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Taking Stock of Water Privatization in the Philippines

The Case of the Metropolitan Waterworks and Sewerage System (MWSS)

Mae Buenaventura and Bubut Palattao

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is a publication of the
Freedom from Debt Coalition
With Offices at
34 Matiyaga Street
Central District, Quezon City
1100 Philippines

Tel.: (632) 9211985
Telefax: (632) 9246399

Email:
mail@freedomfromdebtcoalition.org

Website:
www.freedomfromdebtcoalition.org

Radio Program:
BANTAY TALAKAY!
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Editorial Team:

LIDY NACPIL
Secretary General

MAE BUENAVENTURA
Publications Program

Layout/cover design:
AMY TEJADA

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Executive Summary

With a national policy in place for prioritizing debt service, the Philippine government had failed to invest in building a water supply and distribution system that would provide safe, adequate and affordable potable water to its citizenry. Particularly in Metro Manila, the Metropolitan Waterworks and Sewerage System (MWSS) was unable to maintain continuous water supply. Water losses from leakages and pilferage was staggering. A significant portion of the 12-million coverage populations remained unconnected to the piped network system. The state water agency was also ailing from huge liabilities owed to international finance institutions. The private sector -- commonly perceived to be more efficient and less prone to political maneuverings than government -- supposedly had answers to all these.

In June 1995, as severe drought ravaged agriculture, President Ramos gained emergency powers from Congress to enter into contracts with private companies who could assist government in dealing with the problems of the MWSS. Through this measure, Ramos gained the authority to implement "…the privatization of any or all segments of these agencies, operations or facilities, if necessary, to make them more effective and innovative to address the looming water crisis". By year-end, government had signed up the International Finance Corporation (IFC), the World Bank's private sector investment arm, to recommend and prepare the MWSS for privatization.

In January 1997, the Maynilad Water Services, Inc. (Maynilad/MWSI) and the Manila Water Company, Inc. (Manila Water/MWCI) emerged as the winning bidders for the MWSS concession's West and East Zones, respectively. Maynilad is a partnership between global giant Suez and local elite Benpres Holdings while Manila Water is owned by a group of investors that includes the transnational United Utilities and leading local firm Ayala Corporation. The conclusion of the bidding process was a privatization undertaking hailed by the World Bank as the first large-scale water supply privatization in Asia.

As designed by the IFC, the MWSS privatization took the form of a concession contract: private companies would manage and use existing facilities to provide water and wastewater services to Metro Manila residents, in exchange for revenues they would gain from users' fees. In accordance with the Concession Agreement, the concessionaires committed to achieve a range of performance targets that included the lowering of water rates; uninterrupted water supply to connected consumers at no less than 16 pounds per square inch (psi) by year 2000; compliance with World Health Organization water and effluents standards by year 2000; virtually universal water supply by 2006; and the reduction of water losses (or non-billed water) from 56 percent to 32 percent in the first 10 years.

Water tariffs drastically fell after privatization -- 43.5 percent in the West Zone and 73.6 percent in the East Zone. But public elation would not last long. Within two years, Maynilad and Manila Water got the first of many tariff hikes that would come in only seven years under the privatized setup. Other burdens have since multiplied for consumers while the concessionaires continue to enjoy risk-free business.

The IFC noticed the low bids, especially Manila Water's, but since its priority was obviously to conclude the bidding process for the MWSS privatization to be underway, there was no further revisiting of the concerns raised earlier by IFC's own consultants. The bids were accepted despite the lack of accurate information, and it was simply taken for granted that somebody would shoulder the financial consequences of these gaps.

Manila Water Company Inc.

The IFC ignored the firm's unbelievably low bid, and simply raised concerns about the accompanying unrealistic targets for reducing non-revenue water and generating revenues. But Manila Water, hailed internationally as the better concessionaire, has also been passing on the consequences of their flawed assumptions to consumers.

In 1998, Manila Water and the MWSS-Regulatory Office (RO) came to an impasse because the firm wanted to change one of the bid parameters -- the so-called market-based cost of capital (after taxes payable by the concession business). The RO refused, as this would have improved Manila Water's original bid more than a year after the bidding had been finalized. Arbitration ensued, and eventually, the Appeals Panel ruled in favor of Manila Water. This decision cast doubt on the integrity of the whole bidding process in 1997. For East Zone customers, in particular, it laid the basis for retroactive increases in water rates, as well as increases to be granted to Manila Water in the years to come.

From the application of various cost adjustment mechanisms, Manila Water will charge consumers in 2005 an additional PhP2.18/cubic meter (m^3), bringing its rates up to PhP17.83 or close to a 670 percent increase from its original bid price of PhP2.32. The MWSS Board approved this rate despite questions over a rate of return that is far beyond the limit set by law on public utilities.

Maynilad Water Services Inc.

Despite exclusive distribution rights to the provision of full waterworks services in the West Zone, Maynilad was already financially bleeding in 2000 with losses estimated at PhP3 billion. Maynilad did not want the contract mechanism that spread out the recovery of forex losses over the life of the contract, so it pushed for a new mechanism to automatically recover forex losses from consumers in just 15 months.

The first bailout

Initially, the newly installed Arroyo government was hard put at accepting the Automatic Currency Exchange Rate Adjustment, which had no basis whatsoever in the concession contract. Maynilad's response was to unilaterally stop paying concession fees (roughly PhP2 billion a year). Eventually, however, Maynilad and the Arroyo government (through the MWSS Board) came up with changes in the contract that essentially bailed out the concessionaire from its financial woes.

The approval of Contract Amendment 1 in October 2001 paved the way for the application of additional mechanisms for price adjustment: the Accelerated Extraordinary Price Adjustment (AEPA) allowing the 15-month recovery of Maynilad's foreign exchange (forex) losses instead of 22 years; the Foreign Currency Differential Adjustment (FCDA) authorizing the recovery of current and future forex losses arising from debt-servicing of dollar-denominated loans of MWSS (through payment of concession fees) and Maynilad's; and the Special Transitory Mechanism (deferred implementation) permitting the recovery of other forex losses not recovered through the AEPA and the FCDA.

Getting what it wanted, Maynilad passed on forex losses to consumers by collecting the FCDA and the AEPA. Rates rose by more than 60 percent as a result of the contract amendment. What was even more infuriating was that even after the 15-month period (which should have ended in December 2002), Maynilad continued to charge consumers for the AEPA. It also persisted in collecting the FCDA, despite failure to remit concession fees since March 2001. These unauthorized collections by which the concessionaires continue to overcharge consumers amounted to a hefty PhP10 billion during the first quarter of 2004. This issue remains unresolved to this day.

2003 standoff and arbitration

In December 2002, despite the allowances it had won from government, Maynilad filed a Notice of Early Contract Termination, charging that that it was no longer financially viable to run the water business in the West Zone. It also tried to put the blame on government so that it could be reimbursed of at least US$303 million that it claimed to have invested in the concession area. In response, government filed a Countermotion in February 2003, citing the company's failure to comply with provisions of the Concession Agreement, particularly the non-payment of concession fees.

Because of the standoff, the contracting parties went into dispute arbitration in February 1997. Eight months later, on November 7, 2003, the International Arbitration Panel (IAP) issued a ruling that instructed Maynilad to immediately settle unpaid concession fees. After a week, however, Maynilad filed a petition for Corporate Rehabilitation with the Quezon City Regional Trial Court. This legal maneuver was clearly intended to allow the firm to delay payment of its debts including concession fees that had amounted at the time to PhP7 billion. True enough, a stay order was issued, stopping creditors from collecting further from Maynilad.

At this point, with Maynilad seeking corporate rehabilitation and placing itself under receivership, it would have been well within the rights of the MWSS as contained in the contract to declare a "Concessionaire Event of Termination". It would have also been to government's interest to draw on Maynilad's US$120 million performance bond, monetary payments specifically provided for in the contract to protect consumers against contract violations or the concessionaire's failure to fulfill performance obligations. But government did neither.

Because of Maynilad's refusal to pay concession fees, the government has been incurring new loans to avoid defaulting on maturing loans of the MWSS. For even as the utility's old debts have been assumed by the concessionaires, they remain in government's name. Payments are supposed to be sourced from the concession fees. All told, Maynilad's non-payment of its long overdue concession fees, now amounting to more than PhP10 billion, has forced MWSS to incur more debts from bridge financiers to finance maturing obligations, in its attempt to avoid default.

2004: The failed Contract Amendment 2 and another bailout in the offing

The lower court's stay order led the MWSS to seek, in December 2003, a ruling from the Supreme Court on the issue of collecting concession fees through forfeiture of Maynilad's performance bond. Three months later, however, Contract Amendment 2 was suddenly announced. It came to light that while waiting for the Supreme Court's decision, MWSS and Maynilad had entered into unpublicized negotiations and forged an "amicable settlement". This turned out to be a plan for the conversion of PhP5 billion of Maynilad's then outstanding PhP8 billion concession fees to 63 percent equity of MWSS in the bankrupt firm. In effect, Maynilad would simply shift to government the burden of paying for the company's obligations to its creditors.

In June 2004, the Supreme Court ruled in favor of MWSS, giving the go-ahead for the agency to draw on Maynilad's performance bond and nullifying MWSS' reasons for implementing Amendment 2.

Three months later, Maynilad came up with a revised rehabilitation plan notable for releasing the company from immediately addressing its obligations and giving it far easier conditions to fulfill. The rehabilitation scheme, for example, allows the company staggered payment of its outstanding and future concession fees up to year 2008, at a time when the government is in a fiscal crisis. Customers will no longer be reimbursed of the AEPA and FCDA charges that were collected beyond the defined period. Expansion and water supply targets will be reduced, while company prioritizes "opportunity areas".

A highly troubling part of the revised plan is the proposal to convert at least US$60 million of Maynilad's debts into equity for its bank-creditors, giving Maynilad's French partner (Suez) and foreign creditors 84 percent equity in the company. This would be in violation of the Constitutional provision that companies operating vital public utilities should have a Filipino/foreign ownership ratio of 60:40. Reports received by FDC reveal that MWSS plans to go around this legal impediment by using US$60 million of what it will collect from Maynilad's performance bond to buy 71 percent equity in the bankrupt company. (Suez will then retain a portion of its current shares and will remain in the joint venture.)

Towards the end of 2004, the public again witnessed their interests being swept aside in favor of the concessionaires. First, the local court approved in September 2004 Maynilad's petition containing the third version of its rehabilitation plan, thus paving the way for a new round of tariff hikes in 2005. Second, the public was deceived into participating in a so-called "presentation and discussion" of Maynilad's rehabilitation plan that turned out to be a "public consultation" on new water tariff rates amounting to PhP30.19/m^3 (based on the 2002 rate rebasing process plus Consumer Price Index adjustments). This redounds to a 51.6 percent increase from the current average of PhP19.92/m^3 or a more than 500 percent rise from its original bid of PhP4.96/m^3 in 1997.

A continuing tradition of subsidizing private business risks

At no point (at least to public knowledge), has government through the MWSS Board significantly questioned the wrong assumptions and projections of the concessionaires, nor put them to task for their corporate mismanagement and inefficient operations.

Actual billed water volumes and revenues of Manila Water from 1997 to 2000 fell short of projections by PhP586 million or 12 percent below expectations. IFC's consultants knew but chose to ignore the firm's unrealistic targets for reducing non-revenue water and generating revenues. These included demand projections that were 45 percent higher than what earlier studies indicated and overly optimistic targets of halving Non-Revenue Water (NRW) within five years. Despite the huge capital investment that the latter target would have required, Manila Water also committed itself to operating at a cumulative loss of US$ 496 million or a negative cash flow in the first ten years of operations.

As for Maynilad, it should be recalled that in 2001, government simply accepted Maynilad's only argument for its heavy foreign exchange losses: the Asian financial crisis. Maynilad instead got a quick and ill-deserved breather from the AEPA, skirting contract provisions that unexpected foreign exchange losses be collected (with interest) from consumers on a staggered basis, over the life of the contract.

The firm was never put to task for overestimating revenues, underestimating costs and failing to cushion itself for some fall in the dollar-peso exchange rate, considering the events brewing in the region. Maynilad was way off its projected operating expenses of PhP5745 million for 1997 - 2000, and actually spent PhP8629 million for this period. One explanation surfaces in the high costs of production and operations from the dollar-denominated expenses for foreign consultants and management contracts. A consultancy report from Thames Water revealed that Maynilad allocated 60 percent of its capital expenditures to paying for consultancy fees of its affiliate companies such as First Philippine Balfour Beatty and Meralco Industrial Engineering Services Corp. These associates of Benpres and Ondeo emerged richer by almost PhP5 billion in 2001 and 2002 (considering payments made as well as payables). More basic errors have emerged. Maynilad has admitted that it miscalculated the length of water pipes in the West Zone by 1,200 kilometers; this turned out to be 3,700 kilometers instead of the MWSS estimate of 2,500 kilometers.

Additional taxpayers' burdens and the "public utility" issue

Both Manila Water and Maynilad concessionaires are currently on a tax holiday and will only begin remitting taxes to government in 2006 and 2007, respectively. Nonetheless, payments for tax remittance are already being collected from consumers because these are factored in when determining water rates. Further, a Supreme Court decision early last year against public utilities charging their income tax payments to consumers would have provided relief to taxpayers, along with the ruling's stress on the existing law setting a maximum of 12 percent rate of return of the book value of public utilities' assets. But the concessionaires found a way out of this too.

Government and the concessionaires went into a debate on what public utilities are. Relying merely on opinions presented by framers of the MWSS privatization, the Technical Working Group created to resolve the issue persuaded the MWSS Board and RO to issue resolutions formally identifying the concessionaires as mere agents and contractors and not as public utilities. This must have been cause for celebration, particularly for Manila Water whose rate of return for 1999 was revealed by a Commission on Audit report to have reached 40.92 percent, or 28.92 percent higher than the allowable 12 percent. This translates to profits of about PhP281 million.

In the course of the public utility debate, the Freedom from Debt Coalition (FDC) found out that through Amendment 2, Maynilad also attempted to save at least PhP600 million in capital gains and documentary stamps taxes. Had Amendment 2 pushed through, equity shares would have transferred from Maynilad to said parties without the company having to shell out the required capital gains or donor and documentary stamp taxes that go with a normal turnover of stocks either through sale or donation.

Continuing inefficiencies affecting water rates and water quality

The lowering of water rates is heavily premised on the concessionaires' capacity and efficiency to bring down Non-Revenue Water levels. This has not happened.

Supposedly more efficient than Maynilad, Manila Water has been unable to solve rising NRW percentages. Manila Water's target was to bring down NRW in the East Zone to 16 percent by 2001 from 45.2 percent in 1997, but this only rose to 48 percent in 1997 and again climbed to 52.66 percent in 2002.

The same can be said for the West Zone. While it can be argued that the 1997 crash did cost Maynilad large foreign exchange losses and affected its ability to repair leaking pipes, this does not totally explain why its Non-Revenue Water percentages rose from 57.4 percent in 1997 to 67 percent in 2000. Had Maynilad addressed what is largely causing its high NRW levels - pilferage and billing problems - this would have reduced its losses from 1997-2000.

