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International Arbitration Case Law

School of International Arbitration, Queen Mary, University of London
International Arbitration Case Law

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Award Name and Date: United Utilities (Tallinn) B.V. and Aktsiaselts Tallinna Vesi v Republic of Estonia (ICSID Case No. ARB/14/24) – Award – 21 June 2019

Case Report by: Mihaela Apostol**, Editor: Diego Luis Alonso Massa***

Summary: United Utilities (Tallinn) B.V. (the “**UUTBV**”), a company incorporated under the laws of the United Kingdom of The Netherlands, and Aktsiaselts Tallinna Vesi (the “**ASTV**”), a company incorporated under the laws of the Republic of Estonia, (collectively referred as the “**Claimants**”) brought an action against the Republic of Estonia, as a sovereign state (the “**Respondent**”) pursuant to the bilateral investment treaty between Estonia and The Netherlands 1992 (the “**BIT**”). The Claimants argued that Estonia is liable for breach of the fair equitable treatment standard (the “**FET**”), due process and the umbrella clause included in the BIT, as a result of Estonia’s decisions to cap the water tariffs to “reasonable” levels and its refusal to allow for an increase of such tariffs. The Tribunal decided that it had jurisdiction but dismissed Claimants’ claims.

Main Issues: Whether the Tribunal has *rationae personae* and *rationae voluntatis* jurisdiction to hear the claim. Whether the Tribunal has jurisdiction to hear the case in light of the intra-EU BIT objection. Whether the measures adopted by Estonia led to a breach of the FET. Whether the measures adopted by Estonia are in breach of due process. Whether Estonia breached the umbrella clause from the BIT.

Tribunal: Mr Stephen L. Drymer (President), Professor Brigitte Stern (Arbitrator) and Sir David A. R. Williams QC (Arbitrator).

Claimants’ Counsel: Mr Iain Maxwell, Ms Louise Barber, Ms Elizabeth Reeves (Herbert Smith Freehills LLP, London); Mr Matthew Weiniger QC (Linklaters LLP, London); and Mr Kaupo Lepasepp, Ms Piibe Lehtsaar; Advokaadibüroo Sorainen AS (Tallinn).

Respondent's Counsel: H.E. Minister Raivo Aeg, Ms Marleen Kippar (Ministry of Justice of the Republic of Estonia); Mr Horst Daniel, Ms Ariane Sproedt (Squire Patton Boggs LLP, Frankfurt); Mr Rostislav Pekař, Ms Maria Polakova (Squire Patton Boggs, v.o.s., Prague); Mr Stephen P. Anway, Mr Luka S. Misetić (Squire Patton Boggs LLP, New York); Ms Eveli Lume, Squire Patton Boggs LLP (Berlin); Mr Anton Sigal, Mr Chirag Mody, (Ellex Raidla, Tallinn).

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Digest:

1. Relevant Facts

In 1997, the Claimant, ASTV, was incorporated as a public limited company entirely owned by the City of Tallinn (¶125).

In February 1999, the Estonian Parliament enacted the Public Water Supply and Sewerage Act (the “**1999 PWSSA**”), which set out a national legislative framework regulating the public water supply and sewerage, including the criteria for setting the water tariffs (¶¶128-129).

On 6 July 1999, Tallinn City Council adopted a decision to sell shares of the ASTV to private investors (¶132). Following this decision, the City of Tallinn issued a notice for sale of a 50.4% stake in ASTV (the “**Tender Notice**”) and prepared two memoranda, one setting out the objectives and the general parameters of the privatisation (the “**Explanatory Memoranda**”), and one with the information on the criteria for setting water tariffs under the 1999 PWSSA (“**Information Memoranda**”) (¶¶134, 140, 141). The Explanatory Memorandum provided that the establishment of the water tariffs: (i) were directly related to both the level of services and the needed investment; and (ii) tariffs should allow the investor to achieve a justified profitability (¶138).

The Claimant, UUTBV successfully participated in the tender process and on 5 December 2000 its bid was declared as the best offer (¶171).

