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Legal Barriers to Remunicipalisation? Trade Agreements and Investor-State Investment Protection in Water Services

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ABSTRACT: This article analyses the relevance of investment protection rules as they relate to the remunicipalisation of water services. It describes why investor-state dispute settlement (ISDS) is deemed to be controversial and provides case-law examples. The article focuses on treaty provisions as they relate to the process of remunicipalisation, such as the fair and equitable treatment standard and specific clauses, and highlights where future challenges might come into play, such as environmental issues, which are directly or indirectly related to water scarcity or discussions of water as a human right. The role of municipalities, with regard to both the negotiations of free trade agreements (FTAs) and actual ISDS proceedings, is described. Analysis is accompanied by concrete advice for local actors and communities, demonstrating how challenges for remunicipalisation can be addressed, with regard to both existing FTAs and future negotiations of trade agreements.

KEYWORDS: Remunicipalisation, water, free trade agreements, investor-state dispute settlement

INTRODUCTION

Whenever foreign private investors are involved in providing essential services such as water and sanitation, investment protection rules and investor-state dispute settlement (ISDS) mechanisms can potentially come into play. One of the most notable examples is that of ISDS proceedings against Argentina in the context of its severe economic and financial crisis in the early 2000s.

This article investigates the challenges that municipalities might encounter in trying to bring water services back in house when these rules and mechanisms apply, and offers suggestions for mitigation strategies. The article begins with a general description of investor – state dispute settlements, why it has been controversial in the past, and what role municipalities play in this process. The focus is on remunicipalisation, with an examination of grounds for an ISDS claim. I explain that municipalities risk infringing investment protection provisions when attempting to remunicipalise, for example by contravening the expectations of foreign investors or causing indirect expropriation of their investments.

The article describes how the structure of commitments in free trade agreements (FTAs) in particular must be carefully chosen to prevent 'accidental' liberalisations, which make remunicipalisations more difficult or even impossible. Moreover, it is discussed how the general right to regulate of states can be protected. Furthermore, it is shown where environmental issues and the human right of access to drinking water might matter, as with climate change, where they will become even more important in the future. Also, the potential 'chilling effect' of ISDS on remunicipalisation is discussed.

To conclude the article highlights areas where and how local communities can help shape the outcomes of trade agreements. Municipalities can have a significant impact on trade negotiations, especially through their expert knowledge on how local services such as water are organised.

[1] The article was prepared by the author in her personal capacity and the views and opinions expressed are those of the author.

WHAT IS INVESTOR-STATE DISPUTE SETTLEMENT (ISDS)?

ISDS is an international arbitration procedure, meaning it addresses cases on the basis of an adjudication (rather than through, for example, mediation). It is traditionally incorporated in international investment treaties (bilateral or multilateral). ISDS allows foreign investors to sue their host state under certain conditions. Both parties to a proceeding (the investor and the state) appoint one arbitrator each, and a third arbitrator is chosen jointly. In theory, arbitration mechanisms of ISDS seek to provide a neutral forum where the state cannot influence the outcome of the proceedings, use diplomatic protection or resort to possibly biased or ineffective local remedies (Baetens and Tietje, 2014, para. 18), also serving to avoid so-called 'gunboat diplomacy' or military responses to investment disputes.

The scope of ISDS is agreed upon by the state parties in the relevant treaty and can vary widely. One decision that states must take into account is whether or not ISDS shall be limited to 'treaty claims' alleging the violation of an FTA, or if any disputes in connection with an FTA shall be covered. The latter can mean that the tribunal, for example, could decide also on matters of customary international law or even on domestic law of the host state (UNCTAD, 2014, 39).

ISDS is perceived as controversial for a number of reasons. First, ISDS tribunals can award extensive compensation to investors – in some cases more than US$1 billion. With regard to water services such excessive sums are not (yet) likely, as losses suffered by an investor in, for example, a concession contract, are not as large. However, conflicts involving water projects and environmental issues such as fracking could result in much higher compensations. Still, case-law shows that substantive amounts can be expected also in 'classic' disputes around water services. The mere threat of such compensation, not to mention the additional costs of proceedings and legal representation, could have a deterring effect on states, known as the 'chill effect'.

Second, unlike independent judges, arbitrators are chosen and paid by the parties on a case-by-case basis. Depending on the applicable rules, they can work both as arbitrators and as lawyers, thus switching roles in different proceedings. This might limit their independence and be a source for possible bias. Third, ISDS proceedings are traditionally not as transparent as ongoing proceedings in public courts, which can be problematic when a state defends public goods such as the right to drinking water or when it uses taxpayers' money to settle.

