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Decentralisation of Water Services, Efficiency and International Investment Protection Agreements

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Abstract

In I, Introduction, the presentation explains its basic issues, namely, decentralisation and water economy and its services, decentralisation and international agreements to protect foreign investment.

In II, the economic factors that affect water and its services are analysed, namely: 1 Macro-economic policies; 2. Priority of the sector in budgetary policies; 3. Economies of scale and field and relationship with efficiency and equity; 4 Scale of corruption and relationship with water services; 5. Regulation and harnessing.

In III, the international investment protection agreements are considered, as well as their characteristics and background, including: 1. Investment and water agreements; 2 Agreement problems: A Local powers; B Expropriation; C Fair and equitable treatment; D Ignorance of important regulatory concepts; E Problems associated with the procedure;

The presentation ends with some conclusions.

I. INTRODUCTION

Over the last few years there has been a tendency to reinforce the merits of decentralisation in general, and water services in particular. Declarations such as the Dublin Declaration have placed emphasis on the advantages of decentralisation. A series of documents favour decentralisation and discuss the possibilities of fostering its application with financing alternatives on a local level, generally via municipalities and their indebtedness to finance the services. It has also been stated that decentralisation

fosters efficiency, for example, in highest level reports (Camdessus, Winnipenny, 3rd World Water Forum, 2003; World Bank, 1993)

However, when analysing the decentralisation issue it is advisable to bear certain elements in mind that affect the services and the water resource, even though these are decentralised. These include:

a) General macro-economic policies of the central government have a radical impact on services, and on the insertion of water into the productive economy;

b) The service economy must be the least considered, when dealing with decentralisation;

c) For undeveloped countries, in particular, decentralisation in the context of investment protection agreements can be fiction;

d) The negative impacts of this fiction are fostered insofar as the governability and regulation of water and its services are not fuelled by advanced and appropriate principles in the issue.

II. ECONOMIC FACTORS THAT AFFECT WATER AND ITS SERVICES

1. General Macro-Economic Policies and Sustainability of the Sector

According to the UNDP, in its report on human development and water, water is a domestic need, which also sustains ecological systems, and supplies consumables to production systems that are sources of income. (UNDP, 2006). Indeed, the physical scarcity of water can be a problem in some countries, but the scarcity of water in the centre of the crisis of the global water crisis has its roots in power, poverty and inequality and not in physical availability. Furthermore for the UNDP, water scarcity is manufactured through political processes that are detrimental to the poor.

In line with the comments above, CEPAL has carried out some analyses of the impact of general economic policies and its repercussion on the sector. In this regard, the most emblematic cases come from a comparison between Argentina and Chile in the nineties. Both countries began privatisation processes in that decade. However, whilst Chile started to centralise the services in the eighties, Argentina federalised them from the seventies onwards.

Chile did so in the context of an economy with fiscal balances and assignments of public funds according to social priorities. This resulted in sustained economic growth, which permitted the financing of private water and sanitation systems, until the present day.

On the contrary, Argentina, after 60 years of policies when great priority was placed on the sector (since 1913 when National Health Works was created), decided in the seventies that its priority was to subsidise the parity between the dollar and the peso. To do this, the state borrowed dollars on capital markets, subsidised the exchange rate and maintained a parity that was not the result of the productivity of the economy but of indebtedness. This increased the interest rate, affected investment, and led to the economic crisis of 2003. The general collapse affected water and its services, among other things. On the one hand, the State removed priority from it in the official government budget and on the other hand, the artificiality of the economy affected the income of the people, above all the poor people, who could not pay the water prices.

Water is an expensive service, which demands a lot of investment, and the national economies that do not favour sustainable development, cannot guarantee the sustainability of investments and services. In this regard, no decentralisation can compete with the impacts of macroeconomics in permanent imbalance. Today, the majority of the international water companies that invested in Argentina are suing Argentina in international arbitration courts. The faulty regulation of the services, sometimes induced (Sappington, 1993, suggested creative price transfer mechanisms to

hide profits), the methodological poverty of privatisation (Guash, 2003, 2004, 206) and the lack of general regulatory principles in the sphere of international arbitration make the situation of Argentina very awkward. The faulty advice (Kessides, 2004) that the third world received in the privatising period, the ideologisation of the regulation that was implemented under this advice (Ogus 1994) and the lack of understanding of what the international investment agreements, which were signed without assessment, involved (Khan, Makhdoom Ali 2006), conspire for it to face a difficult situation.

To consider the contexts, it must be added that in several cases the privatisations were favoured by international financing organisations, in situations where the international financial cooperation did not come to fruition without privatisation. This was, according to commentators, the case of Dr-es-Salaam in Tanzania (Dumbar and Peterson, 2008)

In connection with the water resource, in the 80s and 90s, Mendoza, in Argentina, loses almost one quarter of the irrigated surface and the preservation and protection tasks were put back (Díaz and Bertranou, 2003). With this, the impact projections that were carried out in the 50s by Ciracy-Wantrup with respect to the correlation between economic and general institutional factors (interest rates, markets, inflation, prices, entitlement and ownership, subsidies, etc.) and investment and preservation (Ciriacy-Wantrup, 1951) are confirmed.

2. Priority of the Sector in Public Budgetary Policies. Subsidy Systems

Drinking water and sanitation services have very low gross returns on investments, with rates that vary from 6: 1 to 10:1. They are intensive in capital: three or four times more than the electrical industry, and five to six times more than railways. This tell us that the private investment possibilities vary with the state of the general economy and that the situation of the poor people is not easy to remedy, unless they are given efficient subsidy systems, be they direct, crossed, intergenerational, etc.

Again, at this point, it is illustrative to consider the cases of Argentina and Chile in the nineties.

