The role of investment arbitration in water services governance

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Abstract

The flux of foreign investment into the water industry that took place over recent decades had a significant impact on the relationship between water companies and states. The creation of a global network of international investment agreements also altered the method of adjudication of possible disputes between the parties. The emergence of global water markets and the advent of Public–Private Partnerships led to the emergence of what has been called Global Water Governance. This article analyses how the decisions of arbitral tribunals in water-related disputes are becoming an integral part of this global regulatory system and discusses their impact on water services governance. Governments are increasingly required to have a thorough knowledge of the functioning and possible implications of the legal frameworks that underpin foreign investments in the water services market.

Keywords: Global Administrative Law; International investment agreements; Investment arbitration; Water governance; Water services

The emergence of water markets

The provision of urban water services has historically been considered a ‘public service’. This notion has its origins in the association of certain services with the activities and functions of the state. Traditionally, not only water services but also sewage and wastewater disposal, energy supply, communication services, and transportation were provided by the state or by provincial or municipal bodies. The ‘public’ label resulted from the fact that these services were owned and operated by a public organism. The concept had a subjective character which corresponded to the idea of ‘public sector’. From a different perspective, water services were also defined as ‘public’ because they were offered to the general community and perceived as vital for the satisfaction of citizens’ needs. This functional approach focused on the essential character of the service. Water services are a physical monopoly and should be accessible to everyone. Taking into account that water supply serves key public interests, both ownership and operation were traditionally considered of strategic importance and remained strictly within the realm of the public sector. The two perspectives, deeply interrelated, led to the classification of water supply as a public service. The strong ‘public interests’ involved in water supply required that it

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be excluded from the market regime and preserved in the ‘public domain’ – that is, in the hands of the state.

Water supply is operated through a vast physical network, from well to tap. The operation of this vast grid requires substantial technical expertise, maintenance, and investment. All over the world governments were faced with deteriorating and inefficient water systems and the scarcity of capital to maintain and expand the network so as to provide water to all citizens. This situation called for the development of a new paradigm of water services management. Gradually public authorities started mulling over the possibility of allowing private participation in the provision of water services by means of different instruments known as Public–Private Partnerships. This concept refers to an assortment of contractual arrangements whereby private companies build, manage, and/or operate water infrastructures on behalf of governments (Bakker, 2010). Essentially two arguments were advanced in favour of permitting private participation in water management. First, governments could attract the huge funding needed for the maintenance and expansion of water infrastructures (Mandri-Perrott & Stiggers, 2013). The idea was that private participation would relieve governments of the burden of investment financing. This was particularly seductive in the context of fiscal pressure faced by many countries. Second, public entities could benefit from the technical and commercial savoir faire of private companies (Mandri-Perrott & Stiggers, 2013). From this perspective, water utilities’ performance would improve because private entities were more efficient than the public sector. This shift towards the market in search of efficiency and sustainability was boosted by a growing discourse about water as an economic good, epitomised in the 1992 ‘Dublin Statement on Water and Sustainable Development’, also known as ‘the Dublin Principles’. The statement includes the principle that ‘water has an economic value in all its competing uses and should be recognized as an economic good’, setting out recommendations for action at local, national and international level. This momentous change in the way water was understood – emphasising that, while it serves public interests, water also has an economic dimension – was reiterated by numerous international, multilateral and bilateral agencies, calling for significant changes in national regulatory frameworks so as to allow private-sector participation in water services.

The privatisation trend that took place from the 1990s has, however, met fierce resistance from different sectors of society. Opponents argue that private management of water services produces social and environmental negative effects, and that publicly run structures are more effective, equitable, and responsive to citizens’ needs, as long as they are properly financed (Bakker, 2003). This heated debate – which is beyond the scope of this article – feeds into a larger discussion about the role of the state in the market, namely in the provision of essential services.

