

**Should Regional Municipal Solid Waste Consortia Enter
Incentive Based Service Contracts for Professional Management Services?**

**John A. Merritt
Merritt Environmental Solutions
152 North Main Street
Natick, MA 01760-2725**

INTRODUCTION

There are myriad challenges facing any regional municipal solid waste management consortium today. Consortia of the sort discussed here include any regional municipal waste authority, board, committee or other governing body. The challenges are especially acute when a waste-to-energy facility is part of the integrated solid waste system. With increasing challenges in the regulatory, technical and financial arenas as well as over-worked staffs, managers of many consortia are turning to professional consultants for a variety of support services. Today, these include, not only the more traditional services, such as engineering, accounting and legal, but also often include business management services, as well.

There are many areas in which solid waste management consultants are asked to provide specialized support to public, waste-to-energy consortia. Three commonly sought services are: a) negotiating contracts and other potentially adversarial matters, b) procuring specialized goods and services and c) marketing facility capacity. In each of these areas, taxpayer dollars can be saved or squandered. Some argue that "success based" or incentivized contracts provide management consultants very strong motivation to get the best deal possible for the client. Remuneration is based on pre-determined benchmarks, and escalates as the client's benefit increases. In some cases, management consultants charge lower than standard rates during a given project, in return for a larger total return if successful.

When appropriate, these contracts can provide excellent results. However, there are circumstances when such arrangements can lead to unexpected, negative consequences. This is particularly true when the client consists of many autonomous municipalities. This paper reviews typical, support services a waste-to-energy consortium might seek from a management consultant. It also discusses incentive based contracts and how to avoid their potential problems.

TYPICAL MANAGEMENT SERVICES

Negotiation Services

Consortium Formation -- Contractual relationships among municipal consortium members, typically include governing, as well as, operational by-laws. These by-laws need to be developed and executed to form the group in the first place. The appropriate regional relationships can, and do, vary dramatically. Some consortia are relatively informal, ad hoc, committees or commissions, focusing upon relatively narrow goals. At the other end of the spectrum are formal, solid waste districts with powers to take land, develop significant facilities and assess taxes. Management consultants, with appropriate experience, can help negotiate agreements that will provide the structure required to accomplish shared goals, without adding unneeded bureaucracy. The significance of a consortium's by-laws, with respect to incentive based contracts, is discussed below.

Contracts – Contracts, for goods and services, between a waste-to-energy consortium and a wide variety of vendors, typically represent millions of dollars. Initial agreements must be negotiated aggressively, in the consortium's interest. After being executed, conditions frequently change, requiring re-negotiation or dispute resolution. The highly specialized nature of many of these goods and services has led some consortia to seek focused assistance to negotiate such contracts. Such service can help develop

appropriate specifications, provide additional oversight and save money by negotiating favorable terms. Re-negotiation, particularly in adversarial circumstances, requires a strong understanding of available leverage. Sometimes, that leverage is chiefly financial. Often, it can also include components of law, technology and public opinion. A complicated negotiation, like restructuring a consortium's basic service agreement with a facility owner and/or operator, would benefit from the services of professionals in several fields. There are circumstances where incentive based contracts for these services may be appropriate.

Regulatory Issues -- Negotiations to resolve compliance or other regulatory issues, arising from operations or changes in law, require a thorough understanding of the relevant agencies and issues. Since these matters often arise in a very public and, therefore, political climate, it is critical to identify management consultants with proven communication and dispute resolution skills. The cost of not mitigating these issues immediately and effectively can be significant.

Incentive based contracts are rarely appropriate in these circumstances. While there often is a financial component to these issues, they also introduce the notion of the public interest. The appearance of the consultant arguing against the public interest, for financial gain, is unseemly.

Procurement Services

Procuring ash management/recycling services, waste handling/processing equipment or exotic chemicals are typical responsibilities of a waste-to-energy consortium. It is critical to draft clear, focused RFPs/RFQs to maximize competition for the consortium's business. When possible, holding pre-proposal conferences, reviewing potential vendors' assessments of the current market and revising procurement documents accordingly, when appropriate, are valuable steps. It is important to be familiar with similar, recent procurements elsewhere, while tailoring a particular consortium's procurement scope to its unique characteristics. Management consultants, with strong technical and business expertise, can strengthen these efforts. There are some fairly clear instances, where incentive based contracts can be appropriate for these services, discussed below.