With private business at the helm of Metro Manila's water facility, the need for cost-cutting measures to ensure profit eventually wins out over public health and sanitation concerns. In October 2003, around 600 residents of poor communities in the Maynilad concession area fell ill from gastro-intestinal diseases; six eventually died. A laboratory examination performed at FDC's request by the University of the Philippines Natural Sciences Research Institute showed Maynilad's water as contaminated with E. coli bacteria, at 16 per 100 ml of water or more than 700 percent the national standard of 2.2 per 100 ml of water.

Maynilad dodged accountability for having failed to bring the West Zone up to safe standards, such as maintaining water pressure in their pipelines to guard against the ingress of contaminated water. Instead, Maynilad president Rafael Alunan III blamed residents for their illegal connections and unsanitary lifestyle. President Arroyo herself had no stand on the matter but passed on the task of investigating the outbreak to local health officials who ended up echoing Maynilad's position.

Problems with expansion of service and access

The MWSS prides itself with a progressive tariff structure. In a situation, however, where the majority is not connected to the piped network, only those with water connections can claim benefits. Meanwhile, connection charges of about more than PhP4,000 remain prohibitive for large numbers of poor households.

Aside from cash flow problems, a continuing disincentive to connect to the network is the poor quality of water and service itself (e.g., intermittent water supply, heavily silted water, etc.) being experienced by Maynilad and Manila Water customers.

Consumers with already limited incomes are forced to buy bottled water or spend more on fuel costs from constantly boiling supposedly safe piped water. Another constraint is the problem of land tenure. Without land titles, there is great uncertainty about the possibility of longterm occupancy and consequently, reluctance about making fixed investments such as having connections installed. On the part of the concessionaires, possible billing problems represent higher business risk and there is consequently no compelling pressure for them to sink investments into these areas.

Meanwhile, concessionaires have been given another profit-generating window by way of charging resellers of utility water the highest block rate in the residential tariff schedule, which is about three times the lowest block rate. This is because bulk water comes with heavily shared connections, such that higher levels of utility water used translates to cumulatively higher rates per cubic meter that are divided among three to five households.

As of 2001, as much as 30 percent of Metro Manila was estimated to still depend for their potable water needs on more expensive small-scale independent providers. This is far below the concessionaires' 2001 coverage target of 77 percent and 87 percent for the East and West Zones, respectively. A survey conducted by the MWSS-Regulatory Office (MWSS-RO) and the World Bank in 2000, called the Public Assessment of Water Services Project, revealed that 67 percent of the 10,000 household respondents felt water services did not improve or became worse since privatization. The same survey registered poor rating for quality of service in more than 50 percent of the communities surveyed.

Transparency, accountability and regulation (or the lack thereof)

Created pursuant to provisions of the Concession Agreement and placed under the jurisdiction of the presidential appointees comprising the MWSS Board of Trustees (BOT) , the MWSS-RO's regulatory tasks are confined to ensuring the implementation of the contract. It has only recommendatory functions when it comes to water tariff setting; only the BOT can decisively set the tariff. Interestingly, the MWSS-RO shares the same roof with the offices of the concessionaires, despite the contract stipulation against such an arrangement. Also in the same building is the Office of the Government Corporate Counsel (OGCC), who acts as MWSS' lawyer and whose head is an ex-officio member of the MWSS-BOT. The conflict of interest represented by all these arrangements is immediately apparent.

Yet, however limited its functions are, the MWSS-RO has shown that it cannot even keep faith with its mandate and can easily fall prey to political meddling. The events leading to the approval of Amendment 1 and 2 clearly portrays regulatory capture, where at one time, no less than the Chief Regulator of the very entity mandated to check for contract compliance unashamedly participated in changing the rules while the game was already in progress.

Conclusion

For the Philippine government to admit the serious flaws of the IFC-designed MWSS privatization deal - the largest undertaking of its kind in the region and the world - would be tantamount to making a strong political statement on the failure of water privatization. But the MWSS privatization has turned into just that - a failed undertaking that is privileging private enterprise at the expense of millions of consumers.

Transparency, accountability and public participation -- critical elements in safeguarding public interest -- have not only been compromised but have been grossly lacking in the MWSS privatization, from the moment of its inception to the way it is unfolding today. This is hardly surprising, considering that government and its proven permeability to big business interest is also one of the contracting parties.

In contrast to its disregard for consumers' interests, the MWSS has consistently accommodated the concessionaires' demands, saving them from their own business failings. It cannot even exercise its own rights under the Concession Agreement. Independent and tight regulation functions are practically absent, with the Regulatory Office itself under the jurisdiction of a politically appointed MWSS Board.

When Maynilad and Manila Water won their concessions, they promised a range of benefits that included the lowering of tariffs for good quality water and uninterrupted water supply. These have not been met, along with other commitments to increased capital expenditures and investments in new infrastructure.

Burdens have instead been unfairly passed on to consumers and taxpayers who bear continuously rising water rates and additional debt burdens, even as water service and quality have not significantly improved and are posing threats to public health. Coverage targets remain dismally unfulfilled, as shown by significant numbers who are still unconnected to the piped grid system and are forced to access muchhigher priced and low quality water.

That private business cannot be held accountable by people in the same way that a government can hold dangerous implications since private business neither has the motivation nor the mandate to ensure democratic access to clean, safe and affordable water, regardless of people's capacity to pay. From where it stands, adequate and affordable delivery of basic water service can happen only with cost recovery. The Manila privatization experience shows as much: a cautionary tale that where water services hinge on profit making, the basic right to water of all individuals, particularly the poor, will always be at risk. ◆

Taking Stock of Water Privatization in the Philippines

The Case of the Metropolitan Waterworks and Sewerage System (MWSS)

Mae Buenaventura & Bubut Palattao

Introduction

With a policy in place for prioritizing debt service over any other public expenditure, government had failed to invest in building a water supply and distribution system that would provide safe, adequate and affordable potable water to its citizenry. Particularly in Metro Manila, the Metropolitan Waterworks and Sewerage System (MWSS) was able to maintain water supply at an average of merely 16 hours a day and to only 67 percent of its 12 million-coverage population. Water losses due to leakages and pilferage stood at a staggering 58 percent. And of the 3,000 million liters of water that MWSS received daily from its main source, the Angat Dam,[1] only 42 percent translated into actual revenues for MWSS. The state water agency was also financially distressed, reportedly burdened by an US$800 million debt owed among others, to the Asian Development Bank (ADB), the World Bank and the

1 A major water reservoir in Central Luzon and from which 97 percent of MWSS' water is being sourced.

Japan Bank for International Cooperation.

Privatization supposedly had answers to all these. The private sector, commonly perceived to be more efficient and less prone to political maneuverings than government, could improve infrastructure, reduce water losses, expand service, and in the process of conducting business profitably, bring down tariffs. Government could also expect some relief from financial troubles by freeing itself of the annual subsidies and equity capital extended to the MWSS. Proponents (that included the ADB and the World Bank) further believed in the capacity of the private sector to easily mobilize the much-needed capital for improving and expanding the scope of services of Metro Manila's water distribution system.

The road to MWSS' privatization

In June 1995, President Ramos sought emergency powers from Congress to enter into contracts with private companies who could assist government in dealing with the problems of the MWSS. Certified as urgent by the President, Republic Act 8041 or the National Water Crisis Act seemed a prompt response to the severe drought and water shortages caused by the El Nino phenomenon at the time, and the bill sailed quite smoothly through Congress. Through this measure, Ramos gained the authority to "adopt urgent and effective measures", which included the reorganization of the MWSS and the Local Water Utilities Administration, and "…the privatization of any or all segments of these agencies, operations or facilities, if necessary, to make them more effective and innovative to address the looming water crisis".[2]

In November of that year, government had signed up the International Finance Corporation (IFC), the World Bank's private sector investment arm, as foreign consultant for the contract fee of US$6.2 million[3]. Using the 1992 Aguas Argentinas model in Buenos Aires, the IFC drafted a privatization plan to recommend and prepare the 126-year old MWSS for privatization, and also laid out the design for an operations and investment agreement. The IFC further supervised the bidding procedures, with the approval of the MWSS Board.

Exchange Rate (US$: Peso)

1997: PhP 37.17
2002: PhP 51.43
2004: PhP 56.18

Central Bank of the Philippines

2 Section 7 of Republic Act 8041 or the National Water Crisis Act of 1995.
3 Maglalang, Ferdie J. "MWSS-IFC US$6.2-M deal questioned". *Manila Bulletin*, Nov. 20, 1995. Sourcing for the US$6.2 million IFC fee was as follows: US$2.2 million "success bonus" from the winning bidder; US$3 million to be reimbursed by the winning bidder to the MWSS for retainers' fees and hotel expenses of IFC officers and staff; US$1 million from the French government (provided in kind, through actual consultancy work done by French engineering firm SOGREAH).

An Enabling Environment for Privatization

By the time the Philippine government contracted the IFC to study and frame the MWSS privatization, an enabling environment for various forms of privatization was already quite well in place.

President Corazon Aquino had launched in 1986 the Philippine Privatization Program (Proclamation No. 50), which provided among others, the policy basis and procedural framework for the "'divestment, disposition and liquidation of non-relevant and non-performing government assets and corporations'".

Her successor, Fidel V. Ramos then actively pursued the privatization thrust, paving the way for independent power producers to do risk-free business in the Philippines through the Philippine Infrastructure Privatization Program (Republic Act 6957); and opening other sectors like water and transport to private big business through the Amended Build-Operate-Transfer Law (Republic Act 7718).

Estrada further expanded the scope of privatization to include additional assets and/or activities identified and considered by Local Government Units as those best handled by the private sector.

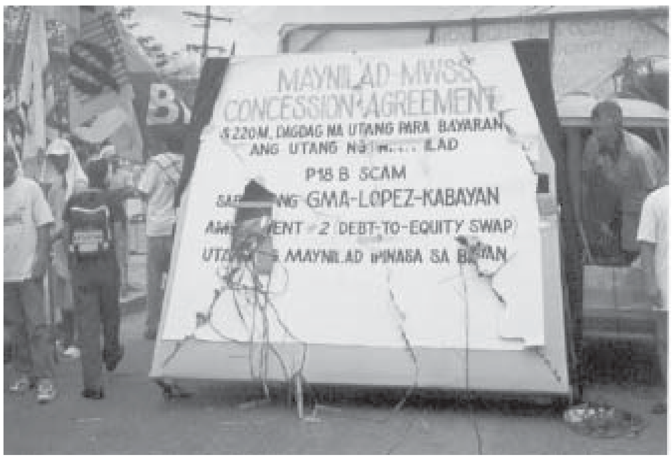
Stop the privatization of water!

The MWSS Privatization Deal

The IFC turned in its strategy report in May 1996 and by end-year, the bidding procedures had been finalized. In January 1997, the winning bidders to two separate 25-year concessions were announced: the Maynilad Water Services, Inc. (Maynilad/MWSI-a partnership between global giant Suez and local elite Benpres Holdings) and the Manila Water Company, Inc. (Manila Water/ MWCI-owned by a group of investors including transnational United Utilities and leading local firm Ayala Corporation).[4] It was hailed by the World Bank as the first large-scale water supply privatization in Asia, in terms of the 11-million service population and the required investment of US$7.5 billion. ADB also singled it out in its 1996 Annual Report as a “role model for future large-scale projects in the Asia- Pacific Region”.

As designed by the IFC, the MWSS privatization took the form of a concession contract that allowed the entry of private companies (or concessionaires) and the use of existing facilities to provide water and wastewater services in a defined area. MWSS would provide the private companies all the water and wastewater facilities needed for treatment, distribution, sewerage and other services. On their part, the concessionaires manage overall operations, as well as invest in maintenance and expansion of MWSS’ assets, in exchange for revenues that they gain by collecting fees from users.

4 Significantly, the MWSS deal only allowed two winning bidders despite being operationally divided into eight service areas.



World Bank, ADB in Local Water

Over the past 10 years, the World Bank provided loans of up to US$171 million in support of private sector participation in LGU water districts outside Metro Manila. This includes the US$32 million funding support extended to the Subic Bay Freeport for privatizing the delivery of its water services. (See Developments in Local Water Privatization) In 1997, the World Bank approved a US$55 million loan to finance the sewerage, sanitation and drainage investments of the water districts of four cities; however, because of the possibility of higher tariffs, they opted out of the project. The Bank instead restructured the loan into a line of credit as a demand-based financing mechanism for the Local Government Units (LGUs).

In 1998, the World Bank used its "Adaptable Program Loan" (APL) instrument for the first time in the water sector to introduce private sector participation. Project documents state: "…there has been active interest shown by the private sector in various types of outsourcing arrangements, ranging from [Build-Operate-Transfer] contracts to service contracts. A significant challenge for the Government is how best to plan and implement investments that lead to sustainable water supply and sanitation services in approximately 1,000 small towns...." Four APLs for the Philippines are lined up for successive releases over a period of 12 years. The Bank's Public-Private Investment Assistance Facility (PPIAF) provides technical assistance to draft legislation for streamlining the economic regulation of water utilities.

For its part, the ADB provided a US$43 million loan for the expansion programs of eight water districts, following the devolution of government functions to the LGUs in 1991. That same year, the ADB provided US$50 million to enhance the capacity of several water districts in cost-recovery operations.

Source

- Violeta Perez-Corral, "WB-IMF/ADB at Work on the Philippne Privatization Program," Freedom from Debt Coalition, 2000.

Unlike divestiture schemes, there was no sale of assets involved; through the Concession Agreement MWSS transferred to the concessionaires "…the tenancy to land and operational fixed assets and an exclusive right to: produce and treat raw water; transport, distribute and market potable water; and collect transport, treat, dispose and eventually reutilize wastewater, including industrial effluent discharged into the sewerage system".[5] Government maintains to this day ownership of the water supply/sewerage system, in accordance with the 1987 Philippine Constitution mandating that public utilities such as power and water remain in government's control.[6]

One adjustment made was

5 "The Privatization of MWSS". See the MWSS website at www.mwss.gov.ph.

6 *1987 Philippine Constitution, Article XII National Economy and Patrimony, Section 2.* All lands of the public domain, waters, minerals, coal, petroleum and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State...The exploration, development and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may enter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations at least sixty per centum of whose capital is own by such citizens...In cases of water rights for irrigation, water supply, fisheries, or industrial uses other than the development of water power, beneficial use may be the measure and limit of the grant.

Schedule of Philippine Adaptable Program Loans (APL)

APL 1 (US$23 million, November 1998-2002): In the first APL, water services were extended to about 9 municipalities (rather than 35, as scheduled) at an investment cost of US$28 million. Many towns are using affermage or lease contracts between the municipal governments and private sector operators. Another 100 towns are at different stages of project preparation.

APL 2 (September 2001-2006 at US$30 million) scales the project up to an additional 40 cities and municipalities.

APL 3 (scheduled for 2004-2008 at US$100 million from World Bank + US$33 million from others) would change the role of government finance institutions and the Land Bank of the Philippines from retailers to wholesalers of loans, inducing private sector banks to invest in LGU-based water supply and sewerage systems.

APL 4 (scheduled for 2006-2010 at US$130 million from the World Bank + US$100 million from others) would finance water supply and sanitation services in about 130 Philippine water utilities, with the World Bank financing used by the Development Bank and Land Bank of the Philippines to leverage private financing in the sector. The role of the two Banks will change from being retail lending institutions to being (a) wholesalers to private financing institutions, (b) underwriters, facilitators of syndication, securitization and insurance for private providers of safer supply and sanitation in secondary cities and towns.

