Unlike the way many utilities view privatization, the Department of Defense (DoD) began privatizing (selling) utility systems in 1998, presenting an acquisition potential for local utility providers. However, the DoD has had varying success with the program and sometimes receives only lukewarm, if any, interest from local utility providers—perhaps because of its unique approach. Acquiring a DoD utility system and the associated utility privatization service contract certainly presents challenges, but also tremendous opportunities. This article highlights the history of the DoD privatization program, discusses upcoming water/wastewater systems scheduled to be privatized, and covers factors that utility providers should consider when pondering acquisition of a nearby DoD utility system. These factors include contractual concerns, acceptance/transfer of risk, pricing, competition from other utility providers, political sensitivities, off-military-base rate-payer impacts, value to the community, regulatory matters, and the cost and complexity of proposing. The article also discusses two successful utility privatization examples (water and wastewater) at Naval Air Station in Key West, Fla.
A POSSIBLE WAY FORWARD

Program history. The DoD utility privatization program is rooted in the challenge of balancing the need to repair aging military installation infrastructure with federal funding limitations and competing demands. The current condition of existing utility systems on military installations clearly demonstrates the need for investment, but presents tough choices for commanders at the installation and higher levels. Despite their direct support of the mission and the way they enhance quality of life, utility systems always compete with and frequently lose to other investment priorities, something municipal utilities also experience. Often, underfunded accounts designated for infrastructure improvements are the result of investments in important weapons-system upgrades. When adding that utility systems typically are not readily visible, those underfunded accounts are normally directed to highly visible military base facilities because of the perception that visibility implies importance.

To tackle this problem, the DoD looked for ways to gain the best value and efficiency to maintain mission readiness while also improving neglected infrastructure. Aside from a few exceptions, utility ownership and even system operation and maintenance are not essential skills for wartime missions, which has given Congress the flexibility to establish privatization as a new means of financing these projects.

The National Defense Authorization Act of fiscal year 1998 authorized the DoD to transfer ownership of its utility systems and added legislative authority under 10 USC 2688 (US Government Publishing Office 2012). Soon after, Defense Reform Initiative Directive #9 in December 1997 directed military departments to privatize electric, gas, water, and wastewater systems. At the outset, the DoD owned 2,600 utility systems valued at $50 billion. Exemption under 10 USC 2688 is allowed if privatizing a system proves to be uneconomical or presents a security risk; however, since the legislation was passed, several systems exempted for economic reasons early in the process are being reissued for another attempt to be privatized.

Acquiring a DoD utility system and the associated utility privatization service contract certainly presents challenges, but also tremendous opportunities.

Program overview. When on-base utility systems are privatized, they are sold to private or public entities—specifically, those that exist to operate and maintain utility systems, such as municipal- or investor-owned utilities. In this way, the purchasing entity becomes responsible for operations, maintenance, and improvement of the military base systems. The military installation becomes the customer or user and enters into a service contract that often has an initial term of 50 years. The contract generally contains a rate structure that leads to greater predictability of costs (tariff-based or fixed-price with economic price adjustments). Under the contract, the government retains ownership of the land around the utility with access provided by means of a right-of-way or easement. Because of the complexities in the procurement process the DoD uses to issue the requests for proposal (RFPs) for each utility ready for privatizing, the initial goals of privatizing by Jan. 1, 2000, proved unsuccessful, as did further attempts with new deadlines.

Privatization process. When initiating a privatization action, the government’s first step is a “sources sought” query to gauge the level of interest among qualified entities. If there is enough interest (usually at least two qualified parties), an RFP is issued for each utility being privatized, typically 3–6 months later. Energy utilities (gas and electric) are normally in a separate RFP from water and wastewater as a means to match the interests of most utilities. The proposing entity can then choose to propose on just one or both systems in the RFP. These intensive RFPs

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subject to a statewide regulatory authority or as an annually adjustable fixed price to a known index such as the consumer price index. The charge includes operations and maintenance costs, ongoing renewal and replacements cost, the credit to the government for the fair market value purchase price, and the recoverable portion of the purchase price (not to exceed 100%).