On 23 November 2000, ASTV was granted an exclusive 15 years licence for the supply and operation of sewerage activity in the main public water of Tallinn (¶164).

In January 2001, the City of Tallinn, UUTBV and, AST entered into three privatisation agreements: share sale and subscription agreement, a services agreement (the “**Services Agreement**”) and a subscription agreement (¶¶173-192). The Services Agreement was subsequently amended by the Parties five times, in 2002, twice in 2005, in 2007 and in 2009 (amending the K-coefficients introduction of new K-coefficient, amending the structure of ASTV, reviewing the Network Extension Programme, profiling the K-coefficients, extension of the duration of the Network Extension Programme) (¶¶198-199, 210, 221-244, 253).

In 2005, ASTV became a public listed company. As a result of the initial public offering, UUTBV held 35.3% of ASTV's ordinary shareholding and the City of Tallinn 34.7% (§209).

During the period 2005-2008, various reforms were proposed to the 1999 PWSSA, by the Estonian Ministry of Environment, the State Audit Office and the Chancellor of Justice expressing their concern regarding the water tariff system, alleging the existence of an abuse of dominance of the ASTV (§§211-220).

On 5 December 2008, the Estonian Competition Authority (the "ECA"), in charge of the control of the water tariffs, issued a decree launching an investigation of the water and sewerage service market (§230). The investigation was followed by a report "Analysis and Opinion on AS Tallinna Vesi' Price Formation" (the "Analysis") which assessed ASTV's price structure – cost based, as well as the notion of "justified profitability". In the Analysis, the ECA "expressed concerns as to whether the tariffs applied by ASTV were cost-based and complaint with the relevant law and regulations" (§238).

In addition to the ECA investigation, in July 2009 the Estonian Chancellor of Justice, conducted an investigation on the legality of ASTV's tariffs by report to the 1999 PWSSA and the provisions of the Competition Act on abuse of dominant position (§247). The Chancellor of Justice concluded the application of the terms "cost-based" and "justified profitability" were contrary to the law, as they should have been applied in "a manner that leads to fair price by reference to prices in a real competitive market situation" (§250).

On 3 August 2010, the Estonian Parliament enacted an Anti-Monopoly Bill (the "AMB") which modified the water tariffs structure and qualified the phrase "justified profitability" by reporting it to the "capital invested by the water undertaking" (§§260, 261).

On 9 November 2010, ECA adopted a tariff methodology (the "Methodology") based on the provisions of the AMB (§§264, 270). Following a complaint from ASTV to the Chancellor of Justice regarding the Methodology, the Chancellor held that ECA failed to explain the role of the participants in the consultation process in adopting the AMB (§271).

On 9 November 2010, ASTV submitted an application (the "2011 Tariff Application") to ECA requiring the approval of the tariffs for 2011 to 2015 (§277). ECA was of the view that the application contained errors that prevented it from being considered, therefore, ASTV resubmitted a new application on 2 December 2010 (§§280, 283). ASTV and ECA disagreed as to the appropriate methodology to be applied in order to determine the tariffs, ECA stated that the tariffs shall be applied by reference to the PWSSA and not to the privatisation agreements and the "justified profitability" shall be determined by report to the capital invested, whereas ASTV contended that the tariffs shall be established in light of the privatisation agreements as well as the privatisation value (§§285-287). Nevertheless, the 2011 Tariff Application was rejected by ECA as not being compliant with the 2010 PWSSA.

On 28 February 2011, ECA started an investigation against ASTV regarding the existing tariffs (§285). As a result of its investigation, on 10 October 2011, ECA issued a prescription (the "ECA Prescription") ordering ASTV to lower its tariffs 29% compared to its 2010 tariffs (§291).

ASTV unsuccessfully initiated domestic proceedings before the Tallinn Administrative Court and the Supreme Court challenging the ECA Prescription and the ECA rejection of the 2010

Tariff Application (¶¶292, 293, 297, 299, 303). Furthermore, on 10 December 2010, ASTV filed a complaint with the European Commission alleging violation of the freedom of establishment and of free movement of capital, which was subsequently rejected (¶¶304-306).