Source

- Long-Term Loans to Roll Out Massive Water Privatization: The Cases of Ghana and the Philippines (http://www.challengeglobalization.org/html/tools/Ghana_Philippines.shtml).

Developments in Local Water Privatization

The Subic Freeport's water services were privatized in 1996 in time for the APEC Summit in what was the first privatization of a waterworks utility in Asia. The 25-year management contract assured an internal rate of return guaranteed to shareholders of 22.4 percent and profit of 20 percent. Today, residents in the area are protesting rising water tariffs - 465% in 1996-2001, 28% in 2003, and 15% in 2004.

After eight years of operation, Subic Water–a joint venture firm with UK-based Biwater and Philippine construction firm DMCI as major shareholders–failed to meet the projected targets in capital expenditures and non-revenue water. Subic Water continues to accumulate huge financial losses, due largely to exorbitant foreign consultant's fees and a so-called "technology transfer" fee which critics allege are merely overpriced second hand booster pumps imported from abroad. Now, these booster pumps are reportedly not functioning well.

In 2000, Clark Water Corporation (CWC), a subsidiary of the France-based Veolia Water Corporation (formerly Vivendi International), won the right to operate the ecozone's water and sewerage system for 25 years. Currently, inside the Clark Special Economic Zone, business locators also complain about high water costs.

In Cebu, the employees union of the Metro Cebu Water District (MCWD) have challenged the "take-or-pay" contract of the PhP1.8 billion Carmen Bulk Water Supply Project proposed by the Ayalas (the same family controlling Manila Water). They described the unsolicited proposal as a "backdoor method of privatization". Lopsided provisions in the draft agreement include the following:

- MCWD shall "take-or-pay" 50,000-60,000 cubic meter/day of treated water from the Ayala-led consortium, whether or not this amount of water is actually sold by MCWD
- MCWD will buy take-or-pay Carmen water at a base rate of PhP25/m^3 ; MCWD currently produces water at PhP10 less/m^3
- AUTOMATIC (usually upward) adjustment in water rates due to inflation, power costs, and other cost adjustments

In the remote mountain town of Butong, Ronda in Cebu island, community residents pay a staggering PhP150 for every cubic meter of water they consume and they have to pay first before they can avail from a solar-powered, prepaid water supply system installed by US-based WorldWater (Philippines), Inc.

patterned after the French concession model - the division of the Metro Manila concession into East and West Zones. Theoretically, this would promote yardstick competition and protect consumers should a single concessionaire later decide to withdraw from the project.

Specifically, the concessionaires committed to achieve the following:

- Lowering of water rates
- Uninterrupted water supply to connected consumers at no less than 16 pounds per square inch (psi) by year 2000
- Compliance with World Health Organization water and effluents standards by year 2000
- Virtually universal water supply by 2006
- 100 percent water coverage within 10 years
- Non-revenue water (NRW)[7] reduced significantly from 56 percent to 32 percent in the first 10 years
- US$7.5 billion in investments for new infrastructure
- Some US$4 billion in income tax revenues over 25 years
- Address needs of roughly 30 percent of the population who are unconnected to the piped network
- Waste water program with 60 percent coverage in 15 years

7 The Non-Revenue Water percentage is equal to water lost over water produced.

improving the assets (whether from its own resources or through loans), and later exercise the authority granted by the Concession Agreement to reimburse these investments from water tariffs charged to users. It was assumed that the companies would exert effort and diligence to reduce costs, while improving infrastructure to expand the scope of services and reduce NRW percentages from pipe leaks and illegal connections because this would be the only way for them to profit and recoup their investments.

MWCI and MWSI's Shareholding Structure

MWCI's Shareholding Structure

Shareholders	Ownership
Ayala Corp.	51.1%
United Utilities B.V.	19.9%
BPI Capital	11.4%
Mitsubishi Corp.	11.4%
Employees	6.3%
Total	**100%**

MWSI's Shareholding Structure

Shareholders	Ownership
Benpres Holdings Corp.	59%
Suez Lyonnaise: Ondeo (20%)	40%
Lyonnaise Asia Water (20%)	

Immediate Impact on Labor

The impact of privatizing the water facility was harsh and immediate for thousands who were either displaced or had no other option but to accept early retirement packages. Of the total 7,370 MWSS employees, only one percent was left with the Residual MWSS (48 percent women, 52 percent men). Six months later, the original MWSS workforce further shrank by 40 percent due to so-called early retirement (27 percent) and voluntary/ involuntary separation (13 percent). Also because of the privatization, both female and male employees close to 15 years of services forfeited lifetime pension benefits.*

According to one office worker, women employees, especially the old timers in support staff positions (clerks, typists, administrative), chose early retirement because they feared they could not 'compete'. They also felt that they fell short of the necessary skills (such as using computers) to survive in the new set up.

The MWSS Employees Union opposed the plan to privatize the MWSS and filed a petition before the Supreme Court in July 1997. Two weeks later, the petition was dismissed.

*** Corral, Violeta Q. *MWSS: Anatomy of a Privatization Deal.* Freedom from Debt Coalition, 1998.**

Flaws from the outset

Winning with a bid of PhP2.32/cubic meter (m^3), Manila Water had the first option of picking its concession area. Predictably, it chose the East Zone where most of the real properties of its largest shareholder, the Ayala Corporation are located. The West Zone, on the other hand, went to Maynilad, which placed a bid of PhP4.96/m^3. Being the concessionaire for the larger part of the MWSS distribution utility and considering that most of the projects funded by MWSS' loans were in the west area, Maynilad agreed to service 90 percent of MWSS old debts.[8]

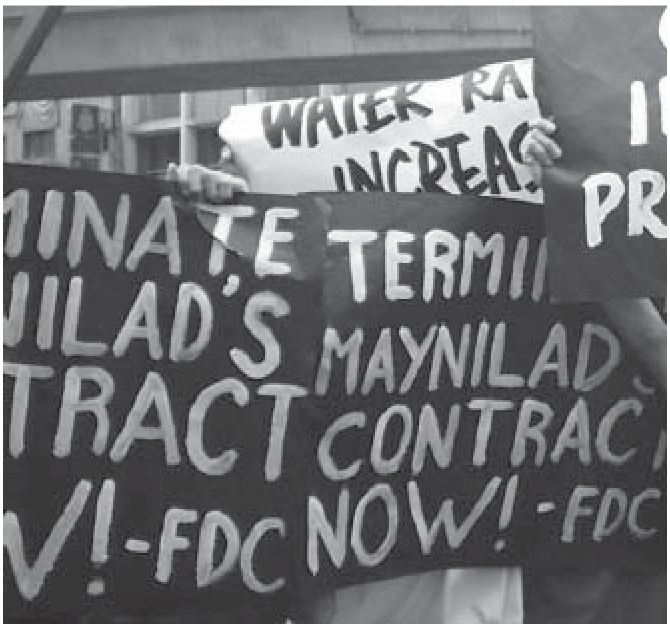
The IFC noticed the rosy projections and the low bids (especially Manila Water's), but took no further action. As IFC's priority was to conclude the bidding process for the MWSS privatization to be underway, there was no further revisiting of the concerns raised and assumptions challenged earlier by its own consultants. Critics looking back at the bidding process observe that no technical studies that would have guided the concessionaires' targets for reducing pilfered or leaked water existed at the time. The bids were accepted despite the lack of accurate information from which to establish a solid and well-defined baseline. It was simply taken for granted that somebody would shoulder the financial consequences of these gaps.

8 Nuqui, Jemileen U. et al. " Hurdles continue to block privatization of MWSS". *Business World*. Feb. 4, 1997. See also Carlos, Maricris C. "New factor for a hike in water rates: taxes". *Manila Bulletin*, Feb. 3, 1997.
It is interesting to note that during a Senate hearing in April 2004, MWSS Administrator Orlando Hondrade reported that actual MWSS loans that were "passed on" to Maynilad at the time of the handover of the water concession amounted to only US$254 million, and not US$800 million. MWSS Deputy Administrator Macra Cruz also reportedly called Maynilad's attention several times to the erroneous figure but the company refused to make the necessary correction. A paid newspaper advertisement of Maynilad in early April continued to carry the US$800 million figure.

Outcomes

Many of the important information about the MWSS privatization became public knowledge only after the deal had been sealed. Such critical documents as the Concession Agreement itself and the IFC Consultant's Report were not readily available to the public. Everything had been fast-tracked, allowing no time for public consultations with various sectors. As events have turned out, President Ramos' "win-win" solution that the Concession Agreement supposedly represented has not been realized. In only a few years, the privatization experience raised as an example for others to follow is turning into a fine corporate mess, with consumers at the losing end of the bargain.

There is no easy way out of the problems spawned by the MWSS privatization deal, bound as the state utility is to a 25-year deal that was borne out of flawed assumptions and did not benefit from public discussion and debate. On one track, it shows how concessionaires are being privileged at the public's expense. On another, it tells how this has been made possible through the enabling role played by government in giving in to the interests and demands of influential big business. Ironically, the supposedly "de-politicized" setup has exposed just how politicized a privatization arrangement can be, given the malleability of the government set-up to dominant economic and political interests and the weakness of regulation.



Ever-rising water rates

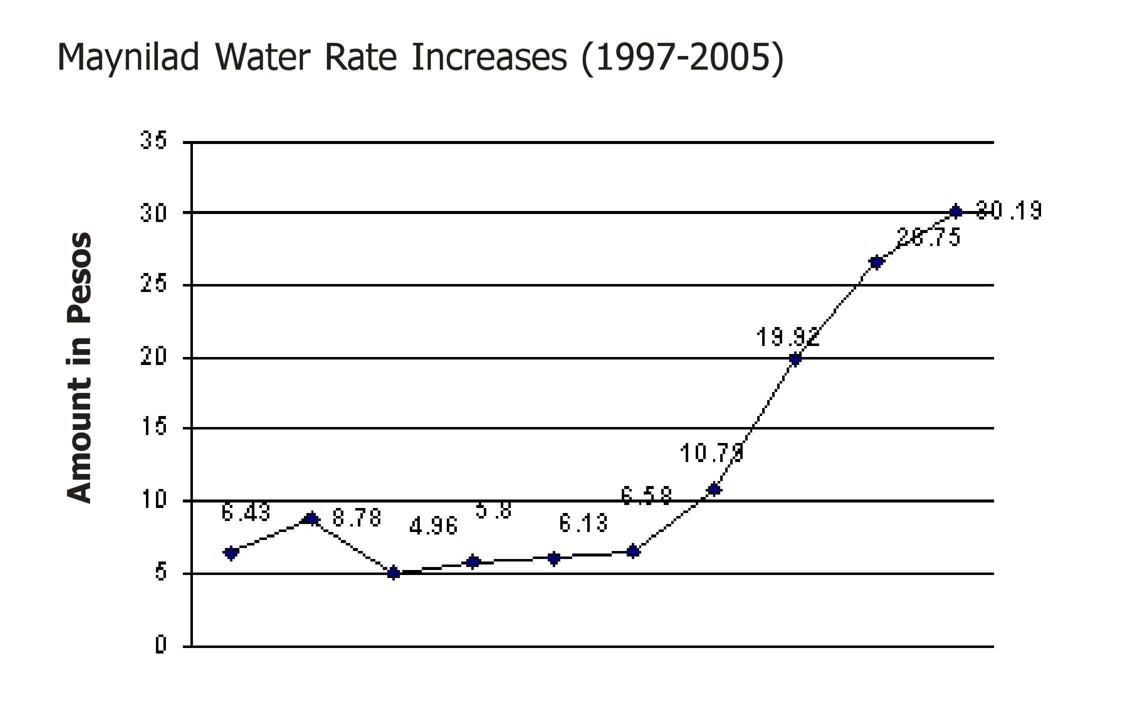
The bidding process immediately resulted in a drastic reduction in water tariffs -- 43.5 percent for the West Zone and 73.6 percent for the East Zone - far better than the targeted 57 percent and 26 percent, respectively. But public elation proved shortlived. Within two years, the two concessionaires applied for an Extraordinary Price Adjustment (EPA)[9] and got their tariff hikes, after citing losses from *force majeure* -- the 1997 Asian financial crisis that caused the devaluation of the peso from PhP26:US$1 to PhP50:US$1. This would only be the first of many water rates increases in the seven years since the MWSS was privatized. To date, water rates have risen by at least 500 percent for West Zone consumers and 670 percent for East Zone consumers.

Maynilad Water Services Inc.

Despite exclusive distribution rights to the provision of full waterworks services in the West Zone, Maynilad was already financially bleeding in 2000. Seeking recovery of foreign exchange losses estimated at PhP3 billion, Maynilad proposed, among others, the institution of the Automatic Currency Exchange Rate Adjustment (Auto-CERA) - so-called because this would have allowed foreign exchange losses to be automatically passed on by the concessionaires to consumers, without having to seek approval from the MWSS Board. To fulfill the requisite by Maynilad's

9 The Concession Agreement provides three mechanisms for rates adjustment:

- **a.** Automatic increases to the standard rates annually, based on changes in the Consumer Price Index.
- **b.** Extraordinary Price Adjustment (EPA). Downward or upward adjustments that may be initiated once a year, based on the financial impacts of unforeseen events beyond the control of the contracting parties. the concessionaires can seek relief against *force majeure* through an EPA application, the basis of which would be validated by the MWSS-RO.
- **c.** Rate rebasing. A process for reviewing tariffs at the start of every five-year period to allow for adjustments, giving the contracting parties the chance to find out if the companies are earning what the Concession Agreement defines as *fair returns.* It is assumed that if the company was efficient enough, it will then have benefited from higher profits collected during the five-year period. But as these profits are reviewed and adjusted at the end of five year-periods, there should also be a lowering of tariffs and consumers end up benefiting as well from the concessionaires' efficiency.



creditors for the release of a US$350-million loan, a related proposal was for the MWSS-RO to approve postponement of targeted service obligations.[10]

Initially, the Auto-CERA, was hard put at gaining government approval, since it was non-existent in the Concession Agreement. In March 2001, President Arroyo directed the MWSS to discuss with Maynilad other ways of recovering its foreign exchange losses. Less than seven months later, Maynilad and the MWSS had worked out those "other ways" of going about the lack of basis in the Contract Agreement for an Auto-CERA. In October 2001, barely five years since the privatization deal was forged, Amendment 1 was approved, paving the way for more rate adjustment mechanisms to be instituted:[11]

- the Accelerated Extraordinary Price Adjustment (AEPA) of PhP4.21/ m^3, allowing the

10Water pressure targets and new sewerage networks

11*Management Discussion and Analysis of Results of Operations and Financial Condition.* Posted at http://www.benpres-holdings.com.

recovery of Maynilad's foreign exchange losses incurred from August 1, 1997 to December 31, 2000, within 15 months and not the remaining life of the contract (22 years). Collection period for the AEPA was set from October 15, 2001 to December 31, 2002;

- the Foreign Currency Differential Adjustment (FCDA) of PhP4.07/ m^3, authorizing the recovery of current and future foreign exchange losses arising from debt-servicing of dollar-denominated loans of MWSS and Maynilad's from the period January 1, 2002 until the expiration date of the concession; and,
- the Special Transitory Mechanism (deferred implementation) to allow the recovery of other foreign exchange losses not recovered through the AEPA and the FCDA for the period January 1, 2001 up to December 31, 2001

All in all, Amendment 1 enabled both concessionaires to enforce not only the AEPA starting October 2001, but also

Maynilad Water Services Inc. Rates History

Period	Average All-in Tariff/ m^3
Pre-Privatization	PhP8.78
1997-1998 (Bid-rate)	4.96
1999 (1st increase)	5.80
2000 (2nd increase)	6.13
January - October 2001 (3rd increase)	6.58
October 2001 (4th increase after Contract Amendment 1)	10.79
January 2002 (5th increase)	19.92
2002 (6th increase after Rate Rebasing)	26.75*
January 2005 (rebated rate + Consumer Price Index adjustments)	30.19

*** Granted by the MWSS-RO but not applied by Maynilad to avoid the legal complications that could arise in relation to the Notice of Early Contract Termination that it had filed.**

the FCDA (or the erstwhile Auto-CERA) beginning July 2002. Maynilad's rates rose by more than 60 percent as a result of the contract amendment.