Argentina, which had privileged the sector for decades, decided, as from the seventies, firstly to decentralise it to provinces, eliminating national contributions and then, in the nineties, privatise it, without any subsidy for the poor. The result was that these could not pay the connection costs, or the rates and they felt neglected. A dual process occurred, on the one hand, the cancellation of the sector priority in the national policy and on the other, the conscious marginalisation of those that could not pay.

Chile, on the other hand, has placed priority on the sector for the last forty years, in a systematic manner, firstly through public sector companies and then with private companies. In both cases, maintaining subsidies for the poor based on income levels.

3. Economies of Scale and Field, their Relationship with Efficiency and Equity

One of the most important, and the most consistently ignored characteristics in certain discourses, of the sector, is that drinking water and sanitation have greater economies of scale and field. The drinking water supply and especially the drainage and wastewater treatment services require more capital investment than other public utility services: almost 25 times the annual income. Thus, the costs and the differences between systems can vary from 1 to 8 depending on whether the systems are large or small. Studies conducted in the United States show that the average investment for small systems is $1 600, per residence with 3 inhabitants, whilst the same costs drop to $ 200 in large systems. Therefore, the water and sanitation services are a natural monopoly. (Phillips, 1993).

It must be pointed out that in the field of drinking water and sanitation services, probably the most successful country of the Latin American region, Chile, adopts its own model, where it capitalises the economies of scale and scope to efficiently satisfy the

coverage of services based on regional companies, which cover a significant area of territory. It thus reformed its traditional municipal system.

Meanwhile, the countries that have adopted very fragmented political-administrative based models at municipality level, have serious difficulties, with no possibilities of carrying out economies of scale and with poor and rich municipalities as well as subsidy models that do not work. It is clear that these fragmented systems also generate high transaction costs.

Thus, in Peru it has been said: “in the country, of a total of 143 wastewater treatment plants (WWTP), no project can be considered as successful”. “Investments in construction of WWTP in the EPS (Public Services Company) of Peru amount to approximately 369 million US dollars, which was placed by different governments” (SUNASS Discussion document).

Whilst, in Colombia, it is stated: "Insofar as waste water treatment is concerned, there are currently 410 systems constructed in 354 municipalities… It is estimated that only 33% of the constructed systems work adequately." (Latin American Sanitation Conference, Cali, Colombia, 12 to 16 November 2007).

In Europe, the emblematic case is England, which, in the eighties, reached the conclusions that satisfying the EU directives with municipal companies would not only be slow and costly, but also inefficient. It therefore organised regional companies that served millions of inhabitants, with considerable costs and time savings. In this regard, it is worth pointing out that France, a municipal-based system, has recently been warned by the European Commission, due to failure to satisfy the European Directive of 1991 on urban effluent treatment in sensitive areas, despite having been convicted for this at the European Court of Justice (IP/08/150, Brussels, 31-01-2008).

Argentina, in South America, created a national company in 1913, due to the urgent need to put an end to water-based illnesses, with agreements with the provinces,

which, on winning economies of field, and reducing transaction costs, succeeds in achieving drinking water and sanitation services in relatively short periods of time. As mentioned above, the changes in priority of the public financing system led to decentralisations and privatisations that ruined the quality of the services, basically due to the bad design and economic assessment of the systems and their sustainability.

Even in the United States, whose water services have traditionally been municipal services, states such as Texas promote consolidation, to improve the coverage of demands for quality and environment, whose added fragmented costs are higher than if the systems are consolidated.

On the other hand, the interesting report of the French Accounts Court on the water industry in France (Cour-des Comptes, Resume, Janvier 1997) , makes a list of the municipal limitations, namely, among others, little competence, lack of means, little cooperation between communes, lack of contractual clarity, lack of information, bad controls and deficient organisation.

In some cases, the decentralisation process as a philosophy has done away with the technical and economic aspects of providing public utility services, with which the economies of scale and agglomeration have been lost. This discourages the search for more efficient alternatives to provide services and also subjects companies to a relationship with the local level that, in some jurisdictions, has resulted in efficient provision and problems in the use of public funds. This is particularly true with respect to the drinking water and sanitation services, given the characteristics of the sector where the duplication of installations would be inconvenient from the economic viewpoint.

Apart from the arguments given, it has been estimated that the fragmentation due to competence reasons has quite a limited role, due to the high transport costs, the absence of integrated distribution systems on a national level and strong advantages of the already established companies. Ofwat, the English regulator, has recently acknowledged that competence does not work in the industry of water and sanitation.