Marketing Services

With highly competitive waste markets in many areas, selling excess capacity is critical to the bottom line of many consortia. Unfilled capacity can mean increases in tip fees to offset revenue loss. Management consultants, with effective waste market identification and penetration strategies can help maintain maximum throughput.

This is a very natural area for incentive based contracts. Goals and current baselines can be readily established and are clear. Improvements are reasonably easy to measure.

INCENTIVE BASED CONTRACTS FOR MANAGEMENT SERVICES

As mentioned in the introduction, a great deal of money is at risk in each of the areas just described. In cases where an objective is clear and unequivocal, an incentive based contract can make a lot of sense. For example, a given consortium's facility currently recovers 50% of the ferrous and receives a contractually established rate for the metal. An incentive based contract could be entered which would pay a management consultant an escalating amount for net financial improvement. If the management

consultant increases the metal recovery rate and/or the rate received for the material to an agreed benchmark, after cost, then a known return will accrue.

In the current example, there are many initial parameters and potential variables that must be pinned down. How much metal is in the stream currently? Will that amount change because of recycling or other external parameters? What actual percentage is currently being recovered? Once they have been established, with provision for externally imposed variables, the project goal can be fairly clearly defined. More importantly, the benefit to all consortium members is clear and mutual.

Generally, procuring well-delineated goods and services can also be appropriate for incentivized arrangements. Management consultants will be motivated to generate the broadest competitive interest and negotiate the most favorable contracts. As long as the client's interest is well known, adequately defined and quantified, these contracts can produce good results.

It is always important, however, to assure that there is no ethical conflict for the management consultant. For example, scenarios where consultants could establish inadequate specifications for the sought goods or services, to keep cost low and maximize their incentives, must be avoided. In cases where there is any question as to the availability of generally accepted standards, independent review of the process should be a component of any incentivized contractual arrangement.

Problem Areas For Incentive Based Contracts

Finally, there are circumstances in which incentivized contracts should generally be avoided altogether. As discussed above, regulatory negotiations present special problems. More generally, however, problems arise when the goal, which defines the client's interest, cannot be clearly and adequately defined.

In a complex negotiation to restructure a consortium's service agreement, for example, it may be difficult to determine, in advance, what will be in the best interest of all the municipalities impacted. The governing rules of the consortium become critically important in cases where those interests diverge as the process develops. It may seem, at the beginning of a large project, that all member communities share the same final goal. However, as time passes, conditions can change dramatically, and all communities may not believe the direction of the project is in their best interest.

Important questions of fairness and equity can arise. For example, should a community, in the minority, continue to be responsible for paying incentives to a management consultant, serving the majority's interest against their own? What mechanism exists for a minority community to escape such expenditure of its funds?

If a consortium decides to enter an incentive based contract, in such complex circumstances, anyway, there are some steps that can be taken to minimize, if not remove, problems of the sort described above:

- Require unanimous votes on matters that can encumber incentive payments to the management consultant
- Establish, in advance, a mechanism allowing dissenting communities to opt out of a process, not in their best interest.

- Spend the time and energy necessary to discuss and define any complex consortium goals as explicitly and clearly as possible.

If it turns out these discussions are troubled and don't result in well defined goals, it is a pretty good sign that an incentive based contract for services would not be advisable. It would make more sense to contract for consultant services, at ordinary rates, to help clarify and define those objectives. If clear, unanimous goals emerge from that process and sufficient safeguards are established to protect minority interests, then incentive based contracts might be considered.

CONCLUSIONS

There are many very good reasons for regional consortia managers to seek specialized assistance with the many challenges they face. In some, well-defined projects, incentive based contracts with service providers can promote excellent results for the consortium. However, when the project is very large and complex, with goals that aren't sufficiently clear, regional consortia must be very careful before executing such contracts. At a minimum, contractual safeguards and remedies must be implemented. They must guard against any member ever having to pay incentives to a management consultant, to work against their own interest. If such safeguards are not possible or practicable, the incentive based contract should be avoided altogether.