UNITED UTILITIES (TALLINN) BV and AS TALLINNA VESI

(Claimants)

V

THE REPUBLIC OF ESTONIA

(Respondent)

DISSENT

INTRODUCTION

1. I have read the Award pursuant to which the majority finds as follows:

   a) The Respondent's objections to jurisdiction are dismissed.[1]

   b) The Claimants have failed to demonstrate that they held any legitimate expectation protected under the Treaty.[2]

   c) Estonia did not, under international law, fail to afford due process to Claimants.[3]

   d) Negative publicity against ASTV does not amount to a violation of the international law by the State.[4]

   e) The claim of impairment of the investment is redundant and duplicative of the legitimate expectations claim.[5]

   f) The umbrella clause claim is dismissed as it is duplicative of the legitimate expectations claim.[6]

2. For the first time in my long career, I find myself in the unfortunate position of being quite unable to agree with my esteemed colleagues on the key findings that have been made in the Award. I set out in this – my first ever dissent – my brief reasons for reaching

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[1] Award, paras 446, 463 and 560.
[2] Award, paras 716 and 761.
[3] Award, paras 901, 906 and 915.
[4] Award, para 918.
[5] Award, para 923.
[6] Award, para 927.

different conclusions on the following issues:

a) whether the Claimants held legitimate expectations and whether those expectations were breached;

b) whether the Respondent breached its due process obligations to the Claimants with regard to the Estonian Competition Authority's (the "**ECA**") determination of tariffs (and specifically with regard to the ECA's analysis, rejection of the ASTV's tariff application and the subsequent prescription issued by the ECA as discussed below).

3. I also disagree with the findings regarding negative publicity, impairment and discrimination, but I will not go into my reasons for disagreeing with these findings, as they are subsidiary to the main issues of legitimate expectations and due process.

4. While I shall indicate why I disagree with my colleagues regarding their legitimate expectation findings, I concentrate my analysis on the issue of due process where I consider that the evidence strongly supports the opposite conclusion to that reached by the majority.

5. In this dissent I adopt the defined terms used in the Award.

FACTUAL BACKGROUND

6. For context, I summarise some of the key factual events relevant to the issues addressed in this dissent. The general factual background to this dispute is set out in more detail at paragraphs 123 – 306 of the Award.

7. On 26 June 2000, the City of Tallinn issued a tender notice for the sale of a 50.4% stake in ASTV.[7] A few days later, on 3 July 2000, the City circulated an "Information Memorandum"[8] which was based on an "Explanatory Memorandum" previously approved by the City of Tallinn.[9] As explained at paragraph 137 of the Award:

> The Explanatory Memorandum envisaged an investment horizon of at least 15-20 years and underscored that investors could expect certainty with respect to the control of management, the ability to make decisions according to parameters previously agreed on, the ability to decide the tariff distribution, as well as clear and stable tariff regulation

8. Bids were invited from multinational companies with significant experience in water supply and water treatment. After extensive pre-bid discussions, including with regard to the concept of "justified profitability", UUTBV submitted its offer for the ASTV shares. On 21

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[7] Exhibit C-12.
[8] Exhibit C-10.
[9] Exhibit C-9.

December 2000, the City of Tallinn selected UUTBV as the winning bidder.

9. As described in paragraph 173 of the Award, between 12 and 22 January 2001, the following agreements were entered into by UUTBV, the City of Tallinn and ASTV: Share Sale and Subscription Agreement; Services Agreement; and Shareholders' Agreement (together the "**Privatisation Agreements**"). The Services Agreement included the tariff methodology whereby tariff increases/decreases (aside from inflation) were represented by a "K-coefficient". The K-coefficients for the first five (5) years were included in the Business Plan attached to the Services Agreement.

