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Optimizing Private Sector Participation in Water Infrastructure: A comment on OECD

A draft checklist for public action

Miguel Solanes, IISD Consultant

August 2008[1]

[1]The present comment benefits from previous work done by Howard Mann, Matthew Porterfield, Jorge Barraguirre, Michael Hantke-Domas, and the Consultant himself. The comments herewith refer to the checklist version discussed at the IMTA-OECD Meeting of September 4–5, 2008, in Mexico.

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Introduction

This is report provides a commentary on the OECD document "Optimising Private Sector Participation in Water Infrastructure: Draft Checklist for Public Action." Part A, is a general comment on the checklist's lack of criteria to distinguish among strategic and ancillary questions and issues. It also suggests expanding the formal coverage of the checklist to explicitly include private sector actors, to whom some of the principles of the checklist are addressed.

Part B consists of specific comments on subjects and issues that the checklist has omitted despite their relevance to private investment in water infrastructure, conflict, regulation and litigation. It includes: international investment agreements; water, corruption, moral hazard and international investment agreements; restrictions on national sovereignty; expropriation, fair and equitable treatment; ignorance of regulatory concepts; umbrella clauses and contract disputes; arbiters; conflicts of interests; and ad hoc nature of proceedings and procedures.

Part C consists of comments and suggestions to the text of the checklist. It includes private investment, local ownership and efficiency, contract and legal regulation, price cap and rate of return regulation, fiscal discipline and transparency, information and principle 14, regulatory bodies and suggested legal principles for regulation, renegotiations and good faith, and responsible business conduct

1.0 General Comment

The OECD checklist attempts to be comprehensive; yet, it has several limitations. First, it does not distinguish between strategic questions and ancillary and accessory matters. These are very important problems for countries trying to decide on alternative courses of action, manners of financing, organization of the sector, and regulation, within contexts of limited time and resources.

It does not go into enough details when discussing a number of issues of crucial importance, such as efficiency and economies of scale and scope, and regulation by either contract or law. Efficiency, and scale and scope, may reduce or multiply the costs and the time of implementing national programs in water and sanitation. Contract regulation has been severely criticized by experts in systems with a long tradition in private provision of public utility services. Yet the checklist gives it the same weight it gives to government (legal) regulation, therefore it may be of limited use, or even confusing, to anyone who does not have expert advice on relevant details and problems. A more focused approach, such as the *Policy Principles* (n.d.) produced by the Public-Private Partnerships for Water Supply and Sanitation may be of greater usefulness to countries, because of its concision.

Another area where the draft checklist needs clarification is the scope of actors to whom its recommendations, and the implicit obligations that they suggest, are addressed. According to paragraph 12 of the Executive Summary, "The project makes four general recommendations to Governments." This creates the wrong impression that only governments should be the passive subject of recommendations and suggestions.

On the other hand, Principle 20 of the checklist is a call for responsible business conduct. It suggests that the checklist applies to both government and private parties. Principle 21 calls for the good faith and commitment of private parties (although it misses the fundamental duty of efficiency). Principle 22 calls for private parties to fight corruption. Other principles call for private-sector behaviour and conduct relate to social consequences of actions (Principle 24) and communication with consumers (Principle 23).

It may be necessary to change the addressees of paragraphs 11 and 12 of the checklist to include private parties and their duties. This is the approach of the *Policy Principles* of the Public-Private Partnership for Water Supply and Sanitation would result in a more balanced set of obligations for both governments and private sector. For the *Policy Principles,* the addressees are a comprehensive group of stakeholders, including*, inter alia,* financing institutions, private sector companies and governments (para. 11). This sense of balance in the *Policy Principles* is reinforced by sets of duties that apply *erga homes* (i.e., in para. 232, 233, 235, 222) and by the equitable principle that major unpredictable or non-attributable risks in water and sanitation are shared among contracting parties, funding providers and donors (para. 3103).

2.0 Specific Comments

2.1. International investment agreements

At the present stage of globalization, no study, guideline, checklist or paper on public utilities is complete without a reference to foreign investment and the institutional arrangements for its protection. The main electricity, water and telephone companies are all multinational, operating at global scale and under the protection of global investment agreements. And most cases of international arbitration refer to natural resources, environment, and public utilities services, including water. Yet, the checklist makes few references to the subject, and provides no elements for its operational consideration.

This is a serious flaw in the checklist. There is an omission of a widely known subject, in crucial public interest areas and in adjudication processes whose principles do not protect countries, but investors. The gravity of the omission is compounded by the fact that countries could improve their chances of success and protection if they had a listing of principles they should include in their contracts and regulations, with a view to international arbitration.

In this sense, the checklist misses an opportunity to cover an important issue and to raise awareness regarding its critical importance. Suggestions that countries prepare lists regarding the duties of investors and corresponding government expectations do not make up for this serious gap, since the seriousness of the impacts of international arbitration is not discussed, and the experts on utilities are not often conversant with international arbitration and its challenges.

Many developing countries have signed, sometimes without due consideration of the implications, numerous agreements for the protection of foreign investment over the last two decades. Attorney General of Pakistan Makhdoom Ali Khan, speaking at a colloquium hosted by the International Centre for Settlement of Investment Disputes (ICSID), cautioned States to scrutinize closely any international investment treaties that they conclude with other governments (Peterson, 2006). Speaking of his own country's experience, he noted that Pakistan long treated such treaties as "photo-op" agreements, which could be signed hastily, with little consideration of their concrete legal consequences. Until very recently bilateral investment treaties were regarded as unimportant documents that could be signed by a visiting official who simply wants a photo op. They were signed without any knowledge of their implications. Only when a country is hit by the first investor-state arbitration do they realize what these words mean. In Pakistan's case, the first arbitration to arise under one of its investment treaties was filed by a Swiss multinational, Société Générale de Surveillance (SGS) in 2001. When this case was filed, the Pakistani Government was taken by surprise. SGS had already lost before the Swiss Supreme Court and in Pakistan. It was a wonder how could it start a third round (Peterson, 2006, p.4).

The new system for the protection of foreign investment (International Investment Agreements) have raised a number of issues in relation to water resources, the financing of water services, and the interrelation between water resources, water services, economic crisis, financing and public interest regulation. Water is a household need that also sustains ecological systems and provides an input into production systems that maintain livelihoods (UNDP, 2006, p. 2).

The physical availability of water is a concern for some countries, but, according to UNDP, the scarcity of water at the heart of the global water crisis is rooted in power, poverty and inequality, not on physical availability. Today, 1.1 billion people in developing countries do not have adequate access to water, and 2.6 billion people lack adequate sanitation (UNDP, 2006, p. 2).