Even more infuriating was that even after the 15-month period (which should have ended in December 2002), Maynilad continued collecting the AEPA from consumers. It has also persisted in charging the FCDA, despite having unilaterally stopped paying its concession fees to MWSS. These unauthorized collections (amounting to PhP8.28/ m^3) by which Maynilad has been overcharging consumers reached a hefty PhP10 billion during the first quarter of 2004.[12] The issue remains unresolved to this day.

Amendment 1 also included changes in the schedule of Rate Rebasing, the process provided by the contract through which bid parameters and water tariffs can be reviewed and revised[13]. The MWSS RO originally had the option of postponing the rate rebasing exercise to the tenth year of the concession contract, thus discouraging the possibility of dive bidding at the onset of the MWSS privatization process. This was also the basis of the government's promise that there would be no significant rate increase in 10 years. Amendment 1, however, made the process mandatory on the fifth year after privatization. This gave both concessionaires the opportunity to change performance goals and postpone commitments.

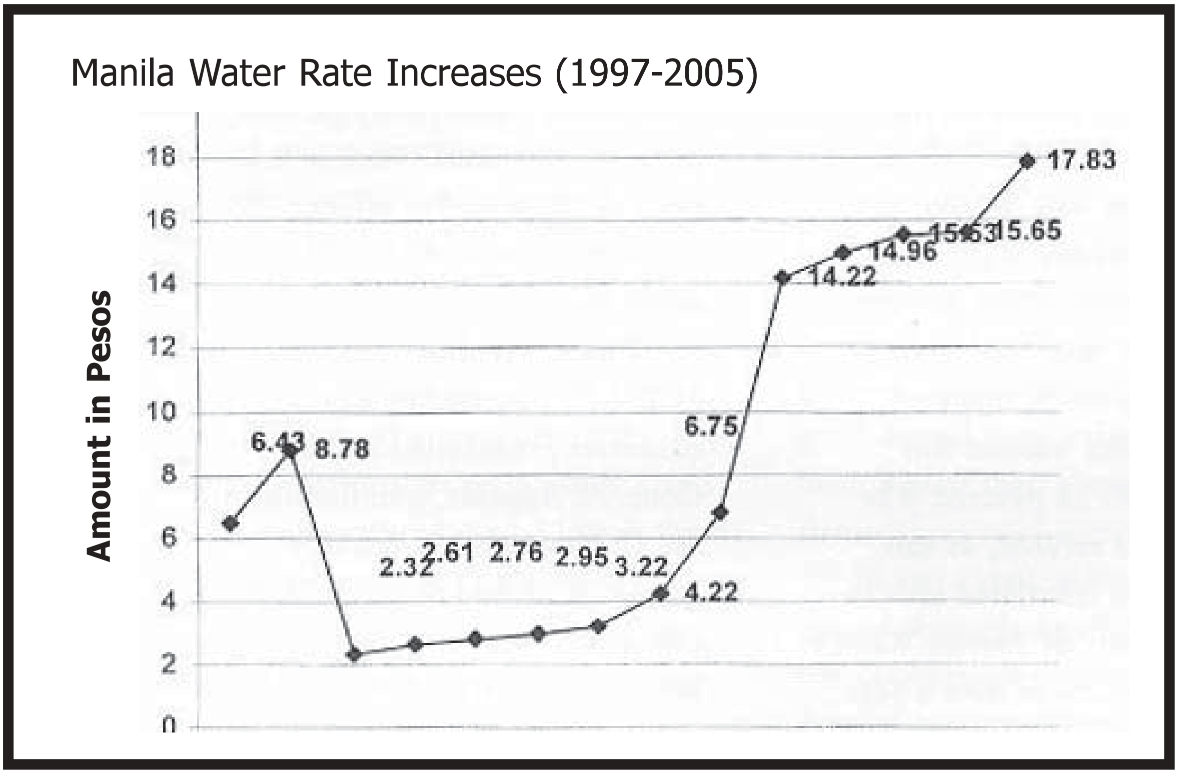
As ensured by Amendment 1, a rate rebasing process transpired in June 2002, less than a year since the last round of rates increases resulting from the MWSS Board's approval of mechanisms for the speedy recovery of past, current and future foreign exchange losses of the concessionaires.

Manila Water Company Inc.

Manila Water, just like Maynilad, made the wrong

12 *As computed by the Freedom from Debt Coalition*

13 Bid parameters that include past accounts and future costs, can be reevaluated through rate rebasing where such factors as inflation, foreign exchange rates, population growth, etc., over the preceding period are considered in determining rate adjustments.



assumptions in 1997. Truth to tell, the company hailed as the better concessionaire, has also been passing on the dire consequences of these erroneous calculations to consumers.

In 1998, Manila Water and the MWSS-RO became embroiled in a dispute over tariffs. The concessionaire wanted a PhP2.26/m^3 increase in its tariff for a four-year period starting in 1999 and thereafter an additional PhP0.97/m^3 for the next 19 years (equivalent to a PhP2.06/m^3 increase for the whole concession period of 25 years). When MWSS allowed only PhP0.4/ m^3 (6 percent of the desired increase), Manila Water sought international arbitration.[14]

The dispute revolved around the issue of the so-called market-based Appropriate Discount Rate (ADR) - or "the real (i.e., not

14 Metropolitan Waterworks and Sewerage System. *Statement of Defense submitted to the International Arbitration Panel.* May 31 1999.

inflation adjusted) weighted average cost of capital (after taxes payable by the concession business)."[15] Based on the concessionaires' financial model assumptions and its dive bid of PhP2.32, Manila Water's ADR at the time came to 5.2 percent (Maynilad's was 10.4 percent). Come May 1998, however, Manila Water wanted this increased to 18 percent. The MWSS-RO refused, as this would have translated into an improvement of Manila Water's original bid, more than a year after the winning bidders had been announced. Eventually, however, the International Arbitration Panel (IAP) granted, in favor of Manila Water, a 9.3 percent ADR and in effect, license to hike tariffs accordingly.

The MWSS Board and the MWSS-RO thereafter filed a certiorari petition before the Court of Appeals, questioning the IAP's abuse of authority since it is limited to procedural concerns only. Inexplicably, however, the MWSS Board

15 Concession Agreement with Manila Water Company, Article 1. Definitions.

Manila Water Company Inc. Rates History

Period	Average All-in Tariff/m³
Pre-Privatization	PhP8.78
1997-1998 (Bid-rate)	2.32
1999 (1st increase)	2.61
2002 (2nd increase)	2.76
January - March 2001 (3rd Increase)	2.95
April - November 2001 (4th increase after ADR adjustment)	3.22
November 2001 (5th increase after Contract Amendment 1)	4.22
2002 (6th increase; application of FCDA)	6.75
2002 (7th increase after Rate Rebasing)	14.22
August 2003 (8th increase from FCDA increase)	14.96
October 2003 (9th increase from FCDA increase)	15.53
January 2004 (10th increase from FCDA increase)	15.65
January 2005 (PhP2 as last installment of 2002 rebased rate + P.18 FCDA)	17.83

through the Office of the Government Corporate Counsel later withdrew the petition unilaterally; not even members of its co-petitioner, the RO, were consulted or notified.

The decision to retroactively reset Manila Water's ADR cast doubt on the integrity of the whole bidding process in 1997, and also set a precedent for concessionaires to possibly claim a new market-based ADR in the future, outside of the rate rebasing process. For East Zone customers, in particular, the new ADR laid the basis for retroactive increases in water rates, as well as increases to be granted to Manila Water in the years to come.

The Regulatory Office, in its deliberations on whether to grant Manila Water's petition, was of the opinion that "a change in ADR implies a change in the bid price otherwise the viability of the concession will be questioned". Further, the RO clarified that "a change in the ADR is not one of the eleven (11) grounds for an EPA (extra-ordinary price adjustment), as provided under the Concession Agreement."

It has also been noted that one of factors for Manila Water's very low bid that enabled it to win the concession, was the 5.2 percent ADR implied from its financial model and projections. Others lost because their ADR assumption came to almost 10 percent. If Manila Water's ADR petition had been applied, its bid price would have effectively been higher than those of other firms.

In any event, since Maynilad gained through Amendment 1 the accelerated recovery of its foreign exchange losses, Manila Water subsequently applied the new cost escalation mechanisms as well, even if it inherited only 10 percent of MWSS' old debts. In 2005, Manila Water will charge consumers an additional PhP2.18/m^3, bringing its rates up to PhP17.83 or close to a 670 percent increase from in its original bid price of PhP2.32/m^3.

New debt burdens

Maynilad's response to government's initial rejection of its Auto-CERA proposal was to unilaterally stop paying the concession fees (around PhP2 billion yearly). And although the concessionaire eventually got what it wanted through Contract Amendment 1, it has not resumed payment since March 2001.

2003 standoff and arbitration. In December 2002, Maynilad filed a Notice of Early Contract Termination, charging that it was no longer financially viable to run the West Zone. It also tried to put the blame on government so that it could be reimbursed of at least US$303 million that it claimed to have invested in the concession area.[16] Government subsequently filed a Countermotion in February 2003, citing the company's failure to comply with provisions of the Concession Agreement, particularly the non-payment of concession fees, which at the time, stood at PhP5 billion.

Because of the standoff, the contracting parties officially went into dispute arbitration on February 21, 2003. Several months later, on November 7, 2003, the IAP ruled that the arguments of both Maynilad and government were without merit;

the management contract remained between said parties. The panel further declared "that Concession Fees which should have been paid by the respondent to the Claimant according to the Concession Agreement are due and they are payable 15 days after the receipt by the parties of this Award". The IAP also denied "all other Claims for Relief by either party".

Petition for corporate rehabilitation. After only one week, Maynilad practically subverted the IAP decision by filing a petition for Corporate Rehabilitation with the Quezon City Regional Trial Court (Branch 90). This legal maneuver was clearly intended to allow the firm to delay payment of its debts, including concession fees that

16 Freedom from Debt Coalition. "The height of Maynilad's duplicity". A position paper on Maynilad's early contract termination and overcharging. March 16, 2003.

Non-Revenue Water of MWCI

Year	Financial Model	Actual NRW
1997	44%	45.40%
1998	31%	39.20%
1999	22%	39.80%
2000	17%	42.80%
2001	16%	48.30%
2002	15%	52.66%

Source: MWSS Regulatory Office

already amounted to PhP7 billion. True enough, a stay order issued by the court prevailed upon creditors from collecting further from Maynilad.

At this point, with Maynilad seeking corporate rehabilitation and placing itself under receivership[17], it would have been well within the rights of the MWSS to declare a "Concessionaire Event of Termination".[18] But it did not do so.

Without the concession fees from which to source debt payments, there have been close calls to defaulting on maturing old loans of MWSS, which remain in government's name. The obvious course would have been for government (as party to the contract) to draw on the performance bond -- monetary payments to be made to MWSS if the concessionaires failed to conform to the contract.[19] Maynilad had posted US$120 million because of its larger share both of the

17 Receivership - a situation where a debtor in bankruptcy (in this case, Maynilad) places itself under an agent/s so designated by a bankruptcy court. The receiver/s is authorized to help reorganize the company, or to liquidate it to satisfy obligations to creditors.

18 Section 10.2 of the Concession Agreement: (i) The Concessionaire shall make an assignment for the benefit of creditors, petition or apply to any tribunal for a receiver or a trustee for itself or of any judicial or other proceedings by reason of its financial difficulties under any reorganization, arrangement, readjustment of debt, dissolution, or liquidation law or statute of any jurisdiction, whether now or hereafter in effect; or there shall be commenced against such party any such proceeding which shall remain undismissed for a period of 60 days, or such party shall by any act indicate its consent to, approval of, or acquiescence in, any such proceeding or the appointment of any receiver of, or trustee for, it or any substantial part of its property, or shall suffer any such receivership or trusteeship to continue undischarged for a period of 60 days; or there shall be any reorganization, arrangement, readjustment of debt, dissolution, or liquidation with respect to such party which does not involve a judicial proceeding."

19 In other words, in the event of either concessionaire's failings, the MWSS could draw on the bond to deliver the unfulfilled commitment/s. The bond is in the form of a Standby Letter of Credit held by Citicorp International Limited, which represents the obligation of said bank on the beneficiary or MWSS. This is contingent on the failure of the bank's customer (the concessionaires) to perform under the terms of the Concession Agreement.

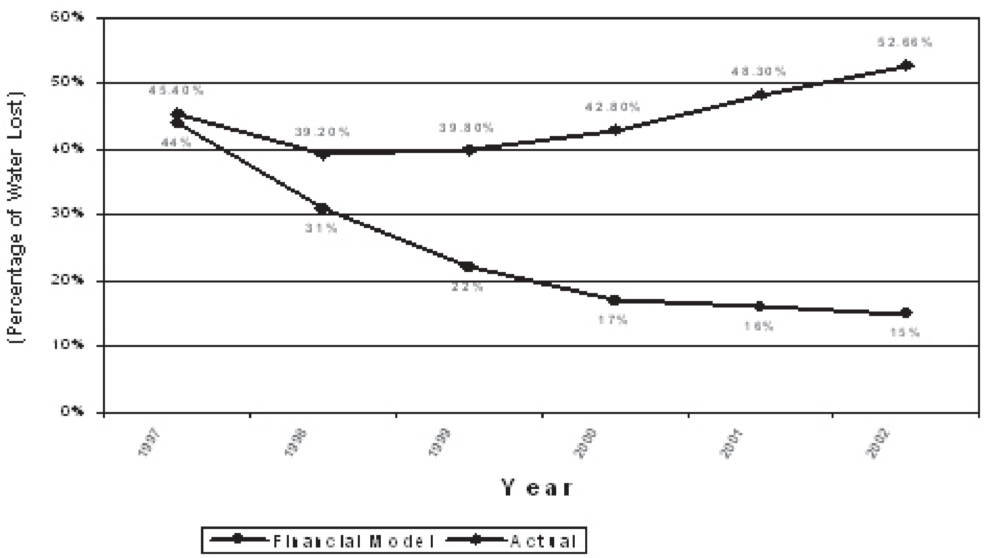
concession area and MWSS' old debts (Manila Water posted US$80 million). Instead, it opted to add damage to the country's sorry fiscal position by incurring new loans to pay for MWSS' loans that had fallen due.

