State monopolies such as telecom, gas, electricity and airlines. The following initiatives formed the backdrop for the Buenos Aires Water Concession:

1. Enactment of the State Reform Law in 1989, granting the President executive powers to privatize public agencies under the ownership of the National Government, including Obras Sanitarias de la Nacion (OSN), the Water and Sewerage public utility for the federal capital area of Buenos Aires.
2. Setting up of a Currency Board in 1991, pegging the Argentine Peso (AP) to the US\$ so as to encourage international investments

1.2 SECTORAL CONTEXT

1. The existing coverage of Water Supply networks in the concession area (approximate population of 9 million) was about 70% and that of sewerage about 58%. The shortfall was particularly acute in the suburban areas – where coverage dropped to 41% and 17% respectively.
2. The sector was plagued by lack of adequate investments and maintenance, with much of the system in a state of dilapidation and disrepair leading to frequent supply interruptions, as high as 45% of Unaccounted for Water (UfW), inconsistencies in pressure and quality and frequent flooding of sewers.
3. The existing tariff regime of flat rates (99% of residential connections were unmetered) was inadequate for covering operational costs. Around 68% of total water bill collections came from large industrial/commercial users, which represented only 2% of the client base.
4. Enforcement mechanisms were also weak since the law did not permit termination of water connections for defaults in payment.

2. PROJECT DEVELOPMENT

2.1 PROJECT CONCEPTUALIZATION

Given the achievement of almost complete coverage in certain portions of the city, the privatization effort was largely aimed at achieving the investment requirements needed to cover the deficient and the newly developing areas. An Area concession model (O&M concession) was selected, transferring the responsibility of investment, operation and extension of coverage to a private Concessionaire, without transferring assets.

2.2 PROJECT DEVELOPMENT

1. A Government Committee coordinated the entire PPP process. The Committee was comprised of the Privatization Secretary and representatives from the Ministry of Economy and Public Works, the Provincial administration of Buenos Aires, OSN and labour unions.