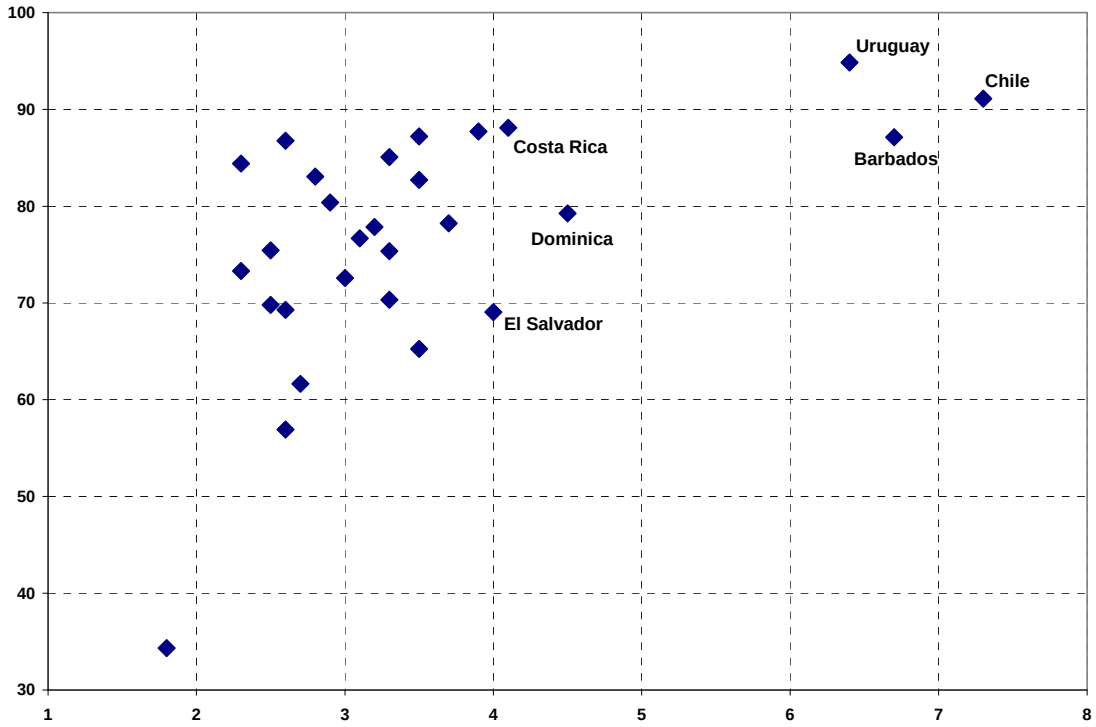
Economies of scale are lost when there is a strong disintegration on a municipal level. Finally, it has been suggested that fragmentation gives rise to an increase in transaction costs and the need to resort to contractual or market agreements to make up for the internal coordination.

It must be highlighted that cost reduction is a sine qua non condition for equity, as with lower costs the possibilities of expanding the services improve. In this regard, the presence of a limited number of large companies also favours equity, on facilitating regulation, an extremely difficulty task when working with universes of thousands of fragmented providers.

4. The Scale of Corruption

Unfortunately, many developing countries occupy an important place in international corruption indices, and the water and sanitation sector has been affected by it. The empiric evidence is that neither statisation nor privatisation has freed the sector of corruption. (Estache, 2006). Further still, in an issue so closely related to corruption, which is the repercussion of renegotiations on privatisation contracts, the drinking water and sanitation sector has stood out more than other public services. (Guash, 2003, 2004, 2006)

Corruption is an important issue, as it means that the available funds for public services are not used either with the greatest efficiency or with the greatest effectiveness. In fact, there is a reverse correlation between corruption and access to services. The table below, prepared by ECLAC, shows this.



Corruption is important when handling aid funds, obviously. In Chile, handling subsidies to the poor through municipalities, for water and sanitation, has hardly been affected by corruption due to intrinsic questions to the country in this issue, but also due to the central subsidy management structure, subject to general standards and with general monitoring procedures. In other countries, the accounting of and responsibility for the national subsidies, on a local level, has been a problem.

One of the questions that arises related to corruption is what relationships, if any, would exist between investment agreements and corruption. Wells and Ahmed (2007) describe cases of international investments in Indonesia, where local partners were relevant and powerful political figures, their relations and associates, with cases where the local partner could even receive dividends before the construction involved in the project had even begun (Wells and Ahmed, 2007). In this context, it is argued that the formal decentralisation of the government increased the corruption problems, as local bureaucrats had authority without formal checks (Wells and Ahmed, 2007). In one case, CalEnergy, where Indonesia suspended an international contract, the lawyers for the Indonesian government wanted to argue corruption. Minister Hatharto, father-in-law of a

local company partner, gave instructions for it not to be invoked. (Wells and Ahmed, 2007). With the structure of arbitration rulings, this immediately destroys the possibility of the question being posed by anyone in a compulsory manner. This does not mean that arbitration favours corruption. But if the governments do not want to pose it, the people, apart from some exceptional cases, remain unprotected.

Thus, in the case of Wena v. Egypt, the court considered that the corruption allegations were disturbing but that as the country had not taken internal measures, the argument was not allowable. (Mann, 2006)

Arbitration decisions can also favour subtle forms of corruption, when they establish that the declarations of an official, or a public organisation force the governments, without conditioning it to context and legality. In MTD Vs. Chile, the court ruled that a government investment authorisation, without informing about regulation plans, which depended on another entity, and which the investor did not control, generates public liability. Possibly, the act of one single individual could generate public liability, especially if one considers that the compensations system, and the way in which it works, generates serious problems of moral hazard (Wells and Ahmed, 2007).

In the particular case of water, the practice of making offers based on low prices, to then re-negotiate, comprises the problem. In Buenos Aires, the price was re-negotiated much earlier on than those undertaken in the concession agreement, based on faulty information. The coincidence of the procedure with that of other countries, such as Tanzania, leads to consider a pattern of behaviour, and the awareness that the purpose of the offer was to win the tender and then re-negotiate without competition. In the case of Buenos Aires, the government re-negotiated in favour of the company every time it was necessary to do so. In the case of Tanzania (Biwater) the company tried to re-negotiate, the Government refused, and the company was sued before the international arbitration courts (Guash, 2004, 2006, Biwater Gauff v. Tanzania, Amicus Curiae).

5. The Regulation

We have seen above that the drinking water and sanitation services are a natural monopoly. This means that they require appropriate regulation, given the lack of competition. The characteristics of a natural monopoly favour, for want of an appropriate regulation, the capture of services by sectors of interest. The basic capture possibilities are:

Capture by service providing companies, in order to obtain profits that go beyond competitive costs and reasonable profit. This may be done through a series of mechanisms, including high salaries, special bonuses and premiums, unreasonable expenses, purchases between member companies, as verified by Halcrow auditors in Buenos Aires, excessive indebtedness, unjustified amortisations, etc. The capture is also expressed in frequent renegotiations that favour the company, either in investments, service quality or rates, to mention some cases.

