

1st Annual Service Contract Compliance Review

Service Contract for
Water, Wastewater and Stormwater Operation and Maintenance
Capital Improvements

Period February 19, 2003 through July 31, 2004

prepared for

Concerned Citizens Coalition of Stockton



December 2004



Annual Contract Compliance Review
For the period February 19,2003 through July 31, 2004

December 7, 2004

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Introduction

(Information presented in this review has been gathered from various public documents. Information comes from annotated City Council minutes, OMI-Thames Water Stockton monthly reports, campaign literature and other information gathered via the Public Records Act. For review of these documents please refer to the Appendix.)

During the 1990's, the City of Stockton embarked on a staged expansion project to upgrade the Regional Water Control Facility (RWCF). In 1998, the consideration of having the private sector build and operate the RWCF surfaced and in 1999 there was serious discussion of possible private operation as compared to the Municipal Utilities Department (MUD) business plan. The process of evaluating the privatization of the MUD began in 2000 with the selection of consulting firms to aid the city. Three private companies were selected to make proposals and in October 2002, OMI/Thames was selected as the preferred provider with which the city would negotiate the RWCF upgrade and MUD operation and maintenance.

During the discovery period, a group of concerned citizens and community organizations formed a coalition to observe the entire process to ensure that the citizens' utility services were protected and the rates citizens paid would remain low.

In November 2002, the Concerned Citizens Coalition of Stockton (CCCoS) qualified a ballot measure allowing the citizens of Stockton to decide whether or not they wanted a private company operating their municipal utilities. That initiative, (Measure F) was placed on the March 2003 ballot. If passed, Measure F would require any operation and/or maintenance contracts with a cumulative value greater than \$5 million to be placed before the voters.

On February 19, 2003, two weeks prior to the March 2003 election, Stockton's City Council voted 4-3 to enter into a Service Contract for Wastewater, Water and Stormwater Utilities, Capital Improvements and Maintenance with OMI/Thames Water Stockton, Inc (OMI). By signing this contract prior to citizen vote, the contract would be exempt and the outcome of the election would apply only to contracts after the election

date. This action pre-empted the wishes of the citizens to have a formal say in the outsourcing process.

Measure F passed overwhelmingly, 60% to 40%. Following the City Council action, CCCoS began circulating a referendum to overturn the Council's action. The referendum effort failed to gather the required number of signatures within the 30-day time limit.

Along with the Sierra Club and the League of Women Voters of San Joaquin County, the CCCoS sued the City Of Stockton for failure to follow the California Environmental Quality Act (CEQA). The City of Stockton has tried to separate the operation and maintenance the city's water, wastewater, and stormwater utilities from the cost and build-out of the Initial Capital Improvements (ICI) in their interpretation of the project contract. We are presently in litigation over the implications of their argument that the contract could be split. The purpose of this report focuses on the performance and failings that have transpired in the day-to-day operations since the city officially entered what they call a "service contract" with OMI-Thames. It does not address the contract's capital improvements. This lawsuit is presently before the Appellate Court in Sacramento.

The CCCoS has taken the task of monitoring the Service Contract. Information provided in this report is only a small portion of the items held up for review in this first year. The data was gathered from OMI's monthly reports, which are required by the Contract. The reports are public information. Since OMI took over the operation and maintenance of the municipal utility, the monthly reports have not been consistent in their manner of presentation. Neither OMI nor those monitoring the Contract for the benefit of the City and its citizens has developed a standard report format. Without this standard report format, monitoring the contract is a difficult endeavor, at best.

First and foremost, City management has failed to provide a structure by which the Contract can be monitored. From a citizen's perspective, not one progress report has

been to the Council or the public made regarding the expenditure of City revenue for the service provided via this Contract. There has been no City enforcement of OMI's failure to provide the services for which they have been contracted, and which they agreed upon to furnish.

Prior to Contract signing City Council and City Management assured the citizens of Stockton that there would be qualified personnel to monitor the implementation of this 900+ page Contract document. Citizens were also guaranteed the Contract was structured to protect their investment in their municipal utility.

Mayor Podesto, the City Council and City Staff moved deliberately and aggressively toward outsourcing the operation and maintenance of the municipal utility. CCCoS participated in the process and through hours of research, document study, reviewing of all the related proposals and active participation in public meetings and hearings, assisted in evaluating and creating a contract that would better protect the investment the citizens of Stockton have made in their municipal utility.

The Service Contract contains, in specific detail, exactly what is required of OMI. City Staff and others built into the Contract numerous safeguards that would protect City resources. Examples include:

- A \$1,000,000 buyout clause should the City decide to terminate this outsourcing arrangement
- A \$10,000,000 line of credit, provided by the vendor, to cover fines and damages so as not to cause City revenues to be used for problems caused by the vendor.
- A detailed ongoing computerized program that will insure the municipal utility will maintained and at the end of the contract term be returned to city operations equal or better than when it was outsourced.

The presentation of this Annual Contract Compliance Review is provided for the benefit of the residents of Stockton and those monitoring the Service Contract between the City and its vendor. It is noted that in most cases the time frame reference is February 2003 through and including July 2004. Discrepancies in Contract fulfillment may have been

met since these dates. If they have been met, they were late. For those areas that have not been met, there have been no consequences for OMI. This Contract spells out what is required and the consequences as well. Within this Contract the consequences for non-compliance are minimal. In many cases it may be more cost effective to pay the consequence than to comply with the Contract.

The Service Contract is a single contract covering the operation and maintenance, initial capital improvements, and asset management. This Review focuses on the asset management, and the operation and maintenance. City Staff should be monitoring the ongoing initial capital improvements.

Contract Amendment Memoranda

Article XVII Section 17.2 (B)

Contract Administration Memoranda. The principal formal tool for the administration of matters arising under this Service Contract between the parties shall be a “Contract Administration Memorandum.” A Contract Administration Memorandum shall be prepared, once all preliminary communications have been concluded, to evidence the resolution reached by the City and the Company as to matters of interpretation and application arising during the course of the performance of their obligations hereunder. Such matters may include, for example: (1) the determination of the specific relief to be given the Company under Section 15.2 on account of an Uncontrollable Circumstance; (2) the determination of the specific amount of any increase or decrease of the ICI Design/Build Price or the Service Fee to which the Company is entitled under any provision of this Service Contract (including the parties’ agreement as to the treatment and designation of the payment of any Extraordinary Item under subsection 13.7(B)); (3) issues as to the meaning, interpretation, application or calculation to be made under any provision hereof; (4) notices, waivers, releases, satisfactions, confirmations, further assurances, consents and approvals given hereunder; and (5) other similar contract administration matters.

Article IV Section 4.3 (7)

Legal Proceedings. There shall be no Legal Proceeding pending before or by any Governmental Body which: (a) challenges, or might challenge, directly or indirectly, (i) the authorization, execution, delivery, validity or enforceability of this Service Contract or either Guaranty, or (ii) the interest of the City in the Managed Assets; (b) seeks to enjoin or restrict the use of the Managed Assets in the manner or for the purposes contemplated by this Service Contract; or (c) seeks damages, fines, remediation or any other remedy in connection with the environmental condition or any other matter pertaining to the Managed Assets, in any such case which can reasonably be expected to materially and adversely affect the City’s or the Company’s ability to comply with its obligations hereunder.

In the early pages of the Contract, there is a reference to two periods, Transition and Commencement. The Transition Period is the span of time necessary for an orderly transfer of services from municipal operation to private outsourcing. This period, which commenced on February 20, 2003, focuses on such issues as labor, asset inventory and valuation, governmental agency approvals and other related operational tasks. Article IV and Appendix 4 of the Service Contract detail the requirements that must be met by the City and OMI during the Transition Period. When all the requirements have been satisfied, the Contract states that OMI may assume total responsibility and liability for the operation and maintenance of the municipal utility.

There will be times when Contract requirements need interpretation and better clarification. In order to document and make legally binding such interpretations, the Contract addresses this need via Contract Amendment Memoranda. Article XVII, Section 17.2 (B) describes the purpose and use of Contract Amendment Memoranda (CAM).

Within the Transition Period requirements, there is a section that protects the citizens' utility investment, the City of Stockton's revenue and resources and OMI's resources, in the event that the legality of any portion of the Contract is questioned through legal proceedings. Article IV, Section 4.3 (7) relates specifically to the lawsuit filed against the City and its vendor. This Section states that if there is any legal proceeding questioning the legality of the Contract, this/these issue(s) must be resolved prior to the Commencement Period.

In order for OMI and the City to end the Transition Period of the Contract and begin the Commencement Period, both parties signed Contract Amendment Memoranda #3 (CAM 3). CAM 3 states that the City and OMI recognize that there is a legal action regarding the Service Contract. Should the courts find in favor of the plaintiffs the City may be required:

- To unwind the contract
- Return to municipal operation
- Pay the expenses related to resolving a legal proceeding

Section 4.3 (7) protected the City and its vendor. The signing of CAM 3 waived Section 4.3 (7) of the contract. It allowed the Commencement Period to move forward and negated the very protections built into the Service Contract. The signing of CAM 3 placed the City at an unnecessary risk. The signers of CAM 3 failed to exercise their fiduciary responsibility to protect citizen and City resources.

Water, Water Connection and Wastewater Rates

A principle reason for all outsourcing contracts is cost. Those costs paid by the City for services provided by OMI AND rates and fees paid by consumers. The City hired a third party consultant, Alternative Resources Inc, to ensure that the outsourcing project would be approved and implemented. Mr. Gary Ingraham, retired Assistant City Manager, was the lead person for City Administration.