2. Procedural History

On 15 October 2014, the Claimants filed a Request for Arbitration, which was registered by ICSID on 24 October 2014 (¶¶6-7). On 19 March 2015, the Secretary-General, notified the Parties that the arbitrators had accepted their appointments and the Tribunal was therefore deemed to be constituted on that date (¶10). On 19 March 2015, the Respondent filed a Request for bifurcation into jurisdiction and merits phase, followed by observations made by the Claimants on the same date (¶12). On 5 May 2015, the Tribunal held a first session and a hearing on the Request for Bifurcation (¶13). On 17 June 2015, the Tribunal rejected the Request for bifurcation (¶17). On 16 September 2015, the Claimants filed their Memorial, which was followed by a Counter-Memorial submitted by the Respondent on 9 February 2016 (¶¶19, 29). Subsequently, on 27 January 2016, the Respondent filed an Application for Provisional Measures to which the Claimants submitted their Response on 18 March 2016 (¶¶25, 31). On 1 April 2016, the Respondent submitted its Reply to the Application for Provisional Measures, followed by a Rejoinder submitted by the Claimants on the 15 April 2016 (¶¶35, 38). On 12 May 2016, the Tribunal granted partially the Application for Provisional Measures, by limiting the breadth of information that the parties may disclose to the public as regards the arbitration proceedings (¶42). On 17 June 2016, the Claimants filed their Reply Memorial (¶47). A hearing on jurisdiction and merits was held at the ICC in Paris, on 7-11 and 14-15 November 2016 (¶71). On 22 August 2018, the European Commission filed an Application for Leave to Intervene as a Non-Disputing Party, to which the parties have submitted their comments (¶¶88-90). On 2 October 2018, the Tribunal partially granted the application for Leave of the European Commission, allowing it to submit a single, written amicus curiae submission (¶91). On 20 June 2019, the Tribunal closed the arbitration proceedings (¶122).

3. Objections to Jurisdictions

3.1. Rationae personae

3.1.1. Respondent's Position

Respondent argued that the Tribunal did not have jurisdiction to hear the claims submitted by ASTV, as it did not qualify as a Dutch national in sense provided by the BIT and ICSID Convention and UUBTV never had sufficient control over the ASTV, as it was just a shell company of United Utilities. It was the Respondent's view that UUBTV never exerted control over ASTV uninterruptedly from the moment of each of the alleged violations until the initiation of arbitral proceedings (¶¶324, 339). Respondent submitted that control should be established based on objective standards, and other criteria rather than the shareholding could be relied on only to rebut or bolster the presumption of control (¶363).

3.1.2. Claimants' Position

The Claimants contended that the relevant moment to be taken into account in establishing the control was the date of consent and furthermore, UUBTV's control remained materially the same since the privatisation of ASTV (¶¶349). Nevertheless, the notion of control should

be limited only to the shareholding and should comprise also voting and management rights (¶361).

3.1. 3. Tribunal's Analysis

The Tribunal held that UUTBV controlled ASTV at the relevant points in time (¶411). The Tribunal was of the view that the notion of 'control' shall be construed flexible on case by case basis (¶¶366, 368). The Tribunal noted that UUTBV exercised operational control over ASTV and it has always been the most important private shareholder of ASTV (¶413). Besides, UUTBV had a dominant influence over the management of ASTV (¶415). In addition, the Tribunal stated that the control of United Utilities over UUTBV did not interfere with the jurisdiction of the Tribunal to hear the claims of ASTV (¶446). The Tribunal rejected the objection raised (¶446).

3. 2. *Rationae voluntatis*

3.2. 1. Respondent's Position

The Respondent contended that the Tribunal lacked jurisdiction *rationae voluntatis*, as the Claimants were barred from initiating arbitral proceedings since they had sought similar remedies from the local courts (¶¶325, 460).

3.2. 2. Claimants' Position

The Claimants argued that national proceedings and the arbitration proceedings relied on different legal basis, the domestic claims referred to a contravention to the Estonian administrative law, whereas the proceedings at hand concern issues of international investment law (¶462).