All told, Maynilad's non-payment of its long overdue concession fees that already amounted to more than PhP10 billion in 2004, has forced MWSS to incur more debts from bridge financiers to finance maturing obligations in its attempt to avoid default -

- US$21 million in 2001 (Philippine National Bank, Banco de Oro)
- US$260 million in 2003 (Keppel, Deutsche, First Metro Investment Corp., Rizal Commercial and Banking Corp., etc.)
- US$150 million in 2004 (BNP Paribas)
- PhP780 million in 2004 (MWSS bonds)[20]

20 MWSS sold some PhP780 million in bonds to pay for its maturing obligations. The debt papers enjoy full government guarantee, meaning that the public will pay in case MWSS fails to pay for these IOUs that will mature after one year. The bond issue was resorted to because of MWSS' failure to borrow in dollars, which the state agency needs to cover for Maynilad's unpaid concession fees. (Tenorio, Arnold S. "MWSS borrows PhP780 million to finance maturing obligations". *Manila Times,* Nov. 13, 2003)

Non-Revenue Water of Manila Water



Non-Revenue Water of MWSI

Year	Financial Model	Actual NRW
1997	57.40%	64.10%
1998	47.90%	60.80%
1999	42%	67.20%
2000	35.60%	65.40%
2001	30.80%	66.30%
2002	29.80%	68.68%

Source: MWSS Regulatory Office

Continuing inefficiencies affecting water rates and water quality

The lowering of water rates is heavily premised on the concessionaires' capacity and efficiency to bring down Non-Revenue Water levels. This has not happened.

Manila Water, hailed as the "more efficient" concessionaire, could have made higher revenues if it had effectively addressed rising NRW percentages. Manila Water's target was to bring down NRW in the East Zone to 16 percent by 2001 from 45.2 percent in 1997, but this only rose to 48 percent in 1997 and again climbed to 52.66 percent in 2002.

The same can be said for the West Zone. While it can be argued that the 1997 financial crisis did cost Maynilad large foreign exchange losses and affected its ability to repair leaking pipes, this does not totally explain why its NRW percentages rose to 67 percent in 2000, from 57.4 percent in 1997. Had Maynilad seriously addressed the factors that are largely causing its high NRW- pilferage and billing problems - it would have significantly reduced business losses from 1997-2000. In Maynilad's revised rehabilitation plan (September 2004), the company admits that a one percent reduction in its NRW is equivalent to a 2 to 3 percent increase in its revenues.

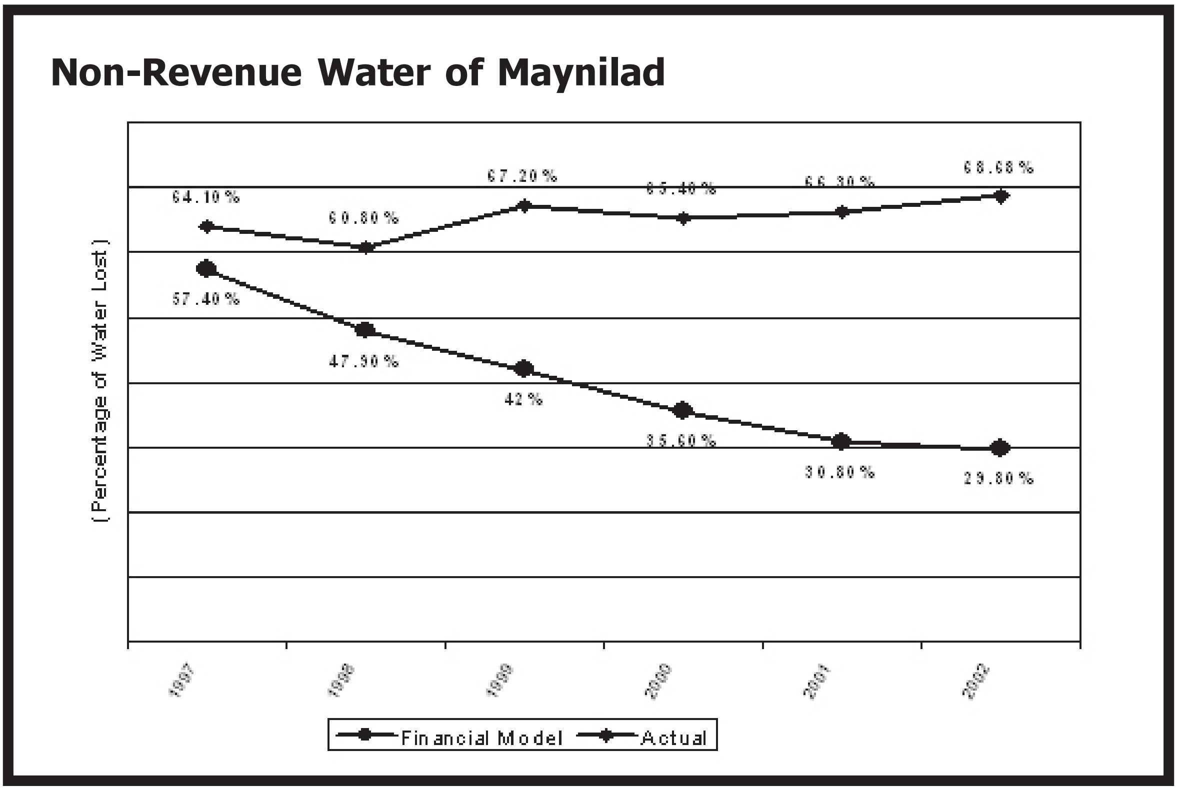
With private business at the helm of Metro Manila's water facility, the need for cost-cutting measures to ensure profit eventually wins out over public health and sanitation concerns. In October 2003, around 600 residents of poor communities in the Maynilad concession area fell ill from gastro-intestinal diseases; six eventually died. A laboratory examination performed at FDC's request by the University of the Philippines Natural Sciences

Research Institute showed Maynilad's water as contaminated with E. coli bacteria, at 16 per 100 ml of water or more than 700 percent the national standard of 2.2 per 100 ml of water.

Maynilad dodged accountability for having failed to bring the West Zone up to safe standards, such as maintaining water pressure in their pipelines to guard against the ingress of contaminated water. Instead, Maynilad president Rafael Alunan III blamed residents for their illegal connections and unsanitary lifestyle. President Arroyo herself had no stand on the matter but passed on the task of investigating the outbreak to local health officials who ended up echoing Maynilad's position.

Problems with expansion of service and access

The MWSS prides itself with the continued use of the "rising block tariff structure" whereby water charges are increased as a consumer's level or block of



consumption rises. Supposedly, this would ensure the affordability of fulfilling basic water needs, while providing a strong incentive to conserve water as high water consumption brings high water charges.

The actual application of the progressive tariff structure means the first 10 cubic meters consumed will be charged at a much lower, subsidized rate. The first 10 cubic meters is the lifeline level, hence the most heavily subsidized. Every 10-cubicmeter increase in water consumption will push the water rates upward. Because of this scheme, heavy water users like commercial and industrial costumers subsidize ordinary households.[21] This all appears to be very progressive on paper, but in a situation where the majority is not connected to the piped network, only those with water connections can avail of whatever benefits this rate structure promises.

Others make a similar comment: "The increasing block tariff structure is designed to benefit the poor but probably fails to do so, one reason being that low-priced blocks only benefit households that have individual connections. Many of Manila's poorest residents rely on standposts and vended water, where high levels of consumption push prices to the high end of the block structure. Also, the initial block of $10m^3$ per month is higher than typical usage of very poor households, which is thought to be about $6m^3$. Since all customers are subject to a minimum charge for the entire first block, this effectively doubles the unit price of water for the poor relative to better off households that consume $12m^3$."[22]

Meanwhile, connection charges remain prohibitive for large numbers of poor households. The connection charge for residential connection or reconnection to a water main or public sewer located within 25 meters from the connection point was pegged at PhP4,246.67 in

21 *Water Rates Shrugged (A Briefing Paper on Water Rates).* Freedom from Debt Coalition, 2002.

22 Shane Rosenthal. *The Design of the Manila Concessions and Implications for the Poor. Conference Background Paper: Infrastructure Development - Private Solutions for the Poor,* The Asian Perspective. Yale University, October 2002.

2003, up from PhP3,722.07 in 2000[23]. The Concession Agreement provides for the automatic increase by the percentage change in the Consumer Price Index of the preceding year. Even on an installment basis, connection fees are still far from the reach of many poor families and the PhP300/day minimum wage earner.

A continuing disincentive is the poor quality of water and service itself (e.g., intermittent water supply, heavily silted water, etc.) being experienced by Maynilad and Manila Water customers. Minimum standards clearly state that the quality of water should conform to the Philippine National Drinking Water Standards (relaxation of standards at the discretion of the RO is limited only to one year). This has not been realized, as evidenced by the outbreak of gastro-intestinal diseases in the West Zone in 2003. Consumers with already limited incomes are forced to buy bottled water or spend more on fuel costs from constantly boiling supposedly safe piped water.

Aside from cash flow problems, another constraint for poor communities is the issue of land tenure. Without land titles, there is great uncertainty about the possibility of long-term occupancy and consequently, reluctance about making fixed investments such as having connections installed. On the part of the concessionaires, possible billing problems represent higher business risk and there is consequently no compelling pressure for them to sink investments into these areas.

Thus, financially unable to connect to the piped water system, poor communities who actually use less water than the more affluent, continue to access water in ways that turn out to be more expensive in terms of actual payments made, as well as increased health and sanitation risks caused by low quality water. As of 2001, as much as 30 percent of Metro Manila was estimated to still depend for their potable water needs on more

23 Automatically increased by the percentage change in the Consumer Price Index of the preceding year.

expensive small-scale independent providers. This is far below the concessionaires' 2001 coverage target of 77 percent and 87 percent for the East and West Zones, respectively.[24]

In slum communities, people lining up for hours at a public tap or buying water from mobile water truckers or mobile suppliers using carts, pedicabs or small tankers is a common occurrence. These small water resellers are neither bound by the water quality standards of the Concession Agreement nor the official tariff structure, and can therefore charge any amount that the market will tolerate.

A study prepared in part by the Water and Sanitation Program of the World Bank came to the same conclusion that households outside the piped water network are poorer than those who are connected. They also tended to use a smaller volume of water and yet pay more, the average cost per cubic meter being nine times higher than those with access. Non-piped water turns out more expensive because of the many intermediaries involved and the modestly-sized customer base.[25]

Another study of communities in the West Zone found out that households pay as much as PhP160 for a 2-cubic meter tank and PhP25 for a .2-cubic meter drum. These rates greatly vary though, and could even be higher depending on the water source of the bulk water provider. Others reported that resold utility water in the West Zone fetches as high as PhP264/m^3 while water from deep wells average PhP132/m^3.[26]

The Concession Agreement allows the concessionaires to make sufficient connections to allow for third-party provision, meaning that concessionaires may

24 Concession Agreement, Water Supply Coverage Targets in the Service Area West and East Zones

25 *How Effective are Small-Scale Independent Providers in Serving the Poor? Experience from the Philippines.* Field Note prepared by the Water and Sanitation Program (World Bank) with its partners, the Department of the Interior and Local Government and the Australian Agency for International Development, August 2003.

26 Rivera Jr., Virgilio C. *Water Services and the Urban Poor: Strategies and Institutional Responsibilities.* A PowerPoint presentation prepared by Manila Water Company Inc. and discussed at the workshop on "Water Services and the Urban Poor: The Power of Policies and Regulation," Sept. 25-26, 2003, ADB Headquarters, Manila, Philippines.

grant licenses to a third-party to operate in its service area. Bulk water sellers have indeed been engaged to help Maynilad and Manila Water achieve coverage targets - but these targets may actually not be reflective of actual need. "Coverage targets", according to the Concession Agreement excludes "…users who obtain water from a legal source other than the MWSS system…" or those "who are connected to a *piped source* of water other than from the MWSS system". This comprises a significant number of people excluded from the concessionaires' targeted service, if one takes into account a 1992 study of the Japan International Cooperation Agency estimating that 40 percent of total water use comes from groundwater, through deepwells and 80 percent of industrial water use is supplied by privately owned waterworks.[27]

Increasing threats to the sustainability of freshwater resources - among them, the increasingly depletion of groundwater due to widespread and unregulated abstraction - numbered among the very reasons for the MWSS privatization. Yet, not only does the Concession Agreement fail to address this; it further adds to the pressure on precarious water resources by freeing the concessionaires from the need to supply MWSS water to the many households and commercial/industrial users dependent on groundwater for their needs.

Meanwhile, concessionaires have been given another profit-generating window by the situation where large numbers of people are not directly connected to the piped grid network and depend on other sources. Through resellers of utility water, Manila

27 Concession Agreement, Schedule of Coverage Targets; David, Cristina C. *MWSS Privatization: Implications on the Price of Water, the Poor and the Environment.*

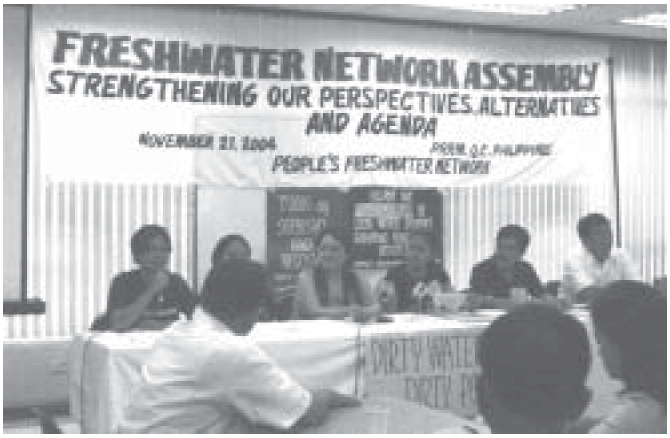
Water for example earns from charging homeowners' associations, community groups, groups of households, etc., the highest block rate in the residential tariff schedule, which is about three times the lowest block rate. This is because bulk water comes with heavily shared connections, such that higher levels of utility water used translates to cumulatively higher rates per cubic meter that are divided among three-five households. The same is true for whole communities connected to mother meters constructed and supplied with utility water by the concessionaires. In effect, the concessionaires have found a means "…to profit from a segment of the market that is otherwise loss-making"[28].

Whether the concessionaires' highly publicized community programs are indeed making headway remains to be validated by independent groups. Perhaps more revealing is a survey conducted by the MWSS-RO and the World Bank in 2000, called the Public Assessment of Water Services (PAWS) Project, where 67 percent of the 10,000 household respondents said that water services did not improve or became worse since privatization. The same survey registered poor rating for quality of service in more than 50 percent of the communities surveyed.[29]

The "public utility" issue: more tax breaks, unlimited returns for concessionaires[30]

Both Manila Water and Maynilad concessionaires are currently enjoying tax holidays and will only begin remitting taxes to government in 2006 and 2007, respectively. Nonetheless, payments for tax remittances are already being collected from consumers as these are already factored in when determining water rates. A Supreme Court decision in early 2004 against public utilities charging their

28Shane Rosenthal. *The Design of the Manila Concessions and Implications for the Poor.*
29PAWS brochure, MWSS Regulatory Office
30Section culled from "Are the MWSS Concessionaires Public Utilities? Summary of arguments of the MWSS, Manila Water, Maynilad and the MWSS-Regulatory Office". Draft prepared by the Freedom from Debt Coalition, Sept. 23, 2004.



income tax payments[31] to consumers would have provided relief to taxpayers but this was not to be the case. Instead government and the concessionaires became embroiled in the various ways interpreting what "public utility" means, with the concessionaires eventually emerging triumphant from the debate.