10. In April 2002, the City of Tallinn requested an amendment to the Services Agreement with regard to tariffs, amongst other things. After six (6) months of negotiations, the 2002 Amendment was signed on 30 September 2002.[10] This Amendment lowered the previously agreed tariff adjustments (K-coefficients) for the years 2003-2005 and introduced K-coefficients for the years 2006-2010. Some further amendments, which did not concern tariffs, were agreed in 2005.[11]

11. On 30 November 2007, the City of Tallinn, UUTBV, and ASTV agreed another amendment to the Services Agreement – the 2007 Amendment.[12] This amendment extended ASTV's mandate period by a further five (5) years and included a new business plan for this period which prescribed no tariff increases from 2011 onwards, aside from inflation adjustments. A final amendment (which did not concern tariffs) was agreed in 2009.[13]

12. As described in paragraphs 211 – 216 of the Award, from 2005 onwards various reform proposals regarding the water tariff regulatory framework began to be raised. The Ministry of Environment expressed concerns that the tariffs charged by water companies in Estonia were too low to adequately cover costs, which would negatively impact infrastructure development. To address this issue, the Ministry of Environment proposed that the Public Water Supply and Sewerage Act (the "**PWSSA**") be amended so that governments of local municipalities could set water tariffs, with oversight at the national level by the ECA and the Environmental Inspectorate. The proposed amendments to the PWSSA were finalised by the Ministry of Environment in June 2008.

13. During the course of 2009, the Estonia Homeowners' Association (the "**EOKL**") made a number of statements concerning water tariffs and in particular the need for ASTV to reduce its tariffs (as detailed at paragraph 228 of the Award). Additionally, at the end of 2008, the ECA embarked on an investigation of the competition situation in the water and sewerage service market.[14] For this purpose, it requested and received information from the City of Tallinn and ASTV (amongst others).

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[10] Exhibit C-30.
[11] Exhibits C-29 and C-31.
[12] Exhibit C-32.
[13] Exhibit C-33.
[14] Exhibit R-159.

14. As a result of this investigation, on 1 December 2009, the ECA published a report entitled "Analysis and Opinion on AS Tallinna Vesi's Price Formation" (the "**Analysis**").[15] ASTV was given one day's notice of the Analysis which concluded that ASTV's return of invested assets was not justified and that its prices would be considerably lower if internationally recognised principles were applied.[16] During a television interview on 1 December 2009, Mr Ots (the ECA's director) stated that "the final outcome should be that [ASTV's] water price reduces by up to 25%".[17]

15. While the ECA's investigation was ongoing, the Chancellor of Justice,[18] also launched an investigation into the legality of ASTV's tariffs under the PWSSA, ultimately concluding that the City of Tallinn should bring ASTV's tariffs into compliance with the PWSSA.[19] The City claimed that the Chancellor had exceeded his jurisdiction by reviewing an administrative act of the City of Tallinn. The Chancellor requested that the Supreme Court of Estonia enforce his recommendation, but the Supreme Court agreed with the City of Tallinn that the Chancellor had exceeded his authority.[20]

16. Over the course of 2009, the original amendments to the PWSSA proposed by the Ministry of Environment were replaced by a new proposal whereby the ECA alone would regulate tariffs for heating and water undertakings. The new proposal was prepared by Mr Reinsalu and Mr Vaher (Members of Parliament and of the EOKL) in the form of the Anti-Monopoly Bill (the "**AMB**"). The AMB proposed: (i) that the ECA would provide a methodology for calculating tariffs; and (ii) an amendment to the definition of justified profitability. The explanatory letter appended to the AMB specifically referred to ASTV, stating that the Bill should mean that ASTV's prices reduce by around 24%.[21] The AMB was enacted by the Estonian Parliament on 3 August 2010 and entered into force on 1 November 2010.

17. Around mid-2010, the ECA began work of its draft methodology for calculating tariffs (the "**Methodology**"). The draft was circulated to industry participants in September 2010 and comments were received by the ECA, including from ASTV.

18. The ECA became the regulating body for water tariffs on 1 November 2010 and adopted the Methodology nine days later (it was published on 12 November 2010).