For some, water scarcity is manufactured through political processes that disadvantage the poor (UNDP, 2006, p. 3). In order to redress the basic unfairness of the system, a number of developing countries decided that the private sector had a role to play providing advice, capital and technology to expand, improve and upgrade their water utilities and services.

The process was encouraged by lending organizations—such as the World Bank, the Inter-American Development Bank, the Asian Development Bank, and the African Developing Bank—and also by bilateral assistance. Privatization programs included countries such as Argentina, Bolivia, Indonesia, Philippines and Tanzania. Water supply and sanitation were privatized in the hope that openness to private investment would alleviate public finances and the lot of the poor. It was expected that there would be an opportunity for the private sector to contribute to the achievement of the Millennium Development Goals in water supply and sanitation, whose price tag is US$10 billion (UNDP, 2006, p. 8).

Thus, the privatization process took off in a number of developing countries, on the assumption that private investment would make up for the shortage of public funds. Privatization was, however, affected by defective economic assessment and outdated regulatory mechanisms. It is therefore not surprising that the largest number of arbitrations involve the service sector—including water and the oil and gas industries (Franck, 2007).

2.2 Water, corruption, moral hazard and international investment agreements

Corruption is a cause and catalyst for the water crisis. It affects all aspects of the water sector from management to hydropower (Water Integrity Network, 2008). In water supply and sanitation, corruption is a highly relevant consideration. Resources diverted through corruption and deficient decision-making intended to favour constituencies result in lower levels of effective investment and systemic efficiency. They reduce resources, private or public, available for public interest purposes.

Incorrect design and perverse incentives contribute to creating situations where corruption flourishes. Wells and Ahmed (2007) detail a number of failed international ventures in Indonesia, where the local partners were powerful political figures, their relatives or associates. In such contexts, in a number of cases, governments have distinctively instructed their lawyers not to invoke the corruption argument. By doing so, the government has effectively blocked the consideration of the subject, since the system of international investment arbitration does not facilitate the consideration of corruption on substantive grounds, nor procedurally.

In *Wena v. Egypt*, referring to allegations of corruption by the defending state, the ICSID Tribunal stated that, "if true, these allegations are disturbing and grounds for dismissal." The Tribunal, however, went on to avoid an investigation of whether the allegations were true, at least in part on the basis that the state had taken no investigative or corrective steps itself on the corruption issue (Mann, 2006). Thus, while corruption would, in theory, vitiate jurisdiction and preclude investment arbitration claims, in practice, governments seldom argue corruption when it involves public officers. In the present structure of international arbitration, if governments do not argue corruption, no one else has compulsory standing to do so.

Moreover, while domestic law courts do not require a high standard of proof to relieve a party from obligations vitiated by corruption, in international investment arbitration court has required strong evidence regarding corruption (Wells & Ahmed, 2007).

Thus, the present structure of the arbitration process may end up locking in corruption. On the one hand, many governments are reluctant to invoke it. On the other, third party intervention is not a general principle of arbitration. Finally, the standard of proof is higher than in domestic law.

Arbitral decisions may also favour corruption when they declare that the behaviour of public officers binds governments without conditioning it with context and legality. For example, in *MTD Equity Sdn. & MTD Chile v.Chile* (ICSID Case Nº ARB/01/7), the company invoked all the grounds for indirect expropriation, but the arbitration tribunal rejected these, concluding only that the investor did not receive fair and equitable treatment. Still, this was sufficient to cause major difficulties for the Chilean government at national and local levels. The tribunal concluded that, in approving the investment, the government should have warned the company that the land was zoned for agricultural use, even though foreign investment contracts do not relieve the investor of investigating whether other laws apply.

Simply put, the tribunal found that, in carrying out his public duties, a government official commits a government. This is a dangerous precedent, considering that acts may be at the same time jurisdictionally correct and substantively and subjectively vitiated. But the present system of

international arbitration does not grant standing to anyone but investors. Affected citizens and populations are unprotected and unrepresented. Any checklist or recommendation on stakeholders' participation is annulled by this basic important fact. Stakeholders have no compulsory representation in international investment arbitration.

Considering that the final destination of water utilities conflicts is international arbitration when there is a foreign investor, this is a major hurdle in any well-wishing, heartfelt, socially-progressive theoretical recommendation on participation.

In addition, the moral hazard element created by investor's protection agreements leads to perverse decisions and to investments that are risky for both countries and foreign investors: "If managers really believe that the new international property rights will secure their investments, they have little reason to worry much about risks. If unfortunate events occur, the 'insured' investors will be compensated anyway. It is much like someone who decides to build in a flood zone under the assumption that government flood insurance will compensate him if his property is damaged" (Wells & Ahmed, 2007). For example, Enron paid managers 10 per cent of Dabhol (India) power renegotiation. In such a situation, it is likely that managers would close in the best looking negotiation, ignoring risks, cashing bonuses and hoping they were in a different position by the time the deal collapsed (Wells & Ahmed, 2007). The cases of Argentina, Bolivia and Tanzania are highly illustrative of other moral hazard situations. In all of them, investors went into contracts without a careful analysis of the situation's context.

The existence of a specialized court mechanism for reviewing the rights of investors, the principle of investor protection, and the possibility of accruing substantial capital resources from relatively modest investments may persuade foreign investors that, rather than pursuing the course of negotiation and compromise, resorting to international arbitration/litigation may prove more financially lucrative in the long term. In part, this calculus stems from the possibility that an investor may collect not just damages for investments effectively made, but also expected profits for investments not yet made. Under this perverse set of incentives, it may in fact be better for a venture to fail, so that the investor could collect effective losses and potential future profits at once. Thus, the system may encourage companies having an interest in failure, rather than performance.

Recent literature for the evaluation of privatization[2] has pointed out that renegotiations in the water supply and sanitation sectors are more common than in any other public utility industry, with the possible exception of roads; that renegotiations are promptly initiated by private concessionaires, in most of the cases; and that private contractors usually benefit from these negotiations, through reduction of investment obligations, delays in investment obligations targets and tariff increases.

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[2] J.L. Guasch & S. Straub (2006) Renegotiation of infrastructure concessions: An overview, *Annals of Public and Cooperative Economics, 77*(4), 484, both of them as quoted in Case No. ARB/05/22, before ICSID, between Biwater Gauff (Tanzania) Limited and United Republic of Tanzania, Amicus Curiae Submission.

Although the draft checklist mentions the Guasch report, it does not make any assessment of the consequences that industry practices have when considered in the context of international investment agreements.

