Chapter 3

The 835 reasons not to sign trade and investment agreements

By Lavinia Steinfort

A democratic decision to regulate a privatised essential service or to return it to public control could potentially trigger international investment arbitration if a country is bound by an international investment treaty. This is what happened to Lithuania's capital city of Vilnius and several other municipalities after they decided against renewing the contract in order to remunicipalise the district heating. As a result the government of Lithuania was taken to court by the French energy giant Veolia.

In 2016, the multinational used the France-Lithuania bilateral investment treaty (BIT) to start international arbitration, filing an Investor-State Dispute Settlement (ISDS) claim because of a so-called "campaign of harassment" and "expropriation" of its investments.[1] The ISDS claim was in part a response to a decision by the city of Vilnius not to extend the 15-year contract with *Vilniaus Energija*, a subsidiary of Veolia, whose contract was to expire in 2017. Additionally the government of Lithuania scrapped subsidies for gas use which, according to Veolia, forced the subsidiary to close down one of its power plants.[2] Moreover after years of investigation Lithuania's energy regulator concluded that *Vilniaus Energija* was responsible for manipulating the fuel price for heating, thereby significantly increasing energy costs for households and generating an unlawful excess profit of €24.3 million between 2012 and 2014.[3] Due to mounting public pressure, alleged fraud and lack of financial transparency,[4] the city of Vilnius refused to renew the contract with *Vilniaus Energija*, leading Veolia to demand €100 million in damages.[5] The ISDS attack could have forced Vilnius to drop its decision and retain the contract. However, in 2017 the local authorities followed through and brought the district heating back into public hands.

In this chapter we show that such ISDS lawsuits do not only affect the energy sector but also the water, transport and telecommunication sectors. Overall, ISDS puts excessive price tags on remunicipalisation, thereby putting foreign investors' profits above the responsibilities of government.

Investor protection undermines public control over essential services

Since the year 2000 at least 835 cities, regions and provinces have been confronted with the social and economic price of privatisations and public-private partnerships. They reacted by returning these privatised services to public control. The wave of remunicipalisation coincides with the growing public resistance against trade and investment agreements. It demonstrates that cities can take concrete action to regain local democratic control. Each of the 835 remunicipalisation cases is one more reason for countries not to ratify the Comprehensive Economic Trade Agreement (CETA) between the European Union and Canada, or any similar trade and investment agreement. Insofar as these international agreements aim to protect the profits of private foreign investors, they restrict the capacity of governments to decide how to provide, organise and regulate public services.

Demonstration against TTIP and CETA and for just global trade, Berlin
Photo by Naturfreunde Deutschlands, Flickr

Alliances among cities and citizens can contribute to building a radically different, socially and environmentally just trade regime. This regime would allow for publicly owned essential services in which (local) governments, citizens and workers are in control.

This chapter highlights an added risk of privatisation that has been largely overlooked. Once a local, regional or national government realises that privatisation does not result in the promises of lower prices, necessary investments or more efficiency, it may decide to remunicipalise its water, energy, transport or telecommunication services; but in doing so the government risks being sued for millions, even billions of dollars by foreign investors who invoke the ISDS mechanism embedded in international investment treaties. ISDS, which is inscribed in most of the 3,400 international investment agreements that exist worldwide, provides disproportionate privileges to foreign investors at the expense of universal and good public services.

A new generation of trade and investment agreements has emerged. Examples include CETA, which is in the midst of being approved by the EU countries' national parliaments, or the Transatlantic Trade and Investment Partnership (TTIP), for which negotiations are said to be on hold for the time being. These agreements can severely limit the room for progressive public policy, such as remunicipalisation. They are enforceable and secretly negotiated deals that allow for more liberalisation and less regulation. ISDS is the cornerstone of these current and upcoming agreements and even the mere threat of its use can undermine the deprivatisation of public services.

