Trade agreements and investor protection: A global threat to public water

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Investor-state dispute settlement (ISDS) cases are emerging as a major threat to public water, especially in remunicipalisation cases where municipalities want to take back water into public hands after failed privatisation. ISDS is included in numerous bilateral investment treaties and is being used by water multinationals to claim exorbitant amounts of public money in compensation for cancelled service management contracts. The sole threat of an ISDS case in opaque and industry-biased international tribunals can be enough to convince a local government to stick with private water despite poor performance.

With new trade and investment treaties such as the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) expected to promote ISDS further, the balance of power will tip even more in favour of private firms and leave public authorities with limited policy control over essential services. No less worrying is the international Trade in Services Agreement (TiSA) that could make the liberalisation and privatisation of water irreversible.

Remunicipalisation: A global trend

Remunicipalisation in the water sector and for other social services is a significant trend because it demonstrates that past decisions to privatise are reversible. By March 2015, more than 235 cities and communities in 37 countries had taken back control of their water services over the last 15 years.¹
And this number is growing. Reasons to remunicipalise water services are similar worldwide: deterioration of services, under-investment, disputes over operational costs and price increases, soaring water bills, difficulties in monitoring private operators, and lack of financial transparency. Generally, municipalities decide to revert to public management when they find private contracts to be socially and financially unsustainable. How best to provide essential services is a critical matter for citizens, and elected officials have to make a responsive choice based on citizens’ needs. Almost all cases of remunicipalisation happened when it was (newly) elected local councils that took the bold decision to reverse privatisation. In some cases, residents exercised direct democracy to be heard by their local governments, for example through a referendum.\(^4\) When service providers do not meet expectations, policymakers can reverse a service contract based on pragmatic considerations to best respond to citizens’ needs in a cost-effective way. The ability to respond to new information on service performance or shifting public opinion is an essential part of democracy.

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**Box 1** *What is investor-state dispute settlement?*

ISDS gives foreign investors the ability to directly sue countries in private international tribunals for compensation over health, environmental, financial and other domestic policies that allegedly undermine their corporate rights. Arbitration mechanisms generally designate the World Bank’s International Centre for Settlement of Investment Disputes (ICSID) or other tribunals such as at the International Chamber of Commerce as adjudicators. Investor-state lawsuits are decided by private arbitrators selected by the conflicting parties, not by independent judges. There is a demonstrated arbitrator bias in favour of investors: 42% of cases\(^2\) have been decided in favour of the state compared to 31% for investors. Another 27% of cases were settled without ruling (often resulting in major payments by governments).\(^3\) This extended investor protection mechanism is found in over 3,000 existing international and bilateral investment treaties worldwide.
This chapter examines remunicipalisation cases in which national and local governments were sued by water multinationals using traditional litigation strategies in national courts and the increasingly common investor protection clauses from bilateral investment treaties (BITs), and how this has affected their policy options. The chapter also explains why trade and investment agreements such as the TTIP, TPP and TiSA would undermine the remunicipalisation trend if signed.

Companies are well protected against remunicipalisation

In the last 15 years, many of the municipalities that have terminated private contracts around the world have experienced harsh financial consequences. Termination fees or compensations paid to private water companies are commonplace. Multinationals are generally well protected by national commercial law in the event of contract termination to be compensated for profits that were expected until the end of the contract period. The water privatisation contract in Jakarta (analysed in this book), for example, defines that in the event of any type of termination either by the municipality or the private company, even if due to bankruptcy, the municipality will have to pay a considerable compensation to the private company.

Another stark example is Castres, a city in Southern France that terminated the contract with Suez in 2004 after a seven-year battle initiated by a small group of committed citizens. In 1997, citizens filed a court case and the regional Toulouse Administrative Court ruled that the price of water was too high; moreover, the contract itself was deemed illegal as the former mayor had signed it without consulting the town council, as legally required. Nevertheless, the company, stung by the unilateral termination that followed, went to the court again in 2003 to ask for the reimbursement of investments (€66 million) and damages (€58.8 million). The court ruled that the city had to pay €30 million to Suez to compensate for investments.  