3.2. 3. Tribunal's Analysis

The Tribunal stated that even if the set of facts submitted in the arbitration proceedings were similar to the ones relied upon in the domestic courts, the remedies sought from the investment tribunal raised issues of international law, whereas the national proceeding dealt purely with Estonian law (¶465). The Tribunal rejected the *rationae voluntatis* objections (¶464).

3. 3. *Intra-EU objection*

3.3. 1. Respondent's Position

The Respondent argued that the Tribunal did not have jurisdiction to hear an intra-EU claim as it was barred due to the incompatibility of the BIT with EU Law (¶¶326, 468). The Respondent was of the view that Estonia's accession to the EU on 1 May 2004, or the entry into force of the Lisbon Treaty led to the termination of the intra-EU BITs (¶468).

Additionally, the Respondent contended that even if the VCLT were to apply (namely Article 30(3) VCLT – successive treaties, or Article 59 – implicit termination) EU law would still prevail, as it has the same subject matter as the BIT (¶480).

3.3. 2. Claimants' Position

The Claimants argued that for an implicit termination to take place, two condition precedent must be met: “(i) *the later treaty must relate to the ‘same subject-matter’ as the earlier treaty; and (ii) ‘the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time’*” (¶483).

3.3. 3. Tribunal Analysis

The Tribunal adopted Claimants' view on these issues, and held that the BIT and the TFEU do not have the same subject matter, and hence there is no incompatibility between the two (¶484).

Furthermore, the Tribunal stated that it was not authoritatively bound by the *Achmea* Judgement, although this decision might be considered as part of public international law. One important factor, in the case at hand, was that the BIT in question did not refer to the application of domestic law of the Parties. Additionally, the CJEU did not address in its decision the proceedings conducted under ICSID Rules (¶540).

The Tribunal added that the EU Member States Declaration from January 2019 supports the conclusion that the intra EU-BITs were not implicitly terminated, as in the Declaration the States committed to terminate the intra-EU BITs (¶558). Consequently, the Tribunal rejected the objection based on the incompatibility of the BIT with EU law (¶560).

4. Merits

4. 1. Breach of FET based on legitimate expectations

4.1. 1. Claimants' Position

The Claimants were of the view that they had legitimate expectations that the water tariffs would be calculated on the basis of the 2001 Business Plan submitted during the privatisation of ASTV, or in line with the methodology inserted in the Services Agreement (¶309).

The Claimants contended that Estonia was in breach of these expectations as a result of the following actions: (i) the adoption of the AMB; (ii) the rejection of the 2011 Tariff Application, (iii) and the adoption of a mandatory requirement to lower the tariffs by 29% (¶¶315, 567).

4.1. 2. Respondent's Position

Respondent claimed that the Claimants could not have had legitimate expectations that the tariffs would remain the same as in 2001 Business Plan, since the bidders were aware that the business plan was not definitive in selecting the winning bidder. Moreover, the Services Agreement was drafted in light of the applicable law, which included any further amendments to the regulatory regime (¶¶327,568).

4.1. 3. Tribunal's Position

The Tribunal held that unless an express commitment is given by the host State, the investor cannot expect that the legislative and regulatory regime will be static (¶575). Nevertheless, the Tribunal accepted that investors may rely on implicit assurances and representations from the host State, but in those circumstances the investor shall articulate precisely what were the expectations and establish that such expectations were objectively reasonable (¶576). Furthermore, the alleged expectations shall be analysed in the context of the investment and the relevant historical and socio-economic background (¶580).

The Tribunal stated that neither the privatisation agreements, nor other manifestations of will of the City of Tallinn amount to a commitment to a specific return or level of profitability for the Claimants (¶¶714, 761). Moreover, the agreements lack any stabilisation clause and their wording expressly excludes any expectation of legal or regulatory stability (¶715). The Tribunal concluded that there is no breach of FET based on legitimate expectations (¶761).

