What Went Wrong with the DAWASA Lease Contract?

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To understand what went wrong one needs to understand:

- Where things stood before the PSP
- How the PSP was designed
- How the PSP procurement was conducted
- How things actually played out

Where things stood before the PSP

- DAWASA was the sole provider of water supply and sewerage services
- The WSS infrastructure had been neglected for many years
  - Filters had not worked in 20 years
  - Pumps and transformers were constantly breaking down
  - No complete inventory/assessment of existing assets
- Estimated NRW was over 60% of production
  - Most connections were unregistered spaghetti
  - Lots of illegal connections off transmission mains
  - Only 1,000 customer meters for a system that should be able to serve more than 250,000 customers
  - There were no bulk meters in the system

Where things stood before the PSP

- Monthly collections only occasionally covered operating expenses
  - 100,000 customer billed monthly, but only 15,000 paid
  - No one knew who (or where) the customers were (bills were mailed to P.O. boxes)
  - Many “customers” in the billing system were duplicates
    - Often set up by staff permitting customers to avoid paying arrears
  - Frequent political pressure to supply free water

Where things stood before the PSP

- Tariffs were low
  - But were raised prior to PSP
    - $0.50/m3 for Domestic; $0.80/m3 for Non-domestic
- Bills were based on “assessed” consumption ~ 35 m3 for Domestic and ~ 150 m3 for Non-domestic
- Plenty of demand
  - Off-system customers were charged $4.00/m3 by private vendors
    - A “water mafia” appears to have existed in the more lucrative areas
    - Much of the private water sold appears to have come from piped system

Where things stood before the PSP

- DAWASA was overstaffed; but lacked critical skills, depth
  - Political connections made it difficult to fire
  - Labor union was strong/political
  - Salaries levels made it difficult to hire/retain qualified staff
- Appears to have been a considerable amount of corruption involving customer service staff
  - Disconnected customers often reconnected in the evening
  - Billing adjustments made for partial payments made directly to staff

How the PSP was designed

- Objective was to:
  - Separate Operations and Asset Ownership
    - Public “owner”
    - Private “operator”
  - Use PSP to:
    - Isolate operations from political influence
    - Improve operating efficiencies
- Regulation “by contract”
  - For first 5 years, while new regulatory authority was being established (but both DAWASA and PSP were licensed to provide WSS services)
- PSP required to inject equity
  - For working capital: e.g. vehicles, computers, etc.

How the PSP was designed

- The PSP consisted of five agreements:
  - The Lease Contract,
  - An emergency works contract (called the “SIPE” contract)
  - A contract for the purchase of 173,000 customers meters (called the “POG” contract)
  - A Subloan agreement – for up to $5.5 M
  - An agreement to design, procure and supervise secondary and tertiary improvements (actually part of the Lease Contract – called the “Delegated Works”)

How the PSP was designed

- The SIPE contract was to enable the PSP to
  - Make emergency repairs to the treatment plants and transmission mains
  - Install bulk meters
  - Rapidly rationalize/meter connections to Non-domestic customers
- The POG contract was to finance the purchase of customer meters
  - PSP to decide what to buy and when
- Contracts were financed 100% by IDA under an LOC arrangement

How the PSP was designed

- The Subloan agreement (~$5.5M) was to provide financing for initial working capital to partially cover cash deficits in first two years.
  - 11.5%, 10 years term, 5 year grace
  - Drawdown “pari passu” with contribution of equity
- The Delegated Works (~$40M works) were to enable the PSP to design and implement (i.e. procure and supervise works contracts) infill mains to replace the spaghetti, as they saw fit to improve hydraulics and commercial performance. PSP design and supervision fee was 10%

How the PSP was designed

- The Lease Contract
  - Gave the PSP the exclusive right to provide piped water supply and sewerage services in the “Operator’s area” for 10 years
    - In exchange for the payment of a rental fee
  - Provided for a separate “Operator Tariff” to cover O&M, working capital, small equipment plus return
    - Bid tariff fixed for 5 years with automatic escalation
    - Major review was to take place in year 6
  - Required the PSP to:
    - Collect and remit separate Lessor tariff
    - Collect and hold in trust separate First Time Connection tariff to finance first time connections for poor customers
    - Pay financial penalties for non-remittance of Lessor Tariff or misuse of First Time fund

How the PSP was designed

- The Lease Contract
  - Split financial responsibilities for assets between DAWASA and the PSP:
    - Defined maintenance and asset replacement responsibilities
      - PSP repair and replacement risk limited to $10,000 per event
      - PSP responsible for small equipment (e.g. <150mm, <6 meters)
      - DAWASA responsible for large mains (e.g. >300mm >6 meters)
    - PSP responsible for installing meters; but could include in DW
    - PSP responsible for undertaking all repairs even if not financially responsible – DAWASA could refuse to pay unreasonable costs
  - Required PSP to conduct asset inventory/ condition assessment during first year