While the City was completing the contract arrangements, the March 2003 election loomed in the forefront. Measure F was the ballot measure that would put to a vote of the citizens the outsourcing of municipal utility operations. To defeat Measure F, opponents spent thousands of dollars in their mail campaign. A principle argument in favor of outsourcing, illustrated in their mail campaign, was that water and wastewater related rates would remain low and that with outsourcing residents would experience a 7% increase in the fees they pay over the life of the contract vs. a 39% increase under municipal operation.

Contrary to some beliefs, the portion of the fees paid to OMI for the day-to-day operations are not fixed. The Service Contract contains two annual adjustments to the fees that the City pays to OMI. These Contract-mandated fee adjustments are tied to different variations of the commonly understood Consumer Price Index (CPI). The two components are (1) the fixed service fee, which covers everything in the contract except (2) the energy fees. These fee adjustments cannot be applied until 2005.

The fixed service fee is adjusted by a figure called CPI-A, which is the unadjusted CPI for ALL URBAN CONSUMERS, all items, except energy. This number is derived using figures reported to the Bureau of Labor Statistics from the entire United States.

The energy fee adjustment is based on CPI-B, which is the CPI for energy in the San Francisco-Oakland-San Jose California.

With this Contract information as background, in June 2003, after the City Council had already approved the Service Contract and began the outsourcing “Transition period” with OMI, the City Council, under the advisement of now Assistant City Manager Gary Ingraham (now retired) and City Manager Mark Lewis, considered an annual fee increase and adjustment to the water, wastewater and water connection fees residents pay. These proposed, and later approved, resolutions would put into place a first year increase of 2.5% and an annual adjustment tied to a CPI index factor. The argument is made that the CPI used for the consumer rate increase is the same as what is used in the Service Contract with the outside vendor. However, the CPI index factor for the rate increase is in fact a third index, called CPI-C.

CPI-C is defined as the unadjusted Consumer Price Index for ALL URBAN CONSUMERS for ALL ITEMS, U.S. city average. The 20-year historical averages of the three CPI indexes are:

CPI-A 3.31

CPI-B 2.99

CPI-C 3.13

For the 20-year annual historical comparison of the CPI indexes, see Appendix CPI or visit www.bls.gov.

Justification used by City Staff on behalf of the City Council for the rate increases can be tied to three primary reasons:

1. The rates had not been increased in many years.
2. Rate increases would cover costs of state mandated improvements.
3. The rising costs of services and commodities; such as natural gas, electricity and other materials necessary for processing sewage and wastewater.

(1) Mr. Gary Ingraham made the proposed rate increase presentation to City Council. Mr. Ingraham stated that rates had not been increased in many years. The City Manager had City Staff gather rate data from numerous other cities within the State of California. In Mr. Ingraham’s presentation he cited an example that connection rates

had not been increased in 10 years, yet the CPI index to be used had risen 29% over the same time period. Additionally water rates had last been adjusted in 1997 and wastewater in 1998. The CPI index has risen 24.6% and 18.8% respectively.

This is a clear indication that rates had been adequately set to meet the needs of the Municipal Utility.

(2) Mr. Ingraham declares that revenue generated by this rate increase would be used to cover the expenses of state mandated improvements. There are numerous projects that are required at the Municipal Utility to meet increased discharge permit requirements. Mayor Podesta comments that other cities “such as Manteca, Lodi, Fresno and Tracy are undergoing construction or planning to enhance their plant and their costs will go up.” Since Stockton does not serve these communities with utility services and that the status of their plants vs. Stockton’s municipal utility plant are vastly different, what happens in those cities would bear no impact on what happens in Stockton.

Mr. Ingraham presents to the Mayor Podesta and the City Council the balances of the various Enterprise Funds. By law Enterprise Funds are a way to segment revenues paid for a service to be used for the delivery of that service and not be co-mingled with City General Fund revenues. But in fact and practice, Mayor Podesta and Mr. Mark Lewis have transferred the interest earned from these Enterprise Funds. Instead of reinvesting back into the public utility to offset the cost of state-mandated improvements and to keep rates lower, Mayor Podesta, the City Council and City Management have used these interest earnings for NON-UTILITY projects.

Mr. Ingraham and Mr. Lewis failed to mention in their presentation to City Council, for the City to remain even in its budgeted expenses for the municipal utility department, that due to the annual increases built into the Service Contract and paid to OMI, these rate increases will not result in any additional revenue to fund the necessary state-

mandated projects. Mr. Ingraham informs the City Council that there will be “many rate adjustments in the near future”, beyond this increase, as well as \$30 million bond issue.

(3) Mr. Ingraham stated “that it is unrealistic to think that the City can operate year after year without any increase when natural gas, electricity, sulfur-dioxide, chlorine, employee medical and workers comp insurance and gasoline costs keep escalating.” Mr. Ingraham informed the City Council that there would be some “highly escalated commodities” purchased and this is a reason for the increase. The City Council outsourced the day-to-day operation component of the Municipal Utility. Part of the fees paid to OMI (the Fixed Service fee) cover the cost of commodities at a set price by contract, and then adjusts this fee by CPI-A. These short-term fluctuations are not a concern for the City as a result of this Contract’s Fixed Service fee. The risk of escalating cost of services has been transferred and is OMI’s concern. The impact of these escalating costs is no just argument for an increase in consumer rates.

After Mr. Ingraham’s presentation, Councilmember Steve Bestolarides questioned the use of CPI. Several City Staff members and Mayor Podesto responded to his question:

Mr. Ingraham responded... “the answer is in the Council approved contract and that is why it needs an adjustment which was a negotiated point of the contract.” Mr. Ingraham stated that the resolutions before the Council contained an annual increase using the same CPI as in the Service Contract. Mr. Ingraham finally states “that generally there has been an increase (in CPI) which is reflected in the 10-year figures” he presented.

CPI-C used in the Resolutions is defined as ALL CITIES/ALL ITEMS. This set of indicators has a slightly higher 10-yr historical valuation than CPI-A (ALL Cities/ All Items Less Energy – used to adjust Fixed Service Fee) and a slightly lower 10-yr historical valuation than CPI-B (SF-Oakland-San Jose area Energy – used to adjust the Energy Fee)

Looking at transcripts of the City Council meetings, statements are presented that the adjustments to consumer rates can go up or down, depending on the direction of CPI. Over the past 20 years CPI-C, the indicator used to adjust water related rates has no negative years. In other words, CPI-C has only gone up for the last 20 years.

Mayor Podesto reminded everyone that “CPIs were included in ALL public facilities fees when they were last approved.”

City Manager Mark Lewis commented that “the OMI contract is also indexed” and these resolutions “will allow the City to keep pace with those contractual commitments to OMI.”

With this information, using the 20-yr historical average of CPI-C, **Stockton water related rates might increase nearly 63%** over the life of the Service Contract. This increase is due in entirety **because the Service Contract has a negotiated rate adjustment.**

Several citizen comments made at the City Council meeting regarding the rate increase include:

- Rate increases will be imposed to mirror the automatic annual OMI-Thames contract, which seems contrary to the Council’s earlier statements regarding strict oversight of the contract
- “Administration by automatic pilot” where no political capital is spent and no public input is required
- These increases already included in the 2003-04 budget
- This agenda item did not include a staff report, committee report, no participation from Councilmembers, no public study session, participation was not encouraged
- A copy of the Resolution was not available until 4:30 p.m. TUESDAY June 24. One hour before the City Council Meeting
- Proposed rate increase will only add approximately \$27 million over 20 years, not nearly enough to pay for any of the necessary projects mandated by the state.
- With all the money being transferred out from the Municipal Utility Enterprise Funds (increased property tax and earned interest) as well as the built in Repair and Replacement expenses AND a suggested savings by the City’s third party consultant, why a rate increase when the money is already there?
- 777 citizen property owners filed a written protest to the rate increase

Some Councilmember comments:

- Councilmember Dr. Richard Nickerson stated “that if privatization was ratified the price of utilities would increase. What other cities charge is no good justification for what the City charges.”
- Councilmember Steve Bestolarides again voiced his concerns regarding the monopoly created by OMI contract
- Councilmember Leslie Martin voiced concerns about automatic increases, whether there was an annual cap, and that the increase should be reviewed each year.

The Resolutions passed 5-2.

We have included rates and rate increases as part of this Review so that Stockton residents are fully aware that the only reason their water related rates increase annually is because of a negotiated component of the Service Contract. Thus far, with only one year under private operation, utility fees have risen 2.5% in 2003 and 2.3% in 2004.

Note: The original Proposal submitted by the current vendor contained a request to include Lifecycle Adjustments. This additional adjustment beyond the CPI adjustments would be made every three years. The Lifecycle Adjustments would allow the vendor to reexamine the relationship between the effect of the indexed adjustments to the Service Fee and the vendor’s actual costs. The result of Lifecycle Adjustments would mean the potential for radical changes upward in the Fees paid to the vendor, which would need in turn to be passed onto consumers. Although this Lifecycle Adjustment did not appear within the final version of the Service Contract, awareness of its existence is paramount for those monitoring the Service Contract and any changes made via Contract Amendment Memoranda or budget adjustments for services provided.

For additional information see Appendix for:

June 24, 2003 annotated minutes Agenda item 9.03

Resolution 03-0361; Resolution 03-0362

CPI Descriptions according to U.S. Department of Labor, Bureau of Labor Statistics

Customer Service

Section 5.15

CUSTOMER SERVICE. • Generally. The Company shall provide customer service for the System in compliance with the requirements of this Section and the performance standards set forth in Appendix 14. On or before the Commencement Date, the Company shall develop and submit for approval to the City five copies of a customer service manual which shall be consistent with this Section and Appendix 14. Upon approval by the City, the Company shall implement the procedures set forth in the customer service manual. The customer service manual shall be revised as necessary from time to time, subject to the approval of the City as provided herein. Any disagreement between the parties as to the content of the customer service manual shall be resolved in accordance with Section 14.11.