19. On 10 December 2010, ASTV complained to the European Commission that Estonia had violated the Treaty on the Functioning of the European Union by enacting the AMB. The European Commission dismissed the complaint, noting that Estonia had the power to amend the regulatory regime.[22]

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15 Exhibit C-38.
16 Exhibit C-38, p. 904.
17 Exhibit C-158.
18 An independent official mandated to review the conformity of Estonian legislation with the national constitution.
19 Exhibit C-168.
20 Exhibit C-192.
21 Exhibit C-39 p. 908.
22 Exhibit C-219.

20. ASTV filed an application with the ECA on 9 November 2010 to set its tariffs for 2011-2015 (the "**2011 Tariff Application**"). In this Application, ASTV sought approval of the tariffs for the years of 2011 to 2015, requesting that the current tariff be adjusted in accordance with the consumer price index ("**CPI**") each year.[23] This was consistent with the 2007 Amendment. Another application was submitted on 2 December 2010 by ASTV.[24] Following several communications, ASTV resubmitted yet another updated application on 29 March 2011, in which it restated that the determination of its tariffs ought to consider the Privatisation Agreements as well as the privatisation value.[25] The ECA dismissed ASTV's 2011 Tariff Application on 2 May 2011 for lack of compliance with the PWSSA.

21. On 10 October 2011, the ECA issued a "Prescription" compelling ASTV to apply for tariffs 29% lower than its 2010 tariffs.[26]

22. ASTV applied to the Tallinn Circuit Court and, later the Estonian Supreme Court, for a ruling on certain aspects of this dispute. On 12 December 2017, the Supreme Court confirmed that the Services Agreement was a public law contract and was legal, but it was not binding on the ECA.[27]

FAIR AND EQUITABLE TREATMENT

23. The Claimants' primary claim in this arbitration was that Estonia acted in a manner contrary to their legitimate expectations, resulting in a violation of the FET provisions of the Treaty. Regarding this issue, the majority reach the following conclusions at paragraphs 711 – 716 of the Award:

> In light of the foregoing, the Tribunal is not satisfied that, in entering into the privatisation agreements, the Claimants formed expectations protected under the Treaty.
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> That the privatisation was aimed at attracting a foreign investor and its expertise, that the investment was understood to be a long-term project, and that the investor structured its bid in a "front-loaded" manner may all be so. These do not, however, substantiate either the legitimacy of the Claimants' expectations under international law or the far-reaching obligations of Respondent that Claimants allege and seek to vindicate here.
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> As mentioned above, the commitment on which the investor claims to have relied in making its investment must be assessed by reference to the terms of the relevant contracts. Context is certainly significant. However, the privatisation agreements themselves belie Claimants' claims.
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> As noted above, the Tribunal does not find that the privatisation agreements or other manifestations of the will of the City contained or constituted a commitment to any type of implied return or specific level of profitability.

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[23] Exhibit C-187.
[24] Exhibit C-195.
[25] Exhibit R-243.
[26] Exhibit C-44.
[27] Supreme Court Decision (12 December 2017).

> Moreover, not only do the privatisation agreements lack any stabilisation clause, but their terms plainly exclude any expectation of legal or regulatory stability, or any specific commitment to shield the privatisation from future legal or regulatory change – which is perhaps not surprising given the lack of involvement in the privatisation by the Central Government, the State entity with jurisdiction to adopt and amend the PWSSA.
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> In the circumstances, Claimants could not legitimately expect that what they refer to as the "key principles" of the privatisation agreements would be maintained throughout the Mandate Period.

24. I strongly disagree with the majority's findings.

25. The key point with which I take issue in the above analysis is the suggestion that a lack of express stabilisation (i.e., regulatory freeze) means that an investor can have no expectation that the agreed parameters of a long-term investment will be respected. The majority's reasoning at paragraphs 708 – 710 of the Award implies that there are only two options available – total regulatory freeze or complete discretion to alter the regulatory framework without any regard to the Privatisation Agreements.

26. Conversely, I consider that those two positions are at either end of a spectrum which includes other, more moderate, positions that could have been taken. This accords with the Claimants' submissions.

