IN Case No. ARB/05/22 before the
International Centre for Settlement of Investment Disputes

BETWEEN
Biwater Gauff (Tanzania) Limited
and
United Republic of Tanzania

AMICUS CURIAE SUBMISSION OF:

The Lawyers' Environmental Action Team (LEAT)
The Legal and Human Rights Centre (LHRC)
The Tanzania Gender Networking Programme (TGNP)
The Center for International Environmental Law (CIEL)
The International Institute for Sustainable Development (IISD)

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AND
UNITED REPUBLIC OF TANZANIA

CONTENTS OF SUBMISSION

1. INTRODUCTION

1. The present submission by *Amici* is being made pursuant to Procedural Order No. 5 of this Tribunal, issued on 2 February, 2007. This submission has been prepared under the terms and conditions specified by the Tribunal in that order. A brief note on the practical impact of these terms and conditions on the preparation of this submission follows in the introduction.

2. *Amici* wish to note with appreciation the effort made to accommodate this submission by the Tribunal and the parties. We note that this is the first of what may be two submissions to the Tribunal, should the Tribunal determine that the issues raised and process followed to date make a second round of submissions appropriate, and look forward to the decision of the Tribunal on this.

1.1 The broad background to the privatization contract

3. The background to the current dispute goes back long before the negotiation of the contract that underpins the current arbitration. Until 1991, water was a free service in Dar es Salaam. From 1991, the Government of Tanzania began the process of removing subsidies to move the water service sector to a self-financing footing. Managerial problems, financing problems and other circumstances, including droughts and floods, prevented significant progress in the early efforts. In 1997, the government created the Dar es Salaam Water and Sewerage Authority (DAWASA) as a quasi-commercial parastatal agency. In 1999, it passed a Water Law allowing for the privatization of DAWASA's operational activities. In 2001, legislation was passed to establish an

independent Energy and Water Utilities Regulatory Authority to govern the provision of water services in Dar es Salaam. Despite these changes, service levels and coverage failed to improve in a significant way and to keep up with growing demand. The social and health impacts of the water system became increasingly serious.

4. In 1997, the Government began to look for a private operator to take over major responsibility for water production, transmission, distribution, billing and collection. This approach was not only supported but in fact mandated by the World Bank and other donors. In March 2000, the World Bank and the International Monetary Fund made the signing of a concession agreement assigning the assets of DAWASA to private management companies one of the conditions for Tanzania to qualify for debt relief under the Heavily Indebted Poor Countries Initiative. Similarly, the World Bank's 2000 Country Assistance Strategy required Tanzania to meet the same conditions in order to qualify for greater annual loans.

5. Tanzania's search for a private partner began in mid-1997 and took a full 6 years to conclude, going through two phases, with two rounds of bidding in the second phase. In the second round of the second phase, the Claimant was the only bidder, and was ultimately awarded a 10-year lease contract in February 2003. Since that time, however, there appears to have been no improvement in some areas of the operation, deterioration in others, and significant lack of required progress in yet others. A succinct summary is provided in a report on the Dar es Salaam privatization by a former World Bank expert on privatization processes:

> *The primary assumption on the part of almost all involved, certainly from the donor side, was that it would be very hard if not impossible for the*

private operator to perform worse than DAWASA. But that is what happened.[1]

6. On 13 May 2005, after months of negotiations, mediations, renegotiations and other efforts, and faced with continued deterioration in the water service, the Government announced that the lease contract was terminated effective from that day. The termination of the contract presumptively created the necessary legal pre-condition for the initiation of this arbitration.

1.2 Overview of the legal arguments of *Amici*

7. This arbitration raises a number of issues of vital concern to the local community in Tanzania, as well as for other developing countries that have privatized, or are contemplating a possible privatization of, water or other infrastructure services. The arguments presented below reflect the primary concerns of *Amici*: human rights and sustainable development. The legal starting point for the present submission is not, however, general principles of human rights law or sustainable development. Rather, it is the basic premise set out in numerous investment arbitrations to date:

> *… that Bilateral Investment Treaties are not insurance policies against bad business judgments.*[2]

8. From the facts *Amici* have been able to gather, it appears that in the present case the failure of the Claimant's investment was closely related either to a lack of business

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[1] Rühl, Christen, Gökgür, Nellis, *United Republic of Tanzania: Privatization Impact Assessment – Infrastructure*, 21 July 2005, p. 27. The report was the output of a technical assistance and dialogue mission financed by the Private Participation in Infrastructure Advisory Facility (PPIAF) of the World Bank at the request of the Government of Tanzania. The primary objective of the mission and the report was to support the review of infrastructure privatization in Tanzania commissioned by the President of Tanzania.

[2] *Maffezini v. Spain,* Case No. ARB/97/7, Award of 13 November 2000, 16 ICSID Rev-FILJ 248 (2001) at para. 64.

competence and acumen, or to a business strategy to force a renegotiation of the contract shortly after it entered into force. Both of these possibilities have significant legal consequences under international investment law. *Amici* will argue that these consequences are amplified in the face of a major water privatization project that directly affects the human right to clean and safe water, and the capacity of a society to pursue its sustainable development objectives.

9. The arbiters of international investment law, when considering whether an investor's rights have been infringed, must have regard to the investor's execution of its own responsibilities and duties. This argument is not novel. Existing investor-state case law and emerging doctrine support at least three specific investor responsibilities:

- the duty to apply proper business standards to the investment process, including proper due diligence procedures;
- the duty to observe the principle of *pacta sunt servanda;* and
- the duty to act in good faith both prior to and during the investment period.

10. *Amici* will examine each of these legal responsibilities under international investment law in light of what we surmise to be the facts involved in the present dispute. *Amici* will suggest that the investor may not have fulfilled these responsibilities, thereby endangering both its own investment and the people of Dar es Salaam's access to water. *Amici* will demonstrate that if the Tribunal determines that in fact these responsibilities have not been met, then legal consequences must flow from such a finding. *Amici* will then show that the responsibility of the investor, based on good faith as an underlying principle, requires that there be no hidden business strategy of seeking to renegotiate the contract shortly after it is completed and other potential bidders are "out of the way".

Drawing on literature from senior World Bank economists and others, *Amici* will note several indicators that point to such a strategy having been at play in the present instance. It will then show that, if this is in fact the case, it must have significant legal consequences in the present arbitration. Both of these levels of argument link directly to the human rights and sustainable development concerns that motivate this submission. *Amici* will demonstrate that these links were well known to the Claimant, the water sector in general, and to the Government of Tanzania.

11. *Amici* will show that the right to water and to pursue sustainable development goals, so fundamental to developing countries, should be understood to increase the standards of responsibilities of investors in the water sector. The provision of water services in developing countries is not, and cannot be understood as, just another business venture. When investors choose to enter into this sector, they encumber themselves with responsibilities that are linked to the achievement of essential human rights. This Tribunal has both the authority and the responsibility to enquire into whether these responsibilities have been fulfilled, and to consider the legal consequences if they have not been fulfilled.

1.3 Impacts of the limitations in Procedural Order No. 5

12. Procedural Order No. 5 imposed specific conditions pertaining to this *amicus curiae* brief. For present purposes, the most important of these was that the request in the original petition for *amicus curiae* status to have access to the arbitral record was denied. The Tribunal indicated, instead, that the *Amici* were to rely on documents in the public domain, press reports, etc. We have done so. In order to balance this limitation, the

Tribunal indicated that a second round of submissions may be invited following the oral hearings in April 2007, should the Tribunal determine this is warranted.

13. *Amici* wish to note that the inability to access the proper factual record has necessarily meant that the present submission is based on an incomplete set of factual information. *Amici* have made a significant effort to obtain documents from public sources. Considerable industry has been used to create a platform that is as informed as possible in the circumstances. Despite these efforts, however, the factual basis will still be incomplete. The arguments made below, therefore, are based on what we have been able to obtain, and certain assumptions we have made from that information. But we have made every effort to stop short of asserting facts where we are not able to verify them. Undoubtedly, there will, as a result, be flaws in the facts discussed below, and other instances where *Amici* are able only to suggest possible factual situations to the Tribunal, and the legal implications that may flow from them if the facts suggested are borne out. We trust that the parties and Tribunal will approach the arguments with an understanding of these limitations.

14. Similarly, *Amici* remain unaware of the legal arguments being made by either party or the facts they allege to support them. We therefore make no comment herein on either party's arguments. Finally, *Amici* wish to note that this submission is without prejudice to any views they might wish to express on jurisdictional issues that might be raised in this case, if any. *Amici* have not seen any arguments in this regard, and this submission should not be read as accepting or agreeing with any positions on such arguments as may have been made by the parties.

2. THE LEGAL ARGUMENT FOR INVESTOR RESPONSIBILITIES IN THE SUSTAINABLE DEVELOPMENT AND HUMAN RIGHTS CONTEXT

15. This section sets out the arguments on investor responsibilities. Section 2.1 reviews the general argument from the emerging case law. Sections 2.2-2.4 develop specific applications of the general principles relevant to the present arbitration: the duty to apply proper business standards to the investment process, including proper due diligence procedures; the principle of *pacta sunt servanda;* and the duty to act in good faith both prior to and during the investment period. Section 2.5 then elaborates on the need to understand the impacts of sustainable development and human rights when assessing claims brought under investment treaties.