(A) Customer Service Requirements. The Company shall perform the customer services in accordance with the requirements of Appendix 14, and the customer service manual shall address the following minimum requirements:

- (1) The Company shall maintain a staff dedicated to assisting customers. The customer service staff shall be trained to answer questions related to the System.
- (2) The Company shall establish and maintain toll-free customer service hotlines to allow customers to ask questions, raise issues and lodge complaints.
- (3) The Company shall establish and maintain a 24-hour per day toll-free hotline, with adequate capacity and personnel, that will be answered at all times by a person and not a voicemail or other automated recorder, for the receipt of reports of emergencies relating to the System.
- (4) The Company shall establish and maintain at least one customer service center to be located at the Plant Site and with hours of operation to be approved by the City, such approval not to be unreasonably withheld.
- (5) The Company shall respond to customer questions and complaints in accordance with the standards set forth in Appendix 14.

The Company shall respond to emergencies in the System, including back-ups, water main breaks, stoppages, spillages and leaks, in accordance with the standards set forth in Appendix 14.

Simply stated the Service Contract lays out what the vendor is to provide to the residents of Stockton in regards to customer service. Residents are to have and OMI is to provide:

- A trained dedicated staff to answer customer questions regarding the municipal utility
- A 24-hour per day toll-free hotline, staffed by a person AT ALL TIMES, to allow citizens to report emergencies, ask questions, raise issues and lodge complaints.
- A Municipal Utility System website capable of customer inquiries

- Five copies of a customer service manual will be delivered to the City on or before the Commencement Date (*due August 1, 2003*).
- A public outreach and education campaign designed to inform customers generally about the scope, nature and extent of the City's operations. This plan shall be developed and implemented in accordance with requirements of Appendix 6. It shall be submitted within 180 days of the Commencement Date (*due date January 27, 2004*).

Throughout the outsourcing/procurement process the issue of Customer Service was paramount in the City Council's argument for outsourcing and in the vendor's promises that residents would see no reduction in services. A concern raised during these discussions was that in order for the vendor to make enough profit to justify taking on the day-to-day operation and maintenance of the Municipal Utility, the level of current service provided to Stockton residents would diminish.

So important was this issue of Customer Service, that the establishment of a Commencement Date could not be met without the approved Customer Service Manual and the establishment of the 24-hour hotline. Customer Service is mentioned in no less than 4 sections of the Service Contract (Section 5.15, Appendix 4, Appendix 6 and Appendix 14).

This report is not the first mention of failure on behalf of the vendor and failure of enforcement by the City in regards to Customer Service. In September 2003, the Concerned Citizens Coalition of Stockton (CCCoS) requested public documents to validate that the conditions of the Transition Period had been met and that the Commencement Period could begin. Assistant City Manager Gary Ingraham (now retired) observed the Transition Period Requirements document review conducted by Mrs. Sylvia Kothe and Mr. Bill Loyko. When Mr. Ingraham was asked for the toll free hotline or the customer service number, Mr. Mark Madison, Municipal Utility Department Director, obtained the number from OMI-Thames Water Stockton. The number was 1-800-306-9566. When dialed this number was a direct line to the Stockton City Fire Department. They knew nothing about the 24-hr hotline number or where to call in an emergency.

After one year of operation, little has been done to correct the contract deficiencies regarding the customer service requirements that should have been met by August 1, 2003 and January 27, 2004.

For those who have access to the Internet, requirements state a website is to be maintained capable of customer inquiries. First place to look would be the City of Stockton website, www.stocktongov.com. This Citywide site includes links to all City Departments and services. If you know how to navigate through the website and end up at the Municipal Utility Department site, the only mention that city utility services are privately operated is if you look to the link for OMI-Thames, and this will give you contract information only. Stockton's own city site has no phone number to call.

Continuing with internet, if you know that the city municipal utility services are provided by OMI-Thames Water Stockton, and you search the internet by typing www.omithameswaterstockton.com, you will find a website with details about OMI, Thames Water, and CH2Mhill. In all of the press releases on this site, the phone numbers link you to the company PR person at their home office in Colorado.

However, at the bottom of the above mentioned website are two phone numbers.

- (209) 937-8763, gives a recording that the mailbox is not available and to call back using the full mailbox number, including the area code. Redialing using the area code, delivers the same message.
- (800)-306-9566 gives a recording that this number has been disconnected.

This Internet requirement has not been met, even as late as November 2004. Not only is there no website easily accessible or advertised, telephone information provided is incorrect or disconnected. During the many meetings held for this outsourcing project, Mayor Podesto repeatedly assured residents they would receive quality service from the vendor selected.

Looking at the obvious, the telephone book, under City of Stockton government offices page, remembering services are under Municipal Utilities Department, the first number is for emergencies. This number, 937-8341 reaches the Public Works Service Center and receives calls for water and sewer, as well as traffic signals, stop signs and other emergencies. After hours this number is answered by a recording that requires transfer or re-dialing a phone number that will connect you to city safety dispatch (Police and Fire). This is a CITY phone number. The Service Contract clearly defines Customer Service 24-hr hotline as a component the vendor is to provide. Mayor Podesto stated many times, in public meetings, that this number was always to be answered by a local person.

The complexity of the Service Contract is to protect the physical assets that make up the municipal utility as well as define, for the vendor, the type and quality of service to be delivered. The details of the contract spell out for vendor and the City exactly what both parties expect. If any section of the Service Contract were questionable, Contract Amendment Memoranda (CAMs) exist as a means of clarification. Since there are no CAMs relating to customer service, it must be clear what is expected and has been agreed upon (see Appendix for all CAMS fully executed as of November 8, 2004).

Since the City of Stockton is still paying the costs of the Customer Service function, a responsibility of OMI, there is no cost savings to the City. Not providing Customer Service as defined in the Contract, is a failure on behalf of OMI and the City.

Point number 5, from the above list, discusses public outreach and education. Developing a plan to inform residents the scope and nature of the City's services is critical, especially when the operation of the utility is performed by a private profit oriented vendor. The City currently pays its vendor in excess of \$1.5 million per month. Understanding what services are provided is paramount, thus the need for a public outreach and education program.

Many residents do not know they can call their municipal utility before “Roto-Rooter” if they have a stopped sewer line. The boundaries of water service are blurred. When driving down any street, again many residents do not know whom to contact if you see leaky water system spewing water out into the street. Public outreach and education regarding water services, water usage and wastewater is necessary in order for residents to practice good conservation and keep water related rates as low as possible. Knowing where to call when there is a problem, knowing where to go for water conservation information, knowing whom to contact regarding all the services that are available to residents within their municipal utility is necessary.

On every municipal utility vehicle, under the “Municipal Utilities” and the Stockton Logo is the name of the private vendor, but the question remains whom does one call for assistance?

Staffing

Section 5.7 of the Service Contract

STAFFING AND PERSONNEL TRAINING. [A] Staffing. The Company shall staff the Managed Assets during the Term of this Service Contract with qualified personnel who meet the licensing and certification requirements of the State, under a staffing plan which is consistent with the Contract Standards. The Company shall notify the City of any material change in staffing levels and positions from time to time, and shall not make any such material change if the new staffing level or staffing positions would adversely affect the ability of the Company to provide the Contract Services.

From Appendix 6 Section 4.0 STAFFING

The Company shall provide a staff of qualified, certified and experienced employees in accordance with the Company's Staffing Plan (to be provided during the Transition Period) and Applicable Law and shall provide such additional third-party support as may be needed to perform its duties and obligations hereunder. Said third parties shall be equally qualified for the particular services to be performed.

The Company shall at all times maintain the necessary number of employees, staff and third-party contractors to operate, maintain and manage the Managed Assets in accordance with the Service Contract, to adequately maintain the Managed Assets in good repair, to adequately operate the Managed Assets to provide quality service to the customers, and to meet Contract Standards in order to protect the health, welfare and safety of the citizens of the City.

The Company shall provide: (i) qualified management, supervisory, technical, laboratory, and operating personnel, licensed and/or certified as required by the State of California for operation and maintenance of the Managed Assets; (ii) a System Manager for day-to-day supervision; (iii) specialists, on-site or as part of a technical support group, as necessary, in water, wastewater, stormwater process control, instrumentation, trouble shooting, emergency management, and similar circumstances; and (iv) office and clerical support staff as necessary.

The Company shall provide a technical support group that will provide on-call backup advice, expertise and quality control, management, maintenance and facility repair to assist the operational staff and ensure performance of obligations hereunder, to assist in the design and construction of any improvements to the Managed Assets and to support the provision of Billing Services. The Company's technical support group shall also provide assistance in the investigation, development and implementation of modifications in the processes as may be appropriate or necessary for regulatory compliance, worker safety, or process improvement. The Company's staff at the Managed Assets and the technical support group shall also provide

support to the City in planning efforts for the Managed Assets in response to regulatory issues and in financing of improvements.

The Company shall provide and maintain an organizational chart that lists job classification, the number of staff proposed for the transition phase and for the full-time operation. The Company shall notify the City of any proposed revisions to the Staffing Plan and/or personnel organization for the Managed Assets.

The following individuals in Table 6-5 are initially approved and represent the Company’s staffing commitment for senior management roles in accordance with the definition of the Service Contract.