We observe how private water companies have the higher hand in similar litigations elsewhere. Set compensation for investments made tend to overlook
past profit gains from the private contract. Commercial law also disregards the quality of public service delivery when examining such contracts.

Yet serious violations of service provision standards by private companies are often at the centre of the motivation for remunicipalisation. Many cases, from Buenos Aires to Jakarta, show that disputes and conflicts over violations of contractual obligations between parties tax public authorities of enormous time and resources to prove.  

Municipalities face even harsher conditions when investor protection regimes are strengthened through BITs. In other words, private companies can use this additional tool to maximise gains when they lose a contract.

ISDS as a mounting threat to public water

In the 1990s, Argentina privatised most of its utility services as part of the neo-liberal government’s agenda. During the same period, Argentina entered 50 BITs whose investor protection mechanisms would come to play an infamous role in future renationalisation cases. In water and sanitation services, 18 concession contracts were signed. Among them, nine were terminated between 1997 and 2008. Tariffs, service performance and investment became core issues and sources of conflict between companies and the responsible public authorities in all cases. Six cases were brought before the ICSID. Argentina is the country that has been most sued under international investment treaties in the world (on 55 known cases). To put this case in context, two-thirds of those cases have to do with recovery measures taken by Argentina following the 2001-2002 national economic crisis. The government passed an Emergency Law in 2002 abandoning dollar-peso parity of exchange and devaluated the currency, in order to help the crisis-hit economy to recover. Argentina also defaulted on its debt and froze the public services tariffs to keep them affordable for residents.

For example, France’s SAUR International filed against Argentina in 2004 concerning a water and sewerage concession in the Mendoza province, claiming they had been expropriated without compensation. SAUR invoked
a violation of the *fair and equitable treatment standard* under the Argentina-
France bilateral investment treaty. The ICSID tribunal found Argentina liable
for claims by SAUR in June 2012.\(^8\)

As another example, the province of Buenos Aires made a concession contract
with Azurix, a subsidiary of US-based Enron in 1999 for 30 years and quickly
faced opposition over tariff increase, water quality and delays in infrastructure
investment. During the ensuing negotiation process, Azurix terminated the
concession contract without complying with commitments made due to the
bankruptcy of its parent company Enron. Azurix still filed a complaint with
ICSID against the Argentine government and the province of Buenos Aires,
claiming public authorities purposely delayed the permission to increase the
water tariff and breached the Argentina-US treaty. ICSID ruled in 2006 that
the Argentine government should pay US$165 million with interest to Azurix
and cover the ICSID expenses.\(^9\)

During that time, Santa Fe province terminated the contract with Aguas
Provinciales de Santa Fe whose majority shareholders were Suez (France)
and Agbar (Spain) due to dissatisfaction with services and a strong public
campaign in 2005. Prior to this, Aguas Provinciales de Santa Fe filed a case
at ICSID and demanded US$243.8 million from the Argentine state, blam-
ing the public authority for its failure to increase tariffs after the country’s
abolition of the dollar-peso parity in 2002, which changed trading condi-
tions. The company said the government’s action destabilised the conces-
sion, and amounted to expropriation, breaching the clause on fair and
equitable treatment under the Argentina-France and the Argentina-Spain
BITs. ICSID accepted this jurisdiction in 2006.\(^10\) Aguas Argentinas SA,
the Suez-led water company that operated in the city of Buenos Aires made
almost identical claims\(^11\) at ICSID prior to the government terminating
the contract in 2006.

The use of ISDS in BITs to demand compensation has increased in the last
few years. Mexico, for instance, received notice of four investor disputes
during 2013.\(^12\) One of them was from French water treatment company
Degrémont, which notified Mexico of a potential ISDS claim at ICSID under the France-Mexico BIT. The dispute concerns investment in local company Tapsa, which operated four water treatment plants from 1999 in the city of Puebla until the contract with the municipal government was terminated in 2012 on the grounds that water quality had fallen below official standards. Degrémont says the termination and subsequent occupation of the plants by state officials amounted to an indirect expropriation and exercise of arbitrary power. The compensation requested by Degrémont is still unknown.