2.1 The general principle of investor responsibilities

16. The first element in the principle of investor responsibilities lies in the dictum already noted: investment agreements are not an insurance policy for bad business decisions and practices, nor for all the negative impacts of governmental actions or activities. For example, in *Maffezini v. Spain*, the Tribunal stated rather starkly that:

> *… Bilateral Investment Treaties are not insurance policies against bad business judgments.*[3]

And in *MTD v. Chile*:

> *The BITs are not an insurance against business risk….*[4]

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[3] See, e.g., *Maffezini v. Spain*, *op. cit*., at para. 64; cited expressly with approval in *Eudoro Armando Olguin v. Republic of Paraguay*, ICSID Case No. ARB/98/5, Award, July 26, 2001, at para. 73.
[4] *MTD Equity v Chile*, ICSID Case No. ARB 01/7, Award, May 25, 2004, at para. 178.

Taking this a little further, the very first decision under NAFTA's Chapter 11 on Investment noted that:

> *It is a fact of life everywhere that individuals may be disappointed in their dealings with national authorities, and disappointed yet again when national courts reject their complaints…. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.*[5]

17. This limitation of not using investor-state arbitrations as an "insurance policy" is complemented by a second limitation: investors are expected to be intelligent and aware of the environment into which they are investing. This includes the general legal, political and administrative culture. In *Olguin v. Paraguay*, the tribunal observed that it was not reasonable for the investor, an accomplished businessman who was well aware of the political environment of Paraguay where he was investing, to seek compensation for his losses in a "speculative, or at best not very prudent" investment through the investor-state process.[6] Similarly, in *Genin v. Estonia*, the tribunal makes the following introductory statement to its analysis of the fair and equitable treatment claim in that case:

> *348. We turn now to the crux of the case to be determined…: the revocation of EIB's license. In doing so, the 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 in an Estonian financial institution, EIB.*[7]

[5] *Robert Azinian et al v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Final Award, November 1, 1999, at para. 83.
[6] *Eudoro Armando Olguin v. Republic of Paraguay*, ICSID Case No. ARB/98/5, Award, July 26, 2001, at para. 65b.
[7] *Alex Genin, Eastern Credit Limited, Inc v. Republic of Estonia*, ICSID Case No. ARB/99/2, Award, June 25, 2001, at para. 348.

18. This view has not been expressed solely with respect to developing countries or states with economies in transition. It appears equally in the decision on the merits in *Methanex v. United States:*

> *9. Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons. Indeed, the very market for MTBE in the United States was the result of precisely this regulatory process ….*
> *10. Methanex entered the United States market aware of and actively participating in this process.*[8]

19. These decisions make it clear that investment agreements cannot be relied upon as a bulwark against factors that investors should know about through good business practices, including the general political economy surrounding the investment. These decisions also make it clear that investors remain responsible for their own actions and omissions during the investment-making and investment implementing processes. This was succinctly stated by the tribunal in *MTD v. Chile*:

> *…the Tribunal considers that the Claimants should bear the consequences of their own actions as experienced businessmen.*[9]

Similarly, in the *Genin v. Estonia* decision, the tribunal stated that:

> *… , the officers of EIB [the investor] who conducted the negotiations regarding the purchase of the branch clearly acted unprofessionally and,*

[8] *Methanex v. United States of America*, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, at Part IV Chapter D, p. 5, paras 9-10.
[9] *MTD v. Chile, op cit*., para. 178.

> *indeed, carelessly… The responsibility for the result of EIB's conduct, including its omissions, is EIB's alone.*[10]

20. It is worth noting that the general principle of investor responsibility is also found in one of the few decisions of the International Court of Justice relating to investor protection. In the 1989 *Case Concerning Elettronic Sicula S.P.A.* between the United States and Italy, popularly known as the ELSI case, the ICJ Chambers, with a spirited dissent by the Judge Schwebel, clearly held that the primary cause of the Claimant's difficulties in that case lay in its own years of mismanagement, and not the act of requisition imposed by the governmental authorities:

> *100. It is important in the consideration of so much detail, not to get the matter out of perspective: given an under-capitalized, consistently loss-making company, crippled by the need to service large loans, which company its stockholders had themselves decided not to finance further but to close and sell off because, as they were anxious to make clear to everybody concerned, the money was running out fast, it cannot be a matter of surprise if, several days after the date at which the management itself had predicted that the money would run out, the company should be considered to have been actually or virtually in a state of insolvency for the purpose of Italian bankruptcy law.*
>
> *101. … There were several causes acting together that led to the disaster to ELSI. No doubt the effects of the requisition* [the governmental act] *might have been one of the factors involved. But the underlying cause was ELSI's headlong course towards insolvency; which state of affairs it seems to have attained even prior to the requisition.*[11]

21. An investor's failure to conduct an adequate risk assessment or unconscionable behavior in order to win a bid will affect its rights under the investment contract and an applicable investment agreement. Two recent arbitral decisions provide ample testimony to this proposition. The tribunals in the *Inceysa*

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[10] *Genin v. Estonia*, *op cit*., para. 345.
[11] *Case Concerning Elettronic Sicula S.P.A (United States of America v. Italy)* {1989} ICJ Reports 15, 20 July 1989, paras 100-101.

v. El Salvador and in *World Duty Free v. Kenya* dismissed the investors' claims on the basis of corruption involved in the pre-investment phase. *Inceysa v. El Salvador* noted expressly that the conduct of the investor in the pre-investment phase breached its duty of good faith.[12] (These cases are discussed in Section 2.4.)

22. *Amici* do not make any arguments with respect to corruption in this case. These cases, however, show unequivocally that the conduct of an investor before an investment is made can be directly relevant to the issues a tribunal must consider.

23. The emerging doctrine in international investment law is also recognizing the role of investor obligations, based in part on the decisions noted above. In a recent article, Prof. Peter Muchlinski extensively considers the role of investor conduct in the context of the evolution of the fair and equitable treatment standard.[13] He concludes that:

> *Indeed, just as the various claims made by an investor can and do overlap, given their origin in one set of facts, so too will the investor's conduct be of relevance to an assessment of all claims they make.*[14]

24. The above decisions establish beyond a doubt that a tribunal sitting under the authority of a bilateral investment treaty may consider the conduct of the investor at any and all stages of the investment process. They establish clearly the principle that investors are responsible for their own acts and omissions, and cannot seek the protections of international investment agreements in order to avoid the commercial, contractual or regulatory consequences of their acts.

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[12] *Inceysa v. El Salvador*, ICSID Case No ARB/03/26, Award, August 2, 2006; *World Duty Free v. Kenya*, ICSID Case No. ARB/00/7, Award, 4 October, 2006.
[13] Peter Muchlinski, "Caveat Investor? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard", 55 ICLQ 527 (2006).
[14] *Id*. at p. 529.

2.2 The duty to apply proper business standards, including proper due diligence procedures

25. A number of arbitral decisions indicate that an investor investing abroad has the responsibility of making a proper assessment of risks involved before entering an investment. This is in line with commercial contract law and practice on due diligence, whereby the investor is expected to assess and carry the responsibility for regular commercial risks.

26. The tribunal in *Waste Management v. Mexico* rejected the claim for expropriation, in large part due to the role the investor's bad business planning played in the failure of the investment:

> *In the Tribunal's view, it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial risks of a foreign investor, or to place on Mexico the burden of compensating for the failure of a business plan which was, in the circumstances, founded on too narrow a client base and dependent for its success on unsustainable assumptions about customer uptake and contractual performance.*[15]

27. In *MTD Equity v. Chile* the tribunal accepted Chile's argument that the investor did not exercise the due diligence that could be expected from a normal investor, stating:

> *Chile has argued that each organ of the Government has certain responsibilities, that it is not its function to carry out due diligence regarding the legal and technical feasibility of a project for investors, and that this is the investors' responsibility. The Tribunal agrees that it is the responsibility of the investor to assure itself that it is properly advised, particularly when investing abroad in an unfamiliar environment…,* [16]
>
> and:
>
> *[The Claimants'] choice of partner, the acceptance of a land valuation based on future assumptions without protecting themselves contractually in case the assumptions would not materialize, including the issuance of the required*

[15] *Waste Management*, Mexico, ICSID Case No. ARB/AF/98/02, June 2, 2000, para. 177.
[16] *MTD v. Chile*, *op cit*., para. 164.

> *development permits, are risks that the Claimants took irrespective of Chile's actions.* [17]

28. Tribunals have also held that an investor has the responsibility to do thorough background checks before deciding to invest. In *Genin v. Estonia,* the tribunal rejected a claim for breach of fair and equitable conduct on the grounds that the investor, who purchased a bank branch in Estonia, had not applied sufficient care, in a case with close parallels to the present one:

> *… , the officers of EIB [the investor] who conducted the negotiations regarding the purchase of the branch clearly acted unprofessionally and, indeed, carelessly. A credit portfolio cannot be checked on the spot in a few hours; the buyers should have known that Social Bank was on the verge of bankruptcy and should thus have taken extra precautions, such as insisting on warranties relating to the quality of the assets. The responsibility for the result of EIB's conduct, including its omissions, is EIB's alone.*[18]

These decisions make it clear that risk-appropriate investigations on the part of the investor are a required element to underpin a claim relating to the risk assumed.