Public–Private Partnerships in the water sector assume varied shapes. The concession model is the most comprehensive form of private participation in water services provision (Nickson & Franceys, 2003). By means of this contract, the public authority (the ‘grantor’) transfers to a private company (the ‘concessionaire’) the commercial management of abstraction, treatment, distribution, and sale of water in a specific city or region. In some cases, water supply is combined with the operation of the sewerage system. The concessionaire is responsible for the capital investments needed for the expansion of services and assumes the full risk of operating the existing assets in exchange for a fee paid to the ‘asset holding authority’. In exchange for the provision of water services, the concessionaire is entitled to bill and collect payments from all customers at tariff levels agreed with the public entity. Normally these contracts have a long period of duration, which may be as long as 30 years, depending on the level of investment and the payback period needed for the concessionaire to recover investment costs. The
fixed assets remain the property of the public authority throughout the duration of the concession. At the end of the contract period the concessionaire hands back all works and equipment, both original and new, in good order, to the state.

The marketisation of water management deeply transformed the role of the state in the provision of these services. The conclusion of concession contracts and other sorts of arrangements between public entities and private companies led to an emphasis on the economics of private investment – the sector entered the age of ‘economization of fresh water’ (De Chazournes, 2013, p. 96).

A regulatory kaleidoscope

Despite being increasingly operated from an economic angle, water is also a public good in the sense that it is vital for the protection of public interests. Accordingly, public authorities are required to regulate and supervise the market to ensure that the service is carried out in a way that suits its essential public function (Costamagna, 2015). The delegation of the provision of water services to private companies does not render the concept of ‘public service’ useless, as public-service obligations may also be discharged under private-law regimes (Wollmann & Marcou, 2010). Even when the state does not operate the water distribution system directly, it is still responsible for the regulation of private water actors (Naegle, 2004). The unrelieved responsibility of states for water services provision has been confirmed in several international documents. In 2000 the International Council of Environmental Law, a non-governmental organisation, submitted a written statement to the Economic and Social Council of the United Nations arguing that

‘...irrespective of the form of water service management and the degree of involvement of private companies in the service, the public authorities must exercise control over the operations of the various public or private bodies involved in water service management. This includes, in particular, the financing of works, the quality of the water, continuity of the service, pricing, drafting of specifications, degree of treatment and user participation.’

The Human Rights Council, in a resolution adopted in 2010 (United Nations General Assembly, 2010), reaffirmed that the delegation of the delivery of safe drinking water and/or sanitation services to a third party does not exempt the state from its human rights obligations and called upon states to adopt a detailed series of measures to fulfil their duties.

The provision of water services has long been qualified as a ‘public service’. Yet, there is no concrete legal definition of public service as the concept is vague and services are organised in different ways from country to country. In the European Union the traditional concept of ‘public service’ evolved to the notions of ‘Services of General Interest’ and ‘Services of General Economic Interest’. The former refers to services that public authorities of the member states at national, regional or local level classify as being of general interest and, therefore, subject to specific public service obligations. The latter covers economic activities that deliver outcomes in the overall public good that would not be supplied (or would be supplied under different conditions in terms of objective quality, safety, affordability, equal treatment or universal access) by the market without public intervention (European Commission, 2011). This concept clearly covers water services. It purposely avoids any reference to the ‘public’ character of the service, implying that it can be delivered by private entities. Nonetheless, the ‘public’
interest is expressly contained in the concept through the reference to services of ‘general interest’. Taking into account that these services satisfy public interests, specific requirements are imposed by public authorities on the provider of the service in order to ensure that certain public-interest objectives are met. These requirements are known as ‘public service obligations’. The state imposes specific requirements relating to security of supply, regularity, quality and price of supplies, and environmental protection so as to ensure that the service fulfils both quantitative and qualitative standards (Hennig, 2011). Regardless of their public or private nature, water service providers are burdened with public-service obligations so as to protect public interests.

Because of its association with public interests, the provision of water services requires some form of regulation. According to Rees (1998), four distinct elements are included in the regulatory regime: the general framework of laws, constitutional rules, policies, and administrative structures; water resource and environmental laws; specific water and sanitation sector regulation, including the legislation on the powers and capacity of any regulatory agencies; and the individual contracts or licences under which the private company operates. This regulatory framework has a multi-layered structure, as the conditions for the provision of the service are contained in diverse legal instruments, from constitutional rules, legislative acts, and administrative regulations to contractual arrangements. These different layers can be grouped into three essential dimensions: contractual rules, legal and administrative norms, and regulation by agencies.