In fact, a state can be sued over mere disagreements on tariff increases, before remunicipalisation is even considered. Estonian company Tallinna Vesi and its owner United Utilities Tallinn brought a claim against the national government under a BIT in October 2014. United Utilities is a UK company registered in the Netherlands, which enables Tallinna Vesi and United Utilities Tallinn to use the Estonia-Netherlands BIT. The company alleges that Estonia breached the fair and equitable treatment standard of the BIT in refusing Tallinna Vesi’s application for tariff increases on the basis of a new law passed in 2010. The law gives the Estonian competition authority power to cap utility companies’ profits at what it determines to be “reasonable” levels. The companies are seeking damages over €90 million to cover their projected total losses over the lifetime of the contract up until 2020.\(^\text{13}\)

Chilling effect on policy

The threat of a lawsuit often prevents governments from passing laws or adopting new policies in the public interest. The case of Bulgarian capital Sofia is a good example. Residents of Sofia have suffered from illegal water price increases and scant investment since the city signed a privatisation contract in 2000 with Sofiyska Voda, whose major shareholder is Veolia. Additional clauses were secretly added in 2008 and one of these clauses enables the company to take Bulgaria to the Vienna International Arbitral Centre. In 2011, the city disconnected 1,000 households from water supply and prosecuted 5,000
more for non-payment of water bills upon a request from the privatized utility. While these actions were violating the human right to water, the municipality said its hands were tied by the private concessionaire’s threat to sue authorities for unpaid bills. Citizens and some elected officials had collected enough signatures to hold a referendum on remunicipalisation of water services but the city did not allow such a plebiscite since the private company was also ready to file a lawsuit should it take place.\textsuperscript{14}

This kind of chilling effect is observed in many places. Montbéliard in France decided in 2010 to remunicipalise the water system managed by Veolia since 1992. The decision was confirmed by an official vote of the council in 2013 and was expected to take effect in 2015 (seven years before the end of the concession contract). But Veolia challenged this decision before a national court and asked for litigation to obtain €95 million in compensation for breach of contract.\textsuperscript{15} In 2014 the city gave in to the threat and reversed its decision to remunicipalise.

These cases show that private companies effectively exercise their power and end up distorting public policies. Across the globe, there is mounting evidence that investors successfully reverse new policies and regulations drafted to protect public health and the environment. If the threat of traditional litigation was already an effective deterrent, it is even more so with ISDS disputes because they raise the costs of such a political decision even further and tend to lead to even more unaffordable compensations.\textsuperscript{16} It is not difficult to imagine that water multinationals will use this powerful tool against states and municipalities in the event of remunicipalisation.

Remunicipalisation is not easy. It requires overcoming a range of technical hurdles in addition to the legal ones discussed above. Public authorities often have to either buy back shares or disburse significant compensation costs.\textsuperscript{17} The current global investment framework marked by the rise of ISDS certainly makes remunicipalisation harder. The choice of how to provide essential services such as water should be based on democratic decisions and should not be guided by foreign investors’ interests.
Box 1 TTIP

The Transatlantic Trade and Investment Partnership (TTIP) is a proposed trade and investment agreement that has been under negotiation between the United States and the European Union since the summer of 2013. The negotiators on both sides want to include ISDS. The process is widely criticised, in large part because of its secrecy, the agreement’s expansive scope, and some controversial clauses including ISDS. According to the European Commission, there will be sectoral exceptions for public services (public education, health and social services, and water). Whether this will indeed be the case remains to be seen. Moreover, exempting the water sector from trade liberalisation under the TTIP is not an effective guarantee against investor-state cases by water multinationals: If investor protection and ISDS are included in the agreement, the corporations can make use of this to ‘protect their investments’ even in the water sector, effectively circumventing the exemption. In those countries where the water sector is already partly liberalised, the TTIP would create a serious obstacle for remunicipalisation.