The initial system deficiencies corrections charge covers the short-term costs to correct the deficiencies identified in the RFP. The costs are recovered from the government via monthly payments and may include recovery of interest if work was financed by the new owner.

The transition charge covers the new owner’s efforts to take over responsibilities, including permit transfers, staffing, and meetings with the government. The duration of the transition period is proposed by the utility.

Following submission of the proposal, the government’s selection process for the best-value offeror for each system is complicated. Each system must be evaluated separately (which is often the reason for a utility to submit a separate proposal for each system) to prove the economic standard set by 10 USC 2688 (US Government Publishing Office 2012). During the initial evaluation of all proposals, the government will develop questions for proposers that are determined to be technically qualified for the privatization. Those proposers will receive questions from the government between six and 12 months after proposals were submitted. This begins the formal process known as “discussions.” Although the government always reserves the right to award a contract without these discussions, it is rare with a process as complex as privatization.

During discussions, the government may go through several rounds of questions with the proposers and may ask for revisions to proposals that reflect the answers provided to questions. Discussions terminate with the government’s request for “final proposal revisions,” which reflect the utility’s best and final offer.

The government will next determine the proposer that represents the apparent best-value offeror for the government. This offeror will enter into negotiations with the government to finalize terms and conditions of the contract, perhaps conduct some additional due diligence on the utility system(s) being privatized, and make preparations to execute transition and startup. The government, meanwhile, has a lengthy approval process to go through for final authority to divest the utility system(s) and execute the 50-year contract.

Program outcomes. Today, the office of the Deputy Undersecretary of Defense reports that military departments continue making progress with privatization without specifying goals for completing the program. In recent years, the US Navy has made little or no evident progress to privatize new systems, but evaluations of the value of privatization and actual savings realized are underway. Likewise, the US Air Force has placed a “strategic pause” on the program to evaluate the benefits, but continues to execute the advertised schedule—at least up until final award of a contract. Last year, the Air Force reported that 167 of about 660 utilities systems were privatized, avoiding more than $500 million in costs. Of the 660 systems, 160 were exempted as noneconomic and 122 systems are in various stages of contracting.

Challenges and opportunities

Demanding process. Interested entities can find the process lengthy and labor-intensive. A large investment of time, effort, and money is going to be necessary not only to complete the initial proposal, but also to traverse the lengthy discussions and negotiations process. In addition to a local utility possibly having little or no experience with federal contracts, the complex RFP (300–400 pages, plus technical data) often leads to noncompliant proposals or may be so intimidating that it discourages

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FIGURE 1 Primary components of the price offered for utility privatization

<table>
<thead>
<tr>
<th>Total cost</th>
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<tr>
<td>Utility service charge</td>
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<tr>
<td>ISDCs/connection charges</td>
</tr>
<tr>
<td>Transition charges</td>
</tr>
</tbody>
</table>

Regulated tariff

Fixed-price economic price adjustment

ISDC—initial system deficiencies corrections

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submitting a proposal at all. In the event the proposal process moves forward, the board or council approval that is often necessary to proceed can be hindered by a lack of awareness regarding benefits. Federal Acquisition Regulations and contract clauses can cause fear of risks that must be mitigated. For example, termination-for-convenience clauses appear one-sided and risky, but can actually be very fair. Nonetheless, other issues such as potential impacts on existing ratepayers must be assessed and resolved.

Future regulatory changes or those caused by the government (including military base closure), and decreasing or even increasing system requirements, may also appear to be a risk to the new owner. However, provisions are available to negotiate such changes with the government and recover costs required to accommodate these changes.

Further challenges to the process relate to DoD staff turnover and approvals. US government contracting officers have experienced high turnover, depleting knowledge of the privatization process and contract execution experience. Necessary approvals from government agencies are burdened by multiple layers in the chain of command. The process, which ideally should take less than two years, often requires three years or more.