Therefore, well over three million Europeans signed a petition to stop TTIP and CETA and to reject ISDS mechanisms. More than 2,300 cities, towns and regions in Europe have declared themselves TTIP/CETA-free zones. In 2015 and 2016, hundreds of thousands of people took to the streets in Germany to oppose the trade agreements. In January 2017, it took Austrian campaigners only one week to collect 500,000 signatures against TTIP and CETA. A growing number of citizens and cities have risen up because they understand that investment protection goes against democracy, the public interest and sustainable, local development.

Box I

Argentina: Investors strike when a country is in crisis

Argentina is by far the most sued country with a total of 59 ISDS cases. After over a decade of privatising most public utilities, Argentina went through the 2001-2002 economic crisis. Some of the measures that the government took to deal with the crisis were to freeze the water tariffs to keep them affordable and, in some cases, to deprivatise the water sector. Contract terminations and water service deprivatisations were due to a lack of investments, to overly high tariffs and to poor service quality.[6] Measures to control or deprivatise the water sector led to nine ISDS cases against Argentina between 2001 and 2007.

To give an example, in 2005 Santa Fe remunicipalised its water services after a strong citizens' campaign. The citizens deemed poor service quality, tariff increases and cut-offs to be unacceptable. Preceding Santa Fe's decision to remunicipalise, France-based Suez and Spain-based Agbar, the major shareholders of the private water company Aguas Provinciales de Santa Fe, filed an ISDS claim.[7]

Suez and Agbar demanded US$243.8 million from the Argentine government for denying a tariff increase during the 2001-2002 peso crisis, because this reduced their profits from the Santa Fe concession. Both companies accused Argentina of expropriation and breaching the so-called Fair and Equitable Treatment clause of the country's BITs with France and Spain. In 2015 the arbitrators ruled in favour of the foreign investors. Yet because the tribunal is not obliged to disclose the awarded sum, we do not know how much Argentine taxpayers had to pay to the French and Spanish investors.

The rise of investment protection

ISDS is an investment protection provision that is far from new. ISDS is not only part and parcel of TTIP and CETA, it is also at the heart of most of the 2,600 international investment agreements that are currently in force (of the 3,400 existing).[8] The majority of these agreements are BITs. ISDS has been around since 1959. During the last decade it has been frequently used by transnational corporations to sue governments of low-income countries in secret international tribunals. Lesser known is that ISDS is also inscribed in mega-regional trade deals such as the

Regional Comprehensive Economic Partnership, of which 16 South and Southeast Asian countries are members, and the Energy Charter Treaty, involving a total of 56 countries from around the world. Moreover, the European Commission is negotiating investment protection treaties with Myanmar, Vietnam, the Philippines and a dozen other middle and low-income countries.[9] Statistics from the United Nations Conference on Trade and Development indicate that there are currently 767 known ISDS cases, 495 of which have been concluded.[10]

How ISDS goes against public interest

The investments of both foreign and domestic investors are generally well protected by national legal systems. When local or national governments terminate a private contract it is not unusual that national commercial law is enforced so that authorities have to pay termination fees or compensation to the private service companies. Then why would foreign investors deserve additional rights that can be enforced through non-transparent and biased international tribunals?

ISDS tribunals are gated one-way streets for the use and abuse of foreign investors only. They are inaccessible to governments, to less resourceful enterprises, to civil society organisations and ordinary persons. As said, most of the countries that are sued through ISDS already have effective and impartial legal systems that would be sufficient to protect the properties of foreign investors. ISDS discriminates against domestic investors, which would go far beyond the legal and constitutional framework of the European Union.[11] ISDS grants enforceable privileges to foreign investors *without* any corresponding enforceable obligations, from creating jobs and protecting workers' rights to environmental standards and universal access to public services. In comparison, the governments that are party to such agreements, regardless of their democratic rights and responsibilities to regulate, must comply no matter the social costs.