Table 6-5

INITIAL COMPANY STAFFING COMMITMENT

Name	Position	Duration
Wyatt Troxel	General Manager and Company’s Contact Person	100% Committed for a minimum of first three years; will live in Stockton.
C. Peter Lee	Operations Manager	Contract Term
To be Determined	Chief Plant Operator	Contract Term
To be Determined	Water Superintendent	Contract Term
Ruth Pauling	Senior Staff	Contract Term
Larry D’Addio	Senior Staff	Contract Term

The City shall have the right to disapprove the individuals designated from time to time by the Company as the Service Manager, and other key managers as defined in the following Table, to manage and oversee the services to be provided under this Service Contract; provided, however, that said disapproval shall not be exercised unreasonably.

From the inception of the outsourcing process, Staffing has been an issue. The emotional stress for existing employees has been evident. The Request For Proposal (RFP) released by the City Council stated that the City would retain certain employees and others would be transitioned from municipal employment to a private sector employer. The complexity of change in benefits and services available to those transitioned employees was to be resolved during the Transition Period. The benefits to those employees were to be equal or better than what was available to said employees

under municipal employment. These issues and how they have been resolved can be seen in documents for Agenda Item 6.13 of the July 8, 2003 City Council meeting. This Annual Contract Compliance Review will not cover whether or not the terms of the contract were met, as much of this information is privileged under Human Resource confidentiality rules. For further information regarding the transition of employees, contact Stockton City Employees Association or Operating Engineers Local Union #3.

Section 5.7 of the Service Contract states summarily that the vendor will provide a qualified trained staff, sufficient to meet the needs of the Service Contract. On the Commencement Date the number of employees, as reported on page 22 of the August 2003 Monthly Operations and Maintenance Report, was 112. By November 2003 there were 104 employees and July 2004, 101 employees. In the Proposal submitted by the vendor, their staffing plan illustrates a reduction to 92 employees. It is through reduction of employees that a private company can produce the necessary profit to justify day-to-day operations.

Quality of service is the benchmark for appropriate staffing levels. For example, at Commencement Date within the Water Division there were 2 Meter Readers to accomplish the task of checking all Stockton Water meters. As of July 2004 there is one. One of the proposals from the vendor was to reduce meter reading from a monthly activity to a bi-monthly activity. This reduction of employees and change in services provided has the potential to produce more profit for the private vendor. This reduction of service does not create a reduction in the rates paid by consumers.

The contract requires a Staffing flowchart to be included in the monthly reports required by the Service Contract. Although a projected staffing plan appeared in the Proposal submitted by the vendor, the first actual staffing flowchart did not appear until November 2003. The November 2003 report was delivered to the City around December 15. This means that the staffing flowchart was four months late.

The vendor has had difficulty keeping qualified employees “on the books”. At Commencement Date there was a 4.5% turnover for the month of August, leaving 7 vacant positions. One year later, still 7 vacancies, different positions, but vacancies nonetheless. At one point, May 2004, there were 10 vacancies in the staffing plan. The problem created by turnover is a plant specific unqualified, unknowledgeable staff. The institutional memory provide by staffing consistencies is deteriorating at the Stockton municipal utility. The vendor has had qualified operator vacancies every month in the water and wastewater divisions.

At the one-year anniversary of the Commencement Date, the vendor was still searching for:

- Director of Technical Services
- Director of Maintenance
- Chief Plant Operator

Examining the staffing employment track record reveals some disturbing information about the qualifications and capabilities of the individuals under the employ of the vendor:

- Of the present 88 OPERATIONS related positions nearly 20% of these positions are vacant or filled with temporary or interim employees
- Of the 12 senior positions, 40% are interim or acting employees.
- The Maintenance Mechanic Supervisor position has had three individuals in 12 months.

Consistency of staff was a concern for the City Council and addressed by the vendor. Article 5 Section 5.5 spells out specific time commitments to be maintained by vendor senior representatives. Even though there are provisions within the Service Contract illustrating some exceptions for the time commitment, during the procurement process, CH2MHill and OMI promised they would be mindful and honor the time commitments within Section 5.5. The proposed General Manager, Wyatt Troxel also made public his commitment to the tenure requirements. The two most prominent senior positions are the General Manager and the Operations Director.

Within the Service Contract, Article 5, Section 5.5 (B) the initial Operations Director would be C. Peter Lee and he would have an initial term of not less than 3 years from the Commencement Date. Peter Lee never made it to Stockton, yet the signed contract makes this commitment.

Within the Service Contract, Article 5, Section 5.5 (A) the vendor's General Manager, the individual who would be the business representative of the vendor for the performance of the Service Contract and who would have no less than a 3-year term beginning with the Commencement Date and ending July 31, 2006, was to be Wyatt Troxel. Mr. Troxel will leave Stockton prior to this Contract commitment. As mentioned, there are valid exceptions, but it was portrayed to the residents and to the City Council, by OMI and the City Staff, that these tenure commitments would be met.

The details of the remaining senior positions from the vendor do not have time commitments. It should be noted that the vendor is still searching for Chief Plant Operator, a position required by contract. To meet State of California requirements for operation of the municipal utility the vendor is using the specific certifications that individuals have earned, yet do not have the title or responsibility of the position for which the certificate is used. For example, Fermin Garcia has the required certifications for the division where he works. Since there is no Operations Supervisor with the appropriate certifications, the vendor is using Mr. Garcia's certifications, and has been since Commencement Date, and Mr. Garcia has the title of Acting Operations Supervisor.

In summarizing this section of the Contract Compliance Review, better attention and monitoring must be done to assure residents that those in operation of their municipal utility are qualified, receive training on a regular basis and that they meet the certification requirements stated within the contract. Those monitoring the contract must also hold the vendor to the commitments made regarding service time as well as

providing the highest quality of service as expected and detailed in the Service Contract.

“Unaccounted For Water”

“Unaccounted-For Water” is defined as that portion of the Finished Water entering the Water Distribution System that is not delivered to water customers, determined using the methodology set forth in Appendix 6.

“Finished Water” means Purchased Water and Well Water, in each case treated to the standards required by Applicable Law prior to conveyance to the Water Distribution System.

“Water Distribution System” means the City’s potable water distribution system and the real property on which the above-ground structures constituting part of such system are located, as described in Appendix 1, consisting generally of pipes, pumping stations, wells, storage reservoirs, mains, valves, treatment works, distribution facilities and equipment, together with all improvements thereto acquired, installed, constructed or reconstructed from time to time.

In a simpler statement, “unaccounted-for water” is the water purchased and treated for usage by consumers, and during delivery is lost. Every drop of water that Stockton’s Municipal Utility provides to its customers is tracked. The utility meters, or measures, all the water that enters the system. This water comes from several different sources and the Utility keeps track of the origin of its water.

When water is delivered to customers, it passes through meters also to measure how much water various customers are utilizing. Water billing utilizes these meter readings to construct the appropriate billing information.

The Service Contract in Appendix 6, Section 1.1.5, bullet point #9 states that the vendor is to “minimize the quantity of Unaccounted-for Water in the Water Distribution System so that it does not exceed 3.5%. Provide to the City, annually, a calculation of the quantity of Unaccounted-for Water in accordance with the method described in Attachment 3 to this Appendix 6.” The full details of Attachment 3 from Appendix 6 can be viewed in this report’s Appendix.

In determining Unaccounted-for Water (UAC), the following formulas and calculations shall apply:

$$UAC_N = \left(\frac{TP_N - TUR_N - WHOLE_N}{TP_N} \right) \times 100$$

Where,

UAC_N = Unaccounted-for Water in percent for year N

TP_N = Total Potable Water for year N.

TUR_N = Total Urban Retail for year N.

$WHOLE_N$ = Wholesale of water for year N.

This is by far the easiest and least subjective area of contract performance. In fact, as a baseline, the 2001 unaccounted-for water report was attached to the Service Contract. The following results have been calculated using the results from the City's reports (see 2001 example) and the vendor's monthly reports.

Under Municipal operation, from 1999 to 2002, using the 2001 format presented in the Service Contract, the UAC has had a range of 2.65% to 3.95%. The vendor assumed modified operations on February 2003 and formal operations August 1, 2003.

Calendar year 2003 UAC is 8.37%. 2004 YTD (January through July) unaccounted-for water was on a pace of 13.33%. Examining the vendor's first full year of operation (August '03 to July '04) the unaccounted-for water report is 7.95%.

The following pages and graphs depict the previously mentioned results. What can be ascertained from this empirical data is that presently utilizing a private vendor and outsourcing the distribution of the City's water resources, water loss has increased by 200%. According to 2004 current data, a 300% increase in lost water.

Lost water can translate into any number of “bad news” scenarios. But in summary it can be said that lost water:

- Wastes a resource we can not afford to waste
- Costs more money to produce water for usage
- Depletes aquifers of water that could have been banked for future use
- Jeopardizes future water resources. If we can't keep track of what we use now, why would the State Water Resource Board grant additional water rights to the City?