The concession contract is the main source of obligations for the parties – the grantor and the concessionaire. Through this and similar types of contractual agreements, public authorities arrange with a private partner the provision of a service that used to be in the hands of the public sector – in this case, water – leading some to talk about ‘government by contract’ (Freeland, 2003). Taking into account the importance of the services rendered, the substantial financial means involved, and the lengthy duration of the arrangement, parties enter into a long and complex contractual framework that regulates in detail how the service is to be operated. The contract sets the basic regulatory structure of the relationship, governing basic matters such as tariffs, performance targets, quality standards, penalties, and termination, embedding the essence of the regulatory framework (Spiller, 2011).

The provision of water services is also subject to a vast legal framework. Legislators at the national or local level enact legal provisions applicable to water services in general and to water concessions specifically: laws on the privatisation process, the provision of water services, environmental laws, etc. The creation of this legal kaleidoscope is normally accompanied by the creation of a regulatory agency to monitor the sector. It is important to note that this body of rules does not merely cover the relationship between the state and the private partner. In fact, as the service is delivered to the public, it is also necessary to regulate the rights of citizens (users/consumers), the third parties to the concession contract who enter into water supply contracts with the concessionaire. Taking into account the public nature of the service, the regulatory web is composed of provisions that regulate the delivery of water with certain standards of quality – for instance, consumer protection laws, laws on the provision of public services, etc. The service provider is subject to compliance with certain principles such as universality, equality, continuity, impartiality, adaption to the needs of users, etc. Consumers are configured as holding certain rights, namely the right of physical and economic access to the services, their quality, the quality of drinking water, information about services, complaints about services and their participation in decisions (Baptista, 2014). With the concession of water services, the traditional bilateral relationship between the state and the citizen is replaced with a triangle, where the state is the regulator of the new provider–consumer relationship (Micklitz, 2011).

The involvement of private companies in the water industry adds their private interest to the public function associated with the sector. These interests, naturally divergent and sometimes apparently
incompatible, are balanced through a combination of legal and contractual provisions but also through the creation of an independent regulatory agency. This agency may be an autonomous regulatory agency or a dedicated part of a competition agency, a concession contract revision agency, or a specialist law court with powers to revise contracts (Stern, 2012). Typically, the concession contract needs to be supplemented by regulation by an independent agency because water services are provided in a regime of monopoly. Independent regulation seeks to balance the interests of consumers and water companies, protecting consumers while allowing the provider to earn a ‘fair’ return on their investments.

The age of Global Water Governance

Besides profoundly altering the role of public entities in the provision of water services, the involvement of the private sector in this industry brought about two other significant consequences: the emergence of an international marketplace, and the enlargement of the number of stakeholders.

Public–Private Partnerships, namely concession contracts, acquired a cross-border dimension. As in other industries, the process of transformation in the water sector was accelerated by the wave of globalisation, increasing the volume and importance of foreign investment. Private-sector management and commercial principles were introduced at a global scale. As the water industry became increasingly international, templates for privatisation were disseminated around the world. This phenomenon was steered by different actors. First, international financial institutions such as the World Bank and the International Monetary Fund started advocating the use of Public–Private Partnerships in the water sector, sometimes establishing private participation as a condition for receiving critical loans (Goldman, 2007). While not all of the loans were necessarily dependent upon privatisation, the provision of expertise and support strongly influenced national policies (Morgan, 2011). The combined forces of globalisation, privatisation and cross-border investment favoured the emergence of transnational water companies, who were awarded concession contracts in different parts of the world (Allouche & Finger, 2002). The global water market became highly concentrated, with a few multinational companies controlling a substantial share of the market (Petrova, 2006; Pinsent Masons, 2012).