A common procedure is to win a contract making a low-ball offer and then renegotiate without competition. In these cases, governments—assuming absence of corruption—are left between a rock and a hard place: If they do not renegotiate, the quality and expansion of service stalls, they suffer political consequences and they incur considerable transaction costs. If they renegotiate, this becomes a bilateral negotiation with unequal negotiating power and no competitive pressure, where the winner of the original bidding has the upper hand.

The fact that arbitration markets are created by investors, and only by investors, may result in decisions that favour them, disregarding national common precedent in the regulation of public utilities (i.e. U.K., U.S.A.) with such scant functional justification that there is an effective corruption of legal principles

2.3. Restrictions on necessary sovereign authority

2.3.1 The issue

Contracts signed with international investors, for the provision of privatized water services come under the protection of international investment agreements. Therefore, conflicts involving privatization contracts are adjudicated under the procedural and substantive rules of investment agreements.

Regulatory power it is now challenged by the arbitration courts' interpretation of the rules of investment protection treaties, under ad hoc developments that were probably unforeseen when most countries signed investment agreements. A number of decisions have seriously impaired governments' regulatory capabilities and have caused concerns about a possible regulatory chill, with negative consequences on public well-being. Argentina alone has been sued in at least eight different cases:

1) *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina Republic* (awarded on November 21, 2000, ICSID Case No. ARB/97/3,)
2) *Azurix Corp. v. Argentine Republic* (awarded on July 14, 2006, ICSID Case No. ARB/01/12)
3) *Azurix Corp. v. Argentine Republic* (registered on 2003, ICSID Case No. ARB/03/30)
4) *SAUR International v. Argentine Republic* (registered on 2004, 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 Republic* (registered on 2003, ICSID Case No. ARB/03/17)
6) *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v. Argentina Republic* (registered on 2003, ICSID Case No. ARB/03/19) consolidated with AWG Group plc v. Argentina (UNCITRAL)

7) *Impregilo S.p.A. v. Argentine Republic* (registered on 2007, ICSID Case No. ARB/07/17)
8) *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic* (registered on 2007, ICSID Case No. ARB/07/26)

Tanzania and Bolivia have also been sued in water-related cases at arbitration courts.

Other cases of international investment arbitration have questioned environmental regulations. In *Tecmed v. United Mexican States*, awarded on May 29, 2003, an arbitration tribunal found that the environmental measures taken by Hermosillo, in Sonora State, Mexico, were a violation of the expropriation norm of the Bit protecting the investment. *Metalclad v. Mexico* (awarded on August 30, 2000) was faulted for allowing environmental regulations that meant interference with the use of property, which has the effect of depriving the owner in whole or significant part of the user or reasonably-to-be-expected economic benefit of the property. According to the tribunal, such a measure was tantamount to expropriation under article 1110 9 (1) of NAFTA. In Pope[3], a NAFTA tribunal found that non-discriminatory regulation is covered by the expropriation norm of the agreement (article 1110). *S.D. Myers v. Canada* (final award on December 30, 2002) accepted the possibility that regulatory takings could fall within the scope of article 1110.

These cases show that the international arbitration system operates under the standard of the sanctity of unfettered property rights Yet domestic experience and national precedent indicate that, under a number of conditions (changed circumstances, unconscionable terms, public policy, compulsion, corruption, inconsistency, asymmetry, moral hazard, etc.), contracts and other aspects of property rights may not be held sacred: "The 'magic' of property rights in the industrialized countries comes not from their being absolute, but rather from a balance between individual or corporate rights and fairness, and, especially, overall economic benefits.[4] That balance is regularly fought over in the United States, but the battles are engaged in forums that enjoy broad public acceptance" (Wells & Ahmed, 2007). International arbitration, as conceived today, does not address these fundamental issues.

There are five key protections for foreign investors that are relevant to the effects of investment agreements on water-related services and on water management, particularly in developing countries: national treatment, most favoured nation treatment, minimum international standards of fair and

[3] *Pope & Talbot Inc. v. Canada* (interim award on June 26, 2000; award on merits on April 10, 2001; award on damages on May 31, 2002 and award on costs on November 26, 2002).

[4] One of the best examples available of this type of balanced approach is that employed in the decision by Judge Holmes in 1912: "An adjustment of this sort under a power to regulate rates has to steer between Scylla and Charybdis. On the one side, if the franchise is taken to mean that the most profitable return that could be got, free from competition, is protected by the 14th Amendment, then the power to regulate is null. On the other hand, if the power to regulate withdraws the protection of the Amendment altogether, then the property is naught. This is not a matter of economic theory, but of fair interpretation of a bargain. Neither extreme can have been meant. A midway between them must be hit" (Cedar Rapids Gas Light Co. v. City of Cedar Rapids 223 U.S. 655 [1912]).

equitable treatment, protection from expropriation without compensation and freedom from the imposition of performance requirements.

These protections are simultaneously the rights of foreign investors and the obligations of their host States, and apply to the full life of an investment, not just to its initial establishment phase. Further, they apply to all actual foreign investments subject to an agreement, whether made before or after the agreement enters into force, and whether the investment is made pursuant to specific rights of establishment or to the simple application of domestic laws on establishing a foreign investment. Thus, foreign investor rights can be very broad and should be understood as applying to the full lifespan of the investment (Mann, 2005; 2006).

The breadth of the rights has also been expanded in some interpretive constructs due to the absence of express obligations on foreign investors or rights of States in relation to the investments. The implications of each type of foreign investor right for governments thus extend not just to the immediate decision on allowing an investment, but throughout its lifespan.

This imposes a large burden on setting the right domestic law framework for the initial decisions on foreign investments, as well as ensuring that the host State has the economic capacity to support the potential success of the foreign investment (Mann, 2006). But even having good regulation and economic capacity does not prevent being sued at arbitration courts. New regulatory needs, or unexpected economic crisis, may trigger arbitrations at any time.

2.3.2 Expropriation

The protection against expropriation is an absolute standard that is not based on treatment of domestic investors. This protection is not a barrier to an expropriation taking place for a public purpose, but it does require fair market value compensation to be promptly paid for any expropriation. This is not a new concept from international law, and is widely applied in almost all domestic legal systems.