29. Case law also indicates that investors cannot expect the "easiest" investment climate when investing in developing countries or countries in transition, and that therefore the business risks that an investor has to accept are greater than they would be in another investment climate. In the *Olguin* case, for instance, the tribunal noted:

> *What is evident is that Mr Olguin, an accomplished businessman, with a track record as an entrepreneur going back many years and experience acquired in the business world in various countries, was not unaware of the situation in Paraguay. He had his reasons (which this Tribunal makes no attempt to judge) for investing in this country, but it is not reasonable for him to seek compensation for the losses he suffered on making a speculative, or at best, not very prudent, investment.*[19]

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[17] *MTD v. Chile*, *op cit*., para. 178.
[18] *Genin v. Estonia*, *op cit*., para. 345.
[19] *Olguin v. Paraguay*, *op cit*., para.65(b).

30. Prof. Muchlinski subsumes these responsibilities under the investor's "duty to engage in the investment in the light of an adequate knowledge of its risks."[20] He argues:

> *The recent case-law on the scope of protection offered by IIAs appears to be developing a principle that the investor is bound to assess the extent of the investment risk before entering the investment, to have realistic expectations as to its profitability and to be on notice of both the prospects and pitfalls of an investment undertaken in a high risk-high return location. Any losses that subsequently arise out of an inaccurate risk assessment will be borne by the investor. They will not be recoverable under the terms of the investment treaty… The development of such a principle is justified by the view that IIAs, 'are not insurance policies against bad business judgments'.*

31. It should go without saying that if investment agreements are not an insurance policy for inaccurate risk assessments, they must be even less so for investments undertaken without a proper risk assessment at all.

2.3 The principle of *pacta sunt servanda*

32. An investor's failure to meet obligations undertaken in a contract with a host state, especially in an infrastructure project, can uproot the entire foundation of the contract, jeopardize its basic goals for the community involved, and create significant risks to human health, the operation of businesses, and the achievement of development and other societal objectives. The principle of *pacta sunt servanda* lies at the core of any contract, and its application to this dispute cannot be doubted:

> *The implicit confidence that should exist in any legal relation is based on the good faith with which the parties must act when entering into the legal relation, and which is imposed as a generally accepted rule or standard. Asserting the contrary would imply supposing that the commitment was assumed to be breached, which is an assertion obviously contrary to the maxim* pacta sunt servanda, *unanimously accepted in legal systems.*[21]

[20] Muchlinski, *op cit*., p. 530.
[21] *Inceysa v. El Salvador, op cit*., para. 233.

33. The sanctity of the contract is critical in the privatization process, where monopoly services are moved, usually as ongoing monopolies, from the public to private sector. When private sector investors fail to meet their obligations, it is not simply the commercial bargain that is put at risk, but the very welfare of the citizens that the privatization was mandated to enhance. The principle of *pacta sunt servanda* remains the most critical bulwark against such a result.

2.4 The duty of good faith

34. The duty of good faith is a foundation for the entire investor-state process. For host governments, it is reflected in the obligation for fair and equitable treatment. *Amici* submit that it is equally applicable to investors coming to the investor-state dispute settlement process under an international investment treaty. This is as basic as the fundamental doctrine requiring a Claimant to come to court with clean hands, a principle that *Amici* submit is equally and fully applicable to this Tribunal.

35. The *Inceysa v. El Salvador* tribunal offers an extensive discussion of the principle of good faith on the investor in international investment law, including:[22]

> 230. *Good faith is a supreme principle, which governs legal relations in all of their aspects and content...*
>
> 231. *In the contractual field, good faith means absence of deceit and artifice during the negotiation and execution of instruments that gave rise to the investment, as well as loyalty, truth and intent to maintain the equilibrium between the reciprocal performance of the parties...*
>
> 232. *Any legal relation starts from an indispensable basic premise, namely the confidence each party has in the other. If this confidence did not exist,*

[22] *Inceysa v. El Salvador, op cit., paras 230-239.*

> *the parties would have never entered into the legal relation in question, because the breach of the commitments assumed would become a certainty, whose only undetermined aspect would be the question of time.*

36. While the *Inceysa* tribunal later also ties the finding of bad faith to the provision in the Spanish – El Salvador bilateral investment treaty requiring the investment to be made in accordance with law, it is clear that its ambit is not restricted to this type of treaty provision. The duty of an investor to act in good faith exists as a general principle of law. It is not contingent on the presence of such a provision in a bilateral investment treaty or contract. In *World Duty Free v. Kenya*, the issue of bribery, a quintessential example of bad faith, is placed within the broader concept of “ordre public international”, with an equally emphatic denial of jurisdiction as found in *Inceysa*. No treaty provision was necessary for this purpose.

37. The decision in *Azinian v. Mexico* provides another illustration of the application of this principle in the absence of a treaty provision requiring the investment to be made in accordance with law. That tribunal considered the impact of several misrepresentations by the investor prior to the signing of a contract for a waste disposal concession. The tribunal found that the investor’s misrepresentation and unconscionable conduct went to support the original findings of the Mexican Courts that the cancellation of the concession contract for waste services was a valid act by the government authority.[23]

38. In *Genin v. Estonia*, the failure of the investor to fully disclose its operating partners and the full beneficial ownership of the bank (the purchase of which was the investment in the case) created one of the principal grounds for the finding that the removal by government authorities of the bank permit was justifiable.[24]

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[23] *Azinian v. Mexico*, *op. cit*., paras 104-110, 117-118, 124.
[24] *Genin v. Estonia*, *op cit*., paras 362, 363.

39. The scope for bad faith is, on the one hand, as limitless as the mind is able to dream up schemes, frauds, and misrepresentations. But it is still possible to apply the principle of good faith with some precision. In section 4, below, a content-specific application is submitted for the consideration of the Tribunal. For his part, Prof. Muchlinski places the concept of bad faith into a larger tent of "the duty of the investor to refrain from unconscionable conduct."[25] He identifies several specific aspects of unconscionable conduct: fraud, misrepresentation, undue influence or abuse of power, corruption, behaviour without candour and transparency, and abuse of a superior bargaining position to extract unduly beneficial promises and other advantages.[26]

40. Because bad faith or unconscionability may go to questions of jurisdiction and justiciability, as is seen in the *Inceysa* and *World Duty Free* cases, the issue arises whether a tribunal can, or must, address such issues even if not raised by the arbitrating parties. *Amici* are not aware of any investor-state arbitration where this issue has arisen specifically. (Indeed, we are not even aware if the Respondent has raised the issue of bad faith or unconscionability in the present proceedings.) Analysis of this issue appears to be limited to date to the issue of corruption, where a number of recent articles conclude that there is indeed a duty on a tribunal to address the issue when credible evidence is before it, even if not by the parties to the arbitration.

41. Dr. Richard Kreindler, in a paper presented at the Geneva Global Arbitration Forum in December 2006, argues the following, while noting relevant recent cases:

> ***5. Should or must the arbitrator determine the issue of illegality in all cases when alleged?***

[25] Muchlinski, *op. cit.*, pp. 536-542.
[26] Muchlinski, *op cit.*, pp. 536-541.

> 5.1 The answer should be yes, as long as the otherwise applicable prerequisites of arbitrability, jurisdiction, and relatedness to the proceedings are fulfilled.
>
> ***6. Should or must the arbitrator, sua sponte, determine the issue of illegality even when not alleged?***
>
> 6.2 …Where a suspected or manifest illegality is at least arguably relevant to the *petita*, then it is also relevant to the duty to render an award which is to the greatest extent enforceable, particularly under the law of the seat.
>
> 6.4 As the agreed or deemed primary trier of fact, the arbitrator is in a unique position, normally not shared or aspired to by the subsequent reviewing or enforcing court, to ascertain the facts. To the extent determining the facts surrounding an alleged illegality may be tied to enforceability, the arbitrator should err on the side of initiating investigation, and thereby preempt any need or temptation of a reviewing court to reopen the case: e.g., *Westacre*.[27]

42. This view is supported by other recent writing as well, often flowing from the notion of the need of the tribunal to uphold the "ordre public international" concept in international arbitrations, as seen in the *World Duty Free* case.[28] *Amici* submit that the present case may indeed rise to the level of "ordre public international" for reasons more fully developed in section 4, below. If bad faith is evidenced such that it goes to undermine the very foundation of the contract, in particular in a sector as sensitive as water services where the highest standards of business conduct must, of necessity, be applied, then *Amici* submit that "ordre public international" is engaged and with it matters relating to the jurisdiction and justiciability of the arbitration.

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[27] Richard H. Kreindler, *Is the Arbitrator Obligated to Denounce Money Laundering, Corruption of Officials, etc.? The Arbitrator as Accomplice - Sham Proceedings and the Trap of the Consent Award*", 12th Geneva Global Arbitration Forum "Settling Disputes on a Shrinking Planet, Geneva, 7 December 2006.

[28] See, eg, Karen Mills, "Corruption and Other Illegality in the Formation and Performance of Contracts and in the Conduct of Arbitration Relating Thereto", in *International Commercial Arbitration : Important Contemporary Questions (ICCCA Congress Series, No. 11),* Kluwer International, 2003.