ISDS is also criticised for largely denying the rights and interests of third parties, such as civil society organisations or municipalities. Further, as ISDS is only available to *foreign* investors, it may put domestic investors at a disadvantage. Foreign investors can use the national courts and ISDS in parallel proceedings with potentially contradictory outcomes, or they can circumvent national proceedings and resort directly to ISDS. Investors could even be in a position to 'choose' an FTA which is favourable for their claim (e.g. through the establishment of shell companies in favourable jurisdictions). Regarding the remunicipalisation of drinking water services, a complex structure of treaty provisions must be taken into account, to the possible benefit of investors. Lastly, ISDS proceedings are highly complex and can be time-consuming, requiring significant financial resources. In sum, much of the controversy about ISDS stems from an institutional and legal structure that seems to favour investors and disadvantage states.

ISDS can be relevant to municipalities whenever a foreign investor is directly or indirectly affected by a measure adopted by them, such as a remunicipalisation, or by another level of government with local effects, for example environmental laws to protect drinking water resources. The role of municipalities in investment protection proceedings can be difficult to grasp, however. Legally, investment protection proceedings do not concern municipalities: they are not a party to investment disputes, only the national state is, as a contracting party to an FTA or as a signatory to an international agreement. If an act or omission by a municipality in the course of a remunicipalisation triggers an investment dispute, the state (or in some cases a province) will always be the party to an arbitration case.

ISDS proceedings focus on the possibility of awarding compensation to an investor. An arbitration panel in general does not order a state (or a municipality) to take any policy measure in its final decision

on a case so that, in this regard, the scope of an arbitration award is quite limited. However, it is possible that the parties agree to a compromise settlement and file consentaneous declarations in order to obtain a consent award, , also non-monetary remedies can be ordered, e.g. by use of preliminary measures. This agreement of the parties can be subject to the fulfilment of certain conditions, such as withdrawal of a state measure that could have led to the original claim in the ISDS proceedings. This means *de facto* that if a municipality's decision gave rise to an investor's claim it can be annulled or altered in response to and influenced by an ongoing ISDS claim in the way of a consent award (e.g. see below the developments in the *Moorburg* case). Such settlements avoid the high costs of a long-lasting ISDS proceeding or the risk of a high compensation award, albeit with potentially significant policy costs.

Depending on states' governance structures, following arbitration proceedings, a municipality could be forced to make compensation payments to its national government if damages are awarded to an investor or in case of a settlement agreement. States are very discreet on how they solve such issues internally, however; so an in-depth assessment of the effects of ISDS settlements on municipalities is very difficult.

EXAMPLES OF LOCAL GOVERNMENTS AFFECTING ISDS

This section highlights two cases of ISDS where a sub-federal level of government was involved. The first is that of AbitibiBowater Inc, an American pulp and paper manufacturer that initiated proceedings against Canada in December 2008 after the provincial government of Newfoundland and Labrador passed a bill on timber and water use (*An Act to Return to the Crown Certain Rights Relating to Timber and Water Use Vested in Abitibi-Consolidated and to Expropriate Assets and Lands Associated with the Generation of Electricity Enabled by Those Water Use Rights)*. AbitibiBowater sought compensation of C$500 m under the North American FTA's Chapter 11 for damages arising out of this act, *inter alia* regarding water use rights. In April 2010 the Canadian government and the investor agreed to settle for C$130m (ICSID, 2010).

This case led to considerable discussion in the academic literature, especially when then-Prime Minister Stephen Harper said in response to the compromise settlement that: "I have indicated that in future, should provincial actions cause significant legal obligations for the government of Canada, the government of Canada will create a mechanism so that it can reclaim monies lost through international trade processes" (The Globe and Mail, 2010). Harper's government did not move on this threat, but the AbitibiBowater case served to shine a spotlight on the financial responsibility of federal governments in ISDS for actions on a sub-federal level.

The second case arose from an attempt to regulate in Hamburg-Moorburg (Germany), where the Swedish state-owned electricity company Vattenfall and the government of Germany came to an agreement under the International Energy Charter Treaty (ICSID, 2011). The case is peculiar for two reasons: first, according to German administrative laws, the permit, which was subject to the parties' agreement, had to be issued by the local authorities, not by the federal government that was a party in the arbitration proceedings; second, this permit, which was issued due to the compromise, was subsequently found in contradiction to European environmental law by the European Court of Justice and thus was withdrawn again by the competent local authority (Environment and Energy Authority, 2017).

This latter case is a clear example of a direct effect of an arbitration claim at the local level. Even though the city of Hamburg was not a party to the arbitration, the parties (Germany and Vattenfall) settled on the condition of a permit issued by the city's environment and energy authority. It is not known how the federal government and the city of Hamburg agreed on this permit, though it was probably through consultation during the proceedings.

The case also shows the limits and contradictions of arbitration proceedings in highly complex legal contexts such as environmental law. In its judgment on European environmental law, the European Court

of Justice did not deal with the fact that the permit had its origin in an agreement reached through an arbitration claim. It is unknown whether any new proceedings are intended by the claimant Vattenfall. According to the agreement between the parties, any dispute arising out of the agreement after the discontinuance of the proceedings shall be settled by three arbitrators in accordance with the United Nations Commission on International Trade Law Arbitration Rules of 1976. This means Germany could find itself again in an arbitration proceeding, this time perhaps with less prospect for a compromise settlement as the judgement of the European Court of Justice might discourage the investor (Vattenfall) from having confidence in a further settlement and may prevent the city of Hamburg from taking further action on the matter.