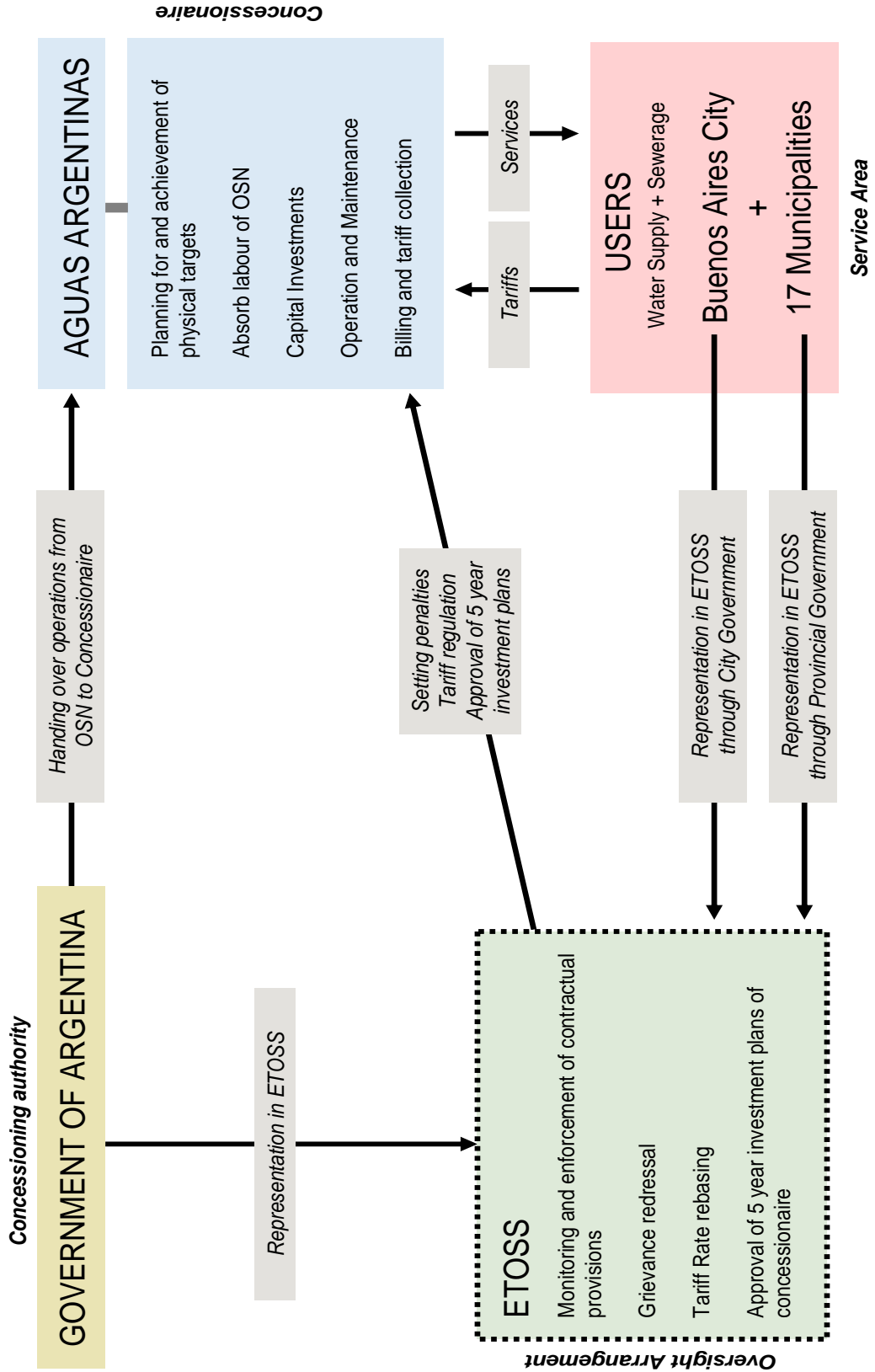
2. Advisory Technical Advisory (TA) was provided by the World Bank in 1991 and a team of consultants from the United Kingdom were appointed as Transaction Advisors under the TA.
3. Initiatives for encouraging private bidders included harnessing support of OSN employees by pledging 10% shares in the new company, reducing OSN staff through a voluntary retirement programme, increasing tariffs by 62%, and amending laws related to termination of water connections in case of default in payment of bills.
4. While several background studies were commissioned, the contract did not guarantee the accuracy of the pre-bid information. It was also decided to continue with the prevalent non-standardized tariff system (flat rates for non-metered connections and a separate system for new metered connections).

2.3 PROCUREMENT PROCEDURE

The Concession was awarded in 1992, following an international competitive bid. Pre-qualification criteria included (in addition to financial profile), the experience of bidding consortia in providing water and sewerage services to a demographic unit of at least 10 million persons. The award - based on largest reduction in prevalent tariffs - was made to Aguas Argentinas, which offered a 26.9% reduction. The winning company comprised of (i) 53% share of foreign firms - Lyonnaise des Eaux and Dumez (France), Aguas de Barcelona (Spain), Anglian water (U.K.), (ii) 37% share of local firms - Sociedad Comercial del Plata, Meller and Banco de Galicia (Argentina) and (iii) 10% share of former workers of OSN.

3. CONTRACT DETAILS

3.1 PROPOSED CONTRACTUAL STRUCTURE



3.2 OPERATOR OUTPUT OBLIGATIONS

The Concessionaire was responsible for all operations and creation of new infrastructure to meet output specifications for coverage, rehabilitation of existing infrastructure, maintenance of water pressure and quality, metering and treatment of waste water provided in the contract. Key outputs to be achieved through successive 5-year investment plans (spreading the indicated final targets over the concession period) included:

1. Increasing coverage for water supply from 70% to 100% and for sewerage from 58% to 90% within the concession period of 30 years
2. Reducing UfW from 45% to 25% by the end of the contract
3. Enhancing primary and secondary treatment of waste water from as low as 4% to 93% by the end of the contract period

3.3 OBLIGATIONS OF THE CONCESSIONING AUTHORITY

Obligations of the Concessioning Authority included dissolution of the public utility (OSN) and peaceful and timely transfer of all operations, assets and human resource from the public utility to the Operator.