What is new, however, is the potential extension of the notion of expropriation to government regulations that have an impact on foreign investors. It has been argued, with some success to date, that a normal regulatory measure that has a significant financial impact on an investor qualifies as an indirect or "regulatory expropriation." While this is alleged by some observers to come from U.S. legal principles on regulatory takings, it is worth noting that no compensation to U.S. investors appears to have ever been paid following the adoption of measures under the U.S. Clean Air Act, Clean Water Act and similar pieces of classic environmental protection at the federal or state levels (Mann, 2006). Most national systems admit regulation, and sacrifices of private property, if owners are not functionally dispossessed, or if there is no confiscation. If regulated owners can still make a reasonable profit out of their property, few national systems will concede expropriation

compensations. Yet a number of cases cited in this proposal show that the standards of international investment arbitration do often equate regulation with expropriation. If this trend carries forward, the ability of governments to balance conflicting interests, or to manage crisis, will be seriously compromised. No comprehensive comparative law study, covering several representative countries, and comparing their domestic national regimes on expropriation and regulation, with the decisions of investment tribunals has yet been implemented.

One of the few countries where such a study has been made is the United States, and in this case the finding is that the balancing characteristics of the United States regulatory principles may collide with international investment principles for expropriation. For example, NAFTA's notion of investment is much broader than real property. Compensation applies for substantial or significant effect on the value of an investment, and conceptual severance, hitherto rejected by the United States Supreme Court, is accepted by international arbitrators.

Porterfield (2004) argues that NAFTA differs from takings in the United States law in three significant ways: protected economic interests are broader, permissibility of conceptual severance is greater, and the degree of economic effect for a measure to be a taking is lower. Thus, not just real property is protected, but also more general interests such as market access, market share and the right to make profit from an investment (Porterfield, 2004). Conceptual severance is accepted, opening the door for strategic organization of business and its location. Decreasing the value of an asset through public-interest regulation may also open the door for compensation.

At the international level, investor-state arbitrations and the literature on this question go in divergent, irreconcilable directions, are often based on predisposed ideological views on property rights and regard governmental regulations in general as often unnecessary interferences with private activity. For example, according to Mann (2005), the final award in *Methanex Corporation v. United States* (awarded on August 9, 2005) cannot be reconciled with the decision on expropriation in *Metalclad Corporation v. Mexico* (awarded on August 30, 2000). This in itself has left many governments confused about the state of the law and to how much of the traditional State right to regulate is removed by the broader claims for the definition of expropriation.

2.3.3 Fair and equitable treatment

Fair and equitable treatment is an absolute standard defined by international law, not on a comparative basis with the treatment of domestic or other foreign investors. However, while it is not a comparative standard, it is intended to be a contextualized standard requiring fair and equitable treatment to be determined in the light of all the facts and circumstances. What is necessary is that the fair and equitable standard must also be seen in a relational manner, requiring treatment that is fair and equitable as between the different rights, obligations and interests of all the stakeholders, not just the foreign investor. The precise nature of this standard is far from clear. Sometimes it is

argued that the standard has been designed as a residual rule when all other norms of international liability do not apply. Therefore the standard would be ad hoc justice, or justice based on equity (Dolzer, 2005; Barraguirre, 2005).

The sources of the standard, on the other hand, have been questioned. The minimum standard of treatment has always had a highly indeterminate content. The standard—and its minimum and equitable treatment component—is the focus of significant controversy, due to its emergence as the most frequently invoked standard of protection in investor-State arbitral disputes.

Increasingly, it is emerging as a form of administrative law standard, invoking elements of transparency in decision-making, due process and the right to be heard, access to administrative or judicial review of decisions, plus liberal doses of fairness and equity in treatment. Patent abuses of administrative decision-making functions will fail this test, but lesser types of abuses, such as a failure to allow an appeal of a decision to be heard, may also fail the test. There is some evidence today that the test will be "scaled" by arbitrators to the level of development of the government in question, but there is no conclusive legal view on this question.

The minimum international standards/fair and equitable treatment tests may also be applied to decisions taken without any abuse of process. In particular, decisions that run counter to explicit or even implicit assurances given by a government official may also fail to meet the standard. An increasingly applied test in this regard is whether the government action or decision is consistent with the "legitimate expectation of the investor," a subjective standard that provides considerable scope for the investor to determine.

In water terms, some examples of the potential breach of this standard could include an increase in water tariffs if none is foreseen in a license or the legislation underpinning a license, increased pollution controls that impact the profitability of a business and that are not clearly provided for in legislation underpinning an investment, reductions in water allocation levels for a water-intensive investment not foreseen in the initial operating decisions, or changes in water service provision contracts that impose increased service requirements, such as universal service. Where express assurances have been given that operating conditions will be maintained for a given number of years, changes to those conditions will found a basis for a claim. The absence of an express assurance will not, however, preclude a claim on this basis if there is no pre-existing regulatory base that foretells the right of government decision-makers to make later changes. In all cases, the presence or absence of a transparent decision-making process, founded in sound administrative practice, will be a very significant factor. Thus, following a pre-designed decision-making process will reduce chances for investor challenges of the result, while ignoring pre-designed procedures or not having any transparent procedures in place will increase them (Mann 2006).

As in the case of expropriation, not much comparative law research has been done regarding domestic law in relevant countries and the principle of fair and equitable treatment as developed by arbitration decisions. The exception, again is the U.S. It is argued that the standard is not a legitimate norm of international law, as it lacks a clearly defined content. This defect cannot be cured by conferring the authority to define the contents of the standard to ad hoc arbitral tribunals or to appellate bodies. A greater degree of legal certainty is needed for areas of such critical social regulation as the environment, public health and community rights (Porterfield, 2006).

Many experts in the United States argue that non-delegation principles would be violated if international decision-makers were able to create a continuously evolving international common law of foreign investor rights discretionally (Porterfield, 2006). This lacks the legitimacy of State consent. Furthermore it is not rooted in customary practice, but in decisions of international investment tribunals that are creating their own law, whereas the binding sources of international law are treaties and custom, not the jurisprudence of tribunals. In addition, it lacks the specificity required regarding binding customary international law.[5] It also collides with domestic interpretations of substantive due process, since it affords a more aggressive review of economic legislation (requirement of a stable business environment) than present domestic legislation (which allows changes, as circumstances change, within certain limits).

2.3.4 Ignoring regulatory concepts =

In Indonesia, the Karaha Bodas Power Company sued the Government for the actual investment—US$96 million—but also for expected future profits, totalling US$512.5 million. Indonesia argued that the project was not finished, that with the Asian crisis the company would not have been able to raise the necessary funds and that profits should not be awarded to investments not made. The country also argued that expenses effectively incurred were wasteful. The court accepted the expenses, even if wasteful, since they had been "openly declared" and were therefore not "questionable." It also granted lost profits in an amount of US$150 million. By collecting lost profits the company is better off if the project fails, than if it is successful. The investor can now invest compensation and lost profits, and collect interest on a larger capital base. The same would happen if, when a bank fails, a saver were granted compensation for capital, and paid for lost future interests. But the US Federal Depository Insurance Corporation does not pay future interests when a bank fails (Wells & Ahmed, 2007).