Both cases show the complex position of the local level in ISDS proceedings. They also show that the incentive of national governments to defend acts of a sub-national level in ISDS proceedings can generally be assumed to be quite high if the former fears existed as considerable compensation payments. Should a sub-national level become directly liable under an FTA, with the financial risk completely shifted to that level, the national government might be less inclined to offer support, particularly if political and ideological orientations differ.

WHY DOES ISDS MATTER TO REMUNICIPALISATION?

Having described the general objectives and mechanisms of investment protection and the role of municipalities in investor – state dispute settlement proceedings, this section explains why ISDS matters to remunicipalisation. Some authors have suggested a form of governance of water services by international investment law, in the absence of substantial international laws or regulation on this matter (Dias Simoes, 2017). While I would not dismiss this idea, I would advise municipalities and states that have to bear the risks of their decisions to base their assessments on the specifics of their case(s) and the applicable agreement(s). This section therefore focuses on some *exemplary* substantial treaty clauses (i.e. commitments in FTAs) that might prove problematic when attempting to remunicipalise water services or when organising water services by municipalities, and by discussing the 'chill effect' created by ISDS. Where possible, potential strategies to address ISDS barriers to remunicipalisation are presented, both for existing and future FTAs.

SUBSTANTIVE FTA PROVISIONS WITH POTENTIAL EFFECTS ON REMUNICIPALISATION IN THE WATER SECTOR

The substantive provisions of FTAs and of other investment treaties are the legal basis on which claimant and respondent may base their submissions and on which the arbitration tribunals decide. When thinking about remunicipalisation of water services, relevant treaty clauses that address the unexpected behaviour of a state include those on protection against investment expropriation and the 'fair and equitable treatment' (FET) standard. In practice, claims in ISDS proceedings are often based on an alleged violation of both.

The FET standard is one of the most controversial legal bases for a claim in ISDS proceedings, as its legal content must be usually defined by means of interpretation by the parties to a treaty and eventually by an arbitration tribunal. An unqualified FET clause can refer to 'fair and equitable treatment' accorded to an investor, without giving any further specifications about what exactly the terms 'fair' or 'equitable' shall mean in the context of a specific FTA. This is why a broad range of different interpretations of the FET standard exist. Some features can, however, be identified which have been regarded as elements of the FET standard in arbitral awards and are briefly depicted in this section with regard to water remunicipalisation.

One key element in FET cases concerns 'legitimate expectations' of investors. This is relevant to remunicipalisation as investments in the water sector are usually long-term investments, for example in infrastructure, which are made with some specific expectations on the side of the investor but at the

same time are prone to regulatory changes. It is not possible to reflect on the full scope of legitimate expectations here, but it is worth considering the underlying risk scenario. While some arbitral tribunals have applied a wide standard, others have tried to shape and limit the obligation of the state within some reasonable parameters. The definition of the arbitral tribunal in *Tecmed* (Tecmed vs. Mexico, 2003) is usually cited as a wide version of the standard. It says:

> The foreign investor expects the host State to act in a *consistent manner, free from ambiguity and totally transparently* in its relations with the foreign investor, so that it may *know beforehand any and all rules and regulations* that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations (ICSID, 2003, emphasis added).

As investments in water services infrastructure are usually undertaken for decades, it can be deemed impossible for the investor to "know beforehand any and all rules and regulations". Moreover, recent trends in policy making, such as a stronger focus on sustainability, environmental issues and the empowerment of local communities, may cause changes in policies that render the host state's actions "inconsistent" as they may introduce new "goals of the relevant policies and administrative practices or directives".

Some arbitral tribunals have realised as well that the standard stipulated in *Tecmed* was not only nearly impossible to fulfil, but also not realistic concerning mid- and long-term investments and having the potential to deprive states of the opportunity to change their policies. In some later arbitral awards tribunals have taken a narrower approach. In several cases these tribunals insisted on a *specific* commitment from the state not to change the conditions of the investment.

Furthermore, in *Genin v Estonia,* a case which concerns investments in a financial institution, the tribunal ruled, in the context of a changing regulatory and political environment, that there was no breach of the obligation to fair and equitable treatment:

> [T]he Tribunal considers it imperative to recall the particular context in which the dispute arose, namely, that of a *renascent* independent *state, coming rapidly to grips with the reality of modern financial, commercial and banking practices* and the emergence of state institutions responsible for overseeing and regulating areas of activity perhaps previously unknown. This is the *context in which Claimants knowingly chose to invest* (ICSID, 2001, para. 348, emphasis added).

