

ADB SERIES PART 2:

The Mess that is Maynilad:

Legal Wrangling at the Expense of Consumers and Taxpayers

By: Jolette Fajardo

Five years ago, proponents of privatization triumphantly declared that the salvation of millions of Metro Manila residents unconnected to piped water had come. The control over the operation and management of Metropolitan Waterworks and Sewerage Systems, one of the oldest water services in Asia, was transferred to private hands.

These proponents, led by no less than former Pres. Fidel V. Ramos, harped on the low bids of Maynilad Water Services Inc. and Manila Water Company Inc. as an indicator to the success of the privatization scheme. Maynilad's starting tariff was half of what MWSS used to charge its costumers. Manila Water's bid is even lower. MWSS charged consumers 8.78 pesos (18 US cents)/cu.m of water. Maynilad's bid price is 4.96 pesos (10 US cents), Manila Water: 2.32 pesos (5 US cents)/cu.m.

Less than six years later, Metro Manila residents are now waking up to the harsh realities of privatization.

Water rates have gone up on both sides of the concession area. In the Maynilad concession area, water rates have shot up from the initial 4.96 pesos (10 US cents) to almost 20 (40 US cents) presently. At the Manila Water area, rates have increased from 2.32 pesos (5 US cents) to 14 pesos (28 US cents) per cubic meter.

As to the vaunted efficiency of the private sector, the Manila experience has added another crack to the tattered myth.

Non Revenue Water (NRW), water treated but lost either through leaks or through theft, in the West Zone increased from 65% to 70%. In the East Zone, it also increased from 44% to 50%.

The argument that privatization will bring in private capital was also demolished. Less than five years after privatizing MWSS, Maynilad and the Philippine government have parted ways because the former has been unable to put in the money it promised to pour into the concession. Worse it has not been able to pay its concession fees for more than two years now.

Maynilad and government have terminated the concession agreement. An International Arbitration Panel was created to thresh out the reasons for the failure and subsequently determine which side is at fault.

The proponents of privatization can only shake their heads and vainly try to

find excuses for the failure of privatization in Manila.

The Fall of Maynilad

Maynilad, despite costly bailouts extended to it by the Arroyo administration in order to keep the privatization myth alive, failed miserably in its duty to provide clean, accessible and affordable water for residents of Metro Manila's West Zone.

Maynilad's woes can be traced primarily to its inability to tame its NRW levels to a manageable level. In its original bid, Maynilad promised to bring down NRW levels to 30% by 2002 from its pre-privatization level of 58%. It only made NRW worse. It now hovers at 70%.

Maynilad NRW	Financial Model	Actual
For the year 1997	57.4%	63.3%
For the year 1998	47.9%	60.5%
For the year 1999	42%	67%
For the year 2000	30.8%	65.5%
For the year 2001	29.80%	65.99%0

In a report submitted to the MWSS Board of Trustees, the MWSS Regulatory Office noted "operational inefficiencies in terms of salaries and wages" in how Maynilad is run. Maynilad officials are a pampered lot. They are paid handsomely for failing to deliver on their efficiency promises. They are even made to drive top-of-the-line luxury vehicles.

Costly bailouts at the consumers' expense

In the last few months of the Estrada administration, Maynilad applied for an automatic currency exchange rate adjustment (auto-CERA) in order to protect itself from foreign exchange fluctuations. It must be noted that the company inherited around \$800M debts from MWSS. Estrada was not able to immediately act on the demand because of the political pressures on him at that time. He was later booted out of office before he can take any action on Maynilad's demands.

Pres. Arroyo proved to be more sympathetic. Despite vigorous protests from civil society, she allowed the auto-CERA plus a new demand by Maynilad: the accelerated recovery of foreign exchange losses from 1997-2000. Since the concession agreement between MWSS and Maynilad mandates that foreign exchange losses should be recovered within the remaining life of the contract, GMA ordered the revision of the contract to accommodate Maynilad's demands.