Another significant change has to do with the involvement of a wider number of actors in water services governance. Both state and non-state actors have created transnational organisations that discuss and shape water policies at a global scale. Water governance acquired a worldwide dimension where the role of states in the provision of water services is increasingly supplemented and reshaped by transnational institutions such as the World Water Council, a transnational ‘think-tank’ (Morgan, 2011). Multinational companies also became partners of international organisations that try to influence water services governance on a global scale (Allouche & Finger, 2002). The increasing importance of a few multinational companies in shaping water policies results in a case of ‘market governance’ (Pahl-Wostl et al., 2008, p. 426). Private participation in water management led to a shift of control from the state to private companies, and decision-making mechanisms are increasingly market oriented (Bakker, 2003). The increasing involvement of non-state actors in the definition of water law and policy calls for a re-evaluation of the role of the state in the provision of water services (Morgan, 2006).

These major changes heralded the arrival of the age of Global Water Governance. This concept encompasses the political, economic and social processes and institutions by which government institutions on all levels (international, national, regional and local), civil society, and the private sector make decisions about how best to use, develop and manage water resources in order to achieve internationally agreed-upon
goals, thereby applying the principles of good governance (Schnurr, 2008). This evolving space of Global Water Governance has been described as ‘a mobius web arena populated by varied actors with competing discourses’ (Gupta et al., 2010). This global regulatory web is, first of all, developed by national institutions. Water services are still deeply embedded in domestic structures and institutions, especially from the perspective of the legal rights and obligations regarding access to water. National regulation includes the legislative framework, lawsuits based on the legislative framework, quasi-judicial resolution fora, such as an ombudsman, and rulings made by regulatory agencies (Morgan, 2006). National and local regulatory dynamics are the most crucial aspects of water service regulation (Morgan, 2012).

However, water governance is not contained within national borders nor in the hands of states. Even though there is no international organisation responsible for the regulation of water services at a global scale, transnational influence in the policymaking is considerable. Morgan (2006) identifies three different forms of international regulatory activity: interstate legal regulation and dispute resolution, private standard-setting, and global bureaucratic soft law. First, bilateral investment agreements create legal rights for companies investing in water services. Second, private standard-setting is exemplified by Technical Committee 224 of the International Organization for Standardization, which develops standards applicable to water and sewerage services. Finally, international soft law is illustrated by the United Nations Committee on Economic, Social and Cultural Rights’ General Comment No. 15 on The Right to Water (United Nations Committee on Economic, Social and Cultural Rights, 2003). Naturally, the different actors that debate and shape water policies at a global scale have different views and interests. Still, they express consensus on three major principles: the principle of cost-recovery in the provision of water services; the centrality of contractual and property rights in the delivery of water services; and the importance of independent regulation for the supervision of the first two principles (Morgan, 2012).

Due to the expansion of the water market and the arrival of new actors with a transnational nature, water governance acquired a global dimension. Domestic regulation is not suited to address universal issues that transcend national borders and legal frameworks. A great part of global governance corresponds to the idea of administration, which is organised and shaped by principles of administrative law (Kingsbury et al., 2005a, 2005b). Based on these observations, some claim that a new area of law is in bloom – Global Administrative Law – in which significant regulatory functions are no longer exclusively domestic but assume a global nature. This global administrative space is populated by diverse actors, including national and international bodies, instead of diverse disconnected levels of regulation (Kingsbury, 2009). This includes formal intergovernmental regulatory bodies, informal intergovernmental regulatory networks and coordination arrangements, national regulatory bodies, hybrid public–private regulatory bodies, and some private regulatory bodies exercising transnational governance functions of particular public significance (Kingsbury et al., 2005a). The division between domestic and international law is blurred as the various regulators come together to discuss and implement global administrative standards and procedures (Krisch & Kingsbury, 2006).

The emergence of Global Administrative Law results from the transnational nature of some problems. As they cannot be properly addressed at the national level, transnational regulatory systems have been developed by means of international treaties and informal networks, transferring many regulatory decisions to an international context (Kingsbury et al., 2005a). The advent of Global Administrative Law mechanisms is already observable in many different areas. It is also clear that globalisation altered the water market in a remarkable manner. It brought about new problems and unexpected challenges, calling for a reconfiguration of the overall system. This makes the need for global governance values in the water sector ever more evident (Retherford, 2013). Modern discourse on water services governance reflects many of the key principles of Global Administrative Law such as accountability, participation,
predictability, and transparency (Grimes, 2009). For instance, the Global Water Partnership, jointly established by the Swedish International Development Agency, the United Nations Development Program, and the World Bank in 1996, has been deeply influenced by principles developed by Global Administrative Law (Fromageau, 2011). According to Kingsbury (2005a), water companies have also been using administrative law principles, like participation and accountability, in the hope of rendering their presence in some markets more legitimate. The author suggests that the major multinational water companies, as repeat players, can benefit from the lessons of Global Administrative Law in order to reinforce their legitimacy, namely in the context of international dispute resolution.