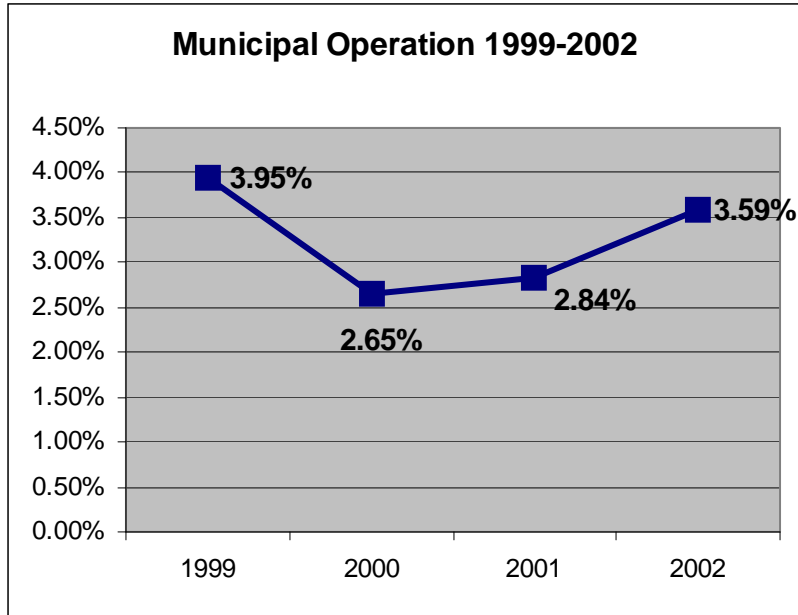


Chart #1 – City of Stockton Municipal Operation only

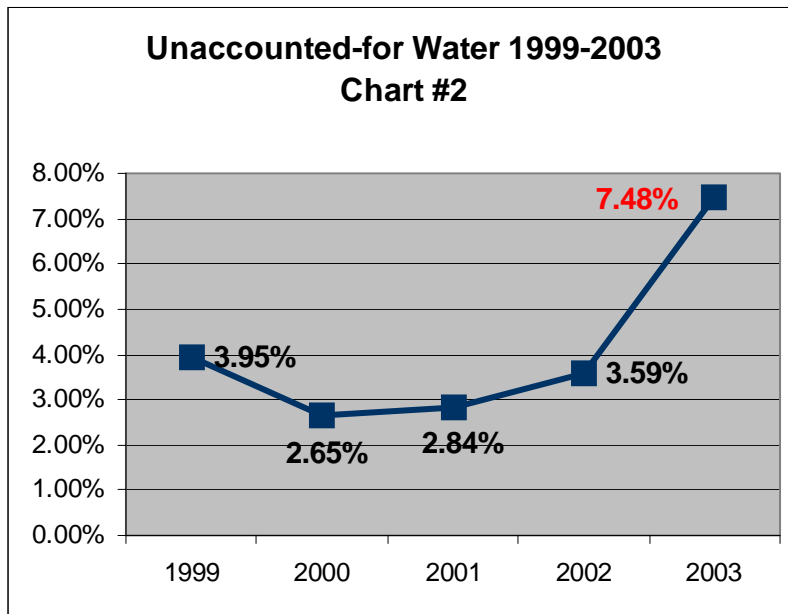


Chart #2 – City of Stockton Municipal Operation to Feb '03, Transition Period Mar '03 through August '03, Commencement Period August '03 to Year End '03. Notice the increase in water loss since OMI assumed operations in 2003.

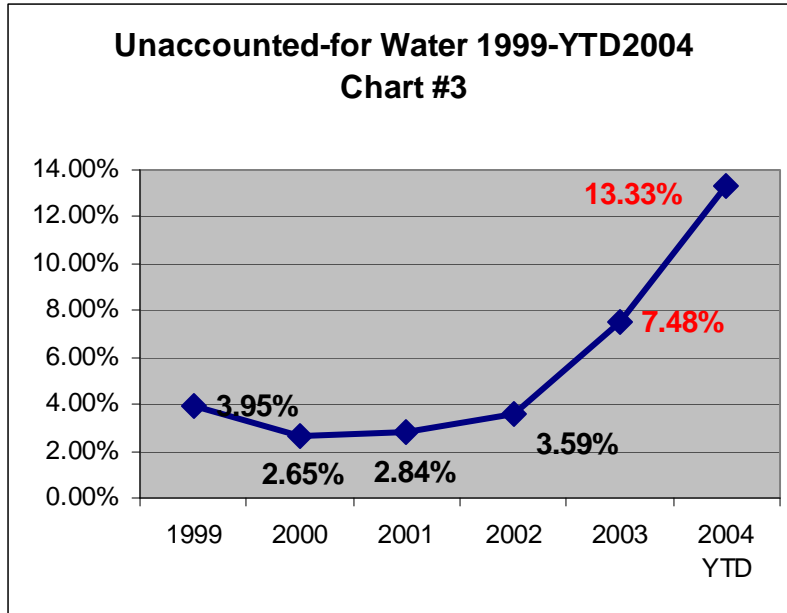


Chart #3 – same data as Chart #2, also includes FYTD 2004 through July'04. OMI has a trend line that is increasing.

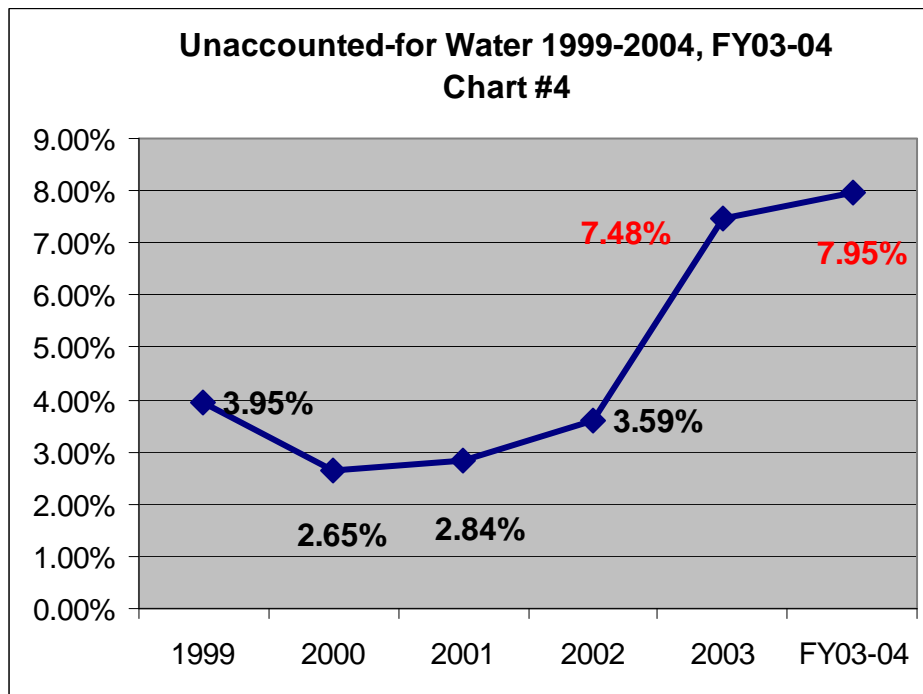


Chart #4 – displays annual data for 1999 to 2003, as well as private vendor first year of operation, August '03 to July '04. This displays the effect of OMI as a sole statistic (FY03-04).

Operation, Maintenance, Repair & Replacement

Any company can “say” they have the knowledge and skill level to correctly operate the Stockton Municipal Utility. In fact three different private partnerships submitted proposals for the right to have the outsourcing contract and the responsibilities within the Service Contract. The real proof is in the “doing what you say you CAN do.” The operation, ongoing maintenance and repair and replacement are covered, in detail, in Article V & VIII, as well as Appendices 4, 6 & 7. For the stakeholders of the municipal utility this is the most important set of provisions within the Service Contract.

There exists in the Service Contract a timeline. For some it may be as hidden as the Da Vinci Code, but when the pieces of the puzzle are laid together, the Service Contract has clarity. A previous section of this Review, discussed the importance of qualified staff. It was also mentioned that the staff needed to be knowledgeable about the Stockton facility. It is safe to say that no two wastewater treatment plants or water distribution systems are alike. Each has its own variations and uniqueness. Institutional knowledge about Stockton’s facility is important.

Here is the timeline of events required by the Service Contract. It cannot be stressed enough that the vendor agreed to all the conditions of the Service Contract. Without specific written documentation (CAMs) that clarify interpretations or change contract requirements, the City and the vendor can be held in violation of the Service Contract.

Appendix 4 is titled Transition Plan Standards. These are all the requirements that were to be completed prior to Commencement Date. This Appendix in theory gave the City an opportunity to actually “see” that the vendor had the capability to perform to contract standards. It provided a safe, low cost exit opportunity for the City if the vendor could not meet the strict contract standards. Appendix 4, 2.0 Specific Transition Services states:

“The Company's Project Transition Manager and O&M Startup and Transition Manager will be in place on the Contract Date in order to implement the Transition Plan.

From the Contract Date to, and including, **the day preceding the Commencement Date, the Company shall be responsible for meeting** the requirements of Section 4.1 of the Service Contract...”

These two paragraphs can be understood by any prudent individual to mean... this is what you must do BEFORE the City releases the municipal utility to its vendor... BEFORE the Commencement Date.

Two, of the many, items to have been completed are:

- Reviewing the existing Operations and Maintenance (O&M) manuals
- **Establishing** standard operating procedures (SOPs) specific to the Managed Assets

The instrumental word is ESTABLISHING. Standard Operating Procedures (SOPs) are the methods to be utilized by the vendor's employees, for the safe and correct operation and maintenance of ALL the managed assets. The process for the establishing the SOPs was:

- OMI to submit to the City, for review and approval, draft SOPs
- City Staff would review and return the draft SOPs to OMI for finalization
- OMI delivers the final versions to City Staff.

This function has a deadline – Commencement Date. The SOPs were to validate that that the vendor in fact really did know how to run the sophisticated municipal plant and water distribution system in Stockton.

In order to meet the deadline of Commencement Date, the vendor provided 50 two-page SOPs created at other sites that they provided as proof they could operate the utility and they delivered these as originals. 30 days after submission the Commencement Date, **these documents were returned to the vendor as unacceptable.**

OMI informed the City that they are not capable of completing the SOPs and they (OMI) have hired a third party vendor to complete this requirement.