- Capture by unions of employees of the service company. In this case, the capture is expressed mainly by salary levels, number of employees, number of directors, too many members of the board of directors, number of companies linked to the sector, all of them with the same end, but fragmented in order to increase the employment potential, is also seen in proxy systems where the contractors are linked to unions, relations, etc.

- Capture by state bureaucracy, which has basically similar expressions to union capture.

- Finally, there have been cases where alliances take place between the different sectors with an interest in capture. Thus, for example, in the nineties, the central political bureaucracy of Argentina ignored the regulators and reached agreements directly with the providers. And the providers, integrating the union into the top

executives of the companies, managed the public hearings so that the users did not have a relevant participation in price discussions, services, etc.

The capture possibilities and the monopolistic characteristics of the drinking water and sanitation services mean that it is a highly regulated sector. Traditional regulation was defined in simple terms: reasonable prices, universal, non-discriminatory service, equality, safe and appropriate service. Apart from the potentials to capture and abuse of a dominating position, there are more regulatory obligations: information, price transfer prevention, control of debts and costs, including personal ones, existence of independent regulators, among others.

As the faulty regulation and capture affect both the efficiency and equity of the service, as they artificially increase their costs and prices, reducing the possibilities of expansion, the sector must have a uniform regulation that adapts to comparisons between different providers. It is also important to guarantee appropriate practices and contracts with contents and minimum obligations. It is difficult to imagine that this will occur within a decentralised context without common conditions.

Both Chile and England have a national regulatory framework that permits comparison and also establishes very significant operating and legal conditionalities. Among the legal conditionalities, the efficiency obligation of the English legislation is fundamentally important, and its transfer to uses, and within the same legislation, on an operating level, the companies' information obligations and the way in which the information must be presented. If Argentina had had a national legal regulatory framework, with common obligations related to efficiency, efficiency transfer, information, price transfer, information organisation and maximum indebtedness of the companies in connection with capital, their legal problems in international arbitration courts would be more manageable. The erratic nature of the regulation on privatisation of Buenos Aires was noted in reports by officials from the World Bank (Alcázar, Lorena, et al, World Bank, 2000).

Finally, the closer the regulator is to the supply level, the easier the capture will be. That is why the English and the Chilean regulators are national.

III. DECENTRALISATION AND INTERNATIONAL INVESTMENT AGREEMENTS

1. Investment and Water Agreements

Over the last 20 years the third-world countries have signed a series of agreements for foreign investment in their territories. These have either been investment agreements or trade agreements, with chapters on investments. Through these agreements they have tried to guarantee the situation and protection of the interests of their investors, as a way of attracting investors. This has been a universal trend, with exceptions such as Brazil, which in an official document stated, seemingly not altogether wrongly, that for a country such as Brazil, with a stable institutionality, constitutional guarantees to property and economic opportunities, the signature of these instruments was not necessary. The document withdrew 6 proposals to ratify investment protection agreements sent previously to the Congress. (Brazil, Message from the Executive to the Congress, 2002, and Peterson, 2003).

The cautious posture of Brazil and its trust in the economy and the internal institutionality are more relevant factors than the investment agreements, for investment purposes, which have been justified by a series of research. Thus, it has been verified that impacts of the investment agreements cannot be assessed separately from the conditions of the economy, governability and domestic institutionality (Tobin and Rose-Ackerman 2006).

The international investment protection agreements are the way in which the international investors have tried to protect their interests, faced with possible arbitrary, confiscatory or unreasonable behaviours of the countries where the investment takes

place. Essential, in practical terms, their mechanisms have been used by investors in developed countries, faced with behaviours of underdeveloped countries. (Franck, 2007).

The agreements have a series of common characteristics:

- They are a limitation to domestic arbitrariness but possibly also to the normal exercise of sovereignty;
- They apply mechanisms and techniques of international law, for situations that are clearly domestic, advancing in fields that have been traditionally the responsibility of national, local and provincial governments;
- The design of arbitration mechanisms responds to private arbitration mechanisms. However, the majority of the arbitration cases have been concentrated on questions of public services, of natural resources and the environment, (Frank 2007), all of which are questions of public interest.
- The objective of the system is to protect the investors' interest. Consequently, this is the guide for the arbitrators. Questions such as the public interest of the countries, human rights and the environment are beyond it.
- When a country signs one of these agreements, it engages all levels of government, regardless, almost, of the constitutional structure.
- The arbitration court is incorporated only on request of the investor, so the arbitration market is a monopsony.
- The interpretations of the courts have tended to be expansive both in the projection of the protected interests and in the scope of the protection mechanisms.
- Each court is supreme in its sphere, without appellations, with reserved procedures, without the intervention of third parties. In some case, the amicus curiae has been admitted, at the court's criterion, both for the intervention and for the consideration of the impacts that this may have on the case.
- Consequently, there is a considerable number of cases where, due to the lack of a jurisprudence unification mechanism, different decisions have occurred in similar cases. An example are Methanex (USA) and Metalclad (Mexico).