Both Maynilad and Manila Water disagreed with the MWSS-RO that a Ground for Extraordinary Price Adjustment (GEA) had occurred, even as any change in law or government policy constituted one of 11 grounds for the adjustment of tariffs, whether upwards or downwards. Maynilad averred that the Supreme Court (SC) decision on the Meralco case does not apply to the concessionaires. It insisted, among others, that the SC ruling to treat income tax payments as non-deductible expenses referred to "a mere 'change' from the previous rulings of the defunct Energy Regulatory Board (now the Energy Regulatory Commission) which has no bearing upon the regulation of water rates of the concessionaires…" and that this "cannot operate to automatically undo the agreed method of computing the rate of return under the Concession Agreement."

In the SC decision, the high court also stressed an existing law setting a maximum of 12 percent rate of return of the book value of public utilities' assets. This limit is similarly stated in Section 12 of the MWSS Charter: "the rates and fees fixed by the Board of Trustees for the System and by the local governments for the

31 In April 2003, the Supreme Court denied with finality the Manila Electric Company's (Meralco) motion for reconsideration of the Nov. 15, 2002 refund decision, in favor of the firm's three million customers. It ordered Meralco to refund more than PhP28 billion in overcharges to its customers since 1994. Meralco is another Lopez-controlled firm.

local systems shall be of such magnitude that the System's rate of net return shall not exceed twelve per centum (12 percent) on a rate base composed of the sum of its assets in operation as revalued from time to time plus two months' operating capital."

This held significant implications for Manila Water. A report of the Commission on Audit (COA) regarding Manila Water's 1999 operations revealed that the concessionaire's actual rate of return for said year reached 40.92 percent, or 28.92 percent higher than the allowable 12 percent. This translates to profits amounting to about PhP281 million.[32] Manila Water subsequently challenged the COA report, saying that it is not a public utility but merely an "agent and contractor" of the MWSS.

Asked for clarification, the Office of the Government Corporate Counsel (OGCC) had the opinion that: "while it is true that no public funds are involved, the business of the concessionaires is imbued with public interest and it is for this reason why the COA intervention is mandated by law." It also emphasized: "That water supply and distribution is classified as a public utility cannot be more apparent."[33]

As well, both Philippine and US Supreme Courts decisions pertaining to public utilities raised the following[34]:

a. the criterion by which to judge of the character of the use is whether the public may enjoy it by right or only by permission

b. the essential feature of the public use is that it is not confined to privileged individuals but is open to the indefinite public

c. the use is public if all persons have the right to the use under the same circumstances.

"It is beyond question that Manila Water is a public utility since the statutory provision that one who operates a water supply and/or sewerage services is one

32*As computed by the MWSS Regulatory Office*

33OGCC Opinion No. 125, June 22, 2000-letter of the OGCC to RO Chief Regulator Fernando Z. Vicente, re: Interpretation of the Rate Audit Provisions of the concession Agreement between MWSS and its two (2) Concessionaires.

34Cited by the MWSS-RO Legal Affairs Department.

engaged in public service is squarely met," the MWSS-RO concluded.

A Technical Working Group (TWG) composed of representatives from the MWSS-RO, Maynilad and Manila Water was formed to avoid costly arbitration. Predictably, after consulting with the framers[35] of the Concession Agreement, the TWG concluded that the framers never considered the concessionaires as public utilities. The Board and the RO later adopted the TWG opinion, abandoning their earlier positions

35 The Technical Working Group relied primarily on the opinion of Dr. Angel Lazaro III, former MWSS Chief Administrator; Gregorio Vigilar, Secretary of the Department of Public Works and Highways (Ramos administration); Mark Dumol, Vigilar's Chief of Staff; and Atty. Eusebio Tan, legal adviser to MWSS and IFC during the MWSS privatization process.

MWSI Profits/Losses

Year	Financial Model Amount (in million dollars)	Actual (Based on audited financial statements)
1997	(467)	(208)
1998	(54)	(781)
1999	373	(698)
2000	604	(2441)
2001	477	(1037)

Source: MWSS Regulatory Office

MWCI Profits/Losses

Year	Financial Model Amount (in million dollars)	Actual (Based on audited financial statements)
1997	(111)	(38)
1998	(26)	(67)
1999	228	101
2000	189	123
2001	220	176

Source: MWSS Regulatory Office

and upholding the concessionaires' view that income tax payments are part of business expenditures and could thus be recovered from consumers. The resolution also means that since the MWSS concessionaires are now considered merely as "agents and contractors" of the MWSS, they are not covered by the law setting a ceiling of 12 percent on the return on rate base of public utilities.

In the course of the public utility debate, FDC found out that through Contract Amendment 2 (the Maynilad Quasi-Reorganization Plan; further discussion on this below), Maynilad also attempted to shortchange government of millions in capital gains and documentary stamps taxes. Had Amendment 2 pushed through, equity shares would have transferred from Maynilad to said parties without the company having to shell out the required capital gains or donor and documentary stamp taxes that go with a normal turnover of stocks either through sale or donation. At the minimum, capital gains tax of 10 percent of the paid up capital of PhP5.2 billion translates to PhP5.25 million plus the documentary stamp of PhP39 million. Maynilad would have been in violation of the Corporation Code of the

Philippines - an act of tax evasion, with the complicity of the MWSS Board, which already approved Amendment 2 early on.[36]

Transparency, accountability and regulation (or the lack thereof)

The MWSS-RO's regulatory tasks are confined to monitoring the implementation of the contract and drafting recommendations when it comes to water tariff setting. Only the MWSS Board - whose members are all presidential appointees -- can decisively set the tariff. The RO budget and the hiring of personnel are also subject to BOT approval.

Created pursuant to provisions of the Concession Agreement and placed under the jurisdiction of the presidential appointees comprising the MWSS Board, one wonders whether the MWSS-RO even deserves the name of its office. Former MWSS Administrator Dr. Angel L. Lazaro himself is of the opinion that the RO enjoys independence only insofar as the MWSS Board would allow it, as "Interim regulatory bodies [are] under control and supervision of [the] government entity, which is also the contracting party."[37]

Interestingly, the MWSS-RO shares the same roof with the offices of the concessionaires, despite the contract stipulation against such an arrangement. Also in the same building is the OGCC, who acts as MWSS' lawyer and whose head is an ex-oficio member of the MWSS-BOT. The conflict of interest represented by all these arrangements is immediately apparent.

Yet, however limited its functions are, the MWSS-RO has shown that it cannot even keep faith with its mandate and can easily fall prey to political meddling. The events leading to the approval of Amendment 1 could very well portray regulatory capture, where no less

36 *"Making Heads and Tails of the MWSS-Maynilad Compromise Deal".* Freedom from Debt Coalition, May 2004.

37 *Water Sector Regulation in the Philippines.* A PowerPoint presentation by former MWSS administrator Angel L. Lazaro, Ph.D.).

than the Chief Regulator of the very entity tasked to monitor faithful compliance with the Concession Agreement - unashamedly played a significant role in changing the rules while the game was already in progress. It eventually became known that the Chief Regulator was party to the withdrawal of the petition challenging the authority and jurisdiction of the arbitration panel to award Manila Water a new ADR.

With no basis at all in the Concession Agreement, the auto-CERA proposal of Maynilad was hard put getting the approval of then newly installed President Arroyo. Other well-placed interest groups apparently aligned with Maynilad's interests decided to circumvent the contract-defined processes for EPA applications. One such group was the cabinet cluster on social services, which counted among its members the Public Works and Highways secretary who is also the ex-oficio chair of the MWSS Board. From efforts at this level, a Memorandum of Cooperation (MoC) that practically echoed Maynilad's original auto-CERA proposal, was hatched.

Two of the five regulators composing the MWSS-RO refused to go along with the MoC. One of them was MWSS Deputy Affairs Administrator and Legal Affairs Division Chief Atty. Virgilio Ocaya, who wrote in reference to the outright support of the Chief Regulator for Maynilad's proposals: "A few millions in grease money for a corrupt director could be considered a justified expense by a Concessionaire and its stakeholders…" He also reported that Tantiongco issued orders transferring to his office, personnel of Administration and Legal Affairs and the Financial Regulation Areas "…at a time when negotiations between the MWSS and one of the Concessionaires for the Auto-CERA were at a feverish pitch. As a result, the capability…to effect a healthy check and balance environment at the RO was severely curtailed, if not eliminated…."[38]

38Statement circulated by Atty. Virgilio Ocaya on July 21, 2001 in response to his detractors.

In the face of increasing privatization and restructuring, various institutions including the World Bank, have stressed the importance of well-designed regulatory systems "Regulation can help protect consumers, workers and the environment. It can foster competition and innovation while constraining the use of monopoly power ... Making the best use of the new options emerging for private provision of infrastructure and social services will also rely, often, on a good regulatory framework".[39]

A continuing tradition of subsidizing private business risks

At no point (at least to public knowledge), has government through the MWSS Board challenged the faulty assumptions and projections of the concessionaires, nor pressed them for their own acts of inefficiency and mismanagement.

Actual billed water volumes and revenues of Manila Water from 1997 to 2000 fell short of projections by PhP P586 million or 12 percent below expectations. IFC's consultants knew but chose to ignore the firm's unrealistic targets for reducing non-revenue water and generating revenues. These included demand projections that were 45 percent higher than what earlier studies indicated and overly optimistic targets of halving NRW within five years. Despite the huge capital investment that the latter target would have required, Manila Water risked losing US$1 billion on its major waterworks contract.[40]

It should be recalled that in 2001, government simply accepted Maynilad's only argument for its heavy foreign exchange losses: the Asian financial crisis. The firm was never put to task for overestimating revenues, underestimating costs and failing to cushion itself for some fall in the dollar-peso exchange rate, considering the events brewing in

39 Tripartite Meeting on Managing the Privatization and Restructuring of Public Utilities, Report for discussion at the Tri-partite Meeting on Managing the Privatization and Restructuring of Public Utilities. Geneva, 12-16 April 1999. International Labour Office, Geneva.

40 "Metro water deal: Ayala says it won't lose." *Philippine Daily Inquirer,* January 31, 1997.

the region. Maynilad instead got a quick and ill-deserved breather from the AEPA, skirting contract provisions that unexpected foreign exchange losses be collected (with interest) from consumers on a staggered basis, over the life of the contract.

Expenditures soared beyond what had been projected in its financial model. Actual operating expenses came to PhP2.88 million more than what was projected while actual operating revenues fell short of the target by PhP4.89 million. Maynilad should have been gaining profits starting 1999, but it was actually losing, and losing heavily. The following year it should have earned US$604 million but lost US$2.4 billion.[41]

Its credit-worthiness also came into question by prospective lenders (a group of banks led by the ADB) who withheld approval of a US$350-million loan needed for capital investments targeted in the first five years of the agreement. This was made contingent on MWSS' setting of a new rate increase.

One explanation surfaces in the high costs of production and operations from the dollar-denominated expenses for foreign consultants and management contracts. A consultancy report from Thames Water revealed that Maynilad allocated 60 percent of its capital expenditures to paying for consultancy fees of its affiliate companies such as First Philippine Balfour Beatty and Meralco Industrial Engineering Services Corp.[42]

More basic errors have emerged. Maynilad has admitted that it miscalculated the length of water pipes in the West Zone by 1,200 kilometers; this turned out to be 3,700 kilometers instead of the MWSS estimate of 2,500 kilometers. This could have been avoided had Maynilad done its homework before making its bid and winning the concession.

Having won the bid, FDC argued, why should Maynilad be extended the privilege to recover what had been either deliberately or neglectfully understated? "Besides, the Concession Agreement clearly states that any

41Figures of the MWSS-RO.

42*Baring Maynilad's Corporate Mismanagement.* Position paper of the Freedom from Debt Coalition, May 6, 2004.

mistake in the financial model are for the account of the concessionaire concerned…. Granting that Maynilad could not have fully anticipated the peso devaluation and therefore could not be made to fully account for this, it still cannot be denied that many of Maynilad's problems were created by its own management and business decisions."[43]

The consistent accommodation of the concessionaires' demands (including those intended to make up for revenues lost because of their own bad business decisions) defines the kind of operations Maynilad and Manila Water enjoy - practically risk-free business. The two concessionaires exploit a situation where, due to the crucial health and social issues at stake, government is likely to subsidize the costs arising from their decisions. Eventually, this leads to more inefficiencies because what should have been the incentives for avoiding them in the first place - reduction of costs and increase of revenues - hardly exists anymore. By government or the MWSS Board's actions, it acts as insurer as well, absolving the concessionaires of the consequences of their action (or inaction).

Near-bailout: Contract Amendment 2

The granting of the corporate rehabilitation petition led the MWSS to seek in December 2003, a ruling from the Supreme Court on the issue of collecting concession fees through forfeiture of Maynilad's US$120 million performance bond. However, in January 2004, while waiting for the Supreme Court's

43 *PAID!* Official publication of the Freedom from Debt Coalition, November 2001.

decision, MWSS and Maynilad issued a joint statement saying that they were looking for an "amicable settlement" that would benefit both parties. Raising the specter of water stoppages, MWSS claimed it wanted to settle the issue in the soonest possible time to avoid service interruptions in the West Zone.

The results of the unpublicized negotiations between the MWSS and Maynilad only reached the public in March 2004 when Contract Amendment 2 was announced. This debt-to-equity scheme aimed for the "…financial recovery of concession fees and [preservation] of the national privatization policy". It proposed that a portion of Maynilad's outstanding liabilities to MWSS in concession fees amounting to PhP5.247 billion are converted into equity for MWSS. This meant that MWSS would be buying 63 percent of Maynilad shares at PhP100 premium over its par value of PhP100/share. The MWSS, it seemed, would be buying non-existing stocks (Maynilad was already bankrupt!) at double its price!

The Quasi-Reorganization Plan also provides for the conversion of Maynilad's debts to Suez (PhP1.583 billion) into shares of stocks for Suez; and further, Maynilad's debts of PhP167 million to Benpres into shares of stocks for Benpres."[44]

The Arroyo government referred to the debt-equity swap as indicative of a "new set-up", and practically, of government's takeover of the concession. This was hardly the case, considering that there was no more Maynilad equity to talk about since the company was already bankrupt.

Further, Amendment 2 explicitly states that "MWSS shall not participate in decisions relating to the running of the business of the Concessionaire and shall not directly manage or make management decisions which shall be the function of the named representative in the Board of Directors of the Concessionaire as designated by the Development Bank of the Philippines in consultation with the Department of Finance"[45].

44Maynilad Quasi-Reorganization Plan.
45Ibid.

The planned conversion of Maynilad's debt to government equity in the ailing firm would only have saved Maynilad from paying its concession fees and shifted to government the burden of paying for the company's remaining PhP12 billion obligations to its creditors.

Amendment 2 also contained clearly anti-consumer elements. For one, it would have authorized Maynilad to implement the Rate Rebasing adjustment of PhP26.34/m^3 as decided by the RO in December 2002. It would also have freed Maynilad from reimbursing the overcharges collected over more than a year through the FCDA and the AEPA by setting these off the potential collections using the Special Transitory Mechanism, to cover Maynilad's alleged "still unrecovered" foreign exchange losses. Further, if these potential collections proved insufficient, Maynilad could apply for a new round of tariff hikes.

The proposed contract amendment was simply silent as to who bears responsibility for paying up to US$140 million in new MWSS loans, which were incurred to cover maturing obligations, when Maynilad decided to stop paying concession fees.