[5] In the United States, the federal courts have recognized the need for international rules to have well-defined content by declining to give domestic legal effect to vague international legal standards (Porterfield, 2006). In *Sosa v. Alvarez-Machain*, the Supreme Court rejected a claim brought against the United States based on an alleged violation of customary international law, on the grounds that the purported customary standard lacked sufficient "specificity" to be enforceable in the United States courts: "Whatever may be said for his broad principle, it expresses an aspiration exceeding any binding customary rule with the specificity this Court requires […] we think courts should require any claim based on the present-day law of nations to rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms we have recognized. This requirement is fatal to Alvarez's claim" (United States Supreme Court, 2004).

It is important to note that in Karaha, the claimant, was a power company. In regulatory public utilities, law providers of public utility services cannot claim wasteful expenses or profits on property that is not used and utilized (Phillips, 1993).

In the case *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A v. Argentina Republic.* (ICSID Case no ARB/03/19, registered on 2003) a water purveyor is demanding compensation for the alleged impact on its business of the general economic emergency measures adopted by the Argentinean Government during the 2002 economic crisis. Furthermore, in May of 2005, an International Centre for Settlement of Investment Disputes (ICSID) tribunal issued its award in the arbitration between United States-based CMS Gas Transmission Company, a 29 per cent shareholder in Argentine natural gas transporter TGN, and Argentina. The tribunal found Argentina liable for violations of the United States-Argentina bilateral investment treaty, as well as of its contractual commitments, as a result of measures taken by the Argentine government in response to that country's financial crisis, including a freeze on public utility rates.

By comparison, during the crisis of the 1930s the U.S. government and its courts upheld emergency regulation of public utilities without a right to compensation. Thus, "during the depression years of the 1930s, the [United States Supreme] Court recognized the decline in interest rates and in business earnings throughout the country, and was willing to accept lower rates of return" (Phillips, 1993).[6]

As in the case of expropriation and fair and equitable treatment there is no comparative law study assessing differences in the treatment of public utility issues in the domestic public law of a number of representative countries, and the decisions of international arbitration courts.

2.3.5 Jurisdiction over contract disputes and umbrella clauses

The acceptance of jurisdiction by international arbitrators has obvious advantages for investors. Questions are submitted to courts created by investors, and by investors only, in a clear example of a monopsony services markets. Governments can not resort to international investment arbitration.

International investment arbitration has some very significant advantages for investors. Their rights are precisely identified, beforehand. The procedure does not include appeals. The substantive principles accepted by arbitrators differ, as seen before, from the domestic law principles that

[6] In the *Federal Power Commission v. Natural Gas Pipeline Co.* case of 1942, the United States Supreme Court argued that "the evidence shows that profits earned by individual industrial corporations declined from 11.3% on invested capital in 1929 to 5.1% in 1938. The profits of utility corporations declined during the same period from 7.2% to 5.1%. For railroad corporations the decline was from 6.4% to 2.3%. Interest rates were at a low level on all forms of investment and among the lowest that have […] ever existed. The securities of natural gas companies were sold at rates of return of from 3% to 6% with yields on most of their bond issues between 3% and 4%. The interest on large loans ranged from 2% to 3.25%. The regulated business here seems exceptionally free from hazards which might otherwise call for special consideration in determining the fair rate of return" (United States Supreme Court, 1942).

national courts would apply on exactly similar questions. While investment arbitration has expanded into formerly domestic matters, their rulings are presided over by the principle to protect the investor, other considerations being ancillary. Social stability, economic crisis and environmental considerations do not operate with the same hierarchical status they have had in the development of public domestic law.

Opening a case to international jurisdiction does also have significant impacts regarding arbitrators. Without jurisdiction there is no case, and without a case there are no, or very scant, honoraria.

It is therefore a foregone result that in most cases arbitration courts accepted their jurisdiction on cases. In an interesting survey done by Franck (2007), she found that investors won all jurisdictional arguments, except in 11.58 per cent of cases.

Thus, Argentinean public utilities contracts included agreed provisions on national jurisdiction. Yet, there is no single definitive ruling where Argentina has won the jurisdictional argument.

The problems of jurisdiction are aggravated by umbrella clauses and jurisdiction shopping. Many international investment agreements include what has become known as an "umbrella clause." With some variation on the theme, an umbrella clause is one that says a host state must comply with all the obligations or agreements it has entered into with an investor. This very broad language has now been interpreted to make any breach of a contract, agreement, license, permit, etc. by a host state a matter of international law under the agreement in question.

Investors can also use the most preferred nation clause of investor's agreements to look for agreements, not originally signed by their home country, but to which the host state is a party, which better serve their interests.

2.4. Problems with the dispute settlement process

2.4.1 Arbiters' conflicts of interest

Decisions resulting from international arbitration processes have the potential to affect the well-being of millions of people. It suffices to mention the US$19 billion currently included in arbitrations, or possible arbitrations, against Argentina alone, to give an idea of the magnitude of the issue. Yet, arbitration procedures can only be created by investors, creating market incentives to satisfy the users that demand their services. Furthermore, arbiters can act as lawyers in some cases and arbitrate other cases, with opportunities and incentives to decide cases with a view to create precedent in the ones they act as lawyers. The procedures (secrecy, initiated only by investors, without appeals) and the criteria (focused on the protection of foreign investors only) applied by arbitration tribunals are not commensurate to the importance of their impact.

Thus, the new "Global Constitutionalism" has the potential to profoundly alter domestic constitutional balances (Young, 2003, p. 2).[7] It has, in fact, added a new dimension to traditional concerns about government intervention. Commenting on NAFTA, public interest lawyers in the U.S. now worry that the basic objective of its conflict adjudication rules is to create, on worldwide basis, broader immunity for business from legislative and administrative controls, including environmental requirements (Echeverria, 2003, p. 29).

Companies also use arbitration to insulate themselves from the risk of doing business. Claiming damage from Argentina's decision to let the peso float in 2001 and 2002, at least 27 companies have filed for arbitration—even though the decision was arguably necessary to fend off an economic depression and even though ordinary Argentineans suffered greatly during the crisis (New York Times, 2004).

The special regime that has been created favours foreign investors over national citizens and investment over social and environmental values. The system is based on the expansive interpretation of a limited set of investors' protection principles, which are given a higher priority than public policy motives and needs of host countries.

2.4.2 *Ad hoc nature of proceedings and procedures*

The review of the substance of arbitration decisions, and the procedural system from which they emanate, reveal that they have many ad-hoc features that may be attributed to the focus of the system-protection of investors rights; the drafting of investment agreements without reference to investors duties; and the procedural features of the arbitration process, which is exclusive resort of investors.