A price tag on remunicipalisation and public interest measures

More and more people acknowledge that ISDS goes at the expense of public goods such as quality water services. The 2015 book *Our Public Water Future: The global experience with remunicipalisation* showed how ISDS has been undermining water remunicipalisations and this chapter extends this effort to other public services. What are the dynamics at play when governments tied by ISDS acknowledge the failings of the private sector in energy, transport and telecommunication services, and decide to return these to public control?

ISDS versus remunicipalisations in the energy sector

The growing push for a just energy transition, in which people demand locally produced and democratically controlled energy provision, is contested by foreign energy investors. In 2016 the Energy Charter Treaty became the most frequently invoked treaty with at least 101 known ISDS cases. In 2012, the Swedish energy giant Vattenfall used the treaty's investment protection to sue the German federal government for taking back control over the energy sector in Hamburg. It claimed damages of €4.7 billion for the shutdown of two nuclear power plants, a decision that enabled the German energy transition (*Energiewende*). In Hamburg deprivatising and remunicipalising part of the power sector was a response to the growing call from residents for a democratic and socially just energy transition. After the Fukushima nuclear disaster, the federal government acted upon nation-wide popular opposition to nuclear power and decided to phase out nuclear energy. This decision was the result of a massive mobilisation that brought 120,000 people to the streets. Together they created a 120-km human chain, passing through Hamburg to connect the nuclear power plants in Brunsbüttel and Krümmel. In the events that followed the citizens' initiative *Our Hamburg, Our Grid* made use of Vattenfall's expiring energy concession and successfully pushed for a referendum in 2013 to buy back the city's electricity distribution grid. The referendum's target was "socially just, climate friendly and democratically controlled energy supply from renewable sources."[12] By 2016 all shares of the distribution grid were transferred back to the municipality. In the first year alone the buy-back generated a benefit for the city of €34.5 million. However, the Hamburg case shows that governments that have signed trade and investment agreements may not be able to avoid costly claims by investors when returning the energy sector to public control. The chapter by Sören Becker in this book discusses the Hamburg case in more depth.

After two decades of privatising almost all key state-owned enterprises, Albania privatised its electricity distribution company in 2009. Following the advice of the World Bank's International Finance Corporation, the government of Albania sold 76 per cent of its stakes in the public energy company OSHEE (*Operatori i Shpërndarjes së Energjisë Elektrike*) to the Czech company ČEZ. Albanian people were soon impacted by higher bills, insufficient service quality and power supply, and unjustified power cuts. Electrical defects also led to fires that injured people and destroyed houses, damages which were not acknowledged by the private company.[13] Due to additional financial difficulties, ČEZ cut investments and began to focus on areas with higher collection rates in order to increase short-term cash flow, leading to claims and counter-claims between the Albanian government and ČEZ.[14] At last, Albania suspended the company's license and renationalised the energy service. The renationalisation resulted in a decrease in debts and network losses. Yet in 2013, the Czech company used the Energy Charter Treaty to sue the Albanian government for €190 million. In 2014, the case was settled for €100 million to be paid by Albania to ČEZ.[15]

ISDS versus deprivatisations in the transport sector

Transport is another public service sector where deprivatisation has triggered international arbitration. At least three Latin American governments that decided to deprivatise part of their transport sector were confronted with an ISDS lawsuit. In 2011 the Bolivian government chose to take back control of its three biggest airports. SABSA (*Servicios de Aeropuertos Bolivianos*) – partly owned by the Spanish company Abertis-AENA – had made significant profits from the airports without realising its initial investment plan.[16] However, based on the Bolivia-Spain BIT, the Spanish multinational accused Bolivia of breaching the Fair and Equitable Treatment clause and demanded a compensation of US$90 million. The case is still pending.