The Standard Operating Procedures were required PRIOR to the Commencement Date, at the time of this Review, and stated in the Monthly Reports from the vendor, still **have not been completed.** Although the documents provided by the third party vendor are described as excellent, approximately 20% of the SOPs have been completed.

The vendor failed to complete the SOPs in time for City review and comment. Evidence that they could in fact manage the operation of the facility had not been provided. Allowing the Commencement Period to begin without SOPs, the City violated their own contract provisions and risks the possibility that the vendor cannot operate the facility properly. More so, moving out of Transition Period now exposed the City to the more costly version of exit strategies.

The next step in the timeline was the creation and implementation of a Computerized Maintenance Management System (CMMS). Section 8.4 titled Computerized Maintenance System states:

The Company shall install, maintain, upgrade, repair and replace, as appropriate throughout the Term, a computerized maintenance management system capable of providing a record of repair and replacement of the Managed Assets on a detailed, item-by-item basis; scheduling, carrying out, monitoring and controlling predictive, preventive and corrective maintenance programs; monitoring routine operations within the Managed Assets; issuing work orders and purchase orders; maintaining a spare parts inventory; and issuing exception, equipment status and repair priority reports. **The computerized maintenance management system shall be installed and operational within 90 days following the Commencement Date,** shall be developed consistently with the Managed Assets Registry, shall constitute part of the Managed Assets, and shall be modified as and when appropriate during the Term to take account of removals from and additions to the Managed Assets. The Company shall utilize the computerized maintenance management system to provide the City with documentation which allows it to efficiently monitor compliance by the Company with its maintenance obligations hereunder. The City shall have computer-based real time, read-only access to such system. The Company shall permit all electronic data to be replicated and provided to the City for review by the City Engineer.

The definitive clauses of this section are “installed and operational within 90 days following the Commencement Date. The deadline for this operation was on or around

October 29, 2003. This new CMMS was to replace the old HTE system the City had been using. The new system would modernize the ongoing maintenance program and in effect, be more efficient.

But in order for the CMMS to be completely functional two activities had to occur. First the vendor had to review the existing operation and maintenance manuals provided by the manufacturer and second, complete the standard operating procedures. Together these two activities created the customized methodologies for the management, operation and maintenance of the entire managed assets.

This is a huge task. The managed assets include the main plant, the tertiary plant, the water distribution system and the stormwater system. The uniqueness of the Stockton system cannot be mentioned often enough. The deadline dates set for the vendor, in reality, are probably unrealistic. However, the need to have completed the steps to validate the ability to maintain the manage assets is very realistic. While the vendor failed to meet their obligation, the City failed in providing realistic timeframes.

The third and final step in this timeline of events is the Operation and Maintenance Manual. The contract wording is misleading. The word manual is pluralized and the inference is that the vendor is to write new Operation and Maintenance Manuals for each piece of equipment. This is not the case. The Operation and Maintenance Manual is described in Section 1.1 Terms as:

“Operation and Maintenance Manual” means the manual and related computer programs prepared by the Company containing detailed standard operating and maintenance procedures and other specific instructions, policies, directives, routines, schedules and other matters relating to the Management Services, developed and maintained as required by Article V and Appendix 6.

And further vendor and City responsibilities are described in Section 5.6:

OPERATION AND MAINTENANCE MANUALS.

(A) Development. The Company shall provide to the City five copies of **draft Operation and Maintenance Manuals within 180 days following the Commencement Date.** Prior to the City’s approval of the draft Operation and Maintenance Manuals in accordance with subsection (B) of this Section, the Company shall use and follow the procedures set forth in the City’s operation and maintenance manuals for the Managed Assets. The content of the Operation and

Maintenance Manuals shall be consistent with the Contract Standards, shall contain a detailed description of the means and methods of properly operating the Managed Assets and all sampling, testing and measurement procedures, shall document predictive, preventive and corrective maintenance procedures, practices and schedules, and shall otherwise be sufficiently detailed to permit the Managed Assets to be operated and maintained by a third party reasonably experienced in wastewater treatment, water distribution and stormwater collection; and shall be reviewed and approved by the appropriate Governmental Body in accordance with Applicable Law. The Operation and Maintenance Manuals shall be developed and maintained in a manner which is fully consistent with the computerized maintenance management system installed and utilized by the Company pursuant to Section 8.4. The Contract Services shall be performed substantially in compliance with the Operation and Maintenance Manuals and the Company's computerized maintenance management system.

(B) City Review and Approval. **The Company** shall review and discuss in good faith with the City any aspect of the draft Operation and Maintenance Manuals, and **shall deliver the final Operation and Maintenance Manuals to the City within 60 days following completion of review and approval by the City**. The Company shall keep the Operation and Maintenance Manuals current and shall supply the City with appropriate updates, supplements or revisions thereto annually or at any earlier time that a material change to the Operation and Maintenance Manuals is made, to be reviewed and approved in accordance with the procedures described in this Section. Such updates shall preserve the standards set forth in the initial Operation and Maintenance Manuals. Notwithstanding any such review and approval by and discussion with the City, **the Operation and Maintenance Manuals shall remain at all times the responsibility of the Company**. Neither the review of or approval by, nor the failure of the City to review, comment on, or approve the Operation and Maintenance Manuals shall: (1) relieve the Company of any of its responsibilities under this Service Contract; (2) be deemed to constitute a representation by the City that operating the Managed Assets pursuant to the Operation and Maintenance Manuals will cause the Managed Assets to be in compliance with this Service Contract or Applicable Law; or (3) impose any liability upon the City.

Again, the principle clauses are (1) provide to the City five copies of draft Operation and Maintenance Manuals **within 180 days following the Commencement Date**, (2) shall deliver the **final Operation and Maintenance Manuals to the City within 60 days following completion of review and approval by the City**.

The Operation and Maintenance Manuals refer to the parts of the whole. For example, the Managed Assets (the whole) is made up of (the parts) the Main Plant, the Tertiary Plant, the Collections System and Water Distribution, to name a few. The Manuals describe how "the parts" work together for an efficient "whole."

These Manuals must have City input and review for several reasons:

- City owned assets
- City money spent for capital improvements
- City's responsibility to assure residents, organizations and governmental agencies that the vendor contracted by the City will in fact operate within the guidelines of applicable laws

So to review the timeline: (1) establish the standard operating procedures by the Commencement Date; (2) install and maintain a computerized maintenance management system starting 90 days after the Commencement Date; and (3) deliver to the City draft Operation and Maintenance Manuals 180 days after Commencement Date and the final versions 60 days after City review and approval of the draft documents. Any step not completed throws the timeline into disarray. From the beginning OMI failed to complete the very first step of the process. Deadlines have been given in terms of days, therefore *(as of December 1, 2003)*:

- Step 1 is 487 days or one year and four months overdue
- Step 2 is 397 days or one year and 1 month overdue
- Step 3 is 100 days overdue

These sections of the Service Contract comprise the guarantees demanded by the City, agreed upon by OMI. It was during the outsourcing process Mayor Podesto, Mr. Gary Ingraham and Mr. Mark Lewis referenced these sections of the contract as the guarantees for high quality delivery of services. The residents of Stockton must rely on the City retained employees, under the direction of Municipal Utility Department Director Mr. Mark Madison, for direct monitoring of the operation of the plant and the maintenance of the managed assets. Entrusting the municipal utility to be operated and maintained by a private profit motivated contractor, as if it were their own property, requires disciplined and deliberate methodologies of monitoring. The standard operating procedures, computerized maintenance management system and the Operation and Maintenance Manuals make it possible to monitor, and hold accountable, OMI.

Without strict monitoring processes, the quality of service and the condition of the managed assets could deteriorate quickly. Since the City is currently embroiled in a lawsuit, monitoring at this present time is paramount so as to assure City residents, if

the courts rule against the City, that the municipal utility will be returned to municipal operation in a condition equal or better than when the Commencement Period began.

The benefit of the maintenance timeline within the Service Contract will provide for the City a baseline for maintenance procedures. The vendor has been given the opportunity to develop a schedule of maintenance that will be efficient and effective, that will serve the private provider as well as the terms of the Contract.

Maintenance Operations

Within the Contract, Appendix 6, Section 1.0, the Operations and Maintenance of the Managed Assets begins with 35 specific General requirements. Following the General requirements are the sections detailing the water, wastewater and stormwater system requirements.

Sections 1.1, 1.2 and 1.3 of Appendix 6 are the detailed requirements for preventative, predictive, corrective and emergency repair and replacement. The complexity of the maintenance operations is complicated further by OMI and the City's failure to complete the maintenance procedure timeline described in the Service Contract.

The designed functionality of the computerized maintenance management system is to provide both scheduling and monitoring transparency. For the City to validate that OMI is conducting operations as required, it is important and necessary to have transparency and openness. The vagueness of the present reporting process makes compliance a difficult task at best. Without full understanding of the Service Contract and the complete working knowledge of the municipal utility, the general citizenry must trust the City Staff.

Two examples of items that have NOT been completed as of August 2004 and which had due dates prior to August 2004 are:

- Sanitary and Stormwater **preventative maintenance procedures** have yet to be developed
- Scheduling of the Operations Staff at the Main Plant and the Tertiary have yet to be completed

And this should be no surprise. Failures noted in this Review previously, means failure in this section. Without the development of preventative maintenance procedures and that scheduling of Operations Staff have not been completed, one could extrapolate that the vendor has no sense of order in the maintenance function. Since there have been no reports delivered to City Council regarding the performance of the Service Contract,

one might also extrapolate that City Staff, City Management and the City Council have no idea whether the services they pay \$1.6 million per month are being performed.