As mentioned previously, one of the significant features of Global Administrative Law is the plurality of sources of regulation. In this sense, the term ‘administration’ includes the making of specific decisions and of general but subsidiary rules (Kingsbury, 2005a). International law emerges not just from legislative and judicial processes but also from executive and administrative actions (Dellapenna, 2014). The subsidiary rule-making activities of national and transnational administrative bodies are included in the ambit of Global Administrative Law (Kingsbury, 2005b). Different entities can participate in water governance such as the United Nations Committee on Economic, Social and Cultural Rights or other bodies concerned with the monitoring of human rights instruments; international standard-setting bodies such as the International Organization for Standardization; and judicial and quasi-judicial organs such as international investment arbitration tribunals established under the International Centre for the Settlement of Investment Disputes (ICSID) or the accountability mechanisms of multilateral development banks. Furthermore, interpretative statements (such as General Comment No. 15), best-practice guidelines (such as the 2007 ISO guidelines), and arbitral and quasi-judicial decisions (such as those of arbitral tribunals) demonstrate the utility of the Global Administrative Law theory as a means of understanding common approaches that arise from different sources (McIntyre, 2012). Because Global Water Governance became very technical, technocratic solutions may result in increased formal and informal administrative law in the water field, some of which might be adopted at an international level, even in the absence of formal legal consensus (Dellapenna, 2014). As a result of the globalisation process, the state lost its exclusive power to regulate matters that lie within the traditional realm of administrative law, namely what was traditionally configured as ‘public services’. As international agencies exert increasing influence over domestic regulatory processes, states have to relinquish some of their regulatory powers (Barak-Erez & Perez, 2013), creating a tension between global governance and national institutions which are still adjusting to the new context of transnational water markets.

**International water markets and investor–state arbitration**

As a consequence of the new market-oriented approach to water, a global marketplace for private water management services quickly emerged. Private operators identified public water systems as opportunities for profit and marketed their ability to make significant capital investments in infrastructures and operate such systems in an efficient manner. The combined forces of globalisation, privatisation, and cross-border investment resulted in a vast number of concession contracts being concluded between water companies and foreign states.

As in many other areas of activity, the astounding increase in the flux of foreign investment in water services which took place over recent decades would not have been possible without the establishment of a transnational system of substantive and procedural guarantees. Currently the international legal framework governing foreign investment consists of a vast network of international investment agreements...
supplemented by the general rules of international law. These agreements include bilateral investment treaties, regional free trade agreements, and sectorial treaties that include investment obligations. While international investment agreements differ in many important respects, they are composed of two essential elements: first, they include a set of standards of promotion and protection for foreign investment; second, they provide mechanisms for the settlement of any possible disputes between the investor and the host state.

Investment agreements are a form of international hard law that creates a series of obligations owed by the host state towards foreign investors (Dolzer & Stevens, 1995; Dolzer & Schreuer, 2008; Newcombe & Paradell, 2009; Sornarajah, 2010; Salacuse, 2015). These include the obligation to treat foreign investors fairly and equitably; provide foreign investors full protection and security; not to expropriate foreign investment except under certain conditions, including the payment of compensation; not to treat foreign investors covered by investment treaties less favourably than foreign investors from third countries (the ‘most-favoured nation’ obligation); not to treat covered foreign investors less favourably than domestic investors (the ‘national treatment’ obligation); and to allow foreign investors to freely transfer money in and out of the country. International investment agreements usually define their scope with reference to the notions of ‘investment’ and ‘investor’. In most agreements, the term ‘investment’ is defined on the basis of an illustrative or exhaustive list of different forms of assets (Schlemmer, 2008). Many investment agreements include concessions in their definitions of investment. Even in the absence of express reference, concession contracts can be considered investments to the extent that they require the investor to commit capital to a venture with the expectation of receiving a return at a later time (Salacuse, 2013).