As shown above, a state that implements changes toward a favourable regulatory environment could contravene the 'legitimate expectations' of an investor. Therefore, when local actors know that regulatory changes for a remunicipalisation could potentially trigger an ISDS claim, seeking a contractual solution with an affected investor could be a safer way to proceed (than unilaterally implementing changes). However, constructing a regulatory environment that gives the investor little choice but to agree to such a contract should also be avoided, as this could give rise to an FET claim as well.

Perhaps the best way to avoid problems with FET clauses would be to leave them out of an FTA or other investment treaty when (re)negotiating it. However, this would also deprive one's own national investors of this protection abroad and therefore would have to be weighed carefully. For this option, trade partners should clearly indicate their intentions.

Another possible way to avoid unexpected interpretations of a FET standard would be to 'qualify' the notion of fair and equitable treatment by adding explicit criteria. The EU has chosen this approach for the Canada-European Union *Comprehensive Economic and Trade Agreement* (*CETA*), especially Article 8.10 (2) and (4) (Official Journal of the EU, 2017, 59). Such a list of qualifications (if well drafted) restricts the FET standard to reasonable limits and helps to predict the outcome of arbitrations.

The United Nations Conference on Trade and Development (UNCTAD) advises in one of its policy papers to use clauses which include general exceptions that may justify the relevant state conduct. Such clauses can also be implemented in a horizontal provision and thus be applicable not only to matters concerning the FET standards, but to all sections of a treaty (UNCTAD, 2012, 77, 112; see also below on

the 'right to regulate'). When using these clauses, special attention should be given to the question of possible interpretations; such general exceptions should not be too narrow, but still precise enough to clearly instruct a tribunal.

Lastly, besides these questions of interpretation of a fair and equitable treatment, the condition of 'specific commitments' (see above) should not be forgotten. In order to prevent an unintended binding effect, created for example by state officials who try to convince investors to invest, a definition of what shall constitute a 'specific commitment' in the remit of the FET clause should also be included.

When thinking about remunicipalisation of water services, relevant actors should also be cautious as to whether the envisaged process could contain elements that might constitute an expropriation and thus could potentially lead to ISDS. While a direct expropriation is usually understood as "an open, deliberate and unequivocal intent, as reflected in a formal law or decree or physical act, to deprive the owner of his or her property through the transfer of title or outright seizure" (UNCTAD, 2012: 6), distinguishing between an indirect expropriation and a 'regular' regulatory measure can be more difficult. In basic terms, an indirect expropriation takes place whenever a state measure undermines property rights at once, or accumulated over a period of time, so that this equates to an expropriation based on the specific FTA. UNCTAD defines the following cumulative elements: "(a) an act attributable to the State, (b) interference with property rights or other protected legal interests, (c) of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment, (d) even though the owner retains the legal title or remains in physical possession" (UNCTAD, 2012, 12). It should be noted that this concept, like the FET standard, has also been subject to varying interpretations – some very broad, some less so – which leads to the same problems of legal uncertainty.

When looking at remunicipalisations, while *intended* direct or indirect expropriations are unlikely, *unintended* indirect expropriations are a possibility. In such situations the state feels that it acts within its right to regulate, so that usually no compensation will be paid, which would then immediately give rise to a claim. For example, the following situations could occur and would have to be assessed on a case-by-case basis: (1) an investor could be deprived of its rights to use drinking water reservoirs, so that the production of drinking water is rendered impossible, but all property rights are left untouched; (2) if a municipality owns the water network and grants a concession to a water company, including *inter alia* the right to use these networks, then if it revokes this right the investor is deprived of the possibility to provide its services.

When it comes to establishing an indirect expropriation in FTAs and arbitration awards, the picture is complex. In *Fireman's Fund v Mexico*, the Tribunal stated:

> To distinguish between a compensable expropriation and a non-compensable regulation by a host State, the following factors (usually in combination) may be taken into account: whether the measure is within the recognised police powers of the host State; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realised; and the bona fide nature of the measure (ICSID, 2006, para 176 (j)).

Regarding remunicipalisation it is important to note that the 'sole effects doctrine' has been criticised in discussions on recent FTAs at least in the EU context. According to this doctrine, only the effect of a measure on the property rights of an investor is taken into account, not the reason for such a measure (e.g. sustainable development of water services in a community). Instead the 'police powers doctrine' seems to take the lead in academic discussions and FTA negotiations. According to this doctrine, the public policy objectives motivating a state to take a certain measure are also considered when deciding whether an indirect expropriation has occurred. It assumes that a measure cannot be deemed as expropriation if it is within the scope of the police power of a state, such as environmental protection. UNCTAD (2012, *Expropriation*, 79) goes so far as to state that: "In present times, the police powers must be understood as encompassing a State's full regulatory dimension".

