



Auditor General's Report on the BIWater (Water Purchase) Agreement



Office of the Auditor General
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Contents

PART I CONTRACTING PROCESS..... 1

INTRODUCTION 1

AUDIT PURPOSE AND SCOPE..... 1

 Restriction of Scope..... 1

ASSESSING THE NEEDS OF THE W&S DEPARTMENT..... 2

BIWATER’S SOLUTIONS FOR THE TERRITORY..... 3

 The Biwater Technical Analysis..... 3

 The Biwater Proposal..... 4

NEGOTIATING THE CONTRACT 6

 Technical Consultants’ Assessment 6

 Financial Consultants’ Assessment..... 7

 Legal Consultant’s Involvement..... 9

EXECUTING THE WATER PURCHASE AGREEMENT 9

LOCAL CONSIDERATIONS..... 10

Part II Providing for Electrical Needs 12

INTRODUCTION 13

AUDIT PURPOSE 13

SUPPLEMENTING ELECTRICAL GENERATING NEEDS..... 13

SECURING A CONTRACT..... 15

FINANCIAL..... 17

CURRENT STATUS - MARCH 2011 18

Part III Administering the Agreement..... 19

INTRODUCTION 20

AUDIT PURPOSE 20

PROJECT COORDINATION 20

 Project Coordinator 20

 Employer’s Representative 21

 Company’s Representative 21

 Records and Effects..... 21

CONDITIONS PRECEDENT 23

 Status July 2011 23

PROGRESS 25

FINANCIAL DISCLOSURE 25

CONCLUSION &RECOMMENDATIONS..... 27



Office of the Auditor General

British Virgin Islands

Audit Examination of BiWater (Water Purchase) agreement and Implementation

This document contains three reports:

Part I is a review of the Government's decision to contract with Biwater Ltd.;

Part II examines the process undertaken to secure electricity for the venture's operations;

Part III is a follow up on how implementation of the project was being pursued.

The reports were issued separately but are presented here together as they are part of the same process.

Sonia M Webster

Auditor General

Government of the Virgin Islands

PART I CONTRACTING PROCESS

INTRODUCTION

1. The Government of the British Virgin Islands is responsible for providing the general public with reliable potable water. It does this primarily by purchasing water from privately owned desalination plants throughout the territory.
2. The territory has, notwithstanding, suffered from insufficiency of public water, with frequent interruptions and regular scheduled rationing.
3. During 2008 a proposal was received by the BVI Government from the international company Biwater PLC to address the territory's water and wastewater issues. The comprehensive proposal included provisions to address a number of broader issues affecting the efficiency of the Water and Sewerage Department and offered a level of technical expertise not currently available to the Government.

AUDIT PURPOSE AND SCOPE

4. This review examines the process through which the Government engaged and contracted with Biwater for a long term water supply and sewage facility agreement.
5. The process involved examination of the files and records of the Ministry of Communications and Works and the Water and Sewerage Department from inception of the project to present, interviews with key personnel on the project and visits to the sites designated for development.
6. Subsequent reports will provide updates on the advancement of implementation.

Restriction of Scope

7. The Ministry maintains information for the project on several different subject files which creates a challenge in establishing chronology and progress. Important documents relevant to the project (such as the initial Biwater proposal, a subsequent Ocean Conversion submission and a report (if submitted) from Eversheds the Legal Advisors to the water purchase agreement) were not present on the files and have been requested for review. After these are received amendments will accordingly be made to this report in addendum.
8. The named liaison person in the Ministry for this assignment to date has been the Permanent Secretary who appears to lack the level of information required to be of full assistance.

ASSESSING THE NEEDS OF THE W&S DEPARTMENT

9. *The Water and Sewerage Department was faced with a number of challenges which impeded its ability to satisfy the territory's growing demands for potable water and sewage treatment facilities. Inefficiencies within the system also led to losses in revenue and heavy reliance on government subsidized service.*

10. The Water and Sewerage Department has in the past years been constantly faced with the challenge of providing sufficient portable water to meet the demands of the populace. This Department's failure to keep pace with the territory's rapid development and booming population, left residents to deal with frequent water shortages and routine water rationing which is at times compounded by the Government's obligation to provide water to visiting cruise ships thereby leaving many in the capital to do without.

11. In addition, the Department's water distribution and storage infrastructure is aged and suffers from regular breakdowns. This contributes to the large percentage of unaccounted for water and loss of revenue to the Department.

12. Compounding the issues for the Department are the recent and persistent challenges in addressing sewage handling, treatment and disposal in heavily populated areas. The system currently in place in Road Town, the territory's capital, is outmoded and oversubscribed. This leads to frequent spillages into the streets and public areas. It also led occasionally to backup of sewage in homes and properties in low lying areas. A problem that is more pronounced during periods of heavy rainfall.

13. There is currently no public sewerage system in other densely occupied areas such as East End/Long Look and Purcell Estate. Studies have been done in the past to assess and address both the water and wastewater issues. Contracts were issued but despite significant sums expended on capital works especially for the East End/Long Look area (aside from the small treatment plant in Cane Garden Bay) none of the projects have been followed through to completion.

14. The Billing system, which is a module of the Government's JDEdwards financial software is inefficient and prone to errors. Inaccuracies are compounded by failure to resolve discrepancies in a timely manner and an absence of supervisory control contributes to ongoing billing errors and customer disputes.

15. The Ministry and Department recognized the need for solutions and sought alternatives for the more pressing issues of water production and sewage processing.

16. In April 2008 discussions were held with Ocean Conversion about the possibility of expanding their water production to meet the needs of the territory's growing demand.

Ocean Conversion responded with a proposal to produce an additional 500,000 IG per day minimum at \$15.50 per 1,000 IG (electricity not included) under a 20 year contract.

