

Performance Incentives And Penalties In U.S. Operating Contracts

Operating Contracts for Water
And Wastewater Services
Workshop
March 17, 2008

U.S. Operating Contracts

- The US market is mature - - several standard contract models are in use. Not much innovation any more.
- The US contracting industry is very competitive - - the governments exploit this fact.
- Most contracts require meeting cost and technical performance targets quickly (Indianapolis example).
- There is often some consideration of performance improvement.
 - - US municipalities don't like paying bonuses; don't want to "pay extra."
 - - Penalties for non-performance seem to be a bigger focus.
 - - Many penalties are in addition to government fines and the requirement to fix the problem.
- Performance improvement frequently relates to cost.
 - - Almost all cost incentives involve sharing the benefits with the government.

Example: Indianapolis, Indiana

- Large urban area.
- Long term operating contract.
- Contract provides for 36 incentive measures/criteria.
- Achievement dates are near term - - a few years for most.
- Many other contracts set these types of criteria as simply elements of the scope of services - - and reflected in the contractor's fee, with no "bonuses" and with penalties if not achieved.

Example: Naugatuck, Connecticut

Wastewater Treatment Plant & Sludge Incinerator

- 20-year contract.
- No provision for sharing savings made by the contractor in its routine operations practices.
- Savings are shared if as a result of additional capital investment:
 - - if financed by contractor: 75% to contractor, 25% to government
 - - if financed by government: 25% to contractor, 75% to government

Example: Naugatuck, Connecticut

Wastewater Treatment Plant & Sludge Incinerator (Con't)

- Innovative aspect - - sharing profits from operation of sludge incinerator:
 - Step 1 - - 30% to government
 - Step 2 - - 40% to government
 - Step 3 - - 50% to government
- After 6 years, is it working? No.
 - - Lesson: the incentive and sharing is tied to a factor the contractor cannot control (market price for sludge disposal in State).
- Penalties - - from \$100/event to \$5,000/event - - including odors (even if no fine).
 - - Lesson: enforcement is difficult; requires constant monitoring.

Example: Taunton, Massachusetts Wastewater Collection System (“Pipes” Only)

- 13-year contract.
- No savings shared from any “routine” savings.
- Over time - - operations savings are shared:
Contractor idea/contractor paid - - 80% of savings to contractor
City idea/contractor paid - - 20% of savings to contractor
City idea/City paid - - 100% to City

Example: Taunton, Massachusetts Wastewater Collection System (“Pipes” Only) (Con’t)

- Over time - - savings from required capital modifications:
If contractor improves on idea and implements - - 35% of savings to contractor.
If contractor improves on idea but City implements - - 25% savings to contractor.
- Lesson: allows government to propose ideas and realize benefits.

Example: New London Connecticut (In Negotiations) Water System, Waste Water System, Customer Billing

Liquidated Damages In Addition to Any Government Fines
Finished Water Treatment Performance:

- Turbidity < 1.0 NTU
 - 1st Event - \$1,000 after 8 hours of non-compliance
 - 2nd Event - \$2,000 after 8 hours of non-compliance
 - 3rd Event - \$3,000 after 8 hours of non-compliance
- Fluoride 0.8 mg/l (average)
 - 1st Event - \$1,000 after 8 hours of non-compliance
 - 2nd Event - \$2,000 after 8 hours of non-compliance
 - 3rd Event - \$3,000 after 8 hours of non-compliance
- PH > 7.0 S.U.
 - 1st Event - \$1,000 after 8 hours of non-compliance
 - 2nd Event - \$2,000 after 8 hours of non-compliance
 - 3rd Event - \$3,000 after 8 hours of non-compliance
- Failure to Monitor All required monitoring parameters
 - 1st Event - \$5,000
 - 2nd Event - \$10,000
 - 3rd Event - \$25,000
- Coliform Negative – Requires Public Notice
 - 1st Event - \$5,000
 - 2nd Event - \$10,000
 - 3rd Event - \$25,000
- Coliform Negative – Requires “Boil Water” Notice
 - 1st Event - \$125,000
 - 2nd Event - \$225,000
 - 3rd Event - \$275,000

Similar LDs also for: water distribution; wastewater collection; wastewater plant; customer billing; “other.”

Stockton, California

Water, Wastewater, Storm Water, Customer Billing

“Administrative sanctions” (performance guarantee violations, reports, logs, missing meetings).

- Nothing for the first failure to perform.
- \$500 for the second failure to perform.
- \$1000 for the third failure to perform.
- \$2,000 for the fourth failure to perform.
- \$4,000 for the fifth failure to perform.
- \$8,000 for the sixth failure to perform.
- \$16,000 for each of the seventh +.

Some U.S. Lessons

1. Do not tie incentives to factors contractor cannot control or influence.
2. Provide for government suggestion of improvements and benefits from its suggestions.
3. In order for penalties, damages and sanctions to be effective, constant contractor monitoring is needed.