- With the exception of special cases, the courts are not obliged to consider general principles of law applied by the main legal systems of the world, and in some matters, such as regulation, expropriation, economic crisis, due process, this gap has produced considerable results, both due to the content and their distance from the practices of the countries.
- In the issues mentioned, the practices and jurisprudence of the countries look towards the long-term stability of the social structure and the equilibrium of interests, whilst the tasks of the arbitration courts is to protect the investor's interests, in the lawsuit of the case.
- In the arbitration system of investment agreements there are no incompatibilities. It is possible to be a judge in one case and a litigant in another, either successively or simultaneously.
- The system has a series of projections in water and its services. Investments in services are covered by the system; also the changes in regulatory service systems; water right systems and control of externalities in this regard; and also common investments where water is often a relevant element: factories, agriculture, real estate and tourist developments, etc.
- In water terms, the fair and equitable treatment, in the peculiar notion of arbitration courts, could be violated for example if prices are created where they did not exist before, or a new conditionality of use that did not enter the initial concession of rights, or charges for non-use when the original legislation did not foresee any obligation of use or charge for non-use; increase in pollution control with impact on the profits of the investor compelled to control externalities; limitations on initial, non-programmed, water allocations; or new requirements in service provision contracts, or price controls derived from economic crisis. With respect to the exception of the police power, Methanex left untouched the express guarantees given by a government, even when such guarantees were factually doubtful.
- For example, the list of cases where Argentina is the defendant in arbitration courts includes a series of provinces, and the decentralisation of services has not

prevented the appeal to the external arbitration court from prospering, without exhausting local instances.

- In fact, due to the special nature and set of interests associated with the arbitration courts, the courts accepted jurisdiction in 88.02% of the cases in which this was questioned (Franck 2007).
- The opening of arbitration jurisdiction is reinforced by umbrella clauses, where any violation of an obligation is automatically considered as a violation of the international investment agreement.
- The cases where Argentina is defendant include:

1. Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina Repúblic (ICSID Case No. ARB/97/3).
2. Azurix Corp. v. Argentine Repúblic (ICSID Case No. ARB/01/12).
3. Azurix Corp. v. Argentine Repúblic (ICSID Case No. ARB/03/30).
4. SAUR International v. Argentine Repúblic (ICSID Case No. ARB/04/4).
5. Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Repúblic (ICSID Case No. ARB/03/17).
6. Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v. Argentina Repúblic (ICSID Case No. ARB/03/19) consolidated with AWG Group plc v. Argentina (UNCITRAL).
7. Impregilo S.p.A. v. Argentine Repúblic (ICSID Case No. ARB/07/17).
8. Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic (ICSID Case No. ARB/07/26).

- Other international cases have referred to Bolivia and to Tanzania.
- Furthermore, there is a series of cases, which will be seen later on in the development of the report, where the actions of the municipal or state powers have been contested by investors and they have lost the lawsuits based on the agreements signed by the national governments.

- That is why, in some agreements, such as Cafta, governments such as the North American government have expressly excluded the matters of state competence of its member states.

2. Problems of Investment Agreements

a) Local Powers

Water rights, activities that have the potential to affect water and public contracts for services that involve water fall under the protection of the investment agreements and are solved under its procedural terms and substantive principles.

The regulatory power of the State is now questioned due to the arbitration courts' interpretation of the inversion agreements, under ad-hoc developments that the countries that signed the agreements probably did not take into consideration. Several decisions have compromised the public regulation capacities.

Thus, the regulatory capacities of the national, state and local governments as well as the community interests have been questioned.

In the case of Tecmed, a Spanish company, it had acquired real estate to operate a sanitary refill in Hermosillo, Sonora, Mexico. When the municipality decided that the refill was not in the best interests of the community, and the community, which publicly stated, and the state of Sonora, considered likewise, the licence to operate the site was not renewed and the company sued for discrimination, violation of the guarantee of full protection and security, indirect expropriation and violation of the principle of fair and equitable treatment.

The court considered that there had been expropriation de facto, indirect expropriation and lack of proportionality. The court also decided that the Mexican authorities had acted in a contradictory fashion, ensuring the operator that he could move

his operations elsewhere, but on the other hand not renewing the licence. On the other hand, the court decided that Mexico had not violated the principle of full safety and protection, nor that of non-discriminatory treatment, as they are not absolute (Alvarez, 2004).

In this particular case, which definitely does have its peculiarities (Is the government responsible for not renewing? And if it is, what meaning does the possibility of renewing have, if it becomes compulsive? Or is it responsible due to the way in which it handled the non-renewal?)

On the other hand, the court also declared that the government's intentions were less important than the effect that the measures had on the owner and his interests, and the form of the measures were less important than their actual effects. (Kriebaum, 2007).

In the Metalcad case, also against Mexico, the doctrine of sole purposes was again applied, considering the impacts on the investor more than the government's motivations. In this case, a municipality (Guadalcazar) refused, in the context of a privatisation, to give a construction permit to operate a refill system with hazardous waste. The state of the municipality also declared that the area was a protection area for a rare species of cactus. It has also been considered that the refill could pollute aquifers. (Sornarajah, 2002). The national government had, on its part, assured that the investment satisfied all the environmental and planning regulations (Kriebaum, 2007)

In this case, the court considered that the expropriation includes the hidden or incidental interference with the use of the property, with the aim of depriving the owner, either totally or partially, of the use or of the economic benefit to be reasonably expected of the property. Therefore Mexico responds, by expropriation, on having permitted the questioned municipal behaviour. The reasons for the measure are irrelevant for the case.

It is important to bear in mind that a case where the environmental rights of an owner were infringed, the European Court for Human Rights decided against the Government of Spain, as guarantor of these rights (López Ostra).

But, outside Europe, within the context of investment agreements and their arbitrations, the question of human rights is outside the agreements and arbitrations, to the extent that the arbitration court could decide against a government, if the decisions or regulations on human rights affect an investment (Kriebaum, 2007).

In another case, Pope, an arbitration court in the Nafta context, sentenced that a case of non-discriminatory regulation is included in the notion of expropriation. And in SD Myers, it was also accepted that the regulation can constitute a case of expropriation.