2.5 Putting investor responsibility in the sustainable development and human rights context

43. At least three investor-state tribunals have noted that human rights law ***can*** be relevant to the issues raised before them, including this tribunal in paragraph 52 of Procedural Order 5.[29] The question for consideration here, therefore, is not whether this is theoretically possible, but how might it be specifically relevant in the present case. This is not an instance of, for example, rampant environmental destruction or the poisoning of water resources. Such issues would raise fairly obvious and direct questions of culpability by any investor, foreign or domestic. Rather, the primary legal issues raised by the sustainable development and human rights contexts in the present case are how they condition the responsibilities of the investor in the present case.

44. The Millennium Development Goals (MDGs), adopted by the United Nations in 2000, include the target of reducing by half the number of people not having proper access to potable water by 2015. The implementation of this target has since been the subject of many conferences, statements, and declarations, and the international community has recognized that "water is a key to sustainable development."[30]

45. The World Summit on Sustainable Development (WSSD), held in Johannesburg in 2002, prominently addressed water-related issues, and the heads of State reiterated the need for the water service goals of the MDG's to be met. The private sector was also present at the WSSD and stressed the urgency of water access needs, especially in the

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[29] The other two known cases are *Aguas Argentinas et al. v. Argentina*, Order in response to a Petition for Transparency and Participation as Amicus Curiae, ICSID Case No. ARB/03/19, 19 May 2005, para. 19, and *Aguas Provinciales de Santa Fe et al. v. Argentina*, Order in Response to a Petition for Participation as Amicus Curiae, ICSID Case No. ARB/03/17, 17 March 2006, para. 18.

[30] Eg Bonn Recommendations for Action, International Conference on Fresh Water, Bonn , 3-7 December 2001, http://www.water-2001.de/outcome/reports/Brief_report_en.pdf.

developing world. The World Business Council for Sustainable Development (WBSCD), for instance, in a foundational paper entitled "Water for the Poor", opens with the simple statement that:

> *Water supply and sanitation are essential for poverty alleviation, health improvement and for sustainable development. The time for talking is long past. Action is needed now if solutions are to be found.* [31]

46. Private sector involvement at the WSSD was further solidified with the creation of "Partnerships for Sustainable Development" in key areas, including water. These partnerships are voluntary, multi-stakeholder initiatives aimed at implementing sustainable development. The partnerships recognize the need for business to be part of the solution and the private sector is recognized as a key player in these partnerships. The Claimant has affiliated itself with this goal: Biwater International is a member of "Partners for Water and Sanitation (PAWS)"[32], one of the "Partnerships for Sustainable Development".

47. The Claimant in the present case has also acknowledged the importance of the Millennium Development Goals to its business ethos, as far back as March 2003:

> *"There is no doubt that the discussions and debates will continue, just as Biwater will continue to demonstrate its willingness to work with all stakeholders to contribute to the achievement of the MDGs. With projects such as the Laguna Alta water supply plant in Panama, the Beetham Wastewater Treatment plant in Trinidad, the Adi Nefas Water Treatment Plant in Eritrea and the Greater Makurdi Water Supply Project in Nigeria, not to mention Cascal's concessions worldwide, Biwater is already working to increase provision of safe and*

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[31] World Business Council for Sustainable Development, *Water for the Poor*, August 2002, p. 3, available at http://www.wbcsd.org/DocRoot/rb0fIAtRuPY7fCmLkPEB/20020821_water.pdf
[32] http://webapps01.un.org/dsd/partnerships/public/partnerships/92.html

> *affordable access to clean water and sanitation, which is not only a Millennium Development Goal – it's our core business."*[33]

48. Not only is access to clean water essential for sustainable development, it is also a basic human right. In 2002, the United Nations Committee on Economic, Social and Cultural Rights, the body monitoring implementation of the corresponding Covenant, declared in a General Comment that a right to water exists as an independent right.[34] In its comment the Committee described water as a limited natural resource and a public good fundamental for life and health, and it stated that the human right to water was indispensable for leading a life in human dignity. While there is no doubt that the fulfillment of this right is replete with challenges, the simple fact that life is not possible without water, and that health is not possible without clean water, attest to this basic human right.

49. The Claimant, as well as other major water companies, has also acknowledged the existence and importance of this basic human right, stating:

> *"Every man, woman and child has* ***the right*** *to a reliable system of clean water and good sanitation".*[35]

50. *Amici* submit that the stated commitments of water companies and the recognition by the international community of the private sector role for achieving sustainable development goals and human rights have important legal significance. Thus the Claimant in the present case must be asked to live up to the standards and goals it has

[33] Biwater, "World Water Forum" in *Biwater Focus*, 16 March 2003, at 15, available at http://www.biwater.com/media_room/library.html#FocusMagazine

[34] General Comment No. 15, The Right to Water (Articles 11 and 12 of the International Covenant on Economic, Social and Cultural Rights), U.N. Doc. E/C.12/2002/11, 26 November 2002.

[35] Biwater, *Water for Life*, 2003, p. 54. http://www.biwater.com/pdf/en/library/Biwater_Corp_bro.pdf. [Emphasis added] See also, e.g. See Suez Environment web site at http://www.suez-environnement.com/info/en/service-1242067.htm, *Access for all to drinking water and sanitation is necessary for life, and is an essential element for human dignity. Every human being is entitled to have access to drinking water..*

enunciated, lest they be made into a dead letter by the investor-state process. *Amici* submit that the Claimant's decision to enter into this sector encumbers it with the highest level of responsibility to meet its duties and obligations as a foreign investor, precisely because the risks associated with failure in this sector are so great for those who need it most: the poor, the sick, the struggling and women and girls (who bear the brunt of getting water when proper services fail). As noted earlier, this is not a run-of-the-mill business. Indeed, there is no other like it. In assessing the investor's conduct and responsibility, this context cannot be ignored.

51. *Amici* do not argue that the fact that this investment, and hence this dispute, concerns the human right to water creates a completely open-ended liability for the Claimant. Nor do we suggest that this alleviates a host state of liability for its possible breaches of international obligations when they are properly established. Rather, *Amici* submit that human rights and sustainable development issues must be factors that condition the nature and extent of the investor's responsibilities, and the balance of rights and obligations between the investor and host state.

52. Prof. Muchlinski picks up this theme as well:

> *…. standards have emerged in international codes of conduct, notable among which are the OECD Guidelines for Multinational Enterprises and the UN Global Compact, and in corporate and industry codes, as well as binding conventions. These standards can serve to inform the content of what may be regarded as ethical business practice. They include, in particular, a general duty to obey the law, to pay taxes, to act in accordance with fundamental labour standards and to observe human rights principles. … These standards could be used to assess the conduct of a foreign investor in a given case.*[36]

[36] Muchlinski, *op. cit.*, p 531.

53. Prof. Muchlinski suggests that these principles reflect “ethical standards” that “represent a benchmark by which the conduct of multinational enterprises will increasingly be judged in the future.” *Amici* submit that this future is now. Foreign corporations engaged in projects intimately related to human rights and the capacity to achieve sustainable development, have the highest level of responsibility to meet their duties and obligations as foreign investors before seeking the protection of international law. This future is present today before this Tribunal.

3. CLAIMANT’S FAILURE TO MEET THE DIFFERENT RESPONSIBILITIES IN THIS ARBITRATION

3.1 Relevant facts

54. Based on the information available to them, *Amici* submit that the investor’s own acts and omissions, rather than those of the Respondent, caused the failed investment.

55. First, the Claimant did not apply proper business standards and necessary care either in the pre-investment or the investment phases. The Claimant submitted a bid that was too low for it to be able to meet the costs of providing the water services it promised to provide. Moreover, the Claimant did not carry out proper due diligence to determine the feasibility and viability of the investment in the pre-establishment phase. Finally, the Claimant failed to minimize unnecessary costs during its period of operation.

56. Each of these failures is attested to in various independent reports on the City Water privatization, including by former World Bank privatization experts and Price Waterhouse Coopers:

1. In its bid, the Claimant had proposed the minimum operator tariff allowed by the Respondent in the bid documents.[37]
2. The Claimant committed in the bid to retain all DAWASA operational employees, notwithstanding that it was under no obligation to do so.[38]
3. Price Waterhouse Coopers found that the unit cost of water was incorrectly understated in the Bid Form submitted by the Claimant, [39] as the unit cost set out therein was less than that in the financial and technical projections also submitted with the bid. For example, the Claimant's Bid Form forecast a unit cost of electricity in Year 1 of 26 Tshs m^3. However, its own technical projections submitted with the bid, when broken down into a per unit basis, provided for a unit cost of electricity of 71 Tshs m^3.[40]
4. The lack of a due diligence investigation prior to undertaking the bid led to significantly higher employee costs than anticipated:[41]
   - Due diligence would have identified the anomaly between the DAWASA staff handbook, which indicated that the compulsory retirement age for staff was 55 years, and the Public Service Retirement and Benefits Act, which provides for a retirement age of 60 years.[42]
   - Legal due diligence would have uncovered the existence of the court case, commenced in 2000, which resulted in a June 2003 court ruling that City

[37] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 27.
[38] *Ibid*.
[39] Price Waterhouse Coopers (PWC), Review of the City Water Services Limited (the Operator) Submission on the grounds for an interim review of tariff under the Lease Contract and equity contribution, November 2004, page 20, referring to Bid Form 13/4 (Volume 2 of 4, Financial Submission).
[40] Price Waterhouse Coopers, *op. cit*., p. 20.
[41] Price Waterhouse Coopers, *op cit*., p. 35.
[42] Price Waterhouse Coopers, *op cit*., p. 37.