Box 3 TPP

The Trans-Pacific Partnership (TPP) is another proposed regulatory and investment treaty. As of 2014, 12 countries throughout the Asia-Pacific region had participated in negotiations: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. While the text under negotiation is secret, it is known to include cross-border services, government procurement and investment, among others. The TPP’s starting point on government procurement for instance seems to be based on a similar agreement under the World Trade Organisation, which excludes water services. However, there is a tendency to expand and deepen liberalisation’s scope and it is still unknown how water services are treated under the TPP.
New trade and investment treaties

Including investor protection clauses in the TTIP, TPP or Comprehensive Economic and Trade Agreement (CETA) would extend the use of ISDS globally. Regarding remunicipalisation and renationalisation, as foreign investors private operators can claim a violation of investor protection on the grounds of expropriation and exercise of arbitrary state power (e.g. Degrémont vs Mexico, Azurix vs Argentina) or following devaluation of local currency (e.g. Aguas Provinciales de Santa Fe vs Argentina). Civil society campaigners fighting excessive investor protection and investor rights see the concept of “fair and equitable treatment” as potentially the most dangerous for taxpayers and regulators. This principle is the one most used in investors’ successful claims. Protecting investors’ “legitimate expectations,” it creates the “right” to a stable regulatory environment for investors, preventing governments from altering laws or regulations, even in light of new conditions or democratic processes.19 Public protests are rapidly building up on the trade and investment treaties under negotiation because they would strengthen massively such investor protection and cover large parts of the world.

TiSA and public services

Although TiSA has gotten less attention so far compared with the TTIP, TPP and CETA, it may have the biggest potential impact on public services and may effectively restrict the policy space of municipalities. One could question why TiSA is needed as the comprehensive General Agreement on Trade in Services (GATT) already exists under the World Trade Organisation. TiSA is an attempt to go further and speed up the process among like-minded states that are committed to extending service liberalisation outside of the WTO. The transnational private services industry pushes this agenda openly and aggressively.

How would TiSA affect public services? In theory, the GATT and TiSA both exclude services “provided in the exercise of governmental authority” from their scope. However, TiSA defines public services extremely narrowly as “any service which is supplied neither on a commercial basis nor in competition
with one or more service suppliers.” In practice, public services such as health care, social services, education, waste, water and postal service systems are delivered to the population through a more complex and mixed system than that, being funded in whole or in part by governments and regulated more or less tightly. So in fact this narrow definition leaves little or no effective protection for public services.²⁰

What is even more striking about TiSA is that it could effectively deprive local authorities of key public service policy space. Its “standstill” clause would lock in current levels of service liberalisation permanently, by banning any moves from market to public provision of services unless there exist explicit exemptions. That is, once a city or state liberalises and/or introduces a public-private mix to service delivery, the level of liberalisation is fixed and a (future) government cannot go back on this decision.

Take the example of the National Health Service (NHS) in the UK, which is publicly run. The government’s Health and Social Care Act of 2012 opened the door for private service providers. Since this act came into force, 70 per cent of health services put out to tender have gone to the private sector.²¹ Saving the NHS from further privatisation has been the focus of the growing protest against the TiSA (and the TTIP) in the UK. Indeed, if the UK government wanted to change health policy and regulation after signing on to the agreement to bring the NHS fully back into public hands, TiSA’s standstill clause would likely prevent it.

In the UK, water, railway and energy services were privatised in the 1980s and 1990s. After decades of private management, public opinion polls have shown that the majority of people want public ownership of these services (71 per cent for water, 68 per cent for energy, 66 per cent for railway).²² TiSA’s standstill provision would be enough for private investors to claim the impossibility to reverse privatisation and they would not even need to bring the government before an international arbitration court to settle the matter (while they could certainly do so to obtain lucrative compensation). The standstill provision precludes remunicipalisation and renationalisation unless sectors have been explicitly excluded in the agreement.
Box 4 TiSA

The Trade in Services Agreement (TiSA) negotiations were launched in late 2012 with the aim to liberalise global trade in services and to improve rules in the areas of licensing, financial services, telecoms, e-commerce, maritime transport and professionals moving abroad temporarily to provide services. The EU and the US are the main proponents of the agreement. The original 16 members of the TiSA have expanded their ranks to include 23 parties. Since the EU represents 28 member states, there are 50 countries represented. Criticism about the secrecy of the agreement arose after WikiLeaks released part of the negotiated document in June 2014. Public Services International (PSI), a global trade union federation, warns that TiSA makes it easier for multinationals to take over vital public services, such as health care and education. PSI warns that TiSA will also restrict governments’ rights to regulate stronger standards in the public interest. ISDS does not appear to have been included in the negotiation so far but this treaty could have devastating impacts on the prospects for remunicipalisation.