In June 2004, the Supreme Court ruled in favor of MWSS, giving the go-ahead for the agency to draw on Maynilad's performance bond. Since this nullified MWSS' reasons for implementing Amendment 2, it withdrew concurrence a month later. Despite the Supreme Court decision, however, the MWSS did not draw on the performance bond, which had been provided for in the Concession Agreement, specifically for the purpose of protecting the public interest in the event that a concessionaire reneged on its obligations. Inexplicably, the MWSS seemed more inclined to buy shares in a bankrupt firm than availing of the US$120 million bond.

Three months later, Maynilad came up with a revised rehabilitation plan notable for releasing the company from immediately addressing its obligations and giving it far easier conditions to fulfill. The rehabilitation scheme, for example, allows the company staggered payment of its

outstanding and future concession fees up to year 2008, at a time when the government is in a fiscal crisis. Similar to what was contained in Amendment 2, customers will no longer be reimbursed of the AEPA collected since October 2001 nor the FCDA collected since 2002. The scheme also involves the reduction of expansion and water supply targets, allowing the company to prioritize "opportunity areas" (meaning, profitable), which will mean further delays in the delivery of piped water services to many urban poor communities. Other details of the rehabilitation plan are as follows:

- only 80 percent of the PhP8.538 billion that Maynilad owed the government as of end-2003 will be paid upfront
- only fractions of concession fees due and demandable for 2004 up to 2007 will be paid on time-
  - 50 percent in 2004
  - 65 percent in 2005
  - 70 percent in 2006
  - 70 percent in 2007
- accrued and accruing concession fees will be paid on a staggered basis
  - The balance of 2001-2003 concession fees that cannot be covered by the bond will be paid by Maynilad on a staggered basis from 2008-2010
  - Payments for 2004-2007 concession fees will also be made on a staggered basis

A highly troubling part of the revised plan is the proposal to convert at least US$60 million of Maynilad's debts into equity for its bank-creditors, thus granting Maynilad's French partner (Suez) and foreign creditors 84 percent equity in the company. This would be in violation of the constitutional provision that companies operating vital public utilities should have a Filipino/foreign ownership ratio of 60:40. Reports received by FDC reveal that MWSS plans to go around this legal impediment by using US$60 million of what it will collect from Maynilad's performance bond to buy 71 percent equity in the bankrupt company. (Suez will then retain a portion of its current shares and will remain in the joint venture.) By MWSS' own admission, this move will create a negative balance of PhP130.63 million for the agency in 2006.

Towards the end of 2004, the public again witnessed their interests being swept aside in favor of the concessionaires. First, the local court approved in September 2004 Maynilad's petition containing the third version of its rehabilitation plan, thus paving the way for a new round of tariff hikes in 2005. Second, the public was deceived into participating in a so-called "presentation and discussion" of Maynilad's rehabilitation plan on Dec. 14, 2004 that turned out to be an attempt to conduct a "public consultation" on new water tariff rates amounting to PhP30.19/m^3. (based on 2002 rate rebasing plus Consumer Price Index adjustments). This redounds to a 51.6 percent increase from the current average of PhP19.92/m^3, or a more than 500 percent rise from its original bid of PhP4.96/m^3. in 1997.

Nevertheless, had the meeting focused on the rehabilitation scheme, this would have been rendered moot and academic, as Maynilad's petition for corporate rehabilitation had already been approved by the local court. This approval came amid questions raised by NGOs, people's organizations and individual petitioners challenging the rehabilitation court's jurisdiction over matters of approving water rates increases. No explanation has been given to the public why MWSS is allowing Maynilad to implement the water tariff determined during the rate review process conducted in 2002, considering that the company has not delivered the corresponding obligations, such as payment of concession fees and improvement/expansion of water services.

Conclusion

For the Philippine government to admit the serious flaws of the MWSS privatization deal would be tantamount to making a strong political statement on the failure of water privatization. It is, after all, the largest water privatization undertaking of its kind in the region and the world, designed no less by expert consultants of the World Bank and held up as an example for others to emulate. But the MWSS privatization has turned into just that - a failed undertaking that is privileging private enterprise at the expense of millions of consumers.

Critics have warned how transparency, accountability and public participation -- critical elements in safeguarding public interest -- are compromised by privatization. Increasingly, the MWSS privatization experience is proving them right. These elements have not only been compromised but have been grossly lacking in the MWSS privatization, from the moment of its inception to the way it is unfolding today. Relying only on sketchy news reports, the public has had practically no opportunity to make informed positions and decisions vis-à-vis a resource as critical to their lives as the supply and access to potable water.

This is hardly surprising, considering a situation where a government (through the MWSS

and its Regulatory Office) which has unfailingly shown its vulnerability to elite economic interests and political pressure is also one of the contracting parties in the Concession Agreement.

In contrast to its disregard for consumers' interests, the MWSS has consistently been compliant to the concessionaires' demands, and has even bailed Maynilad twice, saving it from its own business and management failings. It cannot even exercise its own rights under the Concession Agreement (such as declaring a Concessionaire Event of Termination or drawing from the performance bond) in holding the concessionaires accountable for their unfulfilled commitments and obligations. Independent and tight regulation functions are practically absent, with the Regulatory Office itself under the jurisdiction of a politically appointed MWSS Board.

When Maynilad and Manila Water won their concessions, they promised a range of benefits that included the lowering of tariffs for good quality water and uninterrupted water supply. These have not been met, along with other commitments to increased capital expenditures and investments in new infrastructure.

Burdens have instead been unfairly passed on to consumers and taxpayers who bear continuously rising water rates and additional debt burdens, even as water service and quality have not significantly improved. Coverage targets remain dismally unfulfilled, as shown by significant numbers who are still unconnected to the piped grid system and are forced to access much higher priced and low quality water.

Further, consumers under the privatized setup pay not only for the cost of water provision but also the cost of capital borrowed by the concessionaires to provide this service. Government itself could have borrowed and provided this service, at lower interest rates because of the smaller risk of lending to governments as compared to the private sector.

Private business cannot be held accountable by people in the same way that a government can. This holds dangerous implications considering that private business neither has the motivation nor the mandate to ensure democratic access to clean, safe and affordable water, regardless of people's capacity to pay. From where it stands, adequate and affordable delivery of basic water service can happen only with cost recovery. The Manila privatization experience shows as much: a cautionary tale that where water services hinge on profit making, the basic right to water of all individuals, particularly the poor, will always be at risk.

The Freedom from Debt Coalition's Campaign to Stop Water Privatization in the Philippines

In 1997, the Freedom from Debt Coalition (FDC) began research on water privatization, as part of its campaign on debt and the attendant loan conditionalities prescribed by institutions such as the International Monetary Fund and the World Bank. At that time, the MWSS privatization was already underway. The succeeding years would see the Coalition steadily sharpening its critique and analysis on water privatization, enabling it over time to mount informed and timely interventions in the face of ever-increasing threats posed by big business interests to the Filipino people's basic right to safe, adequate and affordable water.

The Coalition strengthened its opposition to the privatized setup and raised the call for the reversal of the MWSS privatization, starting with the termination of the concession contract of Maynilad Water Services Inc. for the company's gross inefficiencies and sheer failure to provide consumers with decent water and sanitation services. This developed as government frequently took the side of the private water firms, despite their continued escalation of tariffs and unmet commitments to improved and expanded service. When Maynilad filed for early contract termination in December 2002, FDC intensified its campaign to demand that the operations and management of the West Zone concession revert back to public fold.

Holding government accountable for putting the people's right to water on the line while bailing out the concessionaires from their self-inflicted business failings has been a critical campaign platform. The task is three-pronged-engaging and confronting the government and the private sector, in defense of public interest and the basic right to water access; enriching further the Coalition's framework and alternatives; and deepening the understanding of the public on water issues. FDC works on all these parallel tracks through numerous activities that include research and popular education work in communities, parishes, schools, etc., networking and alliance-building, lobbying and organizing popular mobilizations.

In the absence of a strong regulatory regime and under a government that has proven permeable to big business interests, FDC's interventions have significantly contributed to protecting public interest. It disclosed Maynilad's overcharging through the unauthorized implementation of cost escalation mechanisms. It also exposed Maynilad's coliform-contaminated water and rallied the public to hold the company culpable for a cholera outbreak in its concession area.

Only in 2004, the Coalition led in the formation of the *Progresibong Alyansa ng mga Tagatangkilik ng Tubig sa Kamaynilaan* (*PATTAK,* Progressive Alliance of Water Consumers in Metro Manila). PATTAK is gaining ground and taking shape as a grassroots-based consumer movement primarily aimed at improving water and sanitation services, indemnifying the more than 600 cholera victims and advancing the campaign for the reversal of the MWSS privatization.

Also in the last two years, FDC has broadened its efforts to include issues of water privatization outside of Metro Manila. For instance, in Central Luzon, consumers under the privatized water setup of the Subic Freeport have been mounting opposition to tariff hikes that reached 465 percent from 1996-2001. In another part of the country, on the island of Cebu, residents have to use a prepaid water system installed by the US-based WorldWater (Philippines) to access drinking water, priced at a staggering PhP150 (more than US$2.50) per cubic meter of water. More information have been collected from the completed baseline researches on World Bank-funded local privatization initiatives by the Coalition's six chapters in the Visayas region and Mindanao.

To date, the Coalition is in the process of advancing a comprehensive framework on freshwater that links the campaign for the reversal of the MWSS privatization to the wider range of perspectives and advocacies on the entire potable water sector. This allows for stronger unities in the wake of the global trend led by international financial institutions to privatize water resources and services, and the aggressive moves of giant water firms to take advantage of an increasingly scarce and critical resource. This enables as well greater synergies across sectors, organizations and campaigns on water as a human right, a public good and an ecological resource; water use rights; and in particular, water and its differential impacts on women.

In line with these, the Coalition successfully held in 2004 the groundbreaking Consultation on Local Water Issues and the National Conference on Freshwater, which paved the way for the formation of the People's Freshwater Network (Philippines). At its first assembly last November 2004, the Network drafted its agenda and plans on freshwater issues and concerns, taking another important step towards building a future where people's basic rights to water resources and water services are never sacrificed for private ends.

ANNEXES

Annex 1

MWCI Financial Model vis-à-vis Audited Financial Statement

MANILA WATER COMPANY INC. (MWCI)	FINANCIAL MODEL (In Million Pesos) Nominal prices	Actual based on AUDITED FINANCIAL STATEMENT (In Million Pesos)
NET PROFIT (LOSS)		
For the year 1997	(111)	(38)
For the year 1998	(26)	(67)
For the year 1999	228	101
For the year 2000	189	123
For the year 2001	220	176
OPERATING REVENUES		
For the year 1997	636	421
For the year 1998	1120	990
For the year 1999	1423	1310
For the year 2000	1627	1499
For the year 2001	1773	1659
Non-Revenue Water (%)		
For the year 1997	44%	45.2%
For the year 1998	31%	38.8%
For the year 1999	22%	39.8%
For the year 2000	17%	45%
For the year 2001	16%	48.28%
OPERATING EXPENSES (Cash Items)		
For the year 1997	738	453
For the year 1998	998	1016
For the year 1999	1029	1109
For the year 2000	1243	1176
For the year 2001	1292	1261
CONCESSION FEE PAYMENTS		

MANILA WATER COMPANY INC. (MWCI)	FINANCIAL MODEL (In Million Pesos) Nominal prices	Actual based on AUDITED FINANCIAL STATEMENT (In Million Pesos)
As of 1997	287	97
As of 1998	687	360
As of 1999	1048	591
As of 2000	1338	974
As of 2001	1578	1514
CAPITAL EXPENDITURE		
As of 1997	494	253
As of 1998	590	820
As of 1999	606	1098
As of 2000	1088	1341
As of 2001	2266	1678
LONG-TERM LIABILITIES		
As of 1997	492	254
As of 1998	406	129
As of 1999	428	876
As of 2000	374	1885
As of 2001	2002	2471
STOCKHOLDER'S EQUITY (Capital)		
As of 1997	1000	1000
As of 1998	2000	2000
As of 1999	2000	2000
As of 2000	2000	2000
As of 2001	2000	2000
*OE/OR 2000	76%	78%
2001	73%	76%

Conclusion: MWCI was able to get the loan proceeds more than what they have assumed in the Financial Model. The loan proceeds were mostly used in their Capital investments. Per closer perusal of CI's documents, they have been aggressive in their sewerage/sanitation investments as early as 1997 considering that in their Financial Model, sewerage/sanitation investments will start in 2005. MWCI was expecting the increase in sewerage and sanitation charges by 2003, the reason for their aggressiveness in sewerage/sanitation investments.

Source: MWSS Regulatory Office

Annex 2

MWSI Financial Model vis-à-vis Audited Financial Statement

MAYNILAD WATER COMPANY INC. (MWSI)	FINANCIAL MODEL (In Million Pesos) Nominal prices	Actual based on AUDITED FINANCIAL STATEMENT (In Million Pesos)
NET PROFIT (LOSS)		
For the year 1997	(467)	(208)
For the year 1998	(54)	(781)
For the year 1999	373	(698)
For the year 2000	604	(2441)
For the year 2001*	477	(1037)
OPERATING REVENUES		
For the year 1997	1316	751
For the year 1998	2651	1662
For the year 1999	3288	2379
For the year 2000	3861	2635
For the year 2001*	4368	2926
Non-Revenue Water (%)		
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%
OPERATING EXPENSES (Cash Items)**		
For the year 1997	1202	619
For the year 1998	1612	1650
For the year 1999	1555	2437
For the year 2000	1377	3923
For the year 2001*	1599	3963
CONCESSION FEE PAYMENTS		
As of 1997	862	866
As of 1998	2803	3131
As of 1999	4473	5109
As of 2000	5925	7192
As of 2001*	7961	9935

MANILA WATER COMPANY INC. (MWCI)	FINANCIAL MODEL (In Million Pesos) Nominal prices	Actual based on AUDITED FINANCIAL STATEMENT (In Million Pesos)
CAPITAL EXPENDITURES		
As of 1997	1344	176
As of 1998	3313	701
As of 1999	5194	1504
As of 2000	6050	2723
As of 2001*	8137	3856
LONG-TERM LIABILITIES		
As of 1997	157	584
As of 1998	3571	1229
As of 1999	6248	234
As of 2000	9205	415
As of 2001*	9354	864
STOCKHOLDER'S EQUITY (Capital)		
As of 1997	3000	1500
As of 1998	3000	3000
As of 1999	3000	4640
As of 2000	3000	5240
As of 2001*	3000	5240

*Based on Business Plan		
**OE/OR 2000	36%	108%
2001	36%	97%

Conclusion: MWSI was able to get the loan as projected in the Financial Model. Moreover, the loans, which they were able to get, are in the form of short term or bridge loan. It remains a question up to now why in the first place they were not able to get long term loan as assumed in their Financial Model. The deficit in Capital Expenditure maybe explained by the fact that instead of placing loan proceeds for capex investments, the same were used for payment of Concession Fees and Operations and other payables including payables to affiliates.