Over a decade ago the government of Guatemala decided to return its railway services to public control. In 1997, Guatemala had signed a 50-year concession with *Compañía Desarrolladora Ferroviaria*, a US affiliate of the Railroad Development Corporation (DRC), to operate and renovate the railway. When the company failed to fulfil its contractual obligations, the government announced in 2006 its intentions to deprivatise the rail industry. Soon after, DRC invoked the freshly signed free trade agreement between Central America, the Dominican Republic and the US. The foreign investor filed a claim for US$64 million with the International Centre for Settlement of Investment Disputes (ICSID), which is part of the World Bank Group. DRC accused Guatemala of breaching Fair and Equitable Treatment and of expropriation by stating that the government decree to deprivatise the railway hampered their chances to obtain credit. The tribunal decided that the government of Guatemala had to pay US$14 million to the US-based corporation.[17] This case shows that merely announcing future deprivatisation is sufficient to incur liability for millions of dollars.

Argentina had multiple motivations for deprivatising its two national airlines in 2008. Between 2001 and 2008 the Spanish multinational *Grupo Marsans*, owner of the two airlines, accumulated a debt of hundreds of millions of dollars. Other reasons were poor management, lack of investments and suspicions of corruption.[18] Marsans responded to the deprivatisation by invoking the Argentina-Spain BIT and claimed US$1.5 billion in damages – even though the airlines were by then in debt by US$900 million.[19] As Marsans filed for bankruptcy, the government found out that the law firm Burford Capital had paid the litigation costs in exchange for receiving part of the potential award or settlement. Due to the lack of transparency of international arbitration, it is not clear at what stage the procedure currently is. What we do know is that after deprivatisation the financial situation of the airlines improved with an 85 per cent increase in revenues to US$2 billion, compared to 2008. Also, by 2013 the aircraft fleet had increased from 26 to 63 and passenger traffic had increased by 57 per cent, transporting a total of 8.5 million people. The chapter by M'Lisa Colbert in this book discusses the benefits of this renationalisation case in more depth.

ISDS versus deprivatisations in the telecommunication sector

Telecommunication is another public service sector that has been undermined by ISDS. When governments decide to deprivatise their telecommunication services, they can become the target of international arbitration. In 2007, Bolivia decided to return its internet, landlines and mobile telephone services to public control in order to achieve universal coverage. After a year of trying to acquire the 50 per cent of shares owned by European Telecom International (ETI), a Dutch subsidiary of Telecom Italia, the government terminated the company's contract. According to the government, the firm had failed to provide quality services and to invest the committed US$610 million, while earning millions of dollars in profits. ETI responded by suing Bolivia before ICSID for over US$700 million. The lawsuit was based on the Netherlands-Bolivia BIT, enabling letterbox companies such as ETI – which has no substantial commercial presence in the Netherlands – to demand hundreds of millions of dollars in alleged damages. In response, 15 Dutch civil society organisations and 863 individuals from 59 countries called on the World Bank's president and the Dutch government to support Bolivia and to investigate into the corporate abuses of the Netherlands-Bolivia BIT – albeit with an unsatisfactory response. The renationalisation led to more affordable rates and a significant increase in coverage, going up from 1.7 million to 4 million users. Although deprivatisation resulted in concrete benefits for the Bolivian population, the case was settled in favour of the Dutch letterbox company. After three years of arbitration proceedings, it was decided that Bolivia had to pay ETI US$100 million.[20]

In 2009 and 2010 Canadian, British and Belizean investors initiated three ISDS cases[21] against the government of Belize. These cases concerned the country's decision to deprivatise the telecommunication provider Belize Telemedia Limited.[22] The investors demanded a total of US$518.9 million.[23] Moreover, one of the key shareholders of the claimant British Caribbean Bank (BCB) was Lord Michael Ashcroft, who has been accused of using BCB to evade tax obligations in the United States.[24] In 2016 the government of Belize announced that the arbitrators had ruled that it had to pay the foreign investors a sum close to US$395 million, including legal fees and US$198 million in interest payments.[25] Three months later Belize declared a recession, and thereafter the International Monetary Fund called for a tax increase. This is likely to hit the middle and lower income households the hardest and to worsen the recession.