Water claimed had financial implications for its plan to offer early retirement or redundancies to reduce the number of staff.[43]

- Tax due diligence should have shown the anomalies between the pension contributions in DAWASA's records and those required under law.[44]
- The Claimant's failure to include meal and other allowances in the bid, which allowances were included in the staff handbook but not in DAWASA's 2000/2001 budget, indicated weaknesses in the bidder's due diligence.[45]
- Tax due diligence should have identified the Skills and Development levy for which City Water was liable, notwithstanding that DAWASA had had an exemption.[46]

5. Price Waterhouse Coopers also found that once the investment was established, City Water paid tax on employees' allowances although there was no legal obligation to pay it,[47] and that City Water had not adopted procedures to control and minimize overtime.[48]

57. From the above, it appears that had Price Waterhouse Coopers or another similar firm been engaged by the Claimant before the privatization was consummated, this entire arbitration might have been avoided.

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[43] Price Waterhouse Coopers, *op. cit.*, p. 37.
[44] Price Waterhouse Coopers, *op. cit.*, p. 39.
[45] Price Waterhouse Coopers, *op. cit.*, p. 40.
[46] Price Waterhouse Coopers, *op. cit.*, p. 43.
[47] Price Waterhouse Coopers, *op. cit.*, p. 42.
[48] Price Waterhouse Coopers, *op. cit.*, p. 39.

58. Other elements apparently also led to problems with the investment during its operation. According to information available to *Amici*, the Claimant's poor performance led to an income that was lower than projected.

1. In year one of the lease, City Water was supposed to install 16,500 new meters and add 1,000 new water connections. According to the Government of Tanzania, in year one City Water actually installed 8,751 new meters (47 percent shortfall) and added 400 new connections (60 percent shortfall).[49]
2. According to City Water's reports, collections were consistently less than the targeted amount. From August 2003 through March 2005, City Water collected, on monthly average, Tshs 975 million, against a monthly target of 1.3 Tshs billion. This was a 25 percent shortfall, or about $295,000 a month.[50]
3. There was a decline in the availability of water in many parts of Dar es Salaam over the period the lease was in force. Despite a 15 percent increase in water production (mostly coming from the associated works repair and investment program funded by the donor loans that were the main source of capital inputs), parts of the city that previously had water services twice a week were reduced to getting water once a month.[51]

59. Each of the above was within City Water's control and could only negatively impact City Water's income.

3.2 Legal implications

[49] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 29.
[50] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 29.
[51] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 29.

60. First, the Claimant is responsible for failed business judgments - the UK-Tanzania Bilateral Investment Treaty cannot serve as an insurance against business risk.

61. The fact that the Claimant had proposed the minimum operator tariff allowed by the Respondent in the bid documents and that it committed to retain all DAWASA operational employees was a business decision that was entirely the Claimant's. Like in *Waste Management v. Mexico* it appears that the Claimant's business plan was based on "unsustainable assumptions" about contractual performance, in this case the feasibility of the targets committed to in light of the circumstances. The tribunal in that case had noted that it was "clear that the arrangement was not commercially viable, taking into account both the lower than expected proportion of customers serviced and the additional costs incurred"[52]. This seems to resemble closely the situation in the present arbitration where it also appears that the bid on which the Lease Contract was based was "not commercially viable" from the outset. In *Waste Management*, the tribunal concluded that international law did not have "the function … to eliminate the normal commercial risks of a foreign investor, or to place on [the host State] the burden of compensating for the failure of a business plan". The conclusion of the present Tribunal, *Amici* submit, should be the same.

62. Second, like the investor in *MTD Equity v. Chile*, it seems that the present Claimant had not carried out proper "due diligence regarding the legal and technical feasibility". In *MTD Equity v. Chile*, the lack of due diligence led to the tribunal's conclusion that "the Claimants should bear the consequences of their own actions as experienced businessmen."[53] The *Genin v. Estonia* tribunal similarly criticized the investor's omission to check the credit portfolio of the bank it acquired in a thorough

[52] *Waste Management v. Mexico, op. cit.*, para. 57.
[53] *MTD Equity v. Chile*, *op. cit*., para. 178.

manner (which would have indicated that the bank was on the verge of bankruptcy). It concluded that the investor's unprofessional and careless actions and omissions were alone the responsibility of the investor.[54]

63. *Amici* submit that the Claimant, like the investors in *MTD Equity v. Chile* or in *Genin v. Estonia*, should be held responsible for its own acts and omissions.

64. The cases also make it clear that the investors' business experience must be taken into account. As mentioned above, the *Genin v. Estonia* tribunal noted "that the Claimants should bear the consequences of their own actions as experienced businessmen". Similarly, in *Olguin v. Republic of Paraguay* the tribunal noted that the investor was "an accomplished businessman, with a track record as an entrepreneur going back many years and experience acquired in the business world in various countries". This, of course, is also true for the Claimant in the present arbitration. At the time of the bid submission, the Claimant's affiliated entities had already invested in a number of developing countries, including in Africa. The Claimant's group of companies had, for example, invested in water supply and treatment and sanitation operations in Guatemala, Indonesia, Mexico, Malaysia, Nigeria, Panama, Philippines and South Africa.[55]

65. This experience ensures that the Claimant was very much in a position to be aware of the notorious state of financial and operational data on water systems in developing countries. The precarious nature of financial records in African parastatals and quasi-government agencies with a commercial operation was, and remains, widely known. Bernard de Haldevang, Chief Executive of the African Trade Insurance Agency, an intergovernmental trade and investment insurance organization of which Tanzania is a

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[54] *Genin v. Estonia*, *op. cit*., para. 345.

[55] Biwater, *Water for life*, December 2003, available at http://www.biwater.com/media_room/library.html

member, for example, has noted that investing in Africa often requires long and complicated due diligence.[56]

66. Based on the Claimant's experience it is logical to conclude that it should have been aware of the particular challenges and difficulties inherent to investments in the water services sector in developing countries. Yet it appears from the reports seen by *Amici* that it still did not undertake a full due diligence review.

67. Privatization expert Nilgün Gögkür notes in relation to the partial privatization of the Tanzania Telecommunications Company Ltd., undertaken during the same time period:

> *The bidders were constrained by unreliable financial and operational data while preparing their bid and conducting their due diligence. Without judging the actions of any one in the TTCL process, one can say that poor quality data provides an opportunity for unscrupulous bidders to offer inflated prices, knowing that it is likely that if they win, they will uncover information at a later date which, they can claim, negates the assumptions of their earlier offer.*[57]

68. Finally, *Amici* recall the investor's responsibility to meet its contractual obligations: *pacta sunt servanda*. In the present arbitration the Claimant's performance during the investment phase was poor and ultimately led to an income that was lower than projected. However, the poor performance affected not only the Claimant's income but also the people of Dar es Salaam who were dependant on the Claimant for water delivery during the contract period and into the future. First, the number of new connections was less than promised in the contract. Second, the Claimant failed to deposit

[56] Eg. Bernard de Haldevang, Chief Executive of political risk insurers African Trade Insurance Agency, in an interview by Business Day in 2004, noted that investing in Africa often requires long and complicated due diligence investigations, http://www.southafrica.info/doing_business/investment/africainvest.htm
[57] Nilgün Gökgür, "The Partial Divestiture of the Tanzania Telecommunications Company Ltd." in Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 75.

the "social connection tariff" into the "First Time New Domestic Water Supply Connection Fund" which was to be used for the expansion of water services to unserved, low-income areas.[58] Third, there was a decline in the availability of water in many parts of Dar es Salaam over the period the lease was in force.

69. These last failures are particularly noteworthy, for they relate directly to the possible breach of the human rights of the citizens of Dar es Salaam by the Claimant. *Amici* do not argue that this was done as a specific effort motivated to deny basic human rights, and specifically note they have no reason to suggest or support such a motivation here. Rather, it is simply that the acts of the Claimant led to this result.

4. THE DUTY TO ACT IN GOOD FAITH: WAS THERE A STRATEGY TO RENEGOTIATE?

70. As already set out in section 2.4, the duty of an investor to act in good faith is a basic part of any investor relationship with a host state. What is important is to relate this duty to the case at hand. It is here that *Amici* are most at a disadvantage because of their limited access to the facts of the present case.

71. *Amici* submit that the pattern of behavior of the Claimant suggests a pre and post-investment renegotiation strategy – a strategy of bidding low to receive the contract in order to renegotiate it afterwards. *Amici*, given the conditions for these submissions, do not have the capacity to argue affirmatively that such a strategy *was* at play. However, we have noted several factors that appear to be consistent with such a strategy. These are set out below. Given the submissions made in section 2.5 on the possible legal impact of a strategy of renegotiation, i.e. a finding of bad faith, and the responsibility this would

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[58] Rühl, Christen, Gökgür, Nellis, *op. cit.*, p. 29.

place on the Tribunal to consider its potential jurisdictional and justiciability implications, *Amici* approach this issue with the greatest of caution.