While all of these recent developments are positive for the policy space of municipalities, it is still difficult to predict the attitude of an arbitral tribunal toward remunicipalisation and similar policy changes. When envisaging remunicipalisation, state actors should remain cautious as arbitral tribunals could still apply a restrictive approach (and might even be bound to do so by the underlying agreement). Therefore, any measure that could constitute an indirect expropriation should be avoided. Also, even if the goal to establish a sustainable, healthy and environmentally friendly water services system for all citizens would likely be deemed as covered by the state's police powers, measures to achieve this that are only designed to drive one specific investor out of the market in a discriminatory way would still be deemed grounds for compensation, as per the prohibition of discriminatory measures mentioned in the award on *Fireman's Fund vs. Mexico*.

Actors of remunicipalisation should keep in mind the possibility of violating an FTA by indirect expropriation and should either avoid such measures or, if an expropriation is deemed to be necessary, should proceed according to the applicable FTA, for instance by offering sufficient compensation. Again, finding a contractual solution with a private investor might be a safer option than unilaterally implementing regulatory changes.

'RIGHT TO REGULATE' OF STATES AND ITS PROTECTION IN ISDS

One way to ensure the right of a state to regulate are 'right to regulate clauses'. The basic idea behind these clauses is that a state does not want to see its policy space reduced to nothing because of one or more treaty provisions. This is especially true for public goods with high importance for society as a whole, such as public health or environmental protection. In this context one could also think of drinking water, especially in states with water scarcity or problems with infrastructure, quality or affordability. In general, there are several ways to introduce a right to regulate clause, for example a general reference to the right to regulate of the parties to an FTA can be made. However, it is more likely that the right to regulate will be affirmed by making reference to specific areas of regulation such as public health, safety or the environment. Sometimes, these references are further restricted by a condition such as 'legitimate policy objectives'.

With regard to already existing treaties it is useful to check whether or not the right to regulate is expressly ensured. If the intentions of the parties are not sufficiently reflected in a treaty, a joint interpretative declaration on the right to regulate could mean a simpler solution than a re-negotiation. There is no guarantee that an arbitral tribunal would respect such a declaration, however this is better than knowingly proceeding with an FTA which can potentially hamper the state's right to regulate.

Such a declaration can also be a powerful tool alongside a newly negotiated FTA, such as the CETA's Joint Interpretative Instrument, (Official Journal of the EU, 2017: 22) as it can enable a tribunal to come to a solid conclusion about the original intent of the parties. However, for the sake of legal certainty carefully drafted clauses within the treaty should be a priority, and an endorsing declaration is a plus. Unilateral declarations such as the "Commission declaration in respect of water" in the Council Minutes on the CETA could help interpretation as well but should not be overstated in their impact (Official Journal of the EU, 2017: 9-22, 12, 14).

A right to regulate clause can be introduced into a newly negotiated FTA in a general section, covering all the agreement or into specific sections, for example with regard to the FET standard or expropriation as these are especially prone to conflict with policy objectives of a state as discussed above. In the CETA, the parties introduced several right to regulate clauses, including one in the preamble (Official Journal of the EU, 2017: 23-1079, 26), probably due to heavy public criticism. This approach of 'better safe than sorry' should not hide the fact that the real effect of a right to regulate clause in a concrete arbitration cannot be predicted as it only guides the tribunal in its interpretation; other than precise carve-outs or exemption clauses it does not provide a clear-cut solution. In that sense, carefully phrased substantial provisions provide more clarity and predictability. Right to regulate clauses should therefore be used as

an additional mechanism to secure policy space; they cannot make up for contrary terms of an agreement.

OTHER POTENTIALLY RELEVANT PROVISIONS OF FTAS

In the context of drinking water services environmental issues should never be overlooked. Shale gas fracking technology, for example, may constitute a threat to drinking water production. Fracking claims to exploit potential gas fields might be protected under an FTA and its investment protection rules, depending foremost on the definition of 'investment' therein. As shale gas fracking can be quite profitable, high compensation sums could be at stake (Kynast, 2015). With water resources becoming scarcer, more claims based on environmental issues can be expected. This also can potentially be an issue regarding remunicipalisation, motivated by water quality problems related to resource extraction.

With regard to existing FTAs, municipalities are well advised to double-check whether or not environmental issues related to drinking water supply in their remunicipalisation projects could affect foreign investors and could be relevant to ISDS. For future FTA negotiations, it will become more important than ever to follow a holistic approach when it comes to scrutinising a draft agreement. Not only should a policy space for remunicipalisation of drinking water services be protected, but environmental issues affecting drinking water sources should be considered as well, pointing to the need to join forces with a wider range of stakeholders.

Another potentially relevant issue is the exact scope of treaty provisions on which ISDS claims can be based. This is very important as 'treaty shopping' might become a problem. In general terms, this creates circumstances that lead to the applicability of an FTA. The most important issue regarding ISDS would probably be to 'shop' a treaty that foresees ISDS proceedings if otherwise an agreement not foreseeing ISDS would be applicable. Moreover, more favourable treaty provisions might also be the target of such practice. Companies that provide water services internationally might theoretically have access to several free trade agreements or could easily establish a further branch in order to obtain the applicability of an FTA. With regard to future FTA negotiations, it would therefore be advisable to define the terms 'investment' and 'investor' in agreements so that artificial arrangements such as creating a branch or restructuring a company for the sole purpose of accessing an FTA are not accepted.