Box II

ISDS principles privilege private companies regardless of the breaches or context

The most frequently invoked ISDS principle is *fair and equitable treatment* (FET). It is a catch-all clause because the companies, and their lawyers, can easily argue that government measures are not fair or equitable with regard to the profits they claim to deserve. This is especially true since arbitrators tend to use a broad interpretation of the FET clause. Three quarters of all cases won by US investors refer to a breach of FET.[26]

The ISDS case by *Tallinna Vesi* and its parent company United Utilities Tallinn used the Estonia-Netherlands BIT to sue the Estonian government for rejecting increases in water and sewage tariffs. They are accusing Estonia of breaching FET by arguing that it is unfair that the country's new law limits corporate profits beyond a "reasonable" level. The two companies are seeking compensation for potential damages of €90 million, including the future profits up to the end of the contract in 2020. The case, which is still pending, shows that arbitrators do not take into account whether regulations, such as keeping services affordable and accessible to everyone, are fair and equitable for society. The arbitrators only assess if foreign investors miss out on (potential) profits.

Another widely used ISDS principle is *expropriation*. When national, regional or municipal authorities return a privatised essential service to public control, foreign investors and arbitrators consider this to be expropriation. No matter the number of contract breaches by the private service provider, under ISDS deprivatising a public service is nearly impossible – unless the government is able and willing to risk paying for an exorbitant ISDS award. The number of rate increases, the decreasing efficiency, the unacceptable service quality or the lack of investments by the private company do not matter. Once a government commits to international investment protection it cannot prevent being sued for hundreds of millions of dollars. Moreover, any measure that negatively impacts profits can be considered as expropriating the foreign investor. For example, health, environment and labour safeguards have often been interpreted by arbitrators as cases of expropriation.

Even when public welfare measures are put in the annex of an investment agreement as exemptions – as is the case with CETA – the government will still have to prove that the public welfare measure is "legitimate" and not "manifestly excessive." The ISDS retaliations against the Argentine government show that even a devastating economic crisis does not count as a legitimate reason to take back control of the water sector.

The threat of lawsuits is sufficient to curb deprivatisation

Once governments have signed trade and investment agreements with an ISDS mechanism, the mere commitment to ISDS can be enough for governments to refrain from certain policy measures, including decisions to return a privatised service to public control. This risk is known as the "regulatory chill." Thus, ISDS can challenge and restrain a government's right to regulate even before investors file a case.

It may not come as a surprise that lobby groups such as the European Federation for Investment Law and Arbitration argue that there is no evidence of such a risk of regulatory chill. However, even leading arbitration lawyer Tody Landau says that regulatory chill exists: "On a number of occasions now, I've actually been instructed by governments to advise on possible adverse implications or consequences of a particular policy in terms of investor-state cases."[27] In other words, governments inquire if they think certain policies can trigger an ISDS claim. When government officials realise that the possible cost is too big, they may refrain from deprivatising essential services.

Regulatory chill, that is compromising policies in favour of the investor, can happen before investors start international litigation but also while a case is pending. As we have seen in the 2009 ISDS case of Vattenfall against Germany, the government changed its policy and waived the environmental commitments of the Swedish energy giant.

The government of Bulgaria decided not to remunicipalise its water services because of the threat of ISDS. The residents of the capital city Sofia and some city officials rose up to reverse the water privatisation by collecting enough signatures to hold a referendum to evaluate the privatised water contract. The reason: the private company *Sofiyska Voda*, a subsidiary of Veolia, is infamous for its lack of transparency, exorbitant management salaries and financial losses. On top of that, the company disconnected 1,000 households and requested to prosecute 5,000 households for unpaid water bills. However, the local government did not allow for the referendum to take place because it was afraid that the private investors might invoke a clause that was secretly added to the contract, enabling the company to sue Bulgaria at the Vienna International Arbitral Centre.[28] The previous cases show that the threat of ISDS claims can be sufficient to prevent deprivatision of a public service and its return to municipal or national control.