17. The Ministry was not happy with the terms proposed by Ocean Conversion. In particular with the requirement that the Government would have to pay for the minimum supply even when not used and despite Ocean Conversion's insistence on a 20 year agreement there was no offer of proportional pricing. There was also concern that if the proposal were accepted it could create a dependency on one private supplier for an essential public utility/service. It was thought that this could be used as leverage for purely economical benefits in the private sector.

18. Another option that was examined came from a Florida company Seven Seas Water. This company offered to supply 350,000 IG per day minimum, electricity charges included, for \$14.25 per 1,000 IG on a three year agreement. The company indicated Brandywine Bay as a possible location and estimated a setup/construction period of four to five months. Seven Seas Water is well known in the Caribbean and has plants in the USVI and St Maarten.

19. Biwater was introduced as a potential alternative in June 2008. The Company met with the Director of Water and Sewerage Department and offered to perform an assessment of the Department's needs with recommended solutions.

BIWATER'S SOLUTIONS FOR THE TERRITORY

20. The technical examination performed by the Company highlighted a number of weak areas within the Water and Sewerage Department that were affecting its ability to provide competent service.

The Biwater Technical Analysis

21. On 21 June 2008 Biwater presented its Technical Report on the Investigation of the BVI Water and Sewerage Department. This report covered a review of the existing situation and proposals for the future. It included an assessment of:

- i. Tortola Water Distribution
- ii. Tortola Storage Reservoirs
- iii. Tortola Unaccounted for water (NRW) Systems
- iv. Tortola Desalination Plants
- v. Tortola Sewerage Systems
- vi. Sites for proposed 2 new Sewage Treatment Plants
- vii. BVI Billing Systems
- viii. BVI Water and Sewerage Department Accounts

22. The report found that the Department was suffering revenue losses because of significant leakages and other unaccounted for water losses which amounted to an estimated 33% of the production volume.

23. This was compounded by billing losses whereby revenue was not being received for approximately 38% of water used.

24. It recommended that the Sabbath Hill Reservoir (which showed severe leakages estimated at 50,000 imperial gallons per day) be isolated from the system and repaired. Suggestions were also made to address other water leakages and losses and to tackle discrepancies in billing cycle and system.

25. The report observed that the contract licenses for the five existing desalination plants had expired and that these plants were functioning outside of their efficient operating life. It recommended that they be replaced with a new plant at Paraquita Bay which would be larger than the total of the existing five plants. It anticipated that this would maximize savings in the cost of water production.

26. With respect to sewage, the report recommended that two plants be constructed. One at Paraquita Bay and the other in Road Town. It suggested completion of the partially constructed plant at Paraquita Bay to serve the eastern end of the island (works on this plant were suspended in 2007) and the construction of a new plant at Road Reef Marina to accommodate the sewage treatment needs of the population in Road Town.

27. There was, in addition, a comprehensive examination of the Water and Sewerage Department and its operations and services leading to a number of other recommendations for service improvements.

The Biwater Proposal

28. In their proposal that followed one month later, Biwater offered to construct a new 2.3M imperial gallons (IG) per day desalination plant at Paraquita Bay, which it would manage, operate and maintain for a period of 25 years.

29. Further, the company proposed to provide the following extra services at no additional cost to the Government:

- i. Constructing a new 500,000 gallon storage tank at Sabbath Hill, repairing the existing tank on the same site and linking these to a new treatment facility via a sixteen inch diameter main;

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- ii. Performing a detailed census of consumers, flow meter installation through the network to facilitate loss analysis and zoning and identification of shortcomings, and the introduction of a remote monitoring system;
 - iii. Introducing a new computerized windows based billing system;
 - iv. Increasing efficiency by reducing leakages and revenue losses;
 - v. Reducing associated energy costs with the use of energy efficient design and energy efficient components.
 - vi. Refurbishing the existing Road Town and Waterfront Sewerage pumping stations;
 - vii. Installing a new twelve inch sewer from the Road Town pump station to the Waterfront pump station;
 - viii. Providing a new sewage treatment plant at Road Reef Marina, to serve the Road Town population of 15,000.
 - ix. Connecting the new plant to the Waterfront pumping station, via a new twelve inch sewer;
 - x. Installing a new connection to the existing sewage outfall;
 - xi. Constructing the existing sewage treatment plant package at Paraquita Bay

30. The proposed sewerage infrastructure would be managed for a period of one year during which Biwater would train Water and Sewerage staff to manage the facilities for continuous operation.

31. The proposal would require no capital outlay from the Government and provide a level of technical resource on the island that was not previously available.

32. The Government would be required to purchase water at a rate of \$12.90 per 1,000 IG over the initial 240 months and thereafter at \$6.85 per 1,000 IG for the remaining contractual period. These rates do not include electricity charges incurred in running the plant.

33. The Biwater proposal was taken to Cabinet for consideration and advice.

NEGOTIATING THE CONTRACT

34. *Notwithstanding the government's failure to put the project to public tender, the Ministry took a number of steps in an effort to ensure that the Government's interests were safeguarded and that full value could be achieved on the project.*

35. Subsequent to receiving the Biwater proposal the Ministry sought and received permission from the Cabinet to negotiate with Company.

36. Three consultants were engaged to provide technical/professional advice to the Ministry and assist with the negotiations. Evershed LLP of London were Legal Advisors, Baker Tilly (BVI) Limited served as Financial Advisors and Ove Arup & Partners were the Technical Advisors.

37. The Cabinet also appointed a negotiation team of four persons. This consisted of the Honourable Vernon Malone, Mr Mervin Charles, Mr Laurie Rhymer and Honourable Julian Fraser (team leader).

38. The consultants and the negotiation team met with representatives of Biwater SA from 16-17 December 2008 in Miami to discuss the terms of the agreement.

Technical Consultants' Assessment

39. Ove Arup & Partners' role was to review the technical aspects of the Biwater proposal to enable the Government to make informed decisions with respect to finalizing an agreement with Biwater and to plan the Government/WSD actions required for implementation.