Finally, each military base or post that privatizes systems is unique in its location and challenges. For example, various system deficiencies may require early investment by the new owner, or technical data may be inaccurate or called into question. In some cases, such technical data may be scarce or even unavailable.

**Potential benefits to the government.** Despite the demands of the process, privatization can offer benefits to both the DoD and the prospective new owner. The warfighting mission is paramount to the government, but the health and welfare of military and civilian personnel and families is still a significant need. Privatizing its utilities relieves the government of the daily responsibility for assets that support the warfighting mission but are not inherently government functions and therefore don’t have to be owned and operated by the military. This may raise the question about community can share the costs of resources such as expensive equipment, and the public utility can build an increasing customer base for greater revenue. The purchase of the installation utility stimulates the local economy and reinforces the connection between the community and the military installation, potentially even reducing the vulnerability of the installation to future base closure. Finally, and in spite of recent examples of communities having financial struggles or even battling bankruptcy, the public utility is more likely to remain solvent and wholly intact during the 50-year contract.

**FACTORS TO CONSIDER**

A public utility considering privatizing one or more utility systems at a local military installation has many factors to consider; following are a few that have been encountered.

**Contractual concerns.** The previously mentioned Federal Acquisition Regulations clauses and contract language place limits on the new owner’s use of the systems and define owner rights for changed conditions and recovering costs for new requirements. These may be onerous but generally not unfair.

**Commodity contracts.** If the local utility is selling the water commodity to the military installation and/or treating its wastewater, the government’s intention is that these existing contracts remain intact and separate from privatization. However, perhaps there are advantages to either the government or the utility (or both) to combine contracts. These should be considered.

Aside from a few exceptions, utility ownership and even system operation and maintenance are not essential skills for wartime missions, which has given Congress the flexibility to establish privatization as a new means of financing these projects.
Acceptance/transfer of risk. The government will transfer all permits and responsibilities for the systems, but retains liability for preexisting environmental contamination. The new owner’s risks include bringing (strengths-weaknesses-opportunities-threats) analysis, will help prepare the mayor, council, or board to make the right decisions.

Off-base ratepayer impacts. There often is the potential that a new utility experience with acquiring or taking over responsibility for new systems, and detailed pricing forecasts covering the 50-year contract period. It is essential that the proposal be completed thoroughly and accurately to be successful in the process. In discussions with government officials, the greatest weakness in proposals submitted by local utilities has been the failure to clearly answer the requirements of the RFP.

Most of these factors can be dealt with effectively by using an expert in the utility privatization program. Such an expert can develop risk profiles and mitigations, system assessments, and funding profiles as well as help develop the detailed proposal documents. Table 1 lists the near-term DoD privatization opportunities.

WHAT A DoD PRIVATIZATION PROCESS LOOKS LIKE

Naval Air Station (NAS) Key West, Fla. The Florida Keys Aqueduct Authority (FKAA) is a utility privatization success story. Established by state legislation in 1937, FKAA is the only water utility servicing the Florida Keys. FKAA presently serves nearly 50,000 customers, adding wastewater services in 1998. As the sole provider of potable water for all Florida Keys (Monroe County) residents, FKAA transports the potable water from its well field on the mainland of Florida through a 130-mi transmission pipeline originally built by the Navy, with an additional 690 mi of distribution pipelines. It has been supplying water to NAS Key West since it began service. FKAA has also been tasked by Monroe County with responsibility for all wastewater systems and has constructed several regional treatment plants to begin eliminating the multitudes of existing septic systems throughout the Keys.

In December 2002, the Naval Facilities Engineering Command issued a water RFP with proposals due in June 2003. The RFP included the distribution systems for all Navy properties in Key West. Compared with the current Defense Logistics Agency model requiring a four-volume
proposal (one each for technical, past performance, contract documentation, and price), the Key West privatization required a two-volume proposal (technical and price). However, the contents and selection criteria were similar: technical capability, past performance, risk, socioeconomic (small business commitment), and price. FKAA needed help with the proposal; beginning in 2002, the first author of the present article provided assistance with the initial proposal and the government-required revised proposals, continuing through negotiations and startup. Following selection and contract negotiations, FKAA was awarded the contract in January 2008.