Box III

Pretending to move away from ISDS

Due to the growing public criticism of ISDS across many European countries, the European Commission decided to reformulate ISDS by proposing the Investment Court System (ICS). Those who have a stake in the current trade and investment agreements present ICS as a radical shift away from ISDS. However, despite some procedural changes, the ISDS architecture that privileges foreign investors remains intact in the ICS proposal. Under ICS, corporations would still be the only actors who can sue governments; the opposite would not be allowed. Corporations could still invoke the FET clause by arguing that government measures were "manifest arbitrariness." ICS even expands FET by introducing the notion of "legitimate expectations" that opens up possibilities for many more investor claims.[29]

The new proposal may mention the right of governments to regulate, but the burden of proof continues to be on them. They would still have to demonstrate that regulations are "necessary," "non-discriminatory" and intended to achieve "legitimate" objectives. Finally, while the new proposal may call the arbitrators "judges," there are no safeguards to prevent the same representatives from the for-profit sector to sit on arbitration panels. It is noteworthy that European judges have stated that the ICS proposal does not the meet the minimum European and international judicial standards.[30]

Box IV

The most encompassing ISDS threat is in the making

In the last years the European Commission also announced the setup of a permanent international investment court, which "would lead to the full replacement of the 'old ISDS' mechanism with a modern, efficient, transparent and impartial system for international investment dispute resolution."[31] This proposal for a so-called multilateral investment court boils down to a convention on a multilateral ISDS mechanism. If two signatory countries find themselves in a dispute, then the multilateral mechanism would apply. Much remains unclear about the Commission's proposal. What is clear, however, is that under the Commission's proposal it is still only foreign investors who would be granted the right to sue the governments – and not the other way around.[32] Although multilateralising investment protection is supposed to increase the transparency of investor-state lawsuits and decrease the risks of conflicts of interest, the proposal does not fundamentally remove the flaws of the current investment protection system. In fact, the multilateralision of ISDS would entrench a permanent and ever expanding lock-in of controversial and unnecessary investor protection rights. This would render remunicipalisation in public services unaffordable.

Conclusion

Our study reveals that decisions to deprivatise public services triggered at least 20 international arbitration cases (ten in the water sector, three in energy, three in transport and four in telecommunications). The track record of investment protection shows that various countries have been sued for millions and billions of dollars when they either decided to regulate privatised essential services in the public interest, or to return privatised services to public control when private companies had failed.

Through ISDS, foreign investors are often awarded with hundreds of millions of dollars, regardless of their misconduct, contract breaches and the damages caused. Moreover, countries stand defenceless against an ISDS claim since they do not have the possibility to appeal a verdict. Investor protection gravely undermines the prospect of deprivatisation and remunicipalisation of essential services, because it can jeopardise plans to claim back public control. When governments do follow through it may lead to an ISDS award that is recouped from the citizens in reduced public budgets, which could reduce the affordability of public services and delay much-needed investments. ISDS puts an enormous and unjust price tag on remunicipalisation, putting the interest of the private sector above the responsibilities of government.

The expanding regime of investment protection will only further restrain the margin of manoeuvre of policy makers and elected representatives. In other words, the current and upcoming trade and investment agreements, in which ISDS is inscribed, can and will obstruct proposals that safeguard the quality and accessibility of public services.

Fortunately the public opposition to ISDS and the number of deprivatisations and remunicipalisations have grown with the years. Privatisation has proven to be unjust, costly and inefficient. Putting essential services back into public hands has time and again resulted in enhanced public revenue (Hamburg, Germany); a decrease in debts and network losses

(Albania); and an increase in coverage and more affordable rates (Bolivia). Still, citizens would have benefited more from these deprivatisations had it not been for ISDS.

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