Trading away democracy

The TTIP, TPP, CETA and TiSA are increasingly being challenged in Europe and elsewhere. In October 2014, over 400 actions were organized in 20 European countries to reject the secret trade deals that the EU is negotiating. A European Citizens’ Initiative had collected one million signatures in just two months by December 2014 to call on the EU to stop negotiations on the TTIP and not to ratify CETA. Critics are particularly concerned about ISDS provisions in CETA and their probable inclusion in the TTIP.

The European Commission held a public consultation on ISDS in the summer of 2014. Nearly 150,000 people contributed from a wide range of institutions – the highest number of responses ever for an EU consultation – showing the strength of public opinion on the matter. This included the European association of public water operators Aqua Publica Europea, which considers “that recourse to ISDS will not improve in any way the investment flow between
the US and EU, may create discriminatory conditions for domestic companies and, above all, can lead to a limitation of states’ right to decide how to organize the provision of public services.”

The European Commission nevertheless made clear that it would not drop the controversial ISDS provisions from the TTIP negotiation.

There is growing concern by parliamentarians and local authorities with the secrecy of negotiations. The three umbrella organisations of German municipalities jointly denounced the risks posed to public services by the CETA, TTIP and TiSA. They argue that public services should be taken out of these agreements and remunicipalisation of public services should not be impeded. Herta Däubler-Gmelin, professor of law and former Minister of Justice in Germany, sharply pointed to the lack of legitimacy of these negotiations and the threat they represent to the principles of democracy as they will require changes in laws at the national level.

At least CETA now excludes certain services such as drinking water due to strong public pressure. If drinking water services were to be included in TiSA, the effect would be even greater than what was feared in the case of CETA.

**Box 5 CETA**

The Comprehensive Economic and Trade Agreement (CETA) is a free trade agreement between Canada and the EU. It includes an ISDS mechanism. On September 2014, Canada and the EU announced the conclusion of the negotiation process. The agreement must still be approved by the European Council and the Parliament, and ratified in Canada. If approved, the agreement will come into effect in 2016. As regards water services, after considerable pressure from the public to exclude them from the agreement, Canada and the EU have included broad reservations on ‘market access and national treatment’ obligations with respect to the collection, purification and distribution of water. These reservations give governments the authority to restore public monopolies where water privatisation has failed, but foreign investors can still challenge this decision under the fair and equitable treatment principle and the expropriation provisions of the investment chapter.
Conclusion

Remunicipalisation is a response of municipalities and citizens to devastating privatisations and is a clear expression of the desire to take services back into public hands. Remunicipalisation is a remedy for municipalities when a private company fails to meet its contractual obligations and when a private contract becomes socially and financially unsustainable. This small but legitimate window to exercise democracy must not be allowed to close due to excessive investor protection through ISDS.

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Endnotes


4 See the cases of Berlin, Stuttgart and Antalya on the Remunicipalisation Tracker: http://www.remunicipalisation.org

5 See the detailed case of Castres on the Remunicipalisation Tracker: http://www.remunicipalisation.org/#case_Castres


9 Refer to the detailed case found in the Remunicipalisation Tracker: http://www.remunicipalisation.org/#case_Buenos%20Aires%20Province
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10 Global Arbitration Review. 2006. Argentina suffers arbitration blow. 16 June; the detailed case is also on the Remunicipalisation Tracker: http://www.remunicipalisation.org/#case_Santa%20Fe%20Province


12 Global Arbitration Review. 2014. Investors line up against Mexico. 4 November.


14 Refer to the detailed case on the Remunicipalisation Tracker: http://www.remunicipalisation.org/#case_Sofia

15 Refer to the detailed case on the Remunicipalisation Tracker: http://www.remunicipalisation.org/#case_Montbeliard


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