40. The Technical Consultant's study was qualified in that it had to be performed in the absence of a detailed design. They did however visit the affected sites in the BVI as well as plants constructed by Biwater in Florida and Panama. In addition they held meetings with Biwater principals, local officials and participated in the December 2010 meetings in Miami. Some of the findings include:

- i. Pipeline Route Feasibility, layout at the Sabbath Hill and Paraquita Bay sites could not be properly assessed because the plans submitted by Biwater were not sufficiently detailed;
- ii. An environmental impact assessment was required to address impact of both construction and operation of all facilities
- iii. The agreement only provided for the water quality criteria. Contractual safeguards were required to ensure the quality of the plant, machinery, buildings, pipelines, trenches and other components.

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- iv. The offer was based on an assumed raw water yield and quality. The actual yield and quality at Paraquita Bay needed to be tested and confirmed;
 - v. Warrantees needed to be put in place for new tank and repairs for existing tank;
 - vi. Need for BVIG to ensure appropriate resource available for training and future sewage plant maintenance and operation or seek alternative arrangement for Biwater to provide these services;
 - vii. Condition survey needed for the existing sewage outfalls to ensure adequate capacity and condition.
 - viii. Client approval, control and monitoring required for the operation and maintenance of the wastewater treatment facilities. Warranties also required to ensure equipment performance and longevity.

41. In their final report dated February 2009, the Technical Consultants concluded that:

It is clear that Biwater are expert in their field and capable of delivering the facilities proposed for Tortola. To ensure appropriate quality, it is important that developing designs are monitored and approved in accordance with provisions of the WPA.

Financial Consultants' Assessment

42. The Ministry also received support and advice from Financial Consultants Baker Tilly (BVI) Limited. The role of the Financial Consultants included but was not limited to, reviewing the proposed contract to determine whether the project was viable, highlighting areas of weaknesses contained within the contract which might require negotiation or change and performing due diligence procedures on Biwater SA, its shareholders and its directors.

43. The Financial Consultants examined the proposed fees and tariffs and in December 2008 submitted to the Minister a detailed matrix of areas that were deemed to require negotiation.

44. The fee structure submitted in the Biwater proposal stated the Government would purchase 2.3million imperial gallons of treated water per day at \$12.90 per 1,000 imperial gallons with tariff adjustments based on the consumer price index and Labor rate. This price would be reduced to \$6.85 per 1,000 imperial gallons per day after 120 months and the tariff would be based only on the Consumer price index.

45. The financial consultants expressed the view that the fee arrangement should embody some flexibility in the event that the Government does not need to purchase 2.3

million IG of water per day. They identified the weaknesses in Biwater's proposed fee structure as follows:

- i. There is no variable element to the tariff;
- ii. The tariff would fluctuate too frequently during the Operating Period (about 4 times per annum);
- iii. The monthly CPIBVI required for the proposed formula is not available within 7 days of the month's end;
- iv. The change in the 3 month Libor affects the tariff.

46. The Financial Consultants assisted the Government in negotiating an amended fee structure which embodied both a fixed and variable elements.

- i. The fixed element required that for the first 120 months of the operating period the Government would pay for 2.3 million IG of treated water per day at an initial charge of \$11.48 per 1,000 IG. For the remaining 180 months the cost would become \$5.43 per 1,000 IG.
- ii. The variable element which is applicable for the entire operating period (300 months) required that the Government would pay \$1.42 per 1,000 IG for water consumed.
- iii. Amendments were negotiated to the tariffs to reduce the frequency in fluctuation of the rates due to changes in the CPI and to import some predictability in the changes.
- iv. The Libor element would be eliminated should Biwater obtain a fixed rate loan for financing the project.

47. There were also other areas that the Financial Consultants brought to attention during the negotiations. Among these were the need to obtain a financial guarantee from Biwater PLC in the event of default by Biwater SA and a provision that Biwater SA would insure the facilities throughout the operating period.

48. In keeping with their contractual obligations, the Financial Consultants also performed due diligence procedures on the Company, its shareholders and its principals. The investigations were for the most yielded no results. The only reported incidents were an unsuccessful business venture in Tanzania resulting in the Company being sued and one incident whereby a principal/shareholder extended privileges in a questionable manner to a president of Ghana.

49. The Financial Consultants concluded that :

... the revised draft agreement represents a viable solution to the water needs of Tortola for the foreseeable future at a drastically reduced cost.

The revised draft agreement will not only reduce the cost of purchase of potable water by the Ministry, but will also drastically improve the provision of sewage treatment services delivered in the East End of Tortola as well as Road Town, significantly increase the income generating ability of the Government with new technology, thereby effectively further reducing the cost of purchase of potable water by the Government, as well as, among other things, strategically reducing the Government's current over-reliance on one major water supplier and improving the efficiency and ability of the Water and Sewerage Department to deliver service.

Legal Consultant's Involvement

50. Eversheds was engaged by the Ministry to advise on the negotiation of the contract document for the water purchase agreement with Biwater based on a public private partnership model.

51. The Legal Consultants corresponded with the Ministry, the Attorney General Chambers and Biwater's principals throughout the vetting and review process. They also participated in the December 2008 negotiation meetings held Miami.

52. The negotiated amendments and clarifications/adjustments secured during the Miami meetings leaned heavily in favour of the BVI Government. The draft agreement was amended to address several of the concerns raised by the consultants. The amended document was vetted by the Attorney General's Chambers and submitted to Cabinet for their consideration and a decision on whether it should be executed.

EXECUTING THE WATER PURCHASE AGREEMENT

53. The water purchase contract between the Government and Biwater was executed after an extended period of consideration and debate.

54. The negotiations between the Ministry and Biwater for the water purchase agreement were substantially complete by early 2009. The process of gaining the approval of the Cabinet to execute the contract (and support in the public domain in accepting the company) resulted in a protracted finalization period.