How the PSP was designed

- The Lease Contract
  - Required the PSP to meet performance targets: e.g.
    - Number of customer meters installed each year
      - All non-domestic customers were to be metered during first year
      - All existing connections were to be metered during the first five years
    - Reduction in UFW
    - Improvement in collections
    - Water and effluent quality
    - Percentage of customers receiving 24 hours supply
    - Number of customer receiving 5m or 10m pressure
  - Required PSP to include 20% local participation
    - TZ national or companies (at least 15% held by TZ nationals)

How the PSP was designed

- The Lease Contract
  - Required the PSP to conduct “enhanced monitoring” of the system for 12 months (during the first 18 months) to:
    - Evaluate accuracy of bid assumptions
    - Define or revise targets
      - Many performance transition targets could not be defined prior to bid due to missing or poor quality data
  - Provided for automatic adjustments in Operator tariff if bid assumptions turned out to be inaccurate
    - Although actual mechanism for translating differences into tariff increases was not clearly set out

How the PSP was designed

- The Lease Contract
  - Provided for dispute resolution using
    - A independent assessor for disagreements in data values
    - An expert panel for performance disputes
    - Regulatory agency for tariffs
    - Arbitration in London
    - Tanzanian Law
  - Provided for automatic rebalancing of Lease Contract economics if Regulatory agency did not approve a contractual tariff adjustment

How the PSP procurement was conducted

- Three bidders were first prequalified
  - All three: SAUR, Vivendi and Biwater/Gauff JV had participated in two earlier PSP attempts
- Bidders worked with Government to define contract terms and conditions and to develop bidding documents
- Bidders conducted own due diligence
  - Bidders had to justify differences from “Lessor’s” assumptions
  - Bidder’s assumptions were to be compared to actual values determined during enhanced monitoring period
- Award was for lowest proposed “Operator” tariff
  - In case of tie, for highest additional month rental fee payable in years 6 through 10

How PSP procurement was conducted

- Operator tariff bid was limited based on amount of equity committed
  - Minimum tariff allowed was TShs 322/m3
  - To bid minimum tariff had to promise $8.5 M equity
  - Minimum equity was $2.5M
- Theory was: the lower the tariff the higher the cash deficit in the early years before improvements could be realized – requiring higher equity and debt capital

How the PSP procurement was conducted

- In the end only Biwater/Gauff bid
  - SAUR and Vivendi appear to have still felt that key risks - particularly related to payment by Government entities- were not adequately mitigated
    - Ability to disconnect was not considered adequate
    - Wanted ability to withhold Lessor tariff remittances or to offset against monthly rental fee
  - Biwater/Gauff bid did not include Government offer to fund retrenchment
    - Planned to reassign and to retrain instead

How things actually played out

- Feb 2003 - Lease Contract, SIPE and POG signed; other agreements signed shortly thereafter
- Mar/Jul 2003
  - Biwater/Gauff joined with STM to form City Water Services Ltd
    - STM was given 49% of CWS and held two positions in five-member board
  - DAWASA restructured into Asset Owner
    - CWS had first claim on all staff except 4 DAWASA Directors
  - CWS mobilization period

How things actually played out

- Aug 2003 - Preconditions were completed and Lease effective; conditions precedent included:
  - Contribution of minimum equity by CWS ($2.5M)
  - Development contract signed between DAWASA and the TZ Government
    - Requiring Government to agree to keep DAWASA “cash positive”
    - Agreeing tariff design and annual escalation mechanism
    - Agreeing capital works program and financing
    - Formalizing Government commitment to pay water bills

How things actually played out

- Oct 2003 – CWS made one and only deposit of First Time collections in special fund, misusing fee for poor connections
- Dec 2003 – CWS began to fall behind with monthly Rental Fee
- Dec 2003 – CWS started to periodically withhold remittances of Lessor Tariff collections
- Dec/Jan 2004 - SIPE and POG became effective
  - Delays due to CWS desire to change bond language from that in bid documents and to CWS' banks inability to received contract currencies
- Apr 2004 – DAWASA imposed penalty for non remittance of Rental Fee
  - CWS ignored, sought WB support to keep DAWASA from exercising its rights under Lease Contract
- Jun 2004 – CWS stopped paying Rental Fee completely

How things actually played out

- Jun/Aug 2004 – Multiple meeting with MOW as acting Interim Regulator
  - DAWASA sought compliance with Lease
    - Arguing that CWS should contribute equity to cover cash requirements
  - CWS argued that conditions were substantially different than as assumed in bid
    - But did not make request for material change as permitted by Lease
    - CWS argued that Regulator should instead order adjustment to economic terms of agreement