2.4.3 *Substance*

Present investment agreements have been precise when defining the rights of investors. They usually include nothing regarding their duties of due diligence, good faith and efficiency when dealing with the important subject of utility services, transparency, compliance with rules of art, and the like.

The main gaps between international investment principles and national principles include:

> **Expropriation:** Investment arbitration has lower standards of infringement on private property rights and greater protection of foreign investors' property rights than expropriation law in relevant countries.

[7] While the original assertion refers to the U.S. system, its rationale applies to every country.

Fair and equitable treatment: Investment arbitration brings in higher standards of government conduct and protects the economic interests of foreign investors beyond the contents of traditional due process in relevant countries.

Regulation of public utilities: Investment arbitration disregards basic principles accepted by the national regulatory law—such as useful property, reasonable expenses and control of transfer pricing—of relevant national regulatory systems.

National economic crisis: Investment arbitration has frequently disregarded economic crisis, except when it is related to national security and specifically considered by investment treaties, ignoring relevant comparative law on economic crisis, such as American, German, French, and British law and jurisprudence at times of economic crisis.

Public policy principles, such as good faith and unconscionability, are given erratic consideration by investment arbitration, as a result of the dearth and uncertainty of principles regarding the duties of investors. The considerations of these principles do also suffer due to the characteristics of the arbitration process (issues of corruption are not usually brought up by governments or investors, and restrictions on third party participation affect their consideration).

2.4.4 *Procedural*

Most of the procedural features of the investment arbitration system have already been explained, including the sole-party (investor) ownership of the right to initiate an action, lack of appeals, scant transparency, potential for conflictive rulings and potential for conflict of interests.

It is, however, important to note other restrictive features of the system, such as the secrecy of the procedures and the lack of participation of third parties (only four cases have allowed amicus curiae briefs: (Methanex[8]; *Glamis*[9]; *Biwater Gauff v. Tanzania;*[10] and *Suez, Aguas de Barcelona and Vivendi v. Argentina*[11]). The closed nature of proceedings assures that issues of corruption will not be heard, except in the unlikely case of serious conflicts between the agents of defendant governments and former government predecessors.

Conflicts of interests are mostly addressed through self regulation, which in the view of regulatory law experts is the first step towards system capture, since professional associations are highly

[8] *Methanex Corporation v. United States of America* (final award on August 9, 2005).
[9] *Glamis Gold Ltd. V. United States of America* (final award on June 8, 2009).
[10] *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* (final award on July 24, 2008).
[11] *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case Nº ARB/03/19).

effective pressure groups (Ogus, 1994, pp. 107, 109). The sole party (investors) right of initiation of actions obviously enhances the chance of system capture and self-interested decisions.

There is a lack of proportion between the present arbitration system and the magnitude of the issues it adjudicates. It is as if the most important issues associated with economic crisis, governance, public utilities and environment in Germany, France, the U.K. and the U.S. had been handed over to commercial firms, instructed to protect only one set of interests, with no appeals and procedural secrecy.

While investors may be right in doubting the impartiality of domestic courts in national systems known for low governance standards and corruption, there is little objective justification for the development of substantive criteria that protect investors disregarding known common practices in countries whose legal systems have resulted in a balancing of interests, ensuring the sustainability of their social and economic fabric, when addressing questions of due process, property rights, public utilities, environment, economic crisis and common interest contract practices.

International investment law has advanced into areas where there are plenty of substantive precedents elaborated by reputable national courts. If there may be some justification in the argument that national courts may not be reliable, there is no ethical or economic argument to impose on host countries higher duties and standards than the ones an investor would find at home. Or conversely, to consider—however implicitly—that the national inhabitants of host countries deserve less protection than the citizens of countries home to the investors.

To the contrary, the lower standards of knowledge in developing countries, the lack of definite investor duties and the impossibility for countries to initiate proceedings—creating a monopsony of services—weakens any ethical argument, while the risk insurance aspects of investors rights and ad-hoc nature of proceedings create moral hazard risks that compromise the economic rationality of investments, and preserve inefficient investments.[12]

In fact, Franck (2007) finds that, in a representative sample of 82 cases and 107 investors, 88.9 per cent of investors came from OECD countries, and that 61 cases were initiated by the U.S., Canada, France, the U.K., the Netherlands, Spain, and Italy. Yet international protection arbitration has developed investor's protection standards that are well above the standards afforded by developed countries that are home to investors. The gap is difficult to rationalize.

[12] How reasonable was it to invest in the castle of cards that was the Argentinean economy?

3.0 Comments to the Text of the Checklist

3.1 Private investment

The checklist is about the optimization of private investment in water infrastructure, and paragraph 4 makes clear that governments seek to involve private participation in financing infrastructure. Yet, the inadequate consideration of sector economics has been a serious hurdle in of the processes of privatization in many developing and transition economies. It has also been a failure of technical assistance given by international advisers, including the financing institutions (Kessides, 2004).

Part of the problem was that the strong political impetus of the privatization process did not allow enough opportunity or interest to study the economics of the business. Governments and international financing organizations thought that they could completely transfer the responsibility for water supply and sanitation to the private sector.

The fundamental economic characteristics of the water industry where disregarded, as well as the fact that it is very capital intensive (12:1; 10:1). This means that it is three to four times more capital intensive than the electric industry and five to six times more than railroads, with low returns to investment These basic facts should have raised questions about the willingness of private sector to invest on behalf of the poor in poor countries (National Public Works, 1987, cited in Haarmeyer, 1994, p. 48).

The checklist rightly points out that the private sector prefers to concentrate on low risk contracts, such as service and management contracts (para. 15). Yet, under some structural conditions, the private sector has been willing to invest. They include, among other things, the size and condition of assets, the quality of exiting public providers, the quality of information, etc. A more detailed analysis of cases where such structural conditions have resulted in sustainable private investment may be usefully incorporated into the checklist, with a view to contribute to the development of realistic criteria regarding sustainable private investment.[13]

On the other hand it is also important that the checklist include more information, or at least references, on the regulatory needs of service and management contracts. This is an area where there

[13] "A la hora de privatizar las empresas, éstas ya eran eficientes (y por consiguiente, existía buena y confiable información sobre el estado de la infraestructura, y su operación y mantenimiento) y ya estaba construida gran parte de las redes de agua potable y alcantarillado, así como las obras mayores de producción y distribución. Dado que la construcción de nuevas redes tiene un importante factor de incertidumbre, puesto que su costo depende de las características de los terrenos sobre los cuales se instalan (condiciones geológicas y topográficas, densidad y características socioeconómicas de la población, etc.), el hecho de ya estar construidas resuelve estos problemas. Si las redes ya existen, se conoce cuánto la población paga, cuánto consume, qué problemas de facturación existen, etc., y además no hay conflictos sobre qué zona priorizar en la expansión. Además, se trata de un regulador con experiencia e información" (Valenzuela & Jouravlev, 2007)

is not much information. Management and service contracts are much used in France. An interesting report of the Cour des Comptes of France (1997) has pointed out the issues affecting the water industry in France. They include limited technical and financial capacities at the local level, lack of contractual precision and clarity, lack of effective competition, information shortcomings-mostly affecting users and public officers, weak public controls, lack of consultation, excessive use of direct negotiations, long term contract leading to perpetual incumbents and intra-holding contracting (price transfers).