55. In addition, from May 2009, the Ministry was engaged with the BVI Electricity Corporation to secure additional generating capacity to accommodate the needs of the proposed Paraquita Bay plant.

56. Approval from the Cabinet to execute the water purchase agreement came in August 2009. The contract was executed on 10 February 2010 after further negotiations.

57. The scope of works remained substantially unchanged under the executed agreement. Biwater would design and construct a new sea water desalination plant with total operational capacity of 2.3 million imperial gallons per day in Paraquita Bay. The company would, in addition, provide a number of other ancillary services for the water distribution infrastructure and facilities, sewage handling and treatment as well revenue recovery for the Department as identified in their earlier proposal.

58. The major amendment to the agreement dealt with the operation period. This was reduced from 25 years to 16 years. The associated fee structure and monthly payments, however remained the same as was negotiated at the December 2009 Miami meetings. The base Tariff would be \$12.90 per 1,000 imperial gallons, to be reduced to \$6.85 per 1,000 imperial gallons after 150 months of the operating period.

59. The tariff would comprise of two components. The fixed Capacity Charge (11.48 during the first 150 months and \$5.43 for the remainder of the operating period) and a Consumption Charge of \$1.42 per thousand imperial gallons delivered to the Government.

LOCAL CONSIDERATIONS

60. The Biwater agreement which promises to provide a more efficient service to the territory has created a measure of imbalance with an essential service being dominated by one private entity.

61. The introduction of Biwater to the territory has not gone unnoticed. The proposed 25 year agreement for a plant that outperforms smaller existing (and somewhat aged) facilities has drawn significant discontent from the shareholders and their supporters. The Ministry has prepared for discussion alternatives whereby the term of Biwater agreement could be reduced from 25 years to 20, 15 or 10 years. In the end the agreement was executed for a term of 16 years.

62. On the surface, a shorter period would result in a lower overall cost to the Government. However consideration must be given to the fact that an early takeover of the plant would require resources and expertise to ensure continued operations.

63. A reduction in the term of the contract, however would not address the concerns of the shareholders of the existing plants as their angst goes more to the level of production and market share that the new company would command. In reality, the proposed plant will singly have the capacity to meet almost 80% of the demands of the island and could render other facilities (currently functioning without agreements) obsolete. No discussion was seen whereby Biwater was invited to propose for a smaller facility.

64. It also brings to the fore, the concerns expressed by the Minister when considering Ocean Conversion's proposal in 2008. That allowing a private company to have such commanding control over an essential public utility may expose the Government to unfair bargaining practices imposed purely for the economic benefit of private investors. Consideration should be given to imposing some form of

65. Notwithstanding the foregoing, the benefits that the territory stands to gain from the **full performance** on this contract cannot be understated as the BVI community has for a number of years struggled with basic needs for clean water and sanitary sewage disposal.

Sonia M Webster
Auditor General
Government of the Virgin Islands

BiWater Report

Part II

Providing for Electrical Needs

INTRODUCTION

1. On February 18, 2010, Government of the Virgin Islands signed a sixteen year agreement with Biwater to build a new desalination plant capable of producing 2.3 million imperial gallons of potable treated water per day.
2. The Agreement obligates the government to ensure that the electrical requirements of the project are provided. BVI Electricity Corporation is required to supply at least four mega watts of continuous reliable electricity by June 1, 2010.

AUDIT PURPOSE

3. This review examines the process through which the Government and BVI Electricity Corporation sought to address the electrical needs for the pending water supply facility that was to be developed by Biwater.

SUPPLEMENTING ELECTRICAL GENERATING NEEDS

4. *The expedited process of securing additional electrical generation capacity meant that a number of safeguards were bypassed. There was no tendering for the equipment, insufficient disclosure between buyer and seller, and the advancement of a multimillion dollar ancillary contract before the primary Water Purchase Agreement had been put in place.*
5. In a letter dated 5 May 2009 the Ministry advised the General Manager of the BVI Electricity Corporation that the Government was in the final stage of the negotiating a water supply agreement with Biwater and enquired whether the Corporation would be capable of supplying to the project four mega watts (4MW) of continuous reliable electricity to the proposed water plant effective 1 June 2010.
6. At that time the generation capacity of the Pockwood Pond facility for the territory was 39MW. The Biwater plant would be requiring about one tenth of the electricity produced for the territory (90% of the stated supply to Virgin Gorda). Accommodating this for the date stated would not be feasible.
7. The General Manager responded that the Corporation was not in the position to supply the 4MW required for the plant. However, it was felt that after the planned expansion, the Corporation would be able to meet the Biwater requirements by the year 2012.

8. The solution proffered by the Corporation would be to source a temporary power supply either on land or by barge adjacent to the plant's location in Paraquita Bay. This would support the plant until the planned electrical expansion was completed for 2012. In addition, the Government was advised that to achieve a constant and reliable source of electricity some infrastructural works would be required to reinforce the distribution network and provide a dedicated supply to the water plant. These works would likely cost the Government an estimated \$900,000.00.

9. This proposal did not meet the Ministry's approval. The Ministry then contacted Wartsila, manufacturers of the Corporation's six largest generators, to examine the possibility of securing another of their engines but, the manufacturer advised that it would not be possible to produce a generator in time for the stated date.

10. The electricity generation constraints were communicated to Biwater's agents who sought to assist by sourcing suitable equipment to support the needs of the proposed water plant.

11. In June/July 2009 the Biwater agents identified a seller, CaribNRG, which had a MAN 18V 28/32 generator set that could provide power for the proposed water plant. Agents of Biwater and MAN inspected the Long Bush power station and determined it to be adequate for installation of the generator set. Plans commenced to acquire equipment for installation. The arrangement was that the Corporation would purchase the generator set for an amount of \$5,880,250.00 from Biwater who was the contact person for the vendor.

12. In the period that followed, a number of issues and concerns were raised about the generator set and the vendor's requirements.