4. 2. Breach of FET independently of legitimate expectations

4.2. 1. Claimants' Position

The Claimants argued that Estonia breached the FET by adopting unreasonable and discriminatory measures: (i) the ECA wrongly disregarded the Services Agreement; and (ii) the adoption of the AMB and the amendment of the term “justified profitability” targeted ASTV (¶¶316-320, 763).

4.2. 2. Respondent's Position

The Respondent contended that the amendments to the 1999 PWSSA, the adoption of AMB and the ECA's decisions were regulatory measures adopted in good faith (¶321, 765). The AMB did not amend the existing tariff, but rather clarified them (¶¶322, 768). Furthermore, ECA had discretion to specify a tariff mechanism (¶323). Moreover, the 2011 Tariff Application was rejected because it was economically flawed (¶¶333, 804).

4.2. 3. Tribunal's Position

The Tribunal stated that the legislative changes of the 1999 PWSSA “*fall within the scope of the changes that an investor should have foreseen*”, especially since the Services Agreement referred to potential changes in the law (¶802). The Tribunal dismissed the claim of FET independently of the existence of legitimate expectations (¶860).

4. 3. Breach of due process, discrimination and unreasonable measures

4.3. 1. Claimants' Position

The Claimant argued that Estonia: (i) failed to afford due process to the Claimants in the adoption of the ECA's Analysis, during the investigation of the Estonian Chancellor of Justice and through the rejection of the 2011 Tariff Application; (ii) was liable for a negative public campaign against ASTV; and (iii) adopted unreasonable and discriminatory measures against ASTV (¶¶862, 919-921).

4.3. 2. Respondent's Position

The Respondent contended that: (i) it respected all the due process requirements and the Analysis was a non-binding assessment which did not have any legal effect (¶¶901, 878); (ii) the statements which were perceived by the Claimants as negative campaign, stemmed from private entities and individuals and cannot be attributed to the State (¶917); (iii) [Respondent's position is not summarised in the award]

4.3. 3. Tribunal's Position

The Tribunal concluded that: (i) the Respondent was not liable for any breach of due process, although, it accepted that Claimant neglected to take into account the privatisation agreement when the Analysis of performed (880); (ii) the actions in the media of private entities and individuals could not engage the liability of the State; (iii) the claims on discrimination were redundant (¶923).

4. 4. Breach of the umbrella clause

4.4. 1. Claimants' Position

The Claimants stated that Estonia breached the umbrella clause inserted in the BIT by disregarding: (i) the tariff methodology from the Services Agreement; (ii) the 2011 Business Plan; and (iii) the 2007 amendments to the Services Agreement (¶¶321, 924, 925).

4.4. 2. Respondent's Position

The Respondent contended that the contractual obligations assumed by the City of Tallinn were not binding on the ECA. Furthermore, the 2007 Amendment did not create any obligations for Estonia, as the City of Tallinn was a distinct entity from the Estonian State (¶¶336, 926).

4.4. 3. Tribunal's Position

The Tribunal decided not to address this claim as it considered it duplicative for violation of legitimate expectations (¶927).

5. Costs

The Tribunal decided that Claimants should reimburse Respondent an amount equivalent to 25% of: (i) its legal costs, fees and expenses; as well as of (ii) the arbitration costs it incurred (¶¶938).

6. Separate Opinion

The arbitrator appointed by the Claimant issued a Separate Opinion. The dissenting arbitrator shared his colleagues' view on jurisdiction, but had a different approach as regards the merits of the case, and more specifically on the findings regarding legitimate expectations and due process.

In respect to the claim of breach of FET based on legitimate expectations, the arbitrator stated that Claimants had legitimate expectations that “*that the essential characteristics of the regulatory regime would remain fundamentally stable vis-à-vis the Claimant*” (¶28 – Separate Opinion).

As regards the due process claim, the arbitrator dissented with the majority and affirmed that Respondent was liable of “*egregious breaches of due process*” given the “*complete lack of transparency and candour in an administrative process*” “*where exercise of power is not done in a manner which is fair to the interests of an investor*” (¶¶51, 58 – Separate Opinion).