There can be no argument that OMI has no funds to allocate for ongoing repair and replacement maintenance. Built into the Fixed Service Fee is \$650,000 (indexed beginning in the second year of the contract) dedicated to cover the repair and replacement of the managed assets. The residents of Stockton's water related fees provide for the repair and replacement activity. In the event of any repair or replacement in excess of the \$650,000, the City is responsible for this expense as well. This method of dealing with repair and replacement, City pays Fixed Fee and City is responsible for excess of Fixed Fee funds, is the reason this contract is an outsourcing vs. a partnership agreement.

Lack of scheduling capability and failure to develop maintenance guidelines creates a "management by crisis" style of operation. This method of management creates opportunities for work to go unfinished or backlogged. With insufficient permanent, qualified employees, backlogged maintenance can create a whole new set of problems. If not addressed, backlogs can get out of hand. Monitoring of compliance with maintenance procedures falls directly upon Mr. Mark Madison and his staff. As an example, from the July 2004 Monthly Report from OMI, the following scheduled maintenance repairs are backlogged:

1. Main Treatment –
 - a. Mechanical 45%
 - b. Electrical 28%
 - c. Engines 9%
2. Sanitary Pumping –
 - a. Mechanical 14%
 - b. Electrical 28%
3. Tertiary
 - a. Mechanical 14%
 - b. Electrical 21%
4. Stormwater Pumping –
 - a. Mechanical 47%

Within the Water Distribution System there is a piece of equipment called a Backflow Device. The Service Contract spells out the required maintenance for equipment necessary to operate the municipal utility. These devices have an inspection and test schedule.

As an example of poor performance, the July 2004 Monthly Report from OMI contains the following data pertaining specifically to the Backflow Devices:

Beginning number of backlogged orders	197
New work orders received for the month	126
Number of work orders completed	52
Remaining backlogged orders	271

The results are that 84% of the Backflow device inspections and testings are backlogged.

Further examples of other backlogs reported from the July 2004 Monthly Report are:

<u>TASK</u>	<u>% Backlog</u>
Water Production Corrective Maintenance	
Mechanical	25%
Structural	9%
Special Projects	
Pre-Rehab for Wells 12 and SS1	100%

Corrective Maintenance Work Orders

Small meter TR Repair/Replace	58%
Small meter DR Repair/Replace	90%
Small meter backyard Repair/Replace	100%
Meter Box Trim	31%
Meter Box Lid Replace	44%
Meter Box Replace	85%
Large Meter Repair/Replace	100%
Water Service Line Manifold R/R	100%

Average Corrective Maintenance Backlog 64%

The intent of Operations and Maintenance Standards lies in the language related to the termination of the Service Contract. The Managed Assets are to be returned to the City for municipal operation at the end of the 20-year term of the contract at a weighted life

equal to 95% or better. In other words, the City is giving OMI high quality assets, and the City wants them returned in the same manner. But the City has no concrete methodology in place to hold OMI accountable for their actions. The City's disregard for the very Service Contract they drafted, may come back to haunt them.

The most interesting quirk however is, as was stated earlier, (1) the City is giving all the managed assets to OMI to use to meet the needs of the Contract, (2) the City will pay for all improvements to make the municipal utility operate more efficiently and at less cost, (3) the City will cover all emergency repairs needed to operate the system and (4) the City will pay \$650,000 annually to keep up with the necessary repairs and replacements. As an example in the real world:

Suppose you went to a car rental agency and wanted to use one of their vehicles. If you had a contract, such as the contract given from the City to their vendor, the agency would give you a car to use along with a debit card for the operation of the car. The agency would pay you monthly to use their car. Should the car need repair, simply use your debit card. If emergency repairs are needed and exceed your debit card limit, the agency would cover your shortfall. When you return the car it only needs $\frac{3}{4}$ tank of gas.

(Note: Above a reference is made to a weighted life of 95%. This measurement is based on the evaluation of the Manage Assets. This evaluation was to be completed within 180 days after the Commencement Date. In the Appendix, CAM #7, executed November 8, 2004, TEN MONTHS after the due date, the evaluation has been delayed and a new deadline date of October 2005. At issue is not the CAM #7, but rather the delay of 10 months and the execution of the CAM post due date – a cover up of a Contract violation)

Violations

The Service Contract does provide some relief for the City, should OMI operate in a manner in appropriate with applicable law. With accurate monitoring procedures in place, notices of violations (NOV) should be few if any. Conversely, the lack of procedures and supervision can produce the opposite.

No one wants NOVs. As with any non-compliant activity, there are consequences. Operating a sophisticated municipal utility inappropriately could damage the managed assets; harm the environment, cause injury or illness to workers and/or residents or any combination of these or other results. NOVs are also an ineffective use of revenue.

Should a NOV be delivered to the City for the behavior of OMI and result in a monetary fine, by contract OMI pays the fine. NOVs come from a number of governmental agencies primarily responsible for ensuring compliance with applicable laws.

Not every action or series of actions creates a NOV. A spill is defined as water or sewage or other liquid material that goes somewhere it does not belong. For example, an accident involving a big rig truck on Interstate 5 might create a spill of a petroleum product that could potentially end up in the water resources.

The following are some of the spills that have occurred under the vendor's operation, but did not lead to a NOV or any monetary consequences as of yet:

October 12, 2003	155 lbs of anhydrous ammonia leaked at the main plant due to a faulty flow meter creating a hazardous vapor.
November 3, 2003	1500 gallons of sewage poured into the Calaveras River
November 4, 2003	200,000 gallons of a sudsy substance entered Mosher Slough
November 27, 2003	1000 gallons of sewage poured into the San Joaquin River
February 8, 2004	4000 gallons of sewage entered the stormwater system due to a failed pump station
February 16, 2004	an unknown amount of sewage spilled due to a lift station failure
September 11, 2004	1800 gallons of sewage entered the Mormon Slough

These are some of the larger spills. OMI and the City are required to report all spills over 1000 gallons. This is a large number. It takes very little foreign substance to contaminate a waterway or create an environment harmful or fatal to fish. The other consequence of hazardous waterways is that people use the waterways for recreation and for food. What goes in the water may enter human systems.

Under municipal operation the City received a NOV and a fine for the failure of an employee to properly monitor the operation of the main plant. The consequence was a fine, paid by the City, and disciplinary action for the employee, which is sealed by personnel regulations.

The City has been in municipal operation for many years, decades even. The City has constructed some +30 wells for drawing groundwater as a source of our finished water. In this time period the City has received only two monetary violations.

Within the Initial Capital Improvements, OMI was compensated for the construction of two additional wells. OMI does not have the resources to construct or complete the entire process to make a well functional. They contracted with a third party provide the wells.

Every well created must go through a sanitizing and priming process. There are standard operating procedures for these activities. For decades the City has created its own wells following correct procedures without incident. Within the first two wells assigned to the vendor, an incident occurred.

To quote the Executive Officer's Report, 22/23 April 2004 from the Central Valley Water Board:

"On March 17, 2004, a contractor working for the City of Stockton disinfected a new well with approximately 40 gallons of 12.5% sodium hypochlorite solution, and then pumped approximately 480,000 gallons from the well to a Woodbridge Irrigation District canal in Stockton. This unauthorized chlorinated discharge caused a fish kill in the canal which is tributary to Bear Creek."

The City received a Notice of Violation and a subsequent fine of \$125,000. OMI will pay the fine; but the real issue at hand is OMI's inability to provide proper supervision, understand rules and regulations for discharges and environmental quality control. Throughout this Review, OMI has displayed the inability to complete a task correctly and on time. The failure to meet contract standards could mean that the vendor has a pattern of behavior that will not be noticed until it is too late.

(Note: from the Executive Officer's Report, 17/17 October 2003, Central Valley Water Board... "In October 2003 the Central Valley Water Board issued a report addressing the Sewage Collection System Spills for the City of Stockton. Since February 2002, the City reported 495 Sanitary Sewage Overflows (SSOs). Of that number, 15 overflowed into surface water bodies. Thirty-three SSOs were over 1000 gallons. The City has provided prompt response and clean up of the sewage spills. However, staff (water board) has concerns with the City's sewer system maintenance and repair/replacement program to prevent sewage spills. Staff has requested that the City develop an SSO Emergency Response Plan, and may consider requiring additional actions to prevent SSOs." This report covers both Municipal and private vendor operations.

The City Staff has created the required Emergency Response Plan and is in the final stages of revisions and approvals. The report from the water board provides a baseline for monitoring future SSOs and whether the vendor is providing enough preventative maintenance to address the spill situations. With proper monitoring by the City Municipal Utility Department time will tell if services are being provided at an adequate level.)

Conclusion

A member of the Concerned Citizens Coalition of Stockton met with Mayor Gary Podesto to discuss the issue relating to the public private partnership, as Mayor Podesto called it, or privatization as others refer to the process. The question asked by Mayor Podesto was “Why wouldn’t you want to privatize?”

With that directive the process of analysis began, specifically to answer the Mayor’s question.

The discovery over the last several years has revealed that an attitude exists which may appear to be in the best interests of the residents, but in fact has been driven by other priorities.

The outsourcing of the municipal operations has been a one sided event. The idea that municipal service could be more efficient and that reduced costs could provide lower stable rates, never had a chance at the table. One person saw this one option as the only way and became the driver to make this outsourcing a reality.

This Review is not a complete analysis of the Project, it was not intended to cover every facet. The process of gathering documents from the present City management prevents timely analysis. For example, modifications of the Service Contract occur with the signatures of Mr. Mark Lewis, City Manager, Mr. Mark Madison, Director of the Municipal Utilities Department and Mr. Wyatt Troxel, General Manager for OMI Thames Water. These changes in the Service Contract are not brought before the City Council, nor do they need the Council’s approval. The City Staff presently at the municipal utility is not looking at the contract for compliance, but rather is diverting their eyes as if they had blinders.