International investment agreements also include procedural protections. They typically contain dispute resolution clauses that enable foreign investors to file claims directly against the host state. The dispute resolution clause usually grants to the investor the option of either filing claims in the local courts of the host state or of initiating an international arbitration (Dugan et al., 2008; McLachlan et al., 2008; Douglas, 2009). The latter is frequently conducted before the ICSID, a World Bank-affiliated arbitration institution established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID, 1965). Water services are increasingly implicated in investor–state disputes. According to figures from the ICSID (2015), 6% of all registered ICSID disputes have involved water, sanitation, or flood protection. In fact, the ICSID has already administered 13 cases arising from water concession contracts. This number, however, may be far from reality, as some proceedings

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may be conducted before arbitral institutions that, differently from the ICSID, do not disclose the initiation of proceedings publicly. As a result, some disputes may remain totally confidential.

In such disputes the foreign investor brings a claim before the arbitral tribunal alleging that certain acts or omissions of organs of the central government or local authorities, which resulted in damages to their investment, violate the host state’s obligations under an international investment agreement. If the host state is a party to an international investment treaty and has consented to investor–state arbitration, the arbitral tribunal has jurisdiction to hear the claims of the concessionaire against the state for violation of its obligations under the treaty. The entry of foreign investment into the water industry had a significant impact on the relationship between the parties and on the adjudication of possible disputes between them. When the management of water services is transferred to a domestic company, as happens frequently in developed countries, the contract is simply managed by the domestic legal system, and disputes are normally solved through local courts. Contrary to this, when the states delegate the management of water services to a foreign company, this arrangement acquires an international dimension. In this case the foreign investor is normally protected by existent international investment treaties that have been negotiated between the host state and the investor’s national government. Because it qualifies as an investor, the concessionaire receives protection under the substantive protections afforded by the investment treaty. Furthermore, the dispute will be taken to international arbitration, not to national courts. A major justification for giving foreign investors the right to pursue international arbitration – a right not enjoyed by domestic investors – is to avoid the bias an investor might face if it were to commence legal proceedings against the host government in domestic courts.

**Investment awards and water services governance**

Investment disputes arise from a long-term relationship between investor and state. Whereas trade transactions generally involve a single exchange of goods and money, investments are effected through a long-term relationship between the investor and the host country (Diehl, 2012). Salacuse (2007, p. 141) describes this relationship as a ‘complex connection, often amounting to a state of interdependence, between the investor and the Host State’. This complexity and interdependence are especially acute in the cases of privatisation of public services such as water. According to the author, in such cases the investor and the host state are

‘[...] linked in a more or less permanent relationship that is very difficult to unravel, far more difficult than that arising out of a simple contract of sale of a commodity in international commerce. In such cases, the Host country is dependent on the continued provision of the investor of the needed public service and at least in the short run has no other option than to continue to deal with the investor. Similarly, the investor, having committed substantial capital to the privatized enterprise, is dependent on the Host country for continued revenues and at least in the short run has few options with respect to selling its investment’ (Salacuse, 2007, p. 141).

The network of international investment agreements that was built over recent decades has fundamentally altered the legal framework for investors and host states in the water sector. Furthermore, the flux of foreign investment into the water industry led to the internationalisation of disputes and of their method of settlement. In a typical investor–state dispute the investor claims compensation for damages
it has allegedly suffered as a result of measures adopted by the host state. Most of the disputes to date involved allegations of indirect or ‘regulatory expropriation’, or allegations that regulatory measures taken by the state constitute ‘unfair or inequitable treatment’. Nowadays the concept of ‘expropriation’ has a very broad scope, covering a wide variety of state conducts, as virtually any regulatory measures that reduce the value of an investment can be considered as a ‘de facto’, ‘indirect’, or ‘creeping’ expropriation (Organisation for Economic Co-operation and Development, 2004). State measures normally include not only legislation but also regulations, policies or practices of the state or of public entities. In the context of water concessions, an investor may challenge decisions such as the modification of the amount or duration of the investment, applicable operational requirements such as quality standards, or the tariffs that the investor is allowed to charge (Morgan, 2006). Issues of price and quality control are often at the heart of the dispute. These are, however, among the most important topics in the regulation of public services as they determine the conditions of access of citizens to the services (Krajewski, 2012). The potential for conflict is self-evident.