3.4 REGULATORY AND MONITORING ARRANGEMENTS

The Tripartite Entity of Sanitation Works and Services (ETOSS), instituted in 1992 as a oversight body for the project, was responsible for monitoring the compliance with contractual commitments, establishing penalties and corrective measures in case of default, regulating and determining tariffs, addressing consumer grievances and reviewing the five year investment plans of the Concessionaire. ETOSS was comprised of representatives from three tiers of Government – National, Provincial (17 municipalities surrounding the city of Buenos Aires were included in the service area) and City Level.

3.5 PROJECT FINANCIALS

1. The contractual commitments of the Concessionaire were output based and not investment based. The Concessionaire was responsible for all capital and operational investments required to meet the output targets. The company was required to prepare 5-yearly investment plans, which were to be approved by ETOSS as mandated by the contract.
2. All investments were to be recovered through user charges (tariffs), which accrued entirely to the Concessionaire. The tariff system to be used was the same that was used before the concession, which included different calculation methods for metered and unmetered connections.
3. The company had to contribute 2.7% of the tariff revenue for partially funding the operating costs of ETOSS.
4. The contract provided for levying an infrastructure fee intended to cover part of the costs of laying new infrastructure, in addition to a connection fee for providing new connections.

3.6 PROJECT RISKS AND ALLOCATION

Investment Risk Associated in this particular project with forecasting of demand for services (since

revenue was tariff based), was borne by the operator and the contract did not provide any guarantees to that effect. Tariff control exercised by ETOSS further transferred the risk to the Concessionaire.

Performance Risk	Borne by the operator through mechanisms for penalties for non-compliance with contractual commitments and through an inflation-indexed performance bond.
Currency Risk	While the initial contract did not safeguard the Concessionaire against Currency Risks , a Contractual Amendment enacted in 1997 indexed water and sewerage tariffs to the US\$, allocating the risk to the consumers.
Force Majeure	In the event of early termination due to changes in policy Aguas Argentinas was entitled to compensation for new assets that had not fully depreciated and loss of revenue for the remaining duration of the contract.

3.7 DISPUTES RESOLUTION MECHANISM

The contract provided for resolution of all disputes arising out of the contract in the Federal Administrative Courts in the city of Buenos Aires and did not permit recourse to international arbitration.

4. PARTNERSHIP IN PRACTICE

The implementation period was fraught by several tariff-related revisions, changes in contractual obligations of the Concessionaire, and defaults in meeting contractual commitments by both parties leading to the eventual termination of the contract by the Government in 2006.

4.1 PROJECT OUTCOMES

SERVICE OUTPUTS

1. The overall coverage of water supply increased from 70% to 83% and that of sewerage increased from 58% to 61% by 1999.
2. Quality of water supplied achieved international standards by 2003, turbidity improving from 58% to 98% and bacteriological standards improving from 98% to 100%.

OPERATIONS

3. Operational efficiency improved with worker productivity improving from 8 to 1.7 persons per 1000 connections by 1998, and bill collection rate improving from 86% to 94% by 1997.

INVESTMENTS

4. The sector experienced higher investments (at least in the first five years of implementation) with Aguas Argentinas achieving approximately 2.4 times the investment achieved by OSN in the six years preceding the concession.

URBAN POOR

5. Aguas Argentinas was able to extend its water and sanitation services to an additional 260,000 low income households through various schemes involving partnerships with users, local governments

and NGOs, employment of cheaper alternative technologies and use of various credit arrangements allowing poorer users to connect to the mainstream network.