How things actually played out

- Aug 2004 – Interim Review ordered by MOW acting as Interim Regulator
  - Which it could do if it felt that a material change of circumstances had occurred
- Aug/Nov 2004 - PWC conducted review to determine whether material change in circumstances had occurred
    - Involved comparing actual performance for 10 factors to Bidder's assumptions
    - Concluded that a material change had not occurred or could not be substantiated

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How things actually played out

- Oct/Dec 2004 – Biwater Chairman lobbies MOW to renegotiate Lease
- Jan 2005 – CWS formally requests re-negotiation of Lease
- Feb 2005 – DAWASA attempted to partially pull performance bond to cover Lessor Tariff arrears
- Mar/Apr 2005 – Lease negotiations held
  - Using Independent facilitator
  - DAWASA made major concessions; but parties could not come to agreement on collection levels
- May 2005 – Full performance bond pulled/ termination notice sent; CWS files arbitration claim and indicates it will not leave
- Jun 2005 –DAWASA takes possession of sites; appoints DAWASCO to take over operations
  - GOT deports expatiate managers

Why the DAWASA Lease Contract failed

- Poor PSP design
  - Data clean up should have come first
    - Substantial customer survey and data base clean up should have been done first
    - Asset registry, including condition assessment needed first
    - Could have been a separate contract which started immediately upon award
  - SIPE, POG and DW design and supervision contracts should have started immediately upon award, instead of being delayed until the Lease Contract effectiveness
    - Bulk metering and modeling of the system was critical for collections improvement

Why the DAWASA Lease Contract failed

- Procurement
  - Should not have allowed JV to bid
    - Added additional layer between parents and operating company
    - Or, needed parent guarantees

Why the DAWASA Lease Contract failed

- Poor performance
  - To be successful, CWS had to rapidly increase collections
    - CWS proposed enough equity/debt to cover deficits for 2 years
    - CWS performance was poor, it:
      - Was not able to increase collections at all above DAWASA levels
      - Was not able to install an effective billing system
      - Was not able to reconcile survey data with billing system
      - Was not able to install bulk meters to monitor system
      - Was not able to undertake enhanced monitoring program needrd to adjust tariff if actual different from bid assumptions
      - Was not able to use SIPE, POG and DW arrangements to reduce NRW and to improve financial viability

Why the DAWASA Lease Contract failed

- Shareholder disagreement
  - STM became upset early when it found out that Biwater and Gauff had allocated the SIPE, POG and DW design and supervision between them
    - Leaving the 49% shareholder with little benefit and little say in day to day management
    - MOW acting as the Interim Regulator tried to resolve the dispute without success
  - Affected equity contribution
    - Which affected CWS' access to the Subloan

Why the DAWASA Lease Contract failed

- Bid mistakes
  - Bid was overly optimistic
    - Assumed improvements would be easy
    - In bid model collections improved > 70% in first year
  - Did not take advantage of GOT offer to fund retrenchment
    - CWS was unable to effectively manage its local staff, arrest staff corruption
  - Bidder’s assumptions were worse than Lessor’s assumptions
    - Making it harder for them to justify a material change in circumstances

Why the DAWASA Lease Contract failed

- Lease design
  - Needed to clearly separate contractual and regulatory accountability
    - DAWASA should have be sole WSS licensee
    - CWS only a subcontractor
  - Needed clearer dispute resolution arrangement
    - CWS ignored all dispute arrangements, appealing instead to MOW as acting regulator (seeking political solution)
    - Should not have included Regulator as a possible dispute resolution path
    - Recommend that expert panel be used for all disputes below arbitration and that panel be named prior to signing agreement

Why the DAWASA Lease Contract failed

- Lease Design
  - Needed to clearly state how changes in assumptions would be translated into changes in contract economics
    - Purpose of Bidder's assumptions was not clearly understood
    - Link between Bidder's assumptions and Material Change in Circumstances components not clearly stated
  - Needed to clearly allow for partial pull of performance bond
    - Partial-pull ability was intended
    - Full pull - all or nothing - can not easily be used to manage performance

Why the DAWASA Lease Contract failed

- Lease Design
  - Needed to properly protect Lessor Tariff and First Time fee collections from misappropriation by the Operator
    - Should have required that all collections be deposited in joint DAWASA/CWS account and allocated by dual signature (or something similar)
      - Included in DAWASCO Lease Contract
  - Needed to clearly state that First Time fund was a trust and to clearly state disbursement arrangement
    - Fund should have been under joint DAWASA/CWS control
    - Lack of trust language made obligation to transfer to new operator unclear