ACCESS TO DRINKING WATER AS A HUMAN RIGHT AND ISDS

Finally, with access to drinking water becoming even more difficult in some regions because of climate change and pollution, discussions on access to water as a human right will gain in importance and relevance and might influence the legal assessment of remunicipalizations. How this could influence ISDS proceedings is illustrated in the case of *Urbaser v Argentina* (ICSID, 2016). This claim concerned water and sewage concessions of a company in the Province of Greater Buenos Aires to which Urbaser was a shareholder. The concession at stake was concluded in the year 2000. With the financial crisis in Argentina in 2001 the peso depreciated while emergency measures included a 1: 1 conversion with US dollars. Despite these dramatic developments, "numerous requests for a new valuation of its tariffs and for a complete review of the Concession all failed in front of the Province's lack of any serious commitment to bring the required renegotiation process to a successful end" (ICSID, 2016, para 34). Urbaser then sued Argentina for breach of the obligation to fair and equitable treatment according to a bilateral investment treaty between Spain and Argentina. Argentina submitted a counterclaim based on the human right to water and sanitation. While the counterclaim was finally dismissed, the arbitral tribunal stated that it would have evaluated differently "in case an obligation to abstain, like a prohibition to commit acts violating human rights, would be at stake. Such an obligation can be of immediate application, not only to States, but equally to individuals and other private parties". This reservation of

the tribunal can be a starting point for future valid counterclaims alongside further considerations which were included in the award.

REGULATORY CHILL

Given the complex system of FTAs and ISDS, some analysts have warned of a 'regulatory chill' deterring governments from moving forward with policies such as remunicipalisation for fear that an investor could take them to arbitration. An often-quoted example occurred in 2002 when the Indonesian government considered banning open-pit mines in protected forest areas leading foreign companies to threaten ISDS claims (Baetens and Tietje, 2014, para 78). Indonesia then modified the measure with significant positive effects for foreign investors, including express permissions to continue mining. The behaviour of the government, press reports and other information available strongly point to a "chilling effect" (Tienhaara, 2006).

Measuring the significance of this effect is difficult, however. While there is no harm in abstaining from a measure when a regulator has come to the conclusion that it would be illegal, it would be alarming in a democratic society if remunicipalisation were not pursued simply because of an abstract threat of an ISDS claim. This is especially important as poorer countries would seem to be more vulnerable to such a regulatory climate given their limited resources to deal with arbitration.

The best way to avoid a chilling effect would be to provide well-informed legal advice to local communities to give them an idea of whether there is a real threat of an ISDS claim. This should go hand-in-hand with the implementation of necessary safeguards in new FTAs. A well-understood level of treaty commitments and obligations could help to avoid regulatory fears. Specific exemptions for drinking water or municipal services from FTAs could be especially useful. However, because of the potential interactions with different aspects of investment protection such exemptions are only one piece of the puzzle when trying to avoid regulatory chill.

One author suggests addressing the problem of inconsistencies between arbitration decisions of different tribunals in order to provide better legal certainty (Ketcheson, 2016). Another develops a simplified modification procedure for commitments to provide regulators with sufficient policy space (Krajewski, 2015). For trade partners who are willing to provide such flexibility, this is an excellent option. However, simplified modification procedures depend on the willingness of both parties, which could be hampered if one party is under pressure by a large national water company that has invested in the other party’s territory.

SPECIFIC COMMITMENTS AND RESERVATIONS IN FTAS

When discussing risks for the remunicipalisation of water services related to ISDS one should not forget that investment protection clauses are only of importance when foreign investors are allowed to operate in a market. Liberalisation provisions which stipulate conditions for an activity in a market cannot be usually enforced through ISDS; however, they have to be taken into account in conjunction with ISDS provisions as they both define the legal context and can limit or protect remunicipalisation projects.

The degree of liberalisation is often defined in specific commitments and reservations of states. Therefore, at least some of the most relevant risks emanating from these provisions should be considered in this analysis as well. This section provides an overview of the general structure of commitments in FTAs, and a description of the 'public utilities' clause of the EU as an example of a reservation that provides policy space for remunicipalised water services. This analysis is not (and cannot) be exhaustive; detailed descriptions can be found in specific analyses on this topic (e.g. Krajewski and Kynast, 2014).

FTAs are usually structured in such a way that the state parties to the agreement provide lists of regulatory measures in order to determine the exact scope of an intended liberalisation. Generally, there are two different approaches with potentially huge practical impact: the positive list and the negative list.