Source: MWSS Regulatory Office

Annex 3

Maynilad's Coverage Targets

City/ Municipality	2001	2006	2011	2016	2021
NCR					
Manila*	100	100	100	100	100
Pasay	100	100	100	100	100
Caloocan	100	100	100	100	100
Las Piñas	58	91	93	95	98
Malabon	84	100	100	100	100
Valenzuela	84	100	100	100	99
Muntinlupa	53	86	88	90	95
Navotas	92	100	100	100	100
Parañaque	76	100	100	100	100
Cavite					
Cavite City	100	100	100	100	100
Bacoor	58	90	92	93	95
Imus	36	61	63	65	72
Kawit	84	100	100	100	100
Noveleta	60	100	100	100	100
Rosario	42	90	90	90	90
TOTAL AREA**	**87**	**97**	**97**	**98**	**98**

* Expressed as a percentage of the total population city or municipality at the time of the target (excluding users who are connected to a piped source of water other the MWSS system)

** The Concessionaire (West) shall be responsible for meeting the new water supply coverage targets (but shall not the corresponding sewerage targets), in the percentages set out in the Table 5 as it appears in the Other Operator's (East) Concession Agreement, for parts of the following cities or municipalities in service area east: Quezon City, San Mateo, Makati, Marikina and Rodriguez.

Source: Concession Agreement

Annex 4

Manila Water's Coverage Targets

City/ Municipality	2001	2006	2011	2016	2021
NCR					
Mandaluyong	100	100	100	100	100
Makati**	92	100	100	100	100
Marikina**	92	100	100	100	100
Quezon City**	100	100	100	100	100
Pasig	92	100	100	100	100
Pateros	84	100	100	100	100
San Juan	96	100	100	100	100
Taguig	44	100	100	100	100
Rizal					
Angono	51	96	98	100	100
Antipolo	78	95	95	95	97
Baras	34	51	53	55	58
Binangonan	40	81	83	85	87
Cainta	64	80	77	75	79
Cardona	34	51	53	55	58
Jala-Jala	34	51	53	55	58
Morong	34	51	53	55	58
Pililla	34	51	53	55	58
Rodriguez	83	95	95	95	58
San Mateo	84	100	100	100	100
Tanay	39	75	75	75	76
Taytay	92	100	100	100	100
Teresa	52	60	60	60	61
TOTAL AREA* **	**77**	**94**	**94**	**94**	**95**

* Expressed as a percentage of the total population in the designated city of municipality at the time of the target (excluding users who are connected to a piped source of water other than from the MWSS system).
*** The Concessionaire (East) shall also be responsible for meeting the new water supply coverage targets (but not the corresponding sewerage targets) in the percentages set out in the Other Operator's (West).
** A portion of the municipality is covered by the West Zone.

Source: Concession Agreement

Annex 5

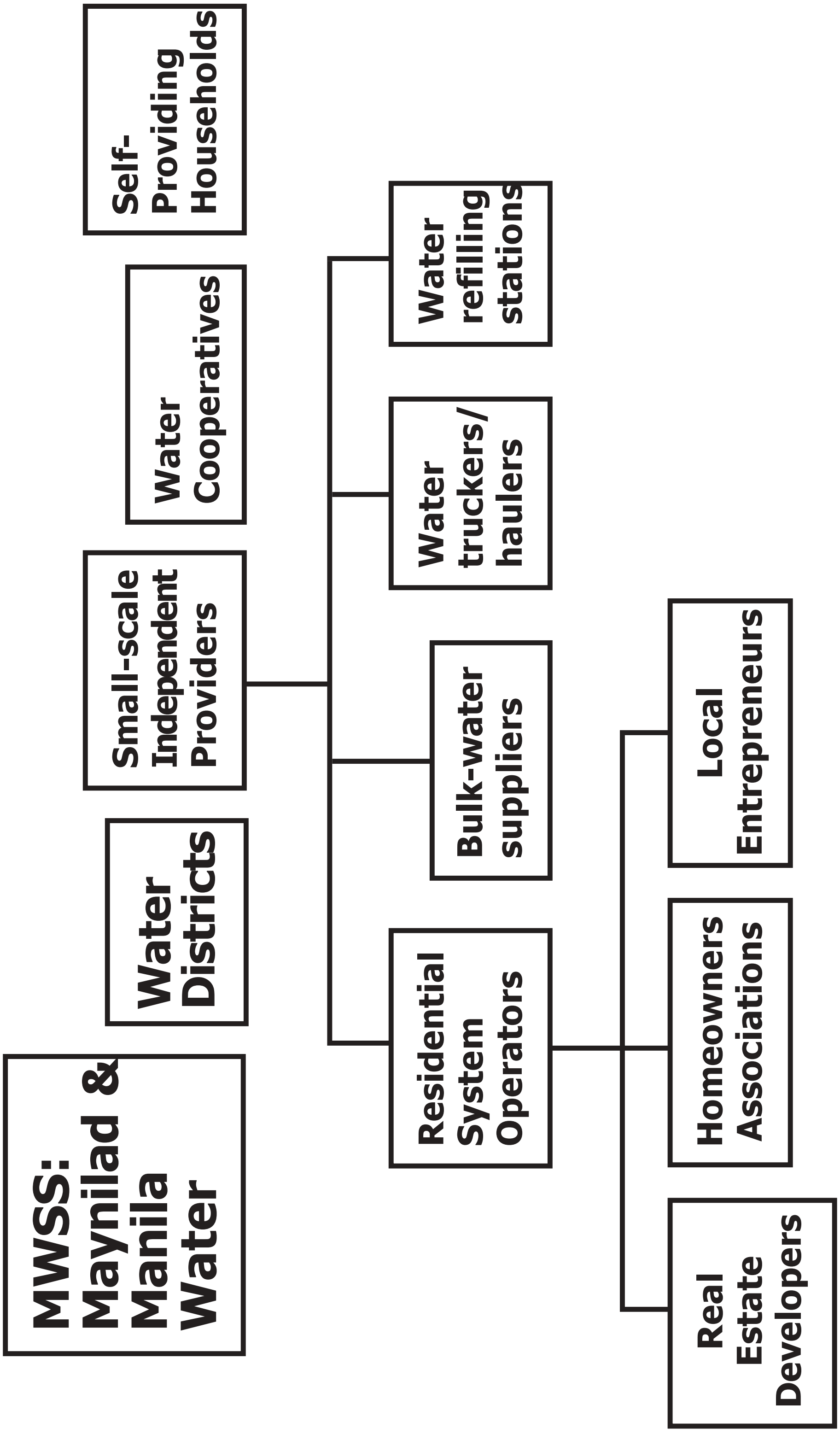
Summary of Concession Fee Payments– Debt Service Maynilad Water Services Inc. & Manila Water Company from August 1997 to December 31, 2004

YEAR	AMOUNT PAID	
	Manila Water	**Maynilad**
1997	85,388,554.48	824,786,303.92
1998	232,453,638.46	2,088,005.349.30
1999	208,938,062.16	1,862,926,475.95
2000	205,622,097.91	1,787,435,904.48
2001	212,100,586.74	342,709,173.83
2002	307,740,522.52	30,000,000.00
2003	378,023,891.88	-
2004	511,577,404.11	-
GRAND TOTAL	**2,141,844,758.26**	**6,935,863,207.48**

Source: MWSS Regulatory Office

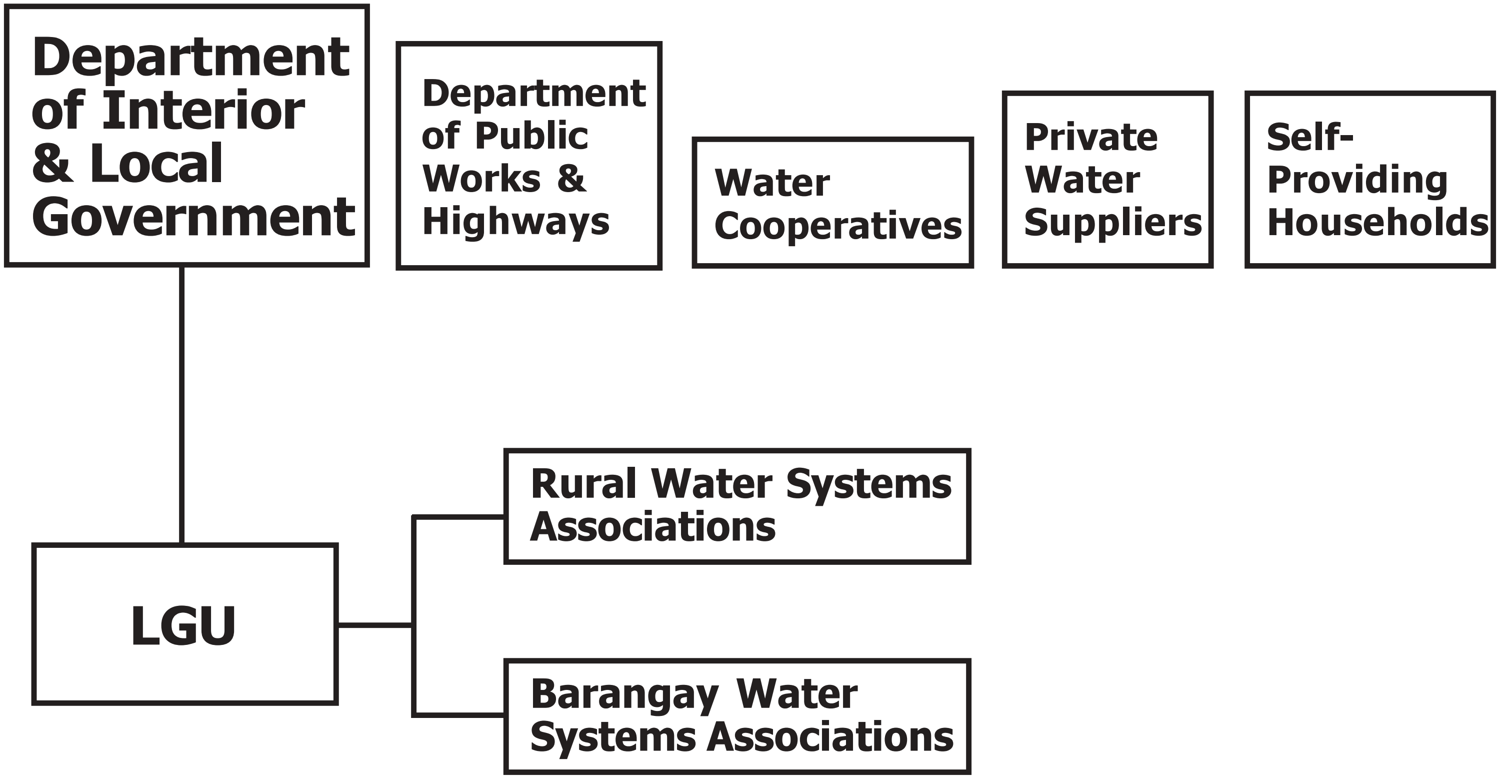
Annex 6

Organigram of Urban Water Supply Systems



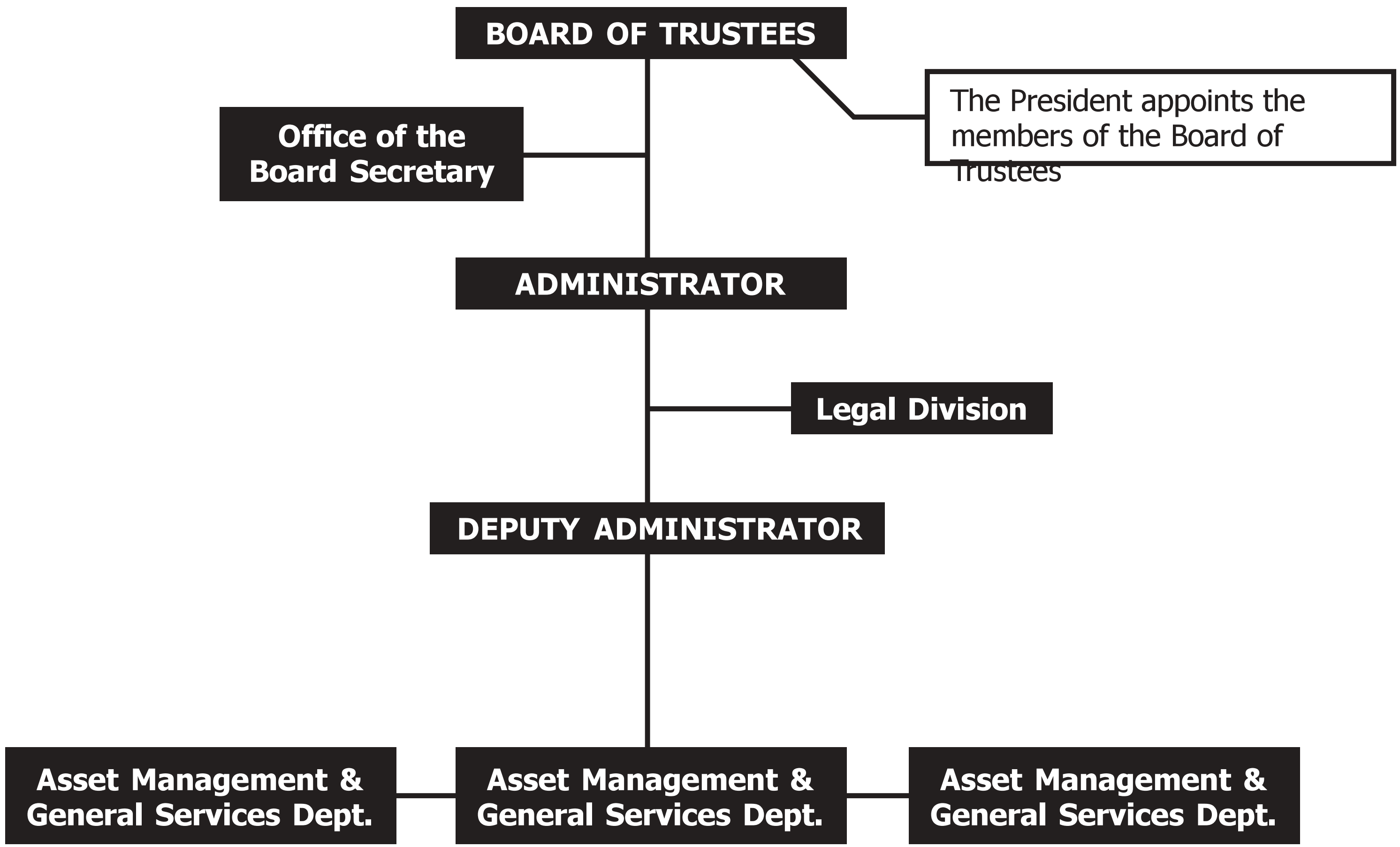
Annex 7

Rural Water Systems



Annex 8

Corporate Structure of the MWSS



Annex 9

Service Area

	CITIES	MUNICIPALITIES
National Capital Region	Kalookan	Malabon
(12 cities and 5 municipalities)	Las Piñas	Navotas
	Makati	Pateros
	Mandaluyong	San Juan
	Manila	Taguig
	Marikina	
	Muntinlupa	
	Parañaque	
	Pasay	
	Pasig	
	Quezon	
	Valenzuela	
Rizal Province	Antipolo	Angono
(1 city and 13 municipalities)		Baras
		Binangonan
		Cainta
		Cardona
		Jala-Jala
		Morong
		Pililla
		Rodriguez
		San Mateo
		Tanay
		Taytay
		Teresa
Cavite Province	Cavite	Bacoor
(1 city and 5 municipalities)		Imus
		Kawit
		Noveleta
		Rosario

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