It is probably due to these cases, although there are others, which we will see later, that it has been stated that the arbitration system for international investment operates on the basis of unlimited property rights. Even despite the fact that the domestic experiences and nation law precedents indicate that with a series of situations and conditions (change of circumstances, terms that indicate bad faith, abuse, contrary to moral and good customs, public policy, compulsion, corruption, inconsistency, information asymmetry, moral risk, among others) the contracts may not be considered as sacred. According to Wells and Ahmed (2007): the magic of property rights in industrialised countries does not come from the fact that they are absolute, but rather from the balance between the rights of the individual and corporate rights, and equity and common economic profit. There are tensions and battles but they take place in forums of great public acceptance.

In this issue of balances, there is a very illustrative decision made by an North American judge, Holmes, in 1912, referring to public services prices, where the power to regulate “must be a process of steering between Scylla and Charibdis”. On the one hand it can be assumed that a service franchise is the right to obtain the highest possible return, without competition, under the guarantee of private property. In this case, the regulating

power is non-existent. On the other hand, if the regulating power means eliminating private property, this does not exist. Neither of these extremes can have been accepted. An intermediate point must be found. ” (United States Supreme Court, Cedar Rapids Gas Light Co. v. City of Cedar Rapids, 223 U.S. 655).

The notions of intermediate point and balance are crucial in modern regulatory systems. The 1912 sentence could be the source of the statement that property rights are not absolute.

However, the guarantees to the foreign investor resulting from the investment agreements, do not pursue a general balance, but the protection of an interest of a sector of investors. These guarantees include the national treatment, the most favoured nation, fair and equitable treatment, property protection and prohibition of imposing performance requirements.

The protection principles apply during the entire life of the investment, as the investor’s rights but without having any general correlative explicit obligations. They apply to investments before or after the agreements. Furthermore, the arbitration courts have extended, via interpretation, the investors’ rights.

This imposes the need to have appropriate regulatory frameworks, before investments take place (Mann, 2006). But even so, there is no guarantee that the countries may eventually find themselves in difficult situations. On the one hand, there is no way of foreseeing the regulatory needs 20 years on, and on the other, the economic crises can seriously affect foreign investment, as in the recent case of Argentina. Furthermore the arbitration courts are sovereign in each case, without obligations with respect to precedent or general principles.

Some of the guaranteed rights have generated dialectics, due to the divergences observed between domestic systems and arbitration system. This has caused the National Conference of State Legislatures (2007), and the State of Washington in the United States

(2005) to have expressed concerns with respect to the impact of the international investment system on local and state governments, and their regulatory capacity and the preservation of their powers, in the protection of public interests, such as health, safety, environment, and occupational rights, and consumer protection. That is why in Cafta, the investment agreement with the US and Central America, the responsibility services of the member states of the Union were eliminated.

b) Expropriation

The guarantee of the property is an absolute standard that is not based on the protection of domestic investors. It is possible to expropriate with compensation. The standard is a traditional component of international law.

What is new, however, is the extension of the standard to question regulations with impacts on international investors. It has been argued quite successfully that a regulation that has a significant impact on international investors is an expropriation. In the Nafta area, this extension is attributed to the property defence tradition in the United States.

It is, however, difficult to conciliate this interpretation with cases such as the case of Penn Station, Charles River Bridge, and legislation such as the Clean Waters, Clean Air Acts, and other pieces of environmental legislation, where no compensation was ever paid for expropriation (Mann, 2005). It is also difficult to conciliate it with jurisprudence on ex post regulation of services, such as the case of Mumm Vs Illinois, with the jurisprudence on regulation of public service rates in the crisis of 29, the jurisprudence on rates that requires confiscation (read work at a loss) in service price issues for there to be expropriation, or with the cases that established that the cancellation of riparian rights not used when the water use riparian rights were changed, replacing them with permits, was a legitimate exercise of police power. Furthermore, it is difficult to conciliate it with the decision of the case, on the pro rata basis reduction, without compensation, of the water use rights of the Mumm lake. This decision was based on the doctrine of public trust and

limited the irrigation rights in the American West, which were considered invincible until then.

In studies conducted in the United States on the differences between arbitration court decisions and the actual domestic jurisprudence and legislation, the conclusion is that the arbitration jurisprudence protects broader economic interests than those protected by domestic jurisprudence and legislation; arbitration jurisprudence accepts the possibility of the conceptual severance, which national jurisprudence rejects; and the economic impact required by arbitration jurisprudence for there to be an expropriation, is less than the economic impact required by the doctrine, law and national jurisprudence (Porterfield, 2007).

The majority of the countries, in their national legislations, have principles to balance collective and private interests, with certain ceilings and floors: on the one hand, the non-plundering of the public and not causing damage for example, and on the other hand, the non-confiscation, or defunctionalisation of the property. However, the tendency of the arbitration courts, and their limited vision and mission may compromise these balances, in some countries.

This is due to the fact that at an international level, the investor-state arbitrations and the connected literature go in diverging and unconciliatable directions, many bases based on prejudiced viewpoints, which consider that the public regulation is normally an unnecessary interference with private property. In agreement with Mann (2006) the decision in Methandex (Methanex against the United States, where it was accepted that the normal exercise of police power, without discrimination, and due process is not compensatable, unless express guarantees have been given [the latter to save the cases against Argentina] on state behaviour). Indeed, in Methanex, the court accepted the notion of constructive notice (in some way a kind of public and notorious as in the United States the investor must be aware that the environmental issue is essential, of public policy and therefore exposed to regulation) is irreconcilable with the decision of Metalclad, which established the expropriation in a similar issue.

It is worth pointing out that the Methanex case has company, as in the Saluka case, the police power was also accepted as a legitimiser of commonly accepted regulations within the police power of the state, which is part of international common law. The international common law justified then economic slander, without compensation, which results from the bonafides regulation. (Watts, 2006)

c) Fair and Equitable Treatment

This standard is absolute, too, and it is not defined by the treatment conferred upon other investors. However, it is defined in a contextualised manner, considering time and circumstances. Some authors claim that it considers not only the interest of the foreign investor, but also the interest of all the stakeholders, or members of society, (Mann, 2006).