Aside from the contract amendment, MWSS has tolerated Maynilad's non-payment of concession fees starting April 2001. A big chunk of concession fees go to servicing of MWSS's past debts. Estimates made by Regulatory Office (RO) officials put the aggregate unpaid concession fees at 5 billion pesos (approximately US\$100M). Since Maynilad is not paying, government has been forced to borrow just to continue servicing these debt.

Turning the tables on MWSS

The rot inside Maynilad was not to be healed by generous bailouts made at the expense of consumers.

During the rate rebasing exercise conducted last year by the Regulatory Office, Maynilad still asked for a 34 pesos (68 US cents)/cu.m. rate. Despite Maynilad's failure to provide services to Metro Manila residents, government granted Maynilad a 26 pesos (52 US cents)/cu.m. rate.

Probably realizing that they cannot decently run Maynilad and turn out some profit, Maynilad filed a notice of termination last Dec. 9, 2002 alleging that government has made it difficult for them to perform their service obligations. MWSS, according to Maynilad, violated provisions of the concession agreement.

The numbers behind Maynilad's decision to turn the table against government is simple. If the Appeals Panel decides that Maynilad should be booted out of the West Zone because of their failure in providing services to the consumers in the west zone, Maynilad will be able to recover only a small portion of the investments they have already put in the concession. But if they turn the table against the government, they stand to recover a termination fee of around 21 billion pesos (US\$420M), the estimated amount of investments the company actually made.

Instead of showing disgust at Maynilad's notice of termination, which blamed government, after the generous bailout the concessionaire got, government negotiated with Maynilad.

When Maynilad stuck to its untenable demands of moratorium on concession fees until 2008 and a scaling down of service obligations, government had no option but to challenge the termination by filing its own counter-notice of termination on January 9, 2003.

The International Arbitration Panel and the Concession Fee Fiasco

An International Arbitration Panel has been constituted to decide on the termination notice and counter-notice. The Panel is mandated by the concession agreement to act as arbiter in case of major disputes between MWSS and the private concessionaire. The panel has three members. Representing Maynilad is Atty. Antonio Picaso. MWSS will be represented by former Supreme Court Justice Bernardo Pardo. The International Court of Arbitration has appointed Allan Philip as Panel chairman.

On February 7 this year, Maynilad tried to return the concession but the Appeals Panel issued a stay order until it decides the termination fee issue. This means Maynilad will continue running the West Zone until the Arbitration panel decides on the termination fee amount. As mentioned earlier, the amount of the termination fee would depend on who is at fault

for the failure of Maynilad. If Maynilad is at fault, the termination fee amount will only be around 4 billion pesos (US\$80M). But since it owes MWSS around 5 billion pesos (US\$100M) in concession fees it unilaterally stopped paying in March 2001, Maynilad will actually have to pay MWSS the difference.

Since April 2001, Maynilad has unilaterally stopped paying concession fees to MWSS. The concession fees are supposed to service the debt of MWSS inherited by Maynilad.

Part of the bailout given by government to Maynilad is an extension of the payment of these fees to end-2002. By December 2002, MWSS has been sending demand letters to Maynilad asking the company to pay its concession fees. The demand letters were ignored.

MWSS asked the Appeal Panel authority to draw on the performance bond of Maynilad securing its payment of concession fees. Last April 29, the Appeals Panel denied the MWSS and gave Maynilad until June 15 to renew its Performance Bond. It warned that if Maynilad fails to renew the bond, it will be constrained to allow MWSS to draw on the existing bond.

The June 15 has passed but Maynilad has not yet renewed its bond. Government has announced it will draw on the bond but whether or not it will actually draw on the bond has been rendered moot because just four days after the deadline, the Appeals Panel issued a stay order ordering MWSS not to draw on the bond.

Quo Vadis ADB?

The Asian Development Bank, together with International Monetary Fund and World Bank, has been very active in pushing government to pursue the privatization of water utilities.

In the ADB country operation strategy for the Philippines in 1993, it called for the greater involvement of the private sector especially in water sector. Maynilad also actively supported Maynilad and its partner Suez Lyonnaise des Eaux, in their successful bid to get into Manila's water sector back in 1997 when MWSS was privatized.

