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## Public-Private Deals Spark Turmoil

### Montana City Attempts to Regain Control of Water System From Carlyle Group

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The Clark Fork River in Montana runs through Missoula, which has sued private-equity firm Carlyle Group for control of the city's water utility. *Michael Albans for The Wall Street Journal*

Three years ago, [Carlyle Group](#) LP bought the pipes, pumps and water wells in Missoula, Mont., and several California communities in what the firm assumed was a relatively low-risk bet.

By most accounts, drinking-water systems nationwide need hundreds of billions of dollars in repairs and upgrades, making them ripe for private investment.

But the reality has been more complicated.

Carlyle finds itself fighting in court to retain control of the Montana water utility. Missoula officials are suing under eminent domain laws to take control, accusing one of the world's largest private-equity firms of renegeing on a handshake deal to sell the system to the city. One of the California locales is considering a similar takeover for its water system.

The dispute highlights the difficulties in what seems like a natural fit: using private money to fix the nation's leaky pipes, outdated airports and crumbling bridges.

"When we began, we thought municipalities would be open to involving the private sector," said Robert Dove, who leads Carlyle's infrastructure investing. "That has turned out to be more of a challenge."

In Washington, officials from both political parties are calling for more private investment in public works. The government says U.S. drinking water infrastructure alone needs \$385 billion in repairs and upgrades by 2030.

President [Barack Obama](#) in July launched an initiative to boost private investment in transit systems and utilities, and a congressional panel expects to issue a report this month on involving private firms in public infrastructure.

Meanwhile, investors have committed about \$263 billion to infrastructure funds since 2006, according to private-equity data tracker Preqin.

Yet, water is proving a particularly tough sell.

An accommodating municipal-bond market has given local officials cheap access to cash for repairs and upgrades. Their constituents often are leery of investors profiting from basic resources such as water.

Even in Detroit, which is digging out of a massive bankruptcy, a plan floated to privatize the water system hasn't gained traction.

Officials from Ojai, Calif., to Fort Wayne, Ind., recently have tried to bring private water systems under public control. As in Missoula, municipal officials waging water fights contend that public ownership can reduce residents' bills because they have lower borrowing costs, tax exemptions and don't need to chase profits.

In one Massachusetts town, police pursued, but didn't ultimately file, criminal charges against a water-company lobbyist over a pulled fire alarm that stalled a public meeting takeover vote.

"There is a re-municipalization trend," said Keith Hays, vice president of Boston-based advisory firm Bluefield Research LLC. Still, he noted, overall there are more towns and cities selling utilities than those trying to purchase them, with private-sector buyers spending more than \$2.9 billion on water systems since 2004.

In the coming years, water deal-making could gain steam in communities where public officials need private-sector expertise to develop and finance major upgrades, such as building a desalination plant, said Tom Curtis, deputy executive director for government affairs for American Water Works Association, which represents utilities.\



Missoula Mayor John Engen is pressing the city's water lawsuit. *Michael Albans for The Wall Street Journal*

Private-equity firm [KKR](#) & Co. and United Water, a unit of [Suez Environnement](#) Co. struck a deal with Bayonne, N.J., in late 2012 to operate and update the municipal water system and pay off the utility's debt in exchange for customer payments for 40 years.

"These situations have extra layers of complexity, but we are hopeful that we can find other opportunities to partner with local governments," said Brandon Freiman, who makes infrastructure deals for KKR.

Carlyle, based in Washington, D.C., launched its infrastructure investing business in 2006, raising \$1.1 billion to buy an Illinois school bus operator and take over operations of Connecticut's highway rest stops, among other deals.

Carlyle purchased Downey, Calif.-based Park Water Co. three years ago for about \$100 million. The company owns two California water utilities and the system in Missoula, a city of 70,000, whose fly-fishing grounds were made famous in the book "A River Runs Through It."

In court filings, Missoula contends its mayor, John Engen, met with Carlyle executives and believed they had a deal that eventually would put the water system in public hands.

The city's relationship with Carlyle, however, quickly went down the drain.

In legal documents, Missoula said it backed the buyout, which helped appease state regulators, under the impression that Carlyle would then sell the Montana system to the city. Missoula officials have eyed the utility for years, including a failed takeover by eminent domain in the 1980s.

But Carlyle rejected a \$65 million bid from Missoula last year for the local company and scoffed when the city came back with an offer of \$50 million for its assets.

The city sued, claiming Carlyle is skimping on upkeep. "The folks in Missoula won't be fooled and we won't be taken advantage of," Mayor Engen said.

Carlyle called the city's suit "a public relations piece" and said it won't sell the utility to Missoula because separating that business would result in a big tax bill, court records show.

In correspondence with city officials, Carlyle promised only to consider offers from Missoula.

A Carlyle spokesman said that under the firm's ownership, the company has spent 40% more a year improving the Missoula system than the prior owners did.

Missoula recently won round one when a state judge denied Carlyle's attempts to have the suit dismissed, and set a trial date for next year.

Meanwhile, Carlyle has enlisted bankers to sell the utility's parent company as it moves to cash out of investments in its infrastructure fund, according to court records and people familiar with the matter.

**Write to** Mark Peters at [mark.peters@wsj.com](mailto:mark.peters@wsj.com) and Ryan Dezember at [ryan.dezember@wsj.com](mailto:ryan.dezember@wsj.com)