Similarly, in March 2008, Naval Facilities Engineering Command issued an RFP that included the NAS Key West wastewater systems; FKAA submitted its proposal in June 2008. After several revised proposals and some starts and stops resulting from Florida regulatory issues and best options for the government, FKAA was selected as the best-value offeror in March 2015. Following final due diligence and negotiations, the contract was awarded to FKAA in October 2015.

The ownership transfer of these systems has proved beneficial for both FKAA and the government. FKAA folded operations into its existing processes, saving on costs and time through part-time, as-needed staff on the NAS, which meant only part-time equipment use as well. FKAA invested immediately to improve system pressures and eliminate an old water storage tank that posed a potential threat of collapse during hurricanes and replaced more than $3 million in water system components in the first five years. FKAA has likewise initiated design and construction to connect the NAS wastewater systems to the closest regional treatment plant and demolish the antiquated Navy plant. FKAA and the base personnel enjoy an excellent working relationship. Figure 2 shows the FKAA system in relation to and in support of the NAS Key West facilities.

One of the greatest challenges for both FKAA and the government has been the rate structure used (prospective price redetermination) in the water contract. It has proved to be an administrative burden and time-consuming. Fortunately, that pricing methodology is no longer used in new RFPs; the wastewater contract uses FKAA’s wastewater tariff. To ease the administrative burden on the water contract, the lead author is working with the Navy to convert the pricing to FKAA’s existing water tariff.

**SUMMARY**

In response to the challenge of utility systems on federal installations that competed for mission-support funding, the DoD began privatizing utility systems in 1998. Although optimistic about the potential to make better use of government resources at the same time as achieving updates and longevity for the most basic of utility needs, the DoD has experienced a mixed response from local utility providers. This article has explored the history of the program and what the privatization process entails. The successful water and wastewater utility privatizations illustrated in the NAS Key West case study demonstrate that the potential for value to both the government and municipality exists. To determine whether it is right for a local utility provider, it is important to weigh the pros and cons before committing to the process and to be prepared to use an expert.

**TABLE 1** Possible DoD Privatization Opportunities 2016 Through 2018

<table>
<thead>
<tr>
<th>Fiscal Year 2016</th>
<th>Fiscal Year 2017</th>
<th>Fiscal Year 2018</th>
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<tbody>
<tr>
<td>Barksdale AFB, La.</td>
<td>Beale AFB, Calif.</td>
<td>White Sands Missile Range, N.M.</td>
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<tr>
<td>Schriever AFB, Colo.</td>
<td>Offutt AFB, Neb.</td>
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<tr>
<td>Patrick AFB/Cape Canaveral, Fla.</td>
<td>Yuma Proving Grounds, Ariz.</td>
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<tr>
<td>Fort Leonard Wood, Mo.</td>
<td>Redstone Arsenal, Ala.</td>
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<tr>
<td>Anniston Army Depot, Ala.</td>
<td>Watervliet Arsenal, N.Y.</td>
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</tr>
<tr>
<td>Aberdeen Proving Ground, Md.</td>
<td>Rock Island Arsenal, Ill.</td>
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<tr>
<td>Fort Buchanan, Puerto Rico</td>
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</table>

AFB—Air Force Base, DoD—Department of Defense

*This information is current as of Mar. 1, 2016. The listed opportunities are subject to change as the DoD issues solicitations on an ongoing basis.*
to the process and to be prepared to use an expert in the utility privatization program to deal most effectively with the complexities involved.

DISCLAIMER

The views expressed in this article are solely those of the authors and do not necessarily represent the views of the Department of Defense.

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REFERENCE


SUGGESTED READING