When using a positive list, parties need to explicitly list all sectors and subsectors to which they want to apply treaty obligations, for example regarding market access or national treatment. When using a negative list, this system is inversed: it is deemed that commitments undertaken in an FTA apply to all sectors and subsectors, unless specific reservations are listed.

It is possible to combine both approaches in one FTA, for example to use a negative list approach but resort to a positive list specifically for market access. More ambitious FTAs include a negative list that reflects in very clear terms where parties do not want to commit themselves. However, the underlying risk of a negative list approach is that a state omits a reservation ('list it or lose it'). This can happen for various reasons, for example if regulations are 'forgotten' when officials are not well versed on a certain sector or if reservations are not phrased correctly. Using a positive list approach regarding market access can lower these risks when concluding an ambitious FTA.

In FTAs that use a negative list approach, to keep (remunicipalised) water services in the hands of municipalities reservations should be implemented that cover all *existing* measures concerning the provision of water services, especially with regard to market access obligations and national treatment obligations. In states where water services are currently not in the hand of municipalities, such reservations should be foreseen regarding possible *future* measures in order to maintain the necessary policy space for remunicipalisation and to avoid the risk that an FTA could infringe and thus give rise to ISDS claims.

In general, there are two options concerning the content of such reservations which aim at remunicipalisations. First, a broader reservation which aims at public services in a more general way could provide protection; secondly also a specific reservation regarding water services such as, for example, in CETA (Official Journal of the EU, 2017: L 11, 23-1079, 924), could be envisaged.

But also when using a positive list approach states should stay vigilant, especially when there is a certain competition for water in their territory due to water scarcity. In this case they might not only want to protect the possibility for remunicipalisation of water services but also ensure (and scrutinise the listed commitments in that sense) that they are free concerning regulatory measures on available sources of water, such as groundwater, river water, lake water, etc. Indeed, having structures and regulatory measures in place for remunicipalisation may prove useless if the local community has to compete with a multinational company for the right to exploit water resources.

Another mistake that should be avoided when drafting or analysing commitments in an FTA is underestimating the 'ratchet effect' related to the right to regulate of states. Ratchet clauses stipulate that a state cannot digress from the level of liberalisation with regard to certain commitments. Usually, these clauses can be found in the annexes of FTAs where states table their reservations. Ratchet clauses can have a detrimental effect on remunicipalisation as they can be very costly in a fully liberalised market or even impossible if the local community is unable to compete in such a market.

Existing FTAs must be screened carefully to see whether any liberalisation in the water sector could be covered by a ratchet clause. If so, such liberalisations should be avoided as ratchet clauses may have the effect that 'political experiments' or liberalisations of water services due to financial needs cannot be reversed once in place.

Lastly, usually exclusive rights (e.g. concessions or monopolies) are protected in special reservations of FTAs. Traditionally these provisions protect state-owned enterprises and public utilities from the pressure of privatisation through an opening of the market by other FTA clauses. The best-known clause is the 'public utilities clause' in the EU General Agreement on Trade in Services schedule, which has been used in many EU FTAs. It reads: "In all EC Member States services considered as public utilities at a national or local level may be subject to public monopolies or to exclusive rights granted to private operators". In an explanatory footnote some examples of such services are given. While there are doubts

about the exact scope of the clause, water services are clearly deemed to be covered (Krajewski and Kynast, 2014).

POTENTIAL INVOLVEMENT OF MUNICIPALITIES IN NEGOTIATIONS OF FTAS AND ISDS PROCEEDINGS

Despite FTAs and ISDS being primarily the domain of national governments there are two important ways in which municipalities can potentially become involved. The first involves direct engagement in the negotiations of FTAs. One cannot help but wonder if the *AbitibiBowater* and *Moorburg* cases cited above could have been prevented if sub-federal levels had been more involved when the underlying treaties were negotiated. In the *Moorburg* case, the city of Hamburg was irritated with regard to the "exotic" claim of Vattenfall. This could have been prevented through their active participation when the Energy Charter was negotiated. On the one hand, the liability for sub-federal activities could *a priori* have been limited (if wished for and accepted by all trade partners); on the other hand, more active involvement in negotiations also means better understanding and awareness of the provisions of an international agreement.

Involving municipalities in treaty negotiations could also take the form of an intensive consultation by the national government prior to and during negotiations. Admittedly, not all municipalities would have the resources to take part in such intense consultations, but could act through representatives; international organisations such as UNCTAD can (and already do) support capacity building in this regard (VanDuzer and Mallet, 2016). With such engagement the introduction of local-level friendly rules could become more likely, such as a right (not duty) to be heard in proceedings. Municipalities could become game changers as they can provide solutions for a compromise settlement, as the *Moorburg* case shows.

A second potential role for municipalities is more active participation in ISDS. It is important to remember that it is the national state that is the respondent to the claim of an investor in an ISDS proceeding, but other models involving the sub-national level have been considered recently. Academic discussions following the compromise settlement in the *AbitibiBowater* case went further than the then-proposed interstate mechanism for reimbursement. The fact that only the federal government is bound by Canada's FTAs was identified as a weak point in negotiations. It was argued that trade partners might not have confidence in commitments in areas of provincial competence (Fafard and Leblond, 2012).