The checklist development work may be the basis for a more detailed itemization of the issues affecting service and management contracts, and consequent regulatory needs.

3.2 Decentralization, efficiency, economies of scale and scope

The checklist conveys the customary message that water and sanitation are local issues, calling for local management (para. 16). In paragraph 43, there is an implicit assertion of the "efficiency" of decentralization. These assertions may be misleading, as decentralization and fragmentation increases costs.

The water industry is highly prone to economies of scale and scope. The difference in the costs per unit between large and small systems can be 1 to 8 (Phillips, 1993). While developed countries with full coverage may forget this feature of the industry, developing countries, short of capital, trying to make up for centuries of neglect and ignorance, cannot afford to ignore it. It may be the difference between covering the entire population in 10 years or doing it in 80 years.

The French expert Jean-François Vergès (2005) succinctly made a point on the importance of scale and scope economies:

> Water supply, sewerage and waste treatment services are the oldest public utilities, as old as the city in human history. They remain almost total natural monopolies in contrast to those of electricity, garbage collection, telecommunications or urban transit. Therefore, it is necessary to have strong regulation to compensate the absence of market competition. Water supply, and particularly sewerage and waste treatment, requires, along with urban transport, the highest capital investments of all public utilities: about 25 times annual revenues. Our grandparents paid much of the present capital tied up in services in developed countries. Even so, capital costs remain half of total costs. Developing countries are trying to make the same effort in a few decades, perhaps too ambitiously, given inadequate long-term financing. This only leads to underfinanced systems that provide water for only a few hours a day.

> The horizontal structure of the water and sanitation industry in France results in grave inefficiencies. For example, in France municipalities are not optimal operating areas. Extreme vertical desegregation produces serious efficiency problems, when, as in France, it leads to only 3,000 population for each concession contract compared to hundreds of thousands in Chile and millions in England. Moreover, it has led to an oligopoly of the 3 largest private providers who confront thousands of small public authorities without coordination or technical assistance (the global situation is little better). (p. 12)

The checklist would increase its usefulness to users and developing countries by being more specific on the subject of scale and scope economies, transaction costs, their crucial importance to developing countries and the costs of decentralization. It should also illustrate in more detail the cases of England and Chile, which have tried to make full use of economies, their justification and their results. While there are some references to the subject in principle 10, which mentions tradeoffs between local empowerment and economies of scale and costs, the subject is not developed to its full importance.

3.3 Contract regulation and legal regulation

One of the limitations of the checklist is that does no seem to have done enough research on comparative regulation, therefore missing some important findings of American experience and regulatory theory. In addition, it strikes an uneasy balance between different regulatory alternatives, whereby contract and legal regulation seem to be equally valid alternatives, self-regulation is an equally valid option, and the addressees of the checklist (governments) are warned on the possible negative consequences of regulating (para. 40). It does not however, elaborate on the possible negative consequences of not regulating.

It would be beneficial if the checklist did some analysis of the regulatory literature regarding contract regulation in the U.S., in order to provide realistic, experience-based information to its addressees (governments). Speedy privatizations, anti-government and anti-regulatory bias prompted financial organizations and governments to regulate through contracts. Many developing countries enact weak and general regulations that generally referred—and still refer—to contracts for final specifications.

A recent regulatory draft for the Dominican Republic had very scant regulatory principles and referred every important decision to contracting, therefore facilitating the process of capturing the regulatory system, as seen below. Contract (i.e., franchising) regulation is fraught with problems, and is not in the public interest. The sponsors of privatization did not transfer existing international experiences to the countries they were steering.

From the end of the nineteenth century through to about 1920, public utility regulation relied on franchising (contracting) in the United States. In the early twentieth century, this approach was abandoned in favour of state regulatory commissions. In a book entitled *The Regulation of Public Utilities: Theory and practice,* Charles Phillips (1993), a well-known and respected American writer, gives the following description of experience with franchising in the United States:

> While use of the well-drawn franchise had some merit, in the main the franchise, as actually used, proved a defective instrument for […] regulation […] little regard was paid to the interest of the public […] franchises […] tended to be poorly drafted […]. And even when they were well-drawn, the company often benefited, since it was common for the utility's lawyers to draft the franchise and then present it to the city council for approval. Changes in the prescribed rates or in the service standards were made with great difficulty […]. As expected, the companies resisted downward rate changes, and the city councils, upward adjustments […]. Service often became poor as the termination date on the franchise drew near. The company would try to keep its investment as small as possible to avoid loss if the contract were not renewed. The agreements also failed to provide for administrative machinery to keep check on the company to see it met the terms of its franchise […]. It was often impossible […] for franchise […] provisions to be changed […]. Detailed requirements were unsatisfactory under changing conditions. (p.130–131)

In France, municipalities, of which there are about 38,000, are responsible for the provision of water supply and sewerage services. They may provide these services either themselves (direct management or *régie direct*) or by contractual delegation to a private operator (*gestion déléguée*).

In recent years, in part because of the highly critical report on the water supply and sewerage industry published in January 1997 by the Cour des Comptes (national audit office), the French government has adopted a number of measures to strengthen the regulatory framework, promote competition and improve transparency in the awarding and management of delegation contracts.
The lesson to be drawn from the discussion presented above is not that the contract approach is bad or that it should not be used when a public utility is to be privatized (in general, some form of competitive selection is usually preferable), but that **the water supply and sewerage industry will always need permanent and detailed traditional regulation**. Water supply and sanitation is a natural monopoly. In the absence of a strong regulatory capacity to protect the public interest, through rules on pricing and investment, there are dangers of monopolistic abuses (UNDP, 2006, p. 10).