13. In addition, the expedited process of procuring the generator set meant that neither the Corporation nor representatives from the Government had the privilege of inspecting the equipment prior to the decision to purchase. A delegation from the Corporation did however travel to St Kitts from 9-11 August to gather information on the type of generator and its operation, as MAN engines are not currently in use by the Corporation, and the staff has no experience or training in their operation and maintenance.

14. Notwithstanding, giving the urgency of the need and the absence of immediate alternatives, plans forged ahead for the purchase.

SECURING A CONTRACT

15. *Inability of the parties to agree on the contractual terms and preconditions for the acquisition led to a delay in finalizing the purchase transaction.*

16. On July 27, 2009, the Minister issued a Letter of Intent to Biwater for the purchase of the 3.87 MW generator set which was to include installation at BVIEC's Long Bush facility with a one year warrantee.

17. Subsequent to this, however, a number of challenges were encountered in the parties' attempts to put a contract in place for the acquisition. One of the major obstacles was the multiplicity of parties involved in the transaction each with varying roles and different levels of information.

- Government of the Virgin Islands –Supported the purchase of the Generator Set and agreed to provide financing for purchase of the required equipment.
- BVIEC – Named party to the purchase agreement. The Corporation would own and operate the equipment. It however had no direct contact with the Vendor or Manufacturer. In addition the Corporation exhibited reservations regarding the equipment, and the manner in which it was being rushed through without apparent due diligence and the normal contractual safeguards.
- Biwater – Other named party to the purchase agreement. The Company sourced the equipment after the Corporation advised that its generation capacity would not be able to accommodate the proposed water purchase contract between BVIG and Biwater. It also served as the middleman with Vendor.
- MAN – Manufacturers of the Generator Set. Acted only through Biwater.
- CaribNRG – Vendor/Owner of the Generator Set. Acted only through Biwater.

18. The Corporation, sought to put in place what it considered to be standard industry safeguard and advised that that the purchase would take effect through a standard FIDIC contract. Biwater responded that the FIDIC conditions would not be applicable to the purchase.

19. A Biwater principal explained that the company intended to use some of its developmental and personnel resources from the main water supply contract towards the installation of the generator set at BVIEC. In doing so it was able to offer a more

reasonable price for the supply and installation of the equipment. Under this arrangement Biwater would not accept any imposition of the FIDIC contractual terms to supply the generator.

20. If however the Corporation insisted on FIDIC conditions, Biwater would consider the purchase as completely separate from the water supply agreement and this would result in higher personnel and finance costs to the Corporation. The estimated additional costs would be in the region of a 10% increase or \$600,000.00.

21. A draft contract based on the non FIDIC terms was forwarded by Biwater to the Government on 20 August 2009, together with notice that the purchase would have to be confirmed by 21 August 2009. Also forwarded was the Factory Acceptance Test Certificate (that had been performed on 28 November 2007).

22. Unable to review and execute the contract in time for the August 21 deadline, the Corporation, issued a letter of intent and wired a deposit of \$2,940,125 to Biwater on said date in a show of good faith.

23. The negotiations on the contract documents were substantially completed in late September 2009 and resultant adjustments led to increased costs of \$325,000.00 (for a total of \$6,205,250.00).

24. There was a brief period to October 2009 in which details of the contract agreement were decided followed by several months of little to no file communication regarding this project. During that period, the Biwater principals and BVI Government were seeking to work out details of the main water purchase agreement.

25. Activity resumed on 14 June 2010 when the Ministry forwarded a cheque in the amount of \$1,180,000.00 to the Corporation and requested an update on the status of the acquisition.

26. By this time the generator set that was the subject of acquisition in 2009 was no longer available. The Biwater agents were however able to secure another, MAN engine but the manufacturer was only willing to hold this until 23 July 2010, the scheduled date for executing the contract.

27. The contract documents were again reviewed by the parties and the Biwater contributions included costs increases which brought the contract sum to \$6,480,250.00. The negotiations were again stymied by the parties inability to agree on the contract terms, in particular the warrantee provisions. This was finally brought

to a head by the Corporation's decision on 22 July 2010 that it would only execute a FIDIC contract.

28. On 23 July 2010, the designated contract execution date, Biwater was asked to return to the Corporation the deposit paid of \$2,940,125.00 and the purchase discussions were terminated.

FINANCIAL

29. *To ensure that the Corporation could provide the needed electricity for the proposed water plant in Paraquita Bay, the Government pledged financial assistance for the acquisition of equipment required to supplement the Corporation generating capacity.*

30. With the pending multimillion dollar water supply contract between the Government and Biwater, it became imperative for the Government to ensure that the basic infrastructure and utilities were in place to support the facility. Throughout negotiations to purchase the equipment, the financing aspect warranted only minor discussion as it was understood that this would be covered by the BVI Government.

31. Funding for the project was taken from the Government's 2009 Capital Budget which provided \$6,000,000.00 for an Equity Contribution to the BVI Electricity Corporation (Head 9 subhead 95058).

32. The generator set which was the subject of discussion from June – October 2009 was presented to the Government with an initial price tag of \$5,880,250.00. This was accompanied with a payment schedule as indicated below.

50%	Down Payment with placement of the order, Effective Date
20%	30 Days from Effective Date
15%	90 Days from Effective Date
10%	At Readiness to Commission
5%	On Completion of all punch list items

33. The Effective Date was defined as the date when all Conditions Precedent had been complied with and the down payment was paid. There was also a requirement that a letter of credit would be established in favour of Biwater AEWT immediately after signing of the contract for the full contract amount less down payment. The proposal would allow for part shipments and transshipments.

34. The Corporation's contract consultants expressed dissatisfaction at the payment terms as these were not tied to identifiable milestones and the initial down payment was deemed "very large."