27. The Claimants did not contend that they held an expectation that the regulatory regime would be frozen throughout the Mandate Period. Indeed, the Claimants agreed that this was not the position taken by the Parties at the time.[28] But such an admission does not mean that the Parties understood that the regulatory regime was subject to total alteration at any time, leading to the complete abandonment of the agreed basis on which the investment was made and the contractual framework underlying the investment.

28. I would have found instead that the representations made by the State (through the City of Tallinn), combined with the provisions of the Privatisation Agreements, created a legitimate expectation on the Claimants' part that the essential characteristics of the regulatory regime would remain fundamentally stable vis-à-vis the Claimants (but not necessarily static) during the Mandate Period. Based on this stability, the Claimants in my view held a further legitimate expectation that the key principles upon which the investment was made as agreed in the Privatisation Agreements (and in particular the key principles of the tariff methodology) would be respected and were compatible with the underlying regulatory regime.

29. I set out below my reasons for coming to this view.

Did the Claimants hold legitimate expectations?

30. It is well accepted that the standard of fair and equitable treatment, without more, does

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[28] See Claimant's Reply Memorial, para 159.

not operate as an undertaking on the part of a host State that the law at the time of the investment will remain unchanged throughout the life of the investment. As noted by the tribunal in *EDF (Services) Ltd v Romania*, the standard does not require that regulations remain frozen in time:[29]

> The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life. Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable.

31. Neither the Claimants nor the Respondent disputed this proposition.

32. However, as stated by the tribunal in the *Biwater Gauff* case:[30]

> the purpose of the fair and equitable treatment standard is to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment, as long as these expectations are reasonable and legitimate and have been relied upon by the investor to make the investment. [emphasis added]

33. Such basic (or legitimate) expectations are assessed objectively, but can arise from specific promises made or from statements or conduct by or on behalf of the State for the purpose of inducing the investment. Thus, the test generally applied in these circumstances is whether the State made representations, gave assurances or otherwise took actions upon which the foreign investor relied.[31]

34. In the present case, the Claimants submitted that they were induced to make a substantial investment, taking significant risk in doing so, on the express basis that they would receive a return on their investment through a specifically designed tariff methodology that would be respected by the State.[32] This expectation was reinforced through the following circumstances:

a) The City of Tallinn initiated a high-profile international tender process, which emphasised the tariff mechanism as the basis of the investors' potential return. The

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[29] Exhibit RL-155, *EDF (Services) Ltd v Romania* (Award) ICSID Case No ARB/05/13, ILC 392 (2009) at para 217.
[30] Exhibit CL-96, *Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania* ICSID Case No. ARB/05/22, Award, 24 July 2008, para. 602.
[31] See Award, para 576.
[32] See Claimants' Reply Memorial, para 160.

City of Tallinn represented that, in return for delivering the required service improvements, ASTV would be entitled to charge tariffs. This was the primary means by which the Claimants would recover and make a return on their investment in ASTV.

b) The investment was to be long-term (in the event, the mandate period was extended to 20 years) and the Claimants' return on their investment was weighted towards the end of the Mandate Period. Estonia represented that, in return for providing the agreed service improvements in the early phase of the project, the Claimants would earn a reasonable return on their investment in the latter phase of the project. The tariff mechanism was designed to operate over the full course of the Mandate Period in order to deliver that return. It is important to note that the majority acknowledges in the Award that:[33]

> ASTV's privatisation was conceived and represented to the bidders as a long-term project demanding significant financial, strategic, managerial and operational input from a foreign investor, whose investment would be recouped by means of water tariffs to be set at levels that would allow the investor to earn "justified" or "reasonable" profits over the anticipated term of the investment.

c) For that reason, the tariff rates were naturally of importance to the Claimants as well as the other bidders. Knowing this, and to encourage investors to submit a bid, the City of Tallinn included in the tender memorandum a representation that the tariff regime would be fixed for the first five years and thereafter would be determined according to a certain formula (the "**Tariff Formula**").