72. *Amici* are not aware of any existing investor-state case that has seriously considered this issue. It appears to be, therefore, a case of first instance before this Tribunal. The closest parallel that has been found, the *Azinian v. Mexico* case,[59] is, however, instructive. It involved a concession in the waste management business that was granted on the basis of a business plan that affirmed the extensive experience of the investors and promised large amounts of capital that would be invested and employment created.[60] In reality, however, the investors had very limited experience and had no resources to invest, relying almost entirely on third parties. The tribunal noted that the business plan as presented by the investors was "apparently devoid of any feasibility study worth the name" and "unrealistic"[61]:

> *... This was the grandiose plan presented to the Ayuntamiento, which was told at the same meeting that the city of Naucalpan would be given a carried interest of 10% in DESONA "without having to invest one single cent and that after 15 years it would be theirs." One can well understand how members of the Ayuntamiento would be impressed by ostensibly experienced professionals explaining how a costly headache could be transformed into a brilliant and profitable operation.*

The tribunal then concluded:

> *The Claimants obviously cannot legitimately defend themselves by saying that the Ayuntamiento should not have believed statements that were so unreasonably optimistic as to be fraudulent.*

73. The *Azinian* tribunal also held that one of the testimonies supported "the conclusion that the Claimants' main effort was focused on getting the Concession

[59] *Azinian v. Mexico*, *op. cit*., Final Award, November 1, 1999.
[60] *Id*. at para.106.
[61] *Id*. at, para.107.

Contract signed, after which they intended to offer bits and pieces of valuable contract rights to more capable partners."[62] Thereupon the tribunal stressed that the government partner was "entitled to expect much more".[63] In other words, the representations and business plan put forward during the negotiations were misrepresentations of their true intentions.

4.1 The concept of the renegotiation strategy

74. *"…perhaps the biggest problem with concessions has been the high incidence of contract renegotiation shortly after their award"*[64]

75. Jose Luis Guasch, the leading expert at the World Bank on this issue, summarizes the renegotiation strategy and how it is set-up:

> *The following equation offers a simplified representation of financial equilibrium, where revenues minus costs should provide the appropriate return on investment:*
> $R = PQ – OC – T – D = rKi,$
> *where R is profits, P is prices or tariffs, Q is quantity or output, OC is operation and maintenance costs, T is taxes, D is depreciation, r is the opportunity cost of capital, and Ki is invested capital. If the award criterion is a transfer fee, it appears under Ki. If it is the lowest tariff, it appears under P.* ***In principle, any appropriate bid, whether based on K or P, has behind it an analysis that balances this equation.***
>
> ***A strategic or opportunistic bid is, presumably, one in which the left hand side of the equation (profits) is less than the right-hand side (returns to capital).*** *Here strategic, opportunistic, or aggressive bidding refers to bids that do not provide firms with financial equilibrium—that is, the costs of submitted bids exceed revenues. That is, bidding a transfer fee or a tariff such that*
> $R = PQ – OC – T – D < rKi.$
> ***The objective of such a bid is to win the concession with the expectation of later renegotiation—****arguing that the equation does not balance, and higher tariffs or lower future investments are needed to restore financial equilibrium.*

[62] *Id*. at para. 114.
[63] *Id.* at para. 115.
[64] Jose Luis Guasch, *Granting and Renegotiating Infrastructure Concessions: Doing it Right* (2004), p. 33. (Hereinafter, Guasch, *Doing it Right*)

> *Ample anecdotal evidence indicates the existence of low-ball bidding on concessions, and that should raise a red flag.*[65]

76. Guasch has elsewhere more specifically defined the concept of "opportunistic" bidding that he frequently uses:

> *The broader picture shows that renegotiations may be of two types. First of all, there are renegotiations initiated by operators (Guasch et al. 2003). These might be shock related, when a devaluation or a recession make the operation of a given concession unsustainable. … They might also be opportunistic, when a firm uses its bargaining power in bilateral negotiation with the government or the regulatory agency to strike a better deal than the initially agreed one. This affects one of the central benefits of the concession model, namely the competitive pressure introduced by the ex ante auction procedure. To the extent that firms are aware of the potential gains due to their bargaining power in a subsequent bilateral negotiation with sometimes inexperienced government officials, they may be tempted to strategically undercut rivals at the bidding stage.*[66]

77. This is precisely what *Amici* refer to as the renegotiation strategy. This strategy is well known in the infrastructure investment business. In the main, analysts have focused on renegotiations initiated by host states in order to increase their share of royalties, taxes, ownership in a joint venture, etc. Such cases have made for large public headlines. While global figures do not appear to be available, recent analysis of renegotiations in Latin America across all major sectors shows that water privatizations are significantly more subject to renegotiation than any other sectors, with a 74% renegotiation rate, and 66% of those initiated by the investor.[67] The average time frame for such renegotiations in the water sector in Latin America has been 1.6 years.[68] These figures suggest that renegotiation is a well known business strategy. Its potential benefits for the private

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[65] *Id.* at p. 36, emphasis added.
[66] Jose Luis Guasch and Stéphane Straub, "Renegotiation of Infrastructure Concessions: an Overview", Annals of Public and Cooperative Economics 77:4 2006, p. 484.
[67] Guasch, *Doing it Right*, pp. 12-13, 16.
[68] *Id*. at p. 13.

sector operator when initiated by them, and losses for the public and government interlocutor, are clear:

> *If concessions are renegotiated shortly after their award, as often happens, the initial bidding or auction turns into a bilateral negotiation between the winning operator and the government—undermining competitive discipline of the auction. At that stage the operator has significant leverage, because the government is often unable to reject renegotiation and is usually unwilling to claim failure—and let the operator abandon the concession—for fear of political backlash and additional transaction costs. In such cases the operator, through renegotiations, can undermine all the benefits of the bidding- or auction led competitive process."*[69]

Costs not noted here, in particular in the water and sanitation sectors, may include significant losses in service to the public, increased costs for service, increased health risks during renegotiation and transition periods, and public security issues resulting from water problems, amongst others.

78. In fact, concerns that the Claimant may have a renegotiation strategy were voiced during the bidding process. This triggered an internal review at the World Bank, as the primary project funder. It determined the project should go ahead.[70] This Tribunal, however, has the benefit of hindsight where the World Bank did not. *Amici* submit that the Tribunal, for the reasons explained in section 2, has the right and the duty to draw its own conclusions on this issue.

4.2 Application to the present case: Was there a renegotiation strategy?

79. Determining whether there has been a renegotiation strategy at play can be difficult. Much like the problem of determining corruption, there is rarely going to be a smoking gun, i.e., a statement that says this was all about setting up a renegotiation.

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[69] *Id*. at p. 33.
[70] Summarized in Rühl, Christen, Gökgür, Nellis, *op. cit*., at p. 27.

Amici submit, however, that this neither precludes the investigation nor alters its potential impacts.

80. In *Methanex v. United States*, the tribunal was faced with a claim that the corruption of the then Governor of California led to the decision to ban MTBE as a gasoline additive, with the resulting adverse impacts on Methanex. There was no smoking gun, and in the end, a finding of no corruption. What is important for present purposes, however, is the methodology adopted by the tribunal in perhaps the most extensive recorded investigation of corruption in an investor-state arbitration decision.

81. The tribunal in *Methanex v. United States* adopted the methodology put forward by the Claimant company that, where clear evidence was not available, it was entitled to draw “appropriate inferences” from the facts before it.[71] While it expressed the need to be cautious in doing so, and to ensure all the dots were being assessed and not just those favourable to one viewpoint, it went on to adopt what it labeled a “connect the dots” approach, even labeling its individual pieces of evidence as Dot 1, Dot 2, etc.. The *Methanex* tribunal also noted that, while corruption could be found in a party’s acts that were illegal under national or international law, acts not considered illegal under any laws could also, when considered together, lead to a finding of corruption in some circumstances.[72]

82. *Amici* submit that this methodology is relevant to the present case. Like the alleged corruption reviewed by the *Methanex* tribunal, a renegotiation strategy will have multiple elements, most if not all being quite legal. It is thus essential to “connect the

[71] *Methanex v.United States*, *op. cit*., Part III, Chapter B, paras. 2-3.
[72] *Ibid*, eg. Part III, Chapter B, paras. 19, 37-38.

dots" to determine if there is a more nefarious explanation than each would attract individually.

83. If one accepts this methodology, what is one to look for? J. Luis Guasch, in his seminal writings, gives some direction, expressly or by implication, of how to find "strategic, opportunistic or aggressive bidding":

- Bids that do not provide firms with financial equilibrium—that is, the costs of submitted bids exceed revenues;[73]
- The early initiation of a renegotiation, with the average time in the water sector being 1.6 years; and
- The financial equation does not balance, and higher tariffs or lower future investments are needed to restore financial equilibrium.[74]

84. Using the above as a reference point, *Amici* turn to the facts available to them, drawn from various reviews of the bidding and investment processes:

- The Claimant submitted the lowest possible level of bid on tariffs, the basic source of income from the project.[75]
- The Claimant bid below the level of its own cost projections,[76] meaning that it could not meet the financial equilibrium posited by Guasch.
- The Claimant failed to undertake a proper due diligence examination of the water services operation before submitting the bid, despite the notoriety of the poor operational and financial shape of the service.[77]

[73] Guasch, *Doing it Right*, p. 36.
[74] *Ibid*.
[75] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 27.
[76] Price Waterhouse Coopers, *op. cit*., p. 20.
[77] Price Waterhouse Coopers, *op. cit*., pp. 37, 39, 40 and 43, discussed in section 3.1 above.