Some argue that this standard is a residual rule, which would be applied when none of the other rules of international responsibility are applicable. Therefore, the standard would be ad-hoc justice, based on equity. (Dolzer, 2005; Barraguirre, 2005). And its sources are questioned as it would have a highly unspecific content, and it is also the most frequently invoked law by investors and courts.

This emerges as a standard of administrative law, invoking elements of transparency in decision-making, due process and right to be heard, access to judicial and administrative review of decisions, as well as liberal doses of equity and reasonability in the treatment of the foreign investor. Notorious abuses in administrative decision-making are penalised under this guarantee, but the test is not limited to cases where we find clear flaws or arbitrarieties that produce a shock in their disdain for law, but which include minor flaws such as lack of appellations, non-renewals of licences, incoherence between decisions of administrative bodies and contexts of national planning and other state behaviours. Although some courts could adjust the test to the circumstances of the country and of the investor there are still no conclusive viewpoints in this issue. It is

sustained that it is a dynamic and evolving standard, which cannot be limited to criteria used in the last century. It could be invoked not only when there are flaws of due legal process, but also when there are decisions that do not adapt to statements or certainties given by public officials. One criterion that is applied more and more in connection with this law is the consideration of whether the government acted consistently with the investor's legitimate expectations, which some consider a very subjective test (Occidental Vs Ecuador, 2004, and other cases, Hantke Domas, 2005)

It is clear that this standard is not limited to the respect for the due legal process, and that it goes further. As with the expropriation protection, we do not know of many studies that explain the differences between this protection and the national equivalent, the due process. But some that have been carried out in the United States indicate a difference between the domestic legislation and the international arbitration court decisions.

Porterfield (2006) argues that the standard is not a legitimate international law standard as its content is indefinite. And the authority to determine this content cannot be delegated in arbitration courts or ad-hoc appeal mechanisms. The critical regulatory areas for general interest such as environment, health and community rights cannot be made vulnerable to a criterion with an indefinite content.

In this field, according to Porterfield, experts consider that the constitutional principles of non-delegation of functions would be violated if the international arbitration courts could create a common international law for all the foreign investors, discretionally, and in constant evolution. This international law, arising from international courts, would lack state consent, and therefore legitimacy. In this regard, the concern for the lack of legitimacy of the content creation process of the standard linked to fair and equitable treatment is common.

There are even people who, acknowledging this illegitimacy, propose recurring to similar procedures to those applied in Roman law. (Gilles-Sourgens, 2007). And to a

certain extent, the proposal is logical. Since the times of Quiritarian law and some mediaeval jurisdictions, a system with so much emphasis on one class, and indifference to more binding values has not been known. Of course, the question of whether it is acceptable to apply Roman principles and procedures in democratic societies is open, and if two thousand years of evolution do not mean anything.

Another point of concern is that the evolution of the principle is not the result of common practice or treaties, but of international courts, constituted only on request of investors, that are creating their own law, when in truth the compulsory sources of international law are the treaties and custom, and not the jurisprudence of ad-hoc courts, entrusted to apply investment treaties. It is also argued that it lacks specificity (US Supreme Court, 2004). Furthermore, the principle in arbitration interpretation permits an aggressive review of economic elements, which are not legitimate in the due process of the United States (stable economic environment requirements).

Munchlinski (2005) argues the need to consider that the application of the principles of fair and equitable treatment have their origin in principles of equity, which claim that whoever argues the defence should, in turn, come in equity, that is, in good faith, and with a clean service sheet. In this regard, he points out that the Right of investment establishes the rights but not duties of the investors, but that despite this there is a series of cases from which it is deduced that some courts have accepted, in some cases, some obligations, such as that of good faith, prudence and diligence when assessing investment and context, including the situation and culture of the country, and a reasonable business operation. There is a series of cases in this regard, such as Electronica Sicula, Genin, Ogulin, Waste Management, Inceysa Vallisolitana, Methanex, where these principles have been put into operation. Muchlinski defends that these obligations should have a more systematic reception in jurisprudence. The problem is that the agreements do not establish them and although the arbitrators can resort to them they are not obliged to do so.

They have also been acknowledged in connection with public services under the form of obligation of efficiency, due diligence, good faith by OCDE (2007).

And, in particular in connection with public services, they are an integral part of the regulatory law of countries with a tradition in the private provision of public services.

The limitation, however, is that, on the one hand, the arbitration courts are not obliged to accept precedent, and on the other, they are not subject to appellation or unification. Their task is not conceived, either, as an equilibrium, nor do they have the obligation to consider the principles of law developed by major national systems for example, in connection with the water resource, or public services..

Thus, progress is made on the domestic sphere, without considering the common precedents in compared law, in issues submitted to arbitral jurisdiction. And although the appeal to arbitration court can be justified due to lack of trust in the quality of local courts, it is not justifiable to be unaware of the precedents that the coincident municipal law has created in this issue. These are not cases of traditional international law, but of domestic law taken to an international sphere. Their impacts are domestic, and the lack of balance makes them more serious.