35. Government advanced the Corporation \$4,130,000 in two separate installments for the purchasing of the generator set. The first installment in the amount of \$2,950,000.00 was received by the corporation on 6 August 2009. Of this, an amount of \$2,940,125.00 was wired to Biwater on 21 August 2009.

36. The second installment in the amount of \$1,180,000.00 was forwarded to the Corporation in June 2010 but was not paid to Biwater.

37. Over the negotiation period the cost of the generator set increased. The initial increase discussed in October 2009 of \$325,000 was the result of some basic requirements imposed in the contract by the Corporation. There was also an additional \$50,000.00 required to cover the cost of the irrevocable, secured letter of credit requested by Biwater.

38. When negotiations on the project resumed in July 2010 the overall amount had increased by \$600,000.00 over the initial sum. Biwater explained that this increase was because the specification of the MAN engine, which was a new unit with built in enhancements together with the provision of auxiliary components where previously selected components were no longer available. Essentially, that it was a different generator.

39. On 11 August 2010, after negotiations had failed for the acquisition of the Generator set the Government requested the return of the \$4.13 million dollars, which had been advance to BVI Electricity Corporation.

CURRENT STATUS - MARCH 2011

40. As of March 2011, the BVI Electricity Corporation had received tenders for an 8.0 mega watts generator. The Corporation has written to the Government requesting financial assistance to cover the cost of proposed acquisition.

Sonia M Webster
Auditor General
Government of the Virgin Islands
March 2011

BiWater Report

Part III **Administering the Agreement**

INTRODUCTION

1. The BVI Government/BiWater contract stipulated that the agreement would come into effect on the date of execution. The obligations of Biwater to carry out and develop the facilities would however come into effect 15 days after all the conditions precedent stipulated in section 40 of the contract are satisfied (deemed the Effective date).

AUDIT PURPOSE

2. This report is intended to provide an update of the project from execution of the contract to date (July 2011).

PROJECT COORDINATION

3. *There appears to be no internal impetus for moving the project forward. The persons tasked to lead in this respect appeared either to be poorly informed or lacking sufficient authority to have meaningful impact.*

Permanent Secretary

4. The Acting Permanent Secretary has been in the position since October 2010 and has named herself as liaison to the auditors reviewing this project. She is also the accounting officer for the Ministry and the most senior government official overseeing this project. However during the meeting with the auditors the Permanent Secretary advised that she has not been involved in the project and has only limited knowledge as to progress if any. She advised that the Project coordinator who was so assigned before execution of the contract was more knowledgeable and thus in a better position to provide information.

5. The Monthly progress reports generated by the Contractor indicate that the Permanent Secretary is not included in project meetings held.

Project Coordinator

6. Mr Ray George was engaged by the Ministry as the Project Coordinator on this assignment. Mr George, an accountant by profession, was initially employed by the Ministry in August 2008 to work on issues related to the Air Lift Services and was retained thereafter on contract as to focus on matters relating to the development and execution of infrastructure development projects being pursued or undertaken by the Ministry of Communications and Works.

7. All correspondence and matters pertaining to the Water Purchase Agreement (WPA) are trafficked through Mr George, who forwards these to the relevant parties for information and action. Mr George was also present at meetings in the pre-contract

phase of the project including the Miami meeting that was attended by the Negotiation Team and Biwater representatives during which the details of the contract were hammered out. Throughout this preliminary period, however, the project was being propelled forward by the substantive Permanent Secretary (Mr Julian Willocks) and the Minister.

8. The Audit Team met with Mr George after a protracted period in which Mr George expressed reservations about being interviewed and the need for permission to be had from the Minister.

9. During the interview Mr George advised that he was not privy to all discussions and meetings related to the project and indicated that Mr Kerof the Employer's Representative as the most significant official acting for the project on the government's behalf. The Coordinator also advised that he did not maintain any files or records for the project as all correspondence was simply forwarded on to the Ministry and other relevant parties.

10. The interview produced very little information regarding the project and its progress.

Employer's Representative

11. The Employer's Representative is appointed by the Minister to exercise the functions and powers of the Government as determined by the terms of the contract. Mr Manoharlal Kerof the Ag. Director of Water and Sewerage was named as the Employer's Representative in July 2010.

12. During our interview with, Mr Kerof, he claimed that he had only limited knowledge of the project and provided technical information to the parties as required. Despite being the Government's representative he was unable (or unwilling) to provide any significant information about the progress of the project.

Company's Representative

13. Contact was made with Mr Bernard Keeley the Company's Representative on the project. Mr Keeley, discussed progress of the project via telephone and offered to forward the most recent of his reports. He subsequently withdrew that offer stating that he had requested clearance from the Ministry of Communication and Works to do so but this was not received. Mr Keeley, as a private contractor, is not obligated to provide information to this office.

Records and Effects

14. *There was a general reluctance by the Ministry, its officers and agents to provide full disclosure of the records related to this project.*

15. Requests for information from the Ministry yielded several general files containing various correspondence related to the project's history but none directly with its administration or progress since execution of the contract.

16. Similarly, both the Project Coordinator and the Employer's Representative were unable to provide files containing up-to-date correspondence or reports for the project. The Project Coordinator advised that he was not in the habit of maintaining files and that all information he received on the project was simply forwarded to the relevant parties to be actioned.

17. This led us to believe that Ministry and the two primary agents on this project failed to provide full disclosure (certain files were not forwarded) as we are aware of other correspondence and reports relating to this project that, from all indications, were received by all three parties and should have been submitted for the audit review. These documents and records were received from other sources.

18. This indicates a lack of transparency by the Ministry which is a severe breach of the Constitution, Audit Act, Public Finance Management Act (get sections). Below is a list of the offices that were contacted for information and the response received.

Information Requested From:	Response
Ministry of Communication & Works	Miscellaneous files with aged information received.
Water and Sewerage Department	No Documents/Files supplied
Project Coordinator	No Documents/Files supplied
Town and Country Planning	Information received in full
Ministry of Natural Resources & Labour	Information received in full
Ministry of Finance	Information received in full
Survey Department	Information received in full
Attorney General's Chambers	Responded "declining request" to provide information.