4.2 PROJECT SHORTCOMINGS

1. Despite increases in coverage and other aspects of service delivery indicated in the previous section, output targets up till the termination of concession for water supply and sewerage remained unachieved. Detailed data available up to 2003 (first two 5-year plans) indicates the shortfall in certain key targets.

Parameter	Initial level	1993 - 2003		
		Target	Outcome	Percentage difference
Population served potable water	6,007,000	2,359,000	1,270,000	46%
Coverage of sanitation services	4,778,000	1,994,000	605,000	70%
Population connected with sludge treatment facilities	343,000	1,301,000	751,000	42%

2. The project introduced one time connection charges for new users. In the case of poor households the charges were as much as 18% of their average income, rendering the connections unaffordable and leading to revenue backlog for the Concessionaire due to non-payment.
3. The decision to continue with the pre-privatization non-standardized tariff system created asymmetries in the user charges levied by the Concessionaire. For instance a new metered user would have to pay approximately seven times the tariff paid by an older user occupying the same built area with flat rates.

4.3 LEGAL/CONTRACTUAL ISSUES

1. A contractual amendment was enacted in 1997, to address the accumulating arrears due to non-payment of connection fees and the issues of non-compliance by the Concessionaire. The amendment:
 - 1.1. Reduced the Connection Charge for new users substantially and imposed a Universal Fee on all consumers to cover the costs of new infrastructure.
 - 1.2. Reduced the output targets for the first five year investment period, and eliminated the fines imposed by ETOSS on the Concessionaire in order to address the revenue losses incurred by the Concessionaire due to non-payment.
 - 1.3. Allowed indexing of tariffs to the US\$ thereby allocating the currency risk to consumers.
2. The composition of ETOSS (representatives from the Concessioning Authority) represented a conflict of interest, affecting its capacity to function as a neutral oversight body. As a result the body was forced to take politically motivated decisions regarding inclusion of new service areas, increase/decrease of tariff rates, etc. The position of the body was further weakened through a Presidential decree placing it under the control of the Secretary of Environment. It should be noted that ETOSS was completely excluded during the negotiations that preceded the amendment of 1997.

3. An Economic Emergency Act was enacted in 2002 following the Argentine Economic Crisis, abolishing the Convertibility Act, and abolishing contractual provisions for periodic adjustments of tariff to accommodate Forex fluctuations. This seriously affected the revenues of the company.
4. The Concessionaire incurred heavy losses during the Economic Crisis since the Peso devaluation doubled their US\$ denominated debts and wiped out their net revenues. The company applied for remuneration to the Government requesting the Central bank to sell dollars at pre-devaluation prices. This led to a series of disputes and the Concessionaire sought international arbitration through ICSID, despite the absence of such provisions in the contract. The case remains unresolved since 2003
5. On March 21, 2006 the Argentinean President issued a decree cancelling the concession contract to Aguas Argentinas citing issues of non compliance with service outputs and environmental standards.

5. LESSONS LEARNT

1. One of the important reasons for the premature termination of the project was the failure of both the Concessioning Authority and the Concessionaire to honour contractual commitments. While the Concessionaire defaulted on output targets, the Concessioning Authority failed to honour key commitments regarding mitigation of Forex risks, made during the contractual amendment.
2. Need to ensure clarity in the revenue mechanisms as part of the contract so as to avoid discrepancies and asymmetries. In the case of the Buenos Aires concession, the decision to continue with the erstwhile non-standardized tariff system led to serious issues of lack of transparency for setting and regulating tariffs and resultant public outcry. Also in such cases (long term water contracts) transfer of revenue risk to the Concessionaire may not be feasible, since the Public Agency is best suited for undertaking the task.
3. Need for ensuring autonomy of regulatory bodies/arrangements in order to eliminate regulatory bias and protect project interests. In this case the regulatory body was politicized and remained favourable to the interests of the Concessioning Authority, leading to issues of lack of trust and eventually affecting project outcomes.