What have been the consequences of the outsourcing?

Contract variance – the Service Contract was created to protect the investments the residents have made in their utility over the past decades of municipal operation. The Service Contract had a series of checks and balances to protect the City, the residents, and OMI. As illustrated in the section on Contract Amendment Memoranda, the City chose to waive Section 4.3 (7) Legal Proceedings, and allow OMI to move forward with the Commencement Date.

This action favored OMI, as they would now be able to proceed with the real value to them in this contract, the Initial Capital Improvements. As a single contract covering the Project of the operation and maintenance and the capital improvements, the only way to proceed with the necessary construction was to waive Section 4.3 (7). The third party consultant gave advice early in the procurement process that only if the capital improvements were in the contract would any companies place proposals for consideration.

The waiver of Section 4.3 (7) favored OMI in another manner; it meant that if the City were to exit from the contract, OMI would receive \$1,000,000 buyout. Without the waiver there was no buyout and the liability to the City and to OMI was significantly different.

Proceeding with the Commencement Date, with the knowledge that legal proceedings were being brought against the City, created far reaching variations that have altered the Service Contract and placed the value of the municipal utility assets at risk. This can be illustrated by the most current action before the City Council in the Request For Proposals for the independent evaluation of the Managed Assets. This independent evaluation was to occur within the first 180 days following the Commencement Date, so as to benchmark the present value and life of the Managed Assets. This is covered in Section 8.2 of the Service Contract. However, the contract was amended and the new date is October 10, 2005. This initial evaluation will be a benefit for OMI, since two years will have been removed from the weighted average life of the Manage Assets, the

City will receive the Assets at the end of the Service Contract Term, with less life than which they were delivered to OMI.

These two examples illustrate that the contract variation are not made to benefit the residents and protect their investment, but rather a deliberate set of actions to protect the outsourcing of the municipal utility.

Water Related Rates – have increased. The idea that water related rates would remain at present levels, without increases, is not possible. The municipal utility system is in need of modification for modernization, efficiency, and state mandated regulations. Using a design build methodology, rates can be kept lower than the traditional practice of using different designers and builders. Furthermore, tying the collaboration of the operators and the designers/builders, as was done in such places as Phoenix, Miami-Dade, Seattle and San Diego; municipal operation can produce the targeted savings needed to keep rates low and meet modification requirements.

Collaboration or other alternatives was never really given a fair chance. City and Utility Management must be about addressing dramatic methodologies for the improved efficiencies and savings required to meet the growing needs of the City of Stockton. This City Management took the approach that it cannot be done under municipal operation and chose to outsource.

The result of the outsourcing is a guaranteed adjustment annually to the utility related rates. The historical Consumer Price Index used to track the annual adjustments has only risen in each of the past 20 years. Common sense would say to expect the same. Contrary to what the City Council, City Management and Alternative Resources, Inc declared, local utility rates will potentially increase by 63%, simply because of the contract Fixed Service Fees.

Utility rates will undergo further increases and bond issues will be presented as methods to pay for the needed improvements. The attitude of the City Council and City

Manager has been to look to the Utility Enterprise Funds for additional revenue, not to fund the general operation of the City of Stockton, but rather to pay for special projects not needed for the day-to-day operation of the City. This attitude will mean greater increases and larger bond issues as the restricted funds are removed for other priorities.

Note should also be taken that because of the attitude of the City Council and City Management, nearly \$3 million has been spent defending a lawsuit where the original decision was against the City.

Customer Service – is what was demanded by Mayor Podesta, promised by OMI and agreed upon by contract. The simple matter is there is no Customer Service. Outsourcing creates concerns for many citizens. Concerns that if a problem or a question exists the only way to get an answer would be to play “touch tone bingo” until the right set of numbers was entered, or even worse, the call would be answered by a computerized voice with “leave a message” as the only alternative.

The Service Contract was very specific about what services OMI was to provide. Today, OMI has failed to provide any customer service or any outreach/education. The City contracted with other vendors to provide some City services, specifically Sunrise Sanitation and Stockton Scavenger. These providers have delivered an enormous amount of public education, outreach and assistance. One just needs to attend any number of City sponsored events, and these vendors were present giving assistance to citizens. They even have local numbers publicized on the City’s website if there are specific questions or problems.

OMI has provided no customer service. Promises they made in public have yet to be delivered. OMI has been involved with the City for over two years, it’s not as if they just came to town. Customer Service is important to the customers. In a monopoly created by the outsourcing of the contract, customer service is not a priority for OMI.

Unaccounted-For Water – is double and on track to nearly triple, in less than two years, contract requirements. The methodology for determining unaccounted-for water (UAC) is an agreed upon process. Using the only historical data available from the Municipal Utility Department, the UAC is significantly greater than under municipal operation.

Regardless of the industry standards or vendor opinion the level of acceptable service demanded by the Service Contract is explicit. The City of Stockton requires a 3.5% level of unaccounted-for water. Reduction of UAC means benefits to the citizen owned utility and to the vendor.

From a vendor perspective this can mean lower electrical and fuel costs to deliver the water to Stockton customers. This can mean for them more profit.

By meeting the standard set by contract, OMI also has an opportunity to set an “efficient water use” example and with a developed outreach program, provide residents with methods on how to lower their water bills through conservation and efficiency.

Reduction of UAC also means an opportunity to lower the risk of backflows and system liability, reduce wear on the equipment and have the potential to expand the system connections without necessarily seeking new water sources. These issues mean lower rates for residents, the sole purpose for outsourcing

The charts in this Review clearly illustrate that OMI has some serious work to do in this area of the contract. The difficulty however is that there seems to be absolutely no consequence for not meeting the contract standards.

The City of Stockton is presently studying and moving toward the creation of a new water source, via the Delta Water Supply project. This project proposes that the needed water demands of Stockton in 2015 will be 85,000 acre feet (af). The water source expectations in 2015 are: Stockton East Water District about 42,000 af and our own groundwater at 40,000 af. That leaves a shortfall of roughly 3,000 af. If OMI can reduce

their unaccounted for water to contract levels, that will meet HALF of this projected shortfall. Education and outreach by OMI would translate into better conservation by consumers and the possibility that water banking might fill the gap.

The costs associated with UAC go far beyond the immediate Service Contract. There should be severe consequences for the poor management and failure to reach contract standards. This is all the water we have; we should treat it like we would treat any limited quantity precious resource.

Staffing capabilities – and the problems created by an unknowledgeable staff has been detailed. OMI's difficulty in maintaining a full complement of employees necessary to fulfill all the components of the Service Contract are is presented to the City Staff monthly. Yet there is a failure to hold OMI accountable.

Businesses always hold their vendors accountable. If a grocery store owner has a contract for top quality produce, that grocer is not going to accept less, and if the grocer does accept less it not be without consequence to the vendor with whom the contract for produce exists. Insurance agents hold their insurers accountable for the contracted services for which their customers pay premiums, or the agent finds a new insurer.

Why is it different between the City and OMI? The domino effect of a poorly trained, low experienced staff reaches far beyond filling in the bubbles of a staffing chart. The City demanded qualified staff, nothing less. While some of the employees "act" or take on "interim" responsibilities, this only benefits the vendor. This strikes directly at the issue of profit motivation, and should not be acceptable.

Institutional knowledge of how the Stockton system works, allows employees to easily recognize problems before they occur. There is a pride in the work they do and the service they provide to the residents of Stockton. Qualified employees, who take pride in their community, live in their community and have a vested interest in their municipal utility. This could be illustrated by the few violations issued to the City prior to

outsourcing, and within less than one year the vendor has a \$125,000 fine for illegal discharge.

The inability to maintain a staff is reflected in the average tenure of the OMI's employees. During the procurement process the parent company stated that their average tenure for their employees was in the realm of 7 years. Municipal employees consistently have a greater average tenure and therefore a greater working knowledge of the systems with which they work.

Poor staffing at the senior level is also a problem for OMI. Consistency in management is necessary to implement any type of program. If the turnover of regular employees and the tenure of senior staff continues to be a problem, OMI management's ability to meet the requirements of the Service Contract will be difficult if not impossible. Throughout the Service Contract, failures in meeting the terms can be attributed to poor staff management.

Finally, the results are beginning to be seen in the ongoing maintenance programs that are not in existence. There are no standard operating procedures, there is no computerized maintenance management program in full operation and the result is no formal operation and maintenance manuals. The \$650,000 built into the Service Contract was the continued investment by the residents and ratepayers back into their municipal utility. Without proper maintenance management, this money will be spent quickly for equipment replacement vs. predictive, preventative or corrective maintenance.

The stated intent of outsourcing examination was to discover if there was a better way to provide the utility service to the residents. What has happened is not anything close to what was promised. The City of Stockton has a vendor with poor employee retention, miserable maintenance record, a \$125,000 fine in their first year, and a senior management team that will not nor has not met contract specifications.

The results:

- Consumers and developers have higher rates with less service,
- The Mayor and the City Manager (with City Council approval) doubled the amount of revenue transferred from the Enterprise Funds and have spent the money on non-utility projects (specifically an arena and a ball park)
- Budget transfers have taken interest earned on the surplus Enterprise Funds, money that would have been used for system improvements, to now be used on non-utility projects (see #2)
- City Municipal Utility Department Management has failed to notify City Management of the problems that exist through vendor failures to meet Service Contract standards
- When a Contract requirement cannot be met, contract revisions are created, like the tail wagging the dog.

Mayor Podesto asked, “Why wouldn’t you want to privatize the municipal utility?” This Annual Service Contract Compliance Review answers that question.