CONDITIONS PRECEDENT

19. *The absence of any meaningful internal management of the project contributed to the extensive delay suffered in securing compliance with the conditions precedent stipulated in the contract.*

20. The conditions precedent are a list of events stipulated in the water purchase agreement that are required to be met before the parties can commence performance on the contract.

21. The Agreement provided that if all the Conditions Precedent were not satisfied within six months of signing the WPA, either party would have the option of terminating the Agreement.

22. At the expiration of the six month period (18 August 2010) most of the conditions precedent was unmet. Significant among these were financing for the project, lease agreement for sites, development approval, novation agreement and collateral warranties. Neither party however, took steps to terminate the Agreement.

23. The status of the conditions precedents are as indicated in the schedule below.

Condition Precedent	Status August 2010	Status July 2011
1. The parties sign the lease agreement for the site made available during the construction of the Facilities including any land required for labour camps, fabrication yards, site offices and stores required by the Company in connection with the construction of the facilities.	Lease vetted by Attorney General Chambers. To be signed after the Non-Belonger Land Holding Licence has been issued to Biwater. Settlement of some wayleaves still pending.	Wayleaves and site Authorisation – 30 September 2010;
2. The Government makes available areas required for labour camps, fabrication yards, site offices and stores required in connection with the construction of the facilities and associated works;	Land made available. Site clearing commenced.	Approved 30 September 2010
3. The Government transfers the Raw Water abstraction rights to the Company, pursuant to an instrument satisfactory to the Company,	Presumed met by way of the provisions of the WPA	Approved in February 2011

Condition Precedent	Status August 2010	Status July 2011
4.All Government authorisations needed or confirmations of no-need of such Government authorisations have been obtained from the Government or other Agencies;	Trade Licences Granted Development approvals pending; Land holding licences pending;	Development approvals received: 27 October 2010 for Water Storage Tank; 4 February 11 for Desal Plant and Waste Water Treatment Plant.; Latter approvals released to contractor on 2 June 2011. Non-belonger’s Land holding Licence issued 8 December 2010;
5.The loan agreement becomes unconditional in all respects;	Loan agreement not finalized.	Biwater in May 2011 decided that it would commence the project through initial self-financing.
6.The Special Purpose Company is established and the Novation Agreement executed;	Special Purpose Company was established. Novation Agreement not signed.	Novation Agreement executed 13 July 2011
7.The collateral warranties are entered into between the employer and the relevant contractors; and	Collateral warranties pending	Collateral Warranties executed on 13 July 2011
8.The plant design criteria and technical specifications; and lifecycle works (appendices 7 and 13) have been agreed to by the parties.	Approval for Plant design criteria and technical specification pending.	Appendix 7 WWTP Approved on 23 and SWROP 24 September 2010. Appendix 13 Approved 24 September 2010

PROGRESS

24. *Progress on the project is largely limited to efforts in achieving compliance with the conditions precedent. Minor preliminary works and testing have also been performed in preparation for commencement.*

25. On the face of it very little has been done performance wise under the agreement. A visit to the site in Paraquita Bay shows an isolated trailer office that is unoccupied, and locked.

26. Preliminary soil testing have been performed at the various sites and some excavation has been done at Sabbath Hill where the reservoir will be located. These works are expected to continue with the fill being deposited at Burt Point. The water tank for the reservoir has been ordered. At the time of our telephone interview, the Company's Representative anticipated that construction of the site offices and storage facility at Paraquita Bay would commence during the second week of August 2011.

27. Less visible are the activities undertaken to prepare for construction. Structural and architectural design work for the project have commenced and was being progressed, in part by a local firm engaged for this purpose. Assessments have been performed of the available wells at Paraquita Bay and a determination made that these are inadequate to supply the raw water needs for the RO plant. Alternative sources were sought and a decision taken that the raw water supply would be obtained from the sea off crown land across from the RO plant site.

28. Non-verifiable activity include information from the Company's Representative regarding items that have already been ordered such as the Sabbath Hill Reservoir Tank, the RO Building, pipes and fittings for the Sabbath Hill and the sea water and brine pipelines, electrical equipment, pumps and other miscellaneous equipment.

29. With the completion of the conditions precedent in July 2011, the activity on the project should increase. This makes it imperative that an improved management system is put in place to ensure that the Government is adequately represented.

FINANCIAL DISCLOSURE

30. *The Government has incurred only indirect costs related to this project.*

31. The Water Purchase Agreement between the Government of the Virgin Islands and Biwater requires the company to construct and operate a reverse osmosis plant and two sewage treatment plants within the terms of the agreement. The Government is then contracted to purchase a minimum amount of desalinated water from the company at rates stipulated. There is however no cash outlay or any form of financing required on the part of the Government in the development of the project. Because of this, the Government's investment to date has been limited to paying consultants, negotiators and covering travel and other costs related to the project.

32. The WPA does however require the Company to provide the Government with details of its financing - drawdown, loan repayment schedule and breakage costs - for approval prior to entry into a loan agreement. Additionally, the Company is prohibited from re-negotiating the Loan Agreement without written consent from the Government.

33. The project is currently being self financed by the Company. This does not however preclude the possibility that the Company will continue to pursue independent financing for the project.

34. International Accounting Standards define a contingent liability as:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

i. it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

ii. the amount of the obligation cannot be measured with sufficient reliability.

35. In the normal course of a government's business a contingent liability may arise through an explicit contractual or legal obligation such as loan or other guarantees and legal claims. They may also be implicit as in the case of bailouts as seen in recent years and disaster recovery financing. (see attached chart).

36. Considering the foregoing it is unclear how the WPA without a financing guarantee by the Government will constitute a contingent liability under these provisions.