d) The Tariff Formula relied to some extent upon the abstract concept of "justified profitability". This would clearly restrict the tariffs that could be charged by ASTV. UUTBV sought assurances from the City of Tallinn specifically on this point, asking the City to commit to an identified method of determining "justified profitability". As a consequence, the Parties specifically defined what that phrase would mean for them in the Services Agreement.

e) Moreover, by the City of Tallinn approving and accepting the Business Plan and agreeing to treat it as a contractual document, the Claimants legitimately inferred that the implied level of profitability contained in the Business Plan was considered "justified" by the State. As events transpired, ASTV's actual level of profitability has been lower than that originally considered "justified" by the State under the Business Plan.[34]

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[33] Award, para 617.
[34] Claimants' Reply Memorial, para 213.

f) The terms and conditions of the Services Agreement (including the Business Plan) were specifically and carefully negotiated by the Parties, who were sophisticated entities acting with legal advice.

g) The stability of the tariff regulatory regime took on increased importance in the context of this specific contract, where the investor's return on investment was weighted towards the end of the Mandate Period. The Tribunal acknowledges this at paragraph 712 of the Award stating that the "investment was understood to be a long-term project, and that the investor structured its bid in a "front-loaded" manner". Having committed to a considerable upfront investment, I consider that the Claimants legitimately expected that the State would honour its agreement as to tariff increases so as to allow the profit element to be weighted towards the latter part of the project.

h) To this end, the 2002 Amendment[35] was effectively an amendment to the Business Plan to spread previously agreed tariff increases over a longer period of time. The Amendment was agreed at the State's request (through the City of Tallinn) which reinforced – and was consistent with – the expectations created by the terms of the Services Agreement and the pre-contractual negotiations.

i) The Claimants did not expect the regime to stay static or frozen – they did not seek a stabilisation clause or expect full stabilisation of the regulatory regime. The Parties specifically agreed at Clause 10(1)(a) of the Services Agreement:

> Notwithstanding any other provision of [the Services Agreement], [ASTV] shall at its own cost carry out its obligation under [the Services Agreement] and shall comply at all times with all Statutory Requirements and Required Consents (including those introduced after the date of [the Services Agreement])

j) In addition, clause 7(1) of the Services Agreement expressly stated that the tariffs had to comply with the law. Clause 7(4)(b) provided that the tariffs had to reflect the K-coefficients only to the extent this would comply with the tariff criteria, which in turn had to comply with the law and its future amendments.

k) However, the State also made specific representations during the pre-contractual negotiations that are relevant to assessing the Claimants' expectations as to the meaning of clauses 7 and 10 above. The following passages from Explanatory Memorandum[36] for the privatisation of ASTV are particularly informative:[37]

> For the success of the privatisation, it is also important to turn attention to the <u>expectation of the investor</u>. Privatisation cannot be

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[35] Exhibit C-30.
[36] Exhibit C-9. The Explanatory Memorandum was prepared by Suprema Securities AS, an Estonian investment bank, for the "Privatisation Committee" which was established by the City of Tallinn to manage the privatisation process.
[37] Exhibit C-9 at pages 146-148 and 150.

successfully conducted without taking into consideration the expectation of the investors. The more assured the investor is of the stability of the operating environment of the company and the more precisely the different aspects of co-operation between the City and investor are defined, the larger is the interest of the Investor which in turn is reflected in the higher offered price.

In the case of AS Tallinna Vesi, the investment horizon is long-term (at least 15-20 years), as investments are of a long-term nature. The investor undertakes to achieve the objectives set by the City and expects to receive reasonable profitability in return. Through the ownership of the share, the profitability comprises of paid dividends and the development of goodwill.

For the achievement of the main two expectations, the investors assume certainty in the following aspects:

- Control over management and the ability to have a say in developing the strategy of the company in order to secure the achievement of the objectives set by the City.
- Ability to make investment decisions according to the earlier agreed parameters.
- Clear and stable tariff regulation.
- Ability to decide over the profit distribution of AS Tallinna Vesi …

The main obligation of the investor is to manage AS Tallinna Vesi so that the population of the City would be provided with the water supply and sewerage service that has the required quality. The obligation of