When disputes over the performance of a water concession contract give origin to investor–state arbitration, public authorities are put in a challenging position. The state needs to combine two different roles – its role in the provision of services of public interest and the fulfilment of its international legal obligations arising from international investment agreements. International investment agreements impose certain standards regarding the protection afforded by states to foreign investors. However, in some situations these canons may conflict with the regulatory power of the host state. The disciplines of international investment law may ‘chill’ governments from enacting regulations that might affect foreign investments. Fundamentally, the notion of regulatory chill suggests that the investment arbitration system may impact the normal course of policy development and implementation. In some circumstances, governments may fail to modify, enact or enforce new regulatory measures because they are afraid of a perceived risk of having to face arbitration proceedings (Tienhaara, 2011). These disputes raise a classic problem in investment arbitration: how to strike a balance between foreign investors’ reliance on the regulations that underpin their long-term investments and the host state’s right to adapt regulations to new needs (Dolzer & Schreuer, 2008).

The creation of global water markets and the advent of Public–Private Partnerships led to the emergence of Global Water Governance. This promoted the amalgam of national and international rules and standards of behaviour. The provision of water services is subject, inter alia, to domestic contracts, national law, and public international law. As there is no international regulatory body responsible for water services, the regulation of these services is highly fragmented and chaotic. However, the existence of transnational legal frameworks for investment protection and international dispute settlement produced an important result: it inadvertently formed an emerging system of regulatory governance over the international water services sector (Chaisse & Polo, 2015). The decisions of arbitral tribunals in water-related disputes constitute a new dimension of Water Services Governance. Existent arbitral awards have contributed to a relatively small but sprouting jurisprudence that illuminates key definitions and provisions contained in investment treaties and concession contracts. In deciding these cases, arbitrators are contributing significantly in shaping the contours and substance of an emerging international economic water services regime, filling the gap that results from the non-existence of an international regulatory body (Chaisse & Polo, 2015).

The investment arbitration system functions as a tool of transnational governance because it determines the legality of governments’ conduct towards foreign investors (Van Harten, 2005). Arbitral tribunals perform a supranational review of state acts, scrutinising the conduct of public entities against the standards of
treatment prescribed in international investment agreements. Their intervention, like that of international courts, is not limited to deciding the particular dispute before them. Rather, they assume a role in global governance. Arbitral awards produce effects that go beyond the individual dispute, having an impact that resonates on general legal structures (Von Bogdandy & Venzke, 2013). Investment arbitrators craft and concretise standards of behaviour for host states, the importance of which extends far beyond the specific dispute (Schill, 2010a). Indeed, those decisions shift actors’ normative expectations and develop legal normativity (Von Bogdandy & Venzke, 2013). As a result, investment arbitration can have positive spill-over effects for the good governance of host states. If a country is faced with an investment claim based on the alleged breach of certain standards of behaviour contained in international investment agreements, the outcome of those proceedings may trigger changes to its internal legal structure.

Moreover, good governance is also likely to be demanded by the local community of the defending state (Schreuer, 2013). In this sense, investment arbitration can also have an impact on the behaviour of civil society (Schill, 2010a). Water services are provided to citizens/consumers, the third-party beneficiaries of the concession contract. Consumers are configured as holding certain rights, namely the right to access information about water services and take part in decision-making processes. Individuals and public-interest organisations have been demanding greater consultation and public scrutiny over water projects and plans for private participation in running these systems (Razzaque, 2009). As a result, they are likely to follow arbitral proceedings closely and monitor their impact on public interests. If they believe that consumer interests are not being taken into due account by arbitrators or properly defended by states, they are also likely to request permission from the tribunal to voice their concerns directly in the arbitration proceedings.