As one of the lenders of Maynilad, the Asian Development Bank helped push government to agree to giving in to Maynilad's demand for a rates increase to prop up the ailing company. The increases were given, people's already difficult lives became even harder, yet Maynilad continued to suffer financial hemorrhages anyway.

Now, ADB is eerily silent on the Maynilad problem. Despite the increases in rates, creditors, including the ADB, continue to stay away from Maynilad as it is very clear that the corporation is unbankable. When Maynilad declared that it is returning the concession, the ADB even had the gall to make a statement saying government should not take over the concession despite the obvious failure of privatization.

ADB should share in taking responsibility for the impact of the failed water privatization in Manila. The privatization policy subjected Metro Manila residents to steep water rate increases with no accompanying service improvements. The policy also took away the provisioning of water from the realm of government services to a sphere which treats water as a source of profit. With water in private hands, the people lost their power to demand better services because of the private corporation's lack of accountability to the public. They cannot even participate in the ongoing legal dispute between MWSS and Maynilad because of lack of "legal personality" to intervene in a "private contract" between MWSS and Maynilad.

ADB is now busy pushing for "improvements" in the capacity of the Regulatory Office through a technical assistance grant in line with the neoliberal policy of taking government away from its active involvement in vital sectors of the economy.

Failure of Privatization

The ADB has been steadfast in promoting privatization as a solution to the water problems of the world. It seems to have forgotten why majority of the world's nations (95%) run water utilities themselves.

The following are the advantages of having government run MWSS again:

1. Lower cost of capital - Loans obtained by government generally have longer terms and lower interest rates
2. Clear and Direct Accountability: Government is directly responsible for water services
3. National Security concern is addressed by government itself
4. Government has duty to serve ALL sectors of society. Providing services to depressed areas may not be enticing to private concessionaires.
5. The cost of delivery and access water can be socialized
6. Democratic ownership and management consumers/the public who are the ones who pay for the cost of delivery and access, would be able to participate in management.

Back in 1997, the Philippine government harped on the fact that running MWSS will cost government around \$7 Billion in the next 25 years. It said it could not afford this huge amount so it had to tap the purse of the private sector. What government did not say was that the private sector will be shelling out only around US\$100M per zone and that the rest of the investments would be source from the cash flow to be generated from selling water to Metro Manila consumers. It also did not anticipate cases of concessionaires unilaterally stopping payments of concession fees.

If push comes to shove, government can also take out loans to run the concession previously held by Maynilad again, provided it is done judiciously.

But all the "development" experts seem to frown upon the idea. They raise the usual arguments of government inefficiency and corruption, and its lack

of capital.

But are they really such strong arguments? Privatization will not solve government inefficiency and corruption. Even privatization proponents admit that strong and good governance is a requisite for privatization to work. The solution is to reform government, not to have it turn its back from its responsibility to its people.

The issue of capital also offers weak support as both government and private companies borrow, with Government loans being generally cheaper. Private concessionaires even ask for government guarantees to facilitate release of their loans. Further, bulk of the capital needed for the maintenance and operation of MWSS will come from the cash flow generated by income from water distribution and sanitation.

Pursuing the privatization policy espoused by multilateral financial institutions like the ADB will not bring "water for all." By pushing government to adhere to a policy of treating water as an economic good that should be provided by the private sector, the ADB succeeded in taking an essential service away from effective government control, making water a source of profit available to only those who can afford it.

Notes:

1) Maynilad has been granted the right to accelerate recovery of around 3 billion pesos in forex losses. It was also granted an automatic currency exchange rate adjustment mechanism. Both are not provided for in the concession agreement so the contract was amended to accommodate Maynilad.

2) Manila Water, on the other hand asked for a P24/cu.m. rate. It was initially awarded a P17/cu.m rate. . Manila Water agreed on a staggered increase so it only charges 14.22. Manila Water will eventually get the P17/cu.m. rates within the next few years.