- The Claimant agreed to keep all previous staff of the public water company and supervising authority, thereby keeping costs high.[78]
- City Water failed to deposit the "social connection tariff" into the "First Time New Domestic Water Supply Connection Fund" to provide for new connections in poor neighborhoods (a key contract provision).[79] This meant that it could allocate revenues for other uses and minimize new sunk capital costs that otherwise would be lost if the investment failed.
- Claimant sought an interim tariff review in August 2004 under the terms of the contract. This was rejected by Tanzania on the basis of the report of independent auditors Price Waterhouse Coopers, which concluded there were no grounds for such a review and increase.[80]
- Efforts to renegotiate the contract then began no later than 16 months after the contract entered into force, in keeping with the expected timeframe described by Guasch.[81]
- The scope of demands by the Claimant included many key elements going to revenues and costs, the financial equilibrium referred to by Guasch above: a five year extension to the contract (50% longer) "in order for the contract to be financially viable"; additional outside financing for modernization; reduced collection targets;[82] reduced employee levels by almost 1/3[83]; and an increased operator tariff.[84]

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[78] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 27.
[79] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 29.
[80] Price Waterhouse Coopers, *op. cit*., p. 1 and Appendix 1.
[81] Rühl, Christen, Gökgür, Nellis, *op. cit*., p. 32, which states that in December 2004 and again in January 2005, City Water proposed a revision of the lease terms.
[82] TRC Economic Solutions, Contract Renegotiations of Lease Contract between Dar es Salaam Water and Sewerage Authority and City Water Services Ltd: Phase II, Draft Final Report, 24 May 2005, p. 22.

- City Water held back from investing the full amount of equity required from it under the Lease Contract. The Lease Contract required City Water to invest $5.5 million in equity by the end of year one. At the end of year one, it had put in $3.9 million and by the date of termination, its total equity investment stood at $4 million.[85]
- City Water refused to inject further capital into the project until the renegotiation was done.[86]
- City Water rejected the mediator's recommendations on a renegotiation.[87]

85. *Amici* appreciate that taken alone, each of these factors would not make a case. Considered together (and subject to facts not knowable to *Amici*), however, *Amici* submit that they constitute a *prima facie* case that the Claimant was following a renegotiation strategy. The question for the Tribunal is whether this *prima facie* case makes it incumbent on it to investigate further. In the view of *Amici*, the significant consequences of the entire experience for the government and people of Tanzania require no less of this Tribunal than to ensure that all the facts are thoroughly investigated.

86. *Amici* submit that, if these elements are borne out by the full record in this arbitration, then the most obvious conclusion is that a renegotiation strategy was at play. Indeed, it is hard to conceive of another business rationale that would explain this combination of factors. This explanation is also consistent with the Claimant's parent company's previous history in the water sector. There are some indications from the

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[83] *Id*. at p. 30.
[84] *Id*. at p. 31.
[85] Rühl, Christen, Gökgür, Nellis, *op. cit*., pp. 28-29.
[86] TRC Economic Solutions, *op. cit*., p. 51.
[87] *Id*. at p. 54.

limited information available to *Amici* that the Claimant's parent company and its affiliates have previous experience with renegotiating water contracts.

87. In November 1999, for instance, the Claimant's parent company, operating through one of its subsidiaries in a joint venture company, Greater Nelspruit Utility Company (GNUC)[88], was awarded a 30-year water concession in Nelspruit, South Africa. In early 2003, just 4 years into the 30-year concession, cost recovery was considerably lower than expected and GNUC threatened to pull out of the concession unless it received assistance from Nelspruit's municipality. In response, the municipality agreed to several relief measures, including a reduction in GNUC's electricity tariffs for the operation of infrastructure; an increase in the portion of the municipality's equitable share; a reduction in the municipality's monitoring fee; and a reduction in the rental fee for municipal property. Further, as part of the 5-year concession review, GNUC's tariffs were renegotiated, and the municipality approved another 15% increase as of January 2005.[89]

88. Another example is the acquisition by the Claimant's affiliate, Cascal, of the Government of Belize's 82.7% shareholding in Belize Water Services Limited (BWS), assuming operation of water supply and sanitation in Belize in March 2001.[90] Within months of the purchase, BWS requested the Government to introduce an infrastructure charge for each new sewer connection plus increase water rates and announced that it would not spend the US$140 million which it had promised on new capital investment.[91]

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[88] GNUC is a joint venture between Biwater's subsidiary Cascal and a black empowerment group, Sivukile.
[89] Brown, J. (2005) Center on Regulation and Competition, Institute for Development Policy and Management, University of Manchester, Working Paper Series, Paper No. 112, *Water Service Subsidies and the Poor: a Case Study of Greater Nelspruit Utility Company. Mbombela Municipality, South Africa*, available at www.competition-regulation.org.uk.
[90] Press Office, Government of Belize, "WASA Privatised", Press Release, 23 March 2001, available at http://www.belize.gov.bz/press_release_details.php?pr_id=1445.
[91] Cutlack, M., "When the dollars run out", *New Statesman*, 4 March 2002. available at http://www.newstatesman.com/200203040023; King, K., "Cascal says WASA was "puss enna beg",

BWS requested the regulatory authority to increase tariffs by 32% for the 2004-2009 period to meet existing debts and short falls.[92] BWS' request was rejected by the Belize Public Utilities Commission (PUC), which approved only a 15% increase. An independent review later recommended a 17% rate increase in February 2004, a rise which was acceptable to the PUC.[93] The company, however, initiated arbitration against Belize. In a settlement agreement in October 2005, the Government re-purchased the majority shareholding in BWS from Cascal for the original price of US$24.8million.[94]

89. The Respondent in the present case did not choose to renegotiate or buy out the Claimant. Instead, the Respondent chose to enforce the Lease Contract by way of termination provided for in the Contract itself.

90. *Amici* submit that the response of the Respondent to terminate the contract in the face of this full set of factors was quite correct. This is turned to in more detail in section 5. For now, we just note the following from J. Luis Guasch:

> *But what if a firm submits an unreasonable bid, one that has a very high transfer fee or very low tariff, and then,* ***as expected****, the financial equation does not hold? Should the firm be held accountable to its bid, or should the firm be bailed out?*
>
> *The right answer is that, barring major external factors, operators should be held accountable to their bids, and if petitions for renegotiation are turned down, operators ought to feel free to abandon the projects, if they choose to do so (with the corresponding penalties). The appropriate*

Amandala, 19 October 2001, available at http://www.belizemall.com/amandala/archives/archives_2001/oct_21_2001.html#2.

[92] Transcript of Public Hearing on a Full Tariff Review: Proceeding involving Belize Water Services Limited and the Public Utilities Commission, 10 November 2003, available at http://www.puc.bz/publications/the%20fairweather%20report%20on%20public%20consultation%20meeting_%20bws%20ftrp.pdf.

[93] Dr Richard Hern, Nera Economic Consulting, Independent Export Report under the First Full Tariff Review Proceedings: Belize Water Services, 26 February 2004, available at http://www.puc.bz/publications/bwsfinalsent260204.pdf.

[94] See Press Office, Government of Belize, "Agreement reached for the purchase of BWS", Press Release, 12 August 2005, available at http://www.belize.gov.bz/press_release_details.php?pr_id=3377; Press Office, Governmental of Belize, "Government and Cascal finalise BWS re-purchasing agreement", Press Release, 3 October 2005, available at http://www.belize.gov.bz/press_release_details.php?pr_id=3235.

> *behavior for government is to uphold the sanctity of the bid and not concede to opportunistic requests for renegotiation. Doing so may lead to the abandonment of a concession, but that is a price worth paying and, in fact, can help government establish a reputation of not being easy in terms of renegotiation demands and, in doing so, would discourage future aggressive bids.*[95]

4.3 Legal implications

91. *Amici* are well aware that it is not generally unreasonable or bad faith for investors to have alternative business strategies and plans in place at any given time. One would in fact often expect this to be so. In the ELSI case, for example, it is clear that the American controlling company of ELSI had concurrent strategies for selling the company and for winding it down in accordance with law in order to maximize its asset values. While this was described in the ICJ decision as “Janus-like”, and the two strategies were certainly played against each other, the legitimacy of each track and their relationship to each other is understandable. Moreover, they were transparent and concurrent alternative strategies. This does not appear to have been a significant factor in the final decision of the ICJ in that case.