In regulatory issues, this lack of balance is seen with concerning clarity in some cases.

d) The Ignorance of Important Regulatory Concepts

In Indonesia, the company, Karaha Bodas Power, sued the government for its effective investment, ($ 96 million) but it also claimed the future expected profits, amounting to a total of $ 512.5 million. Indonesia argued that the project had not been finished, and that with the Asiatic crisis, the company had not been able to obtain sufficient financing, so profits over investments not made could not be granted. It also argued that the expenses effectively incurred were extravagant and excessive. The

arbitration court declared that although the expenses were excessive, they were not questionable, as they had been declared openly. It also granted loss of profit for ~150 million. On being able to collect loss of profit for investments not made, the company is in better conditions if a project fails than if it is successful. The investor can now invest the compensation and the loss of profit, and obtain profits on a higher capital base than that which it effectively invested. The same would happen if, when a bank goes bankrupt, the depositor could claim his deposit under state guarantee plus loss of profit. Normally the regulation does not permit this (Wells and Ahmed, 2007).

In Karaha, the defendant was an electricity company. In private public services law, a service provider cannot claim the refund of extravagant expenses, or profit on investments that are not useful or usable, much less not carried out. (Phillips, 1993).

In some cases in Argentina (Aguas Argentinas S.A., ICSID Case no ARB/03/19), the investor claims compensation for the alleged impact of the economic measures pronounced at the time of the 2002 crisis. In another case, CMS Gas Transmisión Company, the arbitration court found that Argentina had violated its obligations, as a result of freezing service prices at the time of the economic crisis.

A comparison with the 1929-1945 jurisprudence, of national courts, on the same issue, is relevant. Thus the North American Supreme Court acknowledged that it had a decline in the profits of the businesses and in the interest rates in the entire country, and it was prepared to accept lower return rates in public services (Natural Gas Pipeline, 1942).

As in the case of expropriation, and fair and equitable treatment, there are no studies of comparative law that explain the differences between the main legal systems of the world and the investment arbitration system, when dealing with the issues mentioned. Studies in the United States would be an important part in this assessment, but it is not complete without references to the German, Spanish, English, French systems, etc.

e) Problems associated with the Procedure

It has been seen that the cases taken to the arbitration investment courts are extremely important for public interest. They involve general economic policies, basic services, natural resources, just to mention a few basic issues. And these important public policy issues are resolved by three ad-hoc arbitrators, without taking into account general interests (which are ultra vires), without appellation, without intervention of third parties and in secret.

On the one hand, these arbitrators can also be judges in some causes and lawyers in others, successively and simultaneously, and there is no system that regulates conflicts of interests.

With more elements it is important to consider that fees are only accrued when there are causes, and that there are causes only when jurisdiction is accepted.

Finally, the arbitration service is a monopsony; only investors can request it, as they are the ones that create the market.

CONCLUSIONS

The decentralisation of water services and sanitation does not mean that their feasibility is affected by the general economic national policy. It does not guarantee, either, that, if there is no support from the central government, the decentralised municipalities and entities can cover the service costs.

Furthermore, in order to be efficient and foster equity, decentralisation should consider issues such as economies of scale and field and minimisation of transaction costs. In some cases, recommendations are made without bearing in mind the reasons why countries known for their governability and quality and service cover, have created regional services enterprises.

On the other hand, in the context of investment protection agreements, decentralisation does not have the same relevance as without these agreements, as in the last instance, decentralised entities are compelled by these and subject to the maximum centralisation of a single, international court, without appellations, and without exhausting not only the local instances, but also the national ones. Decentralisation, its motives and its basic expression are annulled in the case of conflicts with foreign investors.

A constitutional stage has been reached, in an organic sense, where the traditional principles linked to sovereignty, federalism and local rights are affected both by economic and legal factors.

The investment protection agreements and the investment chapters in commercial agreements, have fundamentally varied the relations of power and the legal capacities of the countries and therefore of their provincial, state or local constitutive parties to take measures and pronounce regulations.

This is the result of several factors, including the purpose of the agreements: to protect investors and not protect the common interest; the fact that the agreements compel all levels of government, except for contractual exceptions; the lack of obligations for investors, at least in agreements; and the mechanics and integration of the arbitration courts. The mechanics include the fact that these courts are created only at the rest of investors, they are sovereign in each lawsuit, they are not compelled to consider general principles of the law of relevant countries, they are not subject to appellation and they are not open to third parties. This has resulted in differences between national practices and arbitral decisions.

The new situation comprises, furthermore, due to the poverty of the regulatory systems of many countries, the basic rejection that many courts have made of the regulation, assimilating it to confiscation; the expansive interpretation of the investors'

rights and the preparation of ad-hoc international rules of law in jurisprudential form, and not by treaty or international custom..

Therefore, it is advisable for the countries and investors in services infrastructures to guarantee the availability of an appropriate regulation, and where appropriate, policy indications whose aim is to notify about the governments' view with respect to the regulation of water and its services, in order to inform and make the public aware of the general regulatory climate.

Moreover, and this is essential, the countries should resist the temptation of making decisions without guaranteeing financial feasibility, institutional consistency and preventing contractual or policy practices, which grant guarantees that are difficult to fulfil in the medium and short term. On the other hand, in their policy indications they must make the behaviour expected of the investors clear, in terms of diligence, good faith, efficiency and transparency.

Furthermore it is important to identify the impacts of the new system on institutions and governability, and whether they coincide or disagree with national practices in the same issues. Closing the gap that may exist with respect to national practices, and detecting if there are countries that effectively use the expansive principles of arbitration courts in their internal jurisprudence, for example in expropriation and due process matters, would be a very important step.

Identifying and preparing common national principles would also be important:

a) of the right of waters as a resource, for example public domain of water, lack of acquired right to contaminate, and obligation to request permits or be subject to pro ratas or not cause damage;

b) of the regulatory right of public water services, for example, efficiency obligations and their operating consequences, of good faith, of transparency and information and due diligence.

The dissemination of these principles, by the countries, and the promotion of their necessary consideration by the arbitration courts would be a contribution than can help remedy some criticism that is being made today of the investment arbitration system.

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