37. The International Accounting Standards provide further that an entity should not **recognise** a contingent liability (include amounts in the entity's Income Statement and Balance Sheet). It should instead **disclose** a contingent liability, in the notes to the accounts. Disclosure requires nature of the contingent liability and estimated amount (if determinable).

38. It is the practice of the Government of the British Virgin Islands to disclose contractual contingent liabilities in its Annual Budget Estimates, but these are not normally included in the Treasury Statements of Accounts unless they become actual obligations or liabilities.

39. Therefore if the WPA is indeed deemed a contingent liability for the government the requirements under this standard would be limited to a note in the financials providing disclosure but this would not have any impact on the actual amounts in the accounting statements.

40. The financial consultants engaged initially on this project should be consulted for independent advice on this matter.

CONCLUSION & RECOMMENDATIONS

41. There appears to be a deliberate effort on the part of the Ministry to conceal and withhold information regarding this project. All of the agents acting for or under the Ministry who were directly assigned in some capacity to the project acted in a manner which could only be described as evasive and uncooperative. Consideration should be given to temporarily suspending this project until the Ministry has put in place a satisfactory system of transparency and accountability. This does not currently exist. This is of particular importance considering the magnitude of this project and the potential for long term government commitment.

42. The Permanent Secretary must assume greater responsibility for this project and be involved in its progress and development. The current state whereby she is routinely excluded from meetings and bypassed by the staff of the Ministry on matters related to this project is unsatisfactory;

43. The role of the coordinator is undocumented and in practice is limited to performing periodic clerical duties. The project would benefit from a coordinator who actively pushes the project forward and is proactive in taking steps to ensure that all government requirements are being addressed as they come on line. Consideration should be given to replacing the current coordinator with someone who is experienced and capable in the field with a history of demonstrative performance. Without this there will continue to be lags in progress and advancement will depend entirely on the Contractor's initiatives.

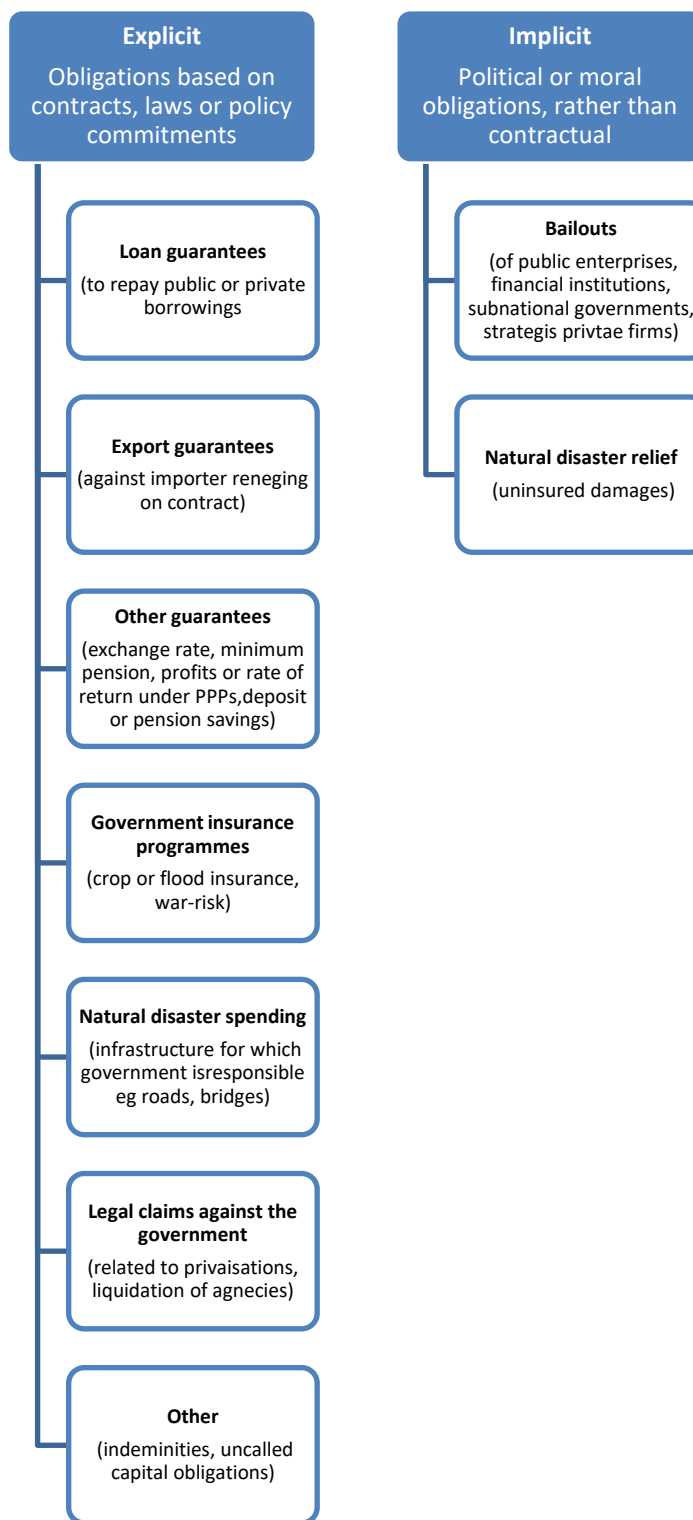
44. It is unreasonable to expect that a Head of Department would have the time and resource to perform effectively as Employer's Representative on this project. Consideration must be given to the employment of an adequately qualified individual to perform this role on behalf of the Government.

45. Steps should immediately be taken to appoint a Contract Management Board in accordance with provision 8 of the Water Purchase Agreement.

46. The financial consultant that was initially engaged as an advisor on the project should be approached for an independent opinion on the application of the IAS regulations for the treatment of this transaction, so that the matter can be addressed professionally.

Sonia M Webster
Auditor General
Government of the Virgin Islands
July 2011

Contingent Liabilities



Source: IMF