92. The issue here is whether the renegotiation approach pointed to in this case constitutes bad faith, as opposed to two legitimate strategies being pursued at the same time to maximize value. In the present case, we are not looking at two alternative strategies, but a single sequential strategy where phase one is to obtain the concession contract and phase two, hidden from view, is to renegotiate it when potential competitors are out of the way. As is typically the case in similar situations, the negotiating partner is a developing country and in this case, as was well known to all, subject to mandatory privatization requirements by the World Bank and hence under important pressures to

[95] Guasch, *Doing it Right*, pp. 37-38, emphasis added.

reach a deal, pressures that the investor is almost always well aware of. This, if found to be present, falls fully and squarely within the scope of the existing investor-state decisions on bad faith, as reviewed in section 2.4.

93. In addition to *Azinian v. Mexico,* discussed above, the decision in *Inceysa v. El Salvador* would also seem closely related to this situation. In that case, the tribunal found, *inter alia*, that the investor submitted false financial information in the tender and made false representations during the bidding process. The tribunal concluded:

> *237: The conduct mentioned above constitutes an obvious violation of the principle of good faith that must prevail in any legal relationship. This Tribunal considers that these transgressions of this principle committed by Incesya represent violations of the fundamental rules of the bid that made it possible for Inceysa to make the investment that generated the present dispute. It is clear to this Tribunal that, had it known the aforementioned violations of Inceysa, the host State, in this case El Salvador, would not have allowed it to make its investment.*[96]

94. *Amici* submit that, if the Tribunal determines that the acts and omissions of the Claimant do demonstrate a renegotiation strategy, then this must have serious consequences as a matter of law.

5. CONCLUSIONS: CONSEQUENCES FOR BREACHES OF INVESTOR RESPONSIBILITIES

5.1. Contract termination for valid reasons

95. The termination of the contract, as *Amici* understand it, was an action by the Respondent to prevent further deterioration of the water delivery services. Citizens were suffering as a direct consequence of the failed investment. The Claimant had failed to meet the agreed performance targets and had caused a decline in the availability of water

[96] *Inceysa v. El Salvador, op cit*., paras. 234-237.

in many parts of Dar es Salaam. The Claimant had failed to meet the water service expansion targets, or set aside the funds required for the "First Time New Domestic Water Supply Connection Fund". Both of these continued to increase human health risks and impose costs and water collection problems on citizens of Dar Es Salaam. These problems especially affected women and children.

96. The Claimant, by not fulfilling the promises contained in its bid, had created a situation of urgency requiring governmental action. In fact, the Government, carrying the duty to provide access to water to its citizens, had to take action under its obligations under human rights law to ensure access to water for its citizens, including under:

- The African Charter on the Rights and Welfare of the Child, Article 14.2 (c), committing States parties to take measures "to ensure the provision of adequate nutrition and safe drinking water" (ratified by Tanzania in 2003);
- The Convention on the Elimination of All Forms of Discrimination Against Women, Article 14.2(h), stipulating that States parties shall ensure to women the right to "enjoy adequate living conditions, particularly in relation to […] water supply" (ratified by Tanzania in 1985); and
- The Convention on the Rights of the Child, Article 24.2(c), requiring States parties to combat disease and malnutrition "through the provision of adequate nutritious foods and clean drinking-water" (ratified by Tanzania in 1991).

97. In line with this, a recent Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises stated:

In sum, the state duty to protect against non-state abuses is part of the

> *international human rights regime's very foundation. The duty requires states to play a key role in regulating and adjudicating abuse by business enterprises or risk breaching their international obligations.*[97]

98. *Amici* respectfully submit that the Tribunal in the present arbitration must take into consideration the human rights and sustainable development aspects of this case when assessing the consequences for the claims at issue here. In this light, terminating the contract, if legitimately done in order to prevent the deterioration or abuse of human rights, cannot be found to be a breach of the contract whose very purpose was to promote and enhance the achievement of those rights.

5.2 Contract termination taking into account investor conduct

99. International investment case law now provides a sturdy basis for the concept that investor conduct has consequences for claims made against the host state under investment treaties. In various cases, tribunals have taken into account investor conduct and the specific investment context, including the developmental, political and social situation in the host state. At least three categories of consequences for the claims examined by various tribunals can be identified:

- The tribunal may find the underlying investment contract invalid and thus dismiss the claims on the basis of a lack of jurisdiction or justiciability;
- In examining the individual breaches, the tribunal may find that reproachable investor conduct affects the finding of a breach and ultimately deny the claim on the merits; or

[97] John Ruggie, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises: Business and human rights: mapping international standards of responsibility and accountability for corporate acts, 19 February 2007, para. 18.

- The tribunal may reduce the damages award in consideration of the investor's conduct.

100. First, investor conduct can affect the validity of the claim altogether. This is the case where the investor is not in good faith or where its conduct is unconscionable. As seen earlier, examples include fraudulent behaviour, misrepresentation, or abuse of power. Addressing "unconscionable conduct" Prof. Muchlinski writes:

> *Where unconscionable conduct is found, this may have serious consequences for any claim made by the investor. Evidence of such conduct may vitiate any right to a claim, especially if the regulatory response that is being challenged arises out of the application, by the host country, of its powers to punish the conduct through an interference with the investment.*[98]

101. Several tribunals, as set out in detail above, have dismissed claims precisely for such unconscionable conduct, and in some instances have referred to reasons of "ordre public international". These include the decisions *Azinian v. Mexico, Inceysa v. El Salvador,* and *World Duty Free v. Kenya.* In *Azinian v. Mexico* the tribunal found that the concession contract was invalid, primarily on the ground of misrepresentation on the part of the investor, and thus dismissed the claim. In *Inceysa v. El Salvador* the tribunal declined jurisdiction largely based on the fact that the investor had violated the principle of good faith and other principles of international law through its behaviour in order to prevail in the bidding process. While in *Inceysa,* the lack of jurisdiction was linked to the violation of Salvadoran law, which vitiated protection under the applicable BIT, this link was not found necessary in *World Duty Free v. Kenya*. In this latter case, the tribunal found the contract, procured by bribing a state officer, in violation of international public policy and thus legally unenforceable. As a consequence it dismissed the claim.

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[98] Muchlinski, *op. cit.*, see footnote 13 above.

102. Thus, in all of these cases, claims were dismissed on the basis that the contract could not be valid because it was based on misrepresentation, bad faith or involved some kind of illegal behavior on the part of the claimant. *Amici* submit that the Tribunal should come to the same conclusion if it concludes that the Claimant's bid was submitted as part of a renegotiation strategy.

103. The second category of consequences in case law relates to the failure of duty of care by the investor in the pre- and post investment phases. In *Genin v. Estonia* and *Olguin v. Paraguay*, the tribunals did look at the individual claims, but ultimately denied all of them. In *Olguin v. Paraguay* the tribunal's conclusion to deny the claims was influenced largely by the fact that the investor had not sufficiently covered itself against risks and could ultimately not rely on the BIT as its insurance policy. In *Genin v. Estonia* the tribunal did not find a violation of any of the BIT provisions, among other things because the investor had failed to cooperate with the Estonian banking authorities, and had concealed ownership questions from the authorities. Moreover, the investor had not carried out its due diligence regarding the financial situation of the bank branch it was acquiring and had not taken precautions against the risks involved.

104. A third category of consequences for investor conduct is the reduction of damages. In *MTD Equity v. Chile* the failure of the investors to protect themselves against business risks did not lead to the denial of the claim but led to a reduction in the damages.

105. *Amici* submit that, should the Tribunal not find the presence of a renegotiation strategy, the Claimant's lack of due diligence in the bidding phase and poor business practices during the investment should be taken into account when considering any alleged bilateral investment treaty violation.

106. Finally, *Amici* submit that, if the Tribunal finds in accordance with this submission, an award of costs against the Claimant is appropriate. In the present case, the government and people of Tanzania and Dar Es Salaam have already suffered the direct and most serious impacts of the failed water privatization. They must face the costs of completing what was not done under the contract and carrying the water services project forward. The Government of Tanzania is also carrying the costs of the World Bank loan used to finance the project, recalling here that the Claimant was the smallest capital provider in the project.

107. In addition, the Tribunal should consider the need to sanction this type of conduct if it finds it to have existed. Serious breaches of a contract for such basic water services cannot be accepted. Moreover, if there is a finding of a secondary hidden strategy, such deceit and bad faith creates, as Guasch noted, serious consequences for the entire sector, where this strategy is widely known to be employed. If investors are not held to the highest standards, it also creates significant consequences for the infrastructure development strategies, and hence for sustainable development strategies more broadly, of developing and least developed countries.

> *What should be done more often is for governments to reject opportunistic requests for renegotiation and, in such cases, allow concessions to fail. Such outcomes would reduce the incidence of renegotiation. That is a key issue in private concessions of infrastructure services—yet one that is often resolved in favor of operators. Thus aggressive bidding and the high incidence of renegotiation should not be surprising*[99]

108. Using the investor-state process to seek compensation for the failure of such a strategy when a state stands up and says “no, we will not be a party to this”, as Prof.

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[99] Guasch, *Doing it Right*, p. 38.

Guasch argues they must, should be rejected as a clear signal for future cases. An award of costs is the most appropriate means for sending this clear signal.

Respectfully submitted on behalf of:

The Lawyers' Environmental Action Team (LEAT)
The Legal and Human Rights Centre (LHRC)
The Tanzania Gender Networking Programme (TGNP)
The Center for International Environmental Law (CIEL)
The International Institute for Sustainable Development (IISD)

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Geneva, 26 March, 2007