To redress this shortfall special commitments of the sub-national level to treaty compliance have been discussed. A political (though not legally enforceable) agreement of the provinces in which they express their will to implement the commitments of an FTA was identified as one viable option; interstate agreements are another (VanDuzer and Mallet, 2016: 95, 124). Such agreements would have a legally binding character and could be enforced by the state according to its national law.

Neither of these examples would have direct influence on dispute settlement but would solely target the compliance with substantial provisions of trade agreements on a national level and could address doubts of trading partners concerning future compliance of the sub-federal level. However, when signing *legally binding* intra-state agreements, municipalities should always carefully exclude the risk of an indirect liability for the costs and compensation claims in ISDS proceedings under their governing national law. A *non-legally binding* commitment of municipalities to comply with an agreement might also cause additional political pressure on municipalities to annul a measure which could be or is already the subject of an ISDS claim.

Apart from these potential disadvantages, agreements between different levels of government on the national level can serve to better implement treaty provisions if they are the outcome of a transparent, among-equals process. They can even help to 'translate' treaty provisions into national actions. If, however, such intra-state agreements are only imposed as an additional layer to please trading partners, they are ill advised with regard to the potential risks mentioned above.

The most far-reaching idea foresees direct liability and potential compensation payments for the sub-national level in ISDS proceedings (Meyer, 2017). To date the idea has only been discussed with regard to federal states in which there are significant sub-national competences and resources. The possibility of direct liability of municipalities has not yet been evaluated.

Still, one should be cautious: aside from its financial power the federal level of government is usually also more competent in dealing with ISDS litigation due to its experience in the matter. This is an advantage that cannot be underestimated. It might not be in the interest of municipalities to shift direct liability for ISDS claims from a national to a sub-national level. Even though a regional or provincial government might be closer to local concerns, a shift of liability might impair their chances at winning arbitration claims and could therefore raise pressure to settle in an effort to avoid measures that could trigger disputes.

A solution for municipalities to be heard in arbitration proceedings without imposing the risk of direct liability could be to foresee the possibility of an Amicus Curiae Brief for them and organisations that represent their interests (Baetens and Tietje, 2014: para. 3, 23). Of course, this should never happen without proper legal advice in order to exclude any possible liability, even if not regarding ISDS, but possibly concerning ongoing or future domestic proceedings. As cases might arise where this is not possible, involvement should never constitute a duty.

CONCLUSION

This article has provided a brief overview of issues which should be taken into consideration when planning remunicipalisations. It is not intended to discourage municipalities but rather to illustrate some of the potential risks which should be taken into account when planning remunicipalisations or when taking part in strategic policy decisions in trade agreement negotiations. While it has been suggested that "the investment world fills a gap that no other organization has been able to address" (Chaisse and Polo, 2015: 62), this article shows that states and municipalities can still reclaim their right to decide on their water policies.

The analysis of investment protection and its potential relevance to remunicipalisation of water services has shown a complex picture of risks but has also suggested solutions. Concerning already existing treaty obligations which threaten to give cause for ISDS claims, municipalities should prudently design their laws and measures when they plan for remunicipalisation of water services. An analysis of whether an FTA is applicable, and what the inherent obligations are, is paramount. Special care should be taken regarding compliance with the FET standard and rules on expropriation as these are very sensitive to policy changes. In some situations, the (safer) solution might fall outside the scope of an FTA: finding an amicable contractual agreement or creating public pressure for a voluntary withdrawal of an investor. Ecological aspects and the legal implications of an acknowledged human right to access to drinking water should not be overlooked either. These aspects will probably gain even more momentum in the future, for example concerning effects of climate change.

As shown, when new FTAs are negotiated, municipalities could take part in consultations or get involved directly in negotiations. Though it is true that their negotiation capacities might be limited, their input and specific knowledge about the organisation of public services such as drinking water could be very valuable. Practical solutions to enable their participation could be found, such as an institutionalisation of information exchange within already existing frameworks of coordination between different levels of government (federal-regional-local). International organisations such as UNCTAD can also support capacity building. Municipalities should also raise their voice regarding reform attempts such as work on the establishment of a Multilateral Investment Court and efforts to modernise investment protection. These are highly technical and academic discussions but municipalities can add valuable input and influence future policies.

As explained, municipalities can also get involved in ISDS proceedings through, for example, an Amicus Curiae Brief. However, direct participation in ISDS proceedings in the sense of direct liability would not be advisable as municipalities would run the risk of high compensation payments with no guarantee of support from the national level.

In the end, the role of municipalities in FTAs and ISDS is still in its infancy, and the impact of these agreements and proceedings on remunicipalisation is still not very well understood. Further research is urgently required as the potential for remunicipalisation appears to be growing.

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