This is why in the U.K. regulation consists of legal principles, to which the licences (not the contracts) to provide services have to adjust. The checklist would provide a greater service to its

addressees by being more explicit on this very important issue. Legal and contract regulation are not two equally valid alternatives. Legal regulation is needed and contracts must adjust to it. It is crucial, therefore, that principle 13—issues for governments—makes a specific reference to legal regulation, and to the need to adjust contracts to regulations. It goes without saying that countries lacking appropriate regulation should be warned about the risks of involving the private sector without regulation.

The checklist does also comment on self-regulation. In fact, regulation experts have given warnings about self-regulation. Self-regulation is the first step towards system capture (Ogus, 1994).

3.4 Price cap regulation and rate of return

Paragraph 40, Box 1.2 states that price cap regulation requires less information than rate of return regulation. At the same time it notes that rate of return may lead to overestimation of costs and overinvestment. However, in an unpublished document, John Rawls and Judith Rees, from the London School of Economics, argue that there is no empirical proof that this system is working less well than any other. Moreover, the original assumption that the price cap method would require a limited amount of information, and that a light regulatory exercise would be enough, turned out not to be true. Moreover, the process of defining the potential for rate reduction has blurred the distinction between this method and the rate of return method. Consequently, the latter has sneaked in "through the back door."[14]

It would be important to make clear that judgements regarding the relative merits and shortcomings of a rate of return and price cap regulations are not uniform, and that, in fact, when there is a need to review adjustments to price cap limits, the amounts of information required are the same. This is the reason for which the U.K. regulatory system—which adheres to price cap regulation—has so many sophisticated principles and tools regarding information duties.

On the other hand, the checklist rightly points out that rate of return has led to less renegotiation than price cap regulation. This is a finding made by Guasch, together with other findings regarding the fact the legal regulation is less prone to renegotiation than contract regulation. Guasch papers are quoted by the checklist and by this comment.

[14] "[The limited information needs of the price cap method] was its assumed advantage over the fair rate of return approach. If maintaining a clear distinction between the two systems proved to be a false hope, so also did the expectation that the price cap method would be 'easy to understand' […] there is an unresolved debate as to whether the allocatively efficient level has been attained. As regards productive efficiency, it is impossible to disentangle the effects of price control from other changes […] the institutional structure in Britain has been criticized for the weakness of its accountability and for the lack of procedural safeguards. This problem, the reliance of regulators on information provided by firms, and the history of bargaining between them all suggest that the system may not be as resistant to the influence of private interests as its proponents hoped" (Ogus, 1994, pp. 312–313).

Later on, in Principle 7, the checklist refers to opportunities for competition for the market, rightly warning that competition for the market can be circumvented. In fact, Ofwat, the U.K. water regulator, has announced that its efforts to promote competition in the sector were fruitless. The current competition regime (water supply licensing) is not working. In more than two years not one of the 2,200 eligible business customers using 50 megalitres a year have switched suppliers (OFWAT, 2008).

3.5 Fiscal discipline and transparency

Principle 4 refers to the tradeoffs between fiscal discipline and transparency, and warns about the tradeoffs between guarantees to investors and contingent fiscal liabilities. It could be important to provide examples on this matter. Argentina, for example guaranteed exchange rates, creating a moral hazard risk, whereby the concessionaire bought inputs and incurred debt outside Argentina. The guarantee did not improve the efficiency of the concessionaire, and was a relevant factor in the final collapse of the contract, since it gave incentives to non-sustainable practices, including transfer price with foreign related companies.[15]

Chile, on the other hand, does not accept exchange risk guarantee, precisely because of the impact that it would have on efficiency and sustainability. Water is a local service that should be locally affordable.

A related comment relates to sub-sovereign lending a borrowing. Borrowing by local units was an important factor behind the Argentine crisis. The issue of local autonomy to borrow in international markets should be very carefully managed, considering contingent liabilities. Principle 8 should be carefully considered in light of the complexities of adding local debts to national liabilities.

3.6 Principle 14 and information

It is not clear that the principles of information and due diligence apply to both, governments and private companies. It should be clear that this is a principle that applies to all stakeholders, public or private.

3.7 Regulatory bodies

It is important that Principle 17 includes the comments on contract regulation and self-regulation, considering American and British experiences. Also, references to holistic approaches are very

[15] In the case of Aguas Argentinas, an auditing carried out by Halcrow on August 15, 1997 concluded that the works of the first three years of the five years plan were generally directly contracted with companies related to Aguas Argentinas. Prices could have been lower if contracts had been grouped. Comparing prices with similar water works, budgets were generally higher than the references.

important, but they may be of little help to countries trying to set a critical path regarding strategic issues. It is important to make comments on regulatory issues and problems affecting the sector in the experience of developed and developing countries to suggest what have been critical matters in regulation and litigation.

An initial listing for legally well-resourced and competent regulators should include:

- Ex post regulation is valid when specific activities are vested with a public interest, provided that purveyors are not forced to work at a loss (confiscation);
- Public utility purveyors have a duty of due diligence and good faith;
- Public utility purveyors have a duty of efficiency and efficiency gains have to be transferred to users;
- Utilities can not charge for property that is not usable and used;
- Property has to be properly valuated;
- Operational expenses have to reflect market values and shall be reasonable;
- There are limits to debt financing;
- Rates and profits have to be reasonable and fair;
- Purveyors have a right to make a reasonable profit, but in systems such as the American one, actual profits are not guaranteed;
- Services are subjected to quality requirements, including environmental impacts;
- Transfer pricing is controlled;
- There are duties of information and disclosure, backed with penalties for misrepresentation;
- Tariffs and Rates vary with the economy, and economic crisis and excess profits justify specific regulation;
- Governments can force access to essential facilities;
- Governments may, under specific conditions, require structural arrangements to promote and enhance economies of scale and scope.

The power of governments to regulate to control monopolies, preventing abuse of dominant position, curbing negative externalities and promoting common well-being is found in most of the world's legal systems and is an important tool for social and economic balance. Such power is globally accepted, not only in relation to public utility services, but also in connection with resources such as water: Cut offs of riparian rights on water have been considered a reasonable regulation under the state's police power (Lauer, 1963).

3.8 Renegotiations

The duty of good faith, transparency and non-discrimination of principle 18 should clearly apply to

both governments and private parties.

3.9 Responsible business conduct

Principle 20 is a call for responsible business conduct. It suggests that the checklist applies to both government and private parties. Principle 21 calls for the good faith and commitment of private parties (although it misses the fundamental duty of efficiency). Principle 22 calls for private parties to fight corruption. Other calls for private sector behaviour and conduct relate to social consequences of actions (Principle 24) and communication with consumers (Principle 23). It may be necessary to change the addressees of paragraphs 11 and 12 to include private parties and their duties.

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