Finally, investment treaty arbitration can also influence investors and states that are party to neither the specific proceedings nor the investment agreement under discussion (Schill, 2010a). Investment treaty arbitration functions as a mechanism of global governance that shapes the behaviour of foreign investors and host states more generally by crafting and concretising principles of international investment law (Von Bogdandy et al., 2008; Schill, 2010a). Even though most arbitration rules contain no explicit legal obligation to make arbitral awards public, the ICSID regularly publishes excerpts of the legal reasoning of tribunals. The Centre actively seeks, and usually obtains, the consent of the parties for the publication of the full text. In practice, it is also common for one of the parties to submit the award for publication in a journal. Many arbitral awards are also available online. As a result, potential parties to investment treaty arbitrations – both water companies and states – have the opportunity to be informed about how investment treaties have been applied and interpreted in the past and, based on that information, build up expectations about how investment treaties will be interpreted in the future (Schill, 2010a). While international investment tribunals do not create precedent that is binding upon other tribunals, some of the standards of investor protection are actually primarily shaped by prior rulings and not by reference to other sources of international law or state practice. Investment treaty arbitration has developed a strong, albeit persuasive – that is, non-binding – system of precedent (Schill, 2010b).

As the body of case law expands, it has the potential to provide guidance for pending cases and future disputes, further defining the parameters of the host states’ regulatory powers with respect to investments in water services. Still, the approach of different international investment arbitrators to similar issues can vary considerably, creating a degree of uncertainty regarding the outcome of international investment disputes. In fact, past arbitral practice allows for diverging interpretations of the existing investment standards. This divergence is explained essentially by three different factors. First, different international investment agreements adopt different languages and formulate investment standards in diverse ways. Second, these legal instruments normally have a wide scope of application and are not
specifically designed for investments in a particular area or industry. Finally, there is no system of binding precedent in investment arbitration. Arbitral tribunals can interpret the applicable investment treaties differently and apply them to the specific facts of the case according to their own appreciation. This underlines the importance of the specific nature and circumstances of each dispute for the decision. This lack of certainty also raises the question of the necessity to create a specific investment regime for investments in water services.

Resorting to the investor–state arbitration mechanism for the settlement of disputes gives arbitration panels a role in national and international water governance.

Understanding how arbitrators are giving consideration to the protection of investors, while at the same time balancing the interests of host states to regulate in the public interest, is decisive for water services policymaking. Through the looking glass of arbitration awards one can realise the substantial consequences that the international investment regime has been producing on water markets. Moreover, the defective performance of a particular private operator may be presented as a symbol of the failure of the Public–Private Partnership model and call for a return to publicly managed systems, putting an increased spotlight on water disputes. This phenomenon should not be overlooked as it is likely to continue shaping water services governance decisively. If a Global Administrative Law of Water Services is slowly emerging, arbitral decisions will surely be one of its major sources. Arbitral case law helps to clarify and consolidate the basic concepts, principles, and standards of behaviour applicable to the international water services regime.

States need to adopt a holistic approach to water services policymaking so as to avoid possible clashes between different legal frameworks. The different layers of regulation applicable to investments in water services all serve to protect investments in this field. Legal instruments, in particular, international investment law, can help to mobilise the huge investments required to transform the water sector. The challenge is to shape national policies in ways that do not breach the rights of foreign investors under international investment agreements. This can only be achieved if host states are truly aware of the scope of their obligations to foreign investors when they design and implement their policies. This requires a clear understanding of the disciplines of international investment law and how they may limit or impact upon national regulation. The numerous claims over water services that surfaced in the last decade provide eloquent evidence of the need for states to rethink and reshape their water policies. The outcome of these disputes may prevent governments from taking measures that interfere with the interests of foreign investors, having a substantial impact on current policies and influencing future options. The creation of an efficient and sustainable market for water services is a tremendous financial and legal challenge. This endeavour can only be achieved with a thorough knowledge of the functioning and possible implications of the economic mechanisms and legal frameworks that underpin foreign investments in the water services market. Governments should be cognisant of the commitments that they undertake under international investment treaties. If they conclude that such obligations restrict their ability to design and implement measures considered to be necessary for the protection of public interests, they may have to rethink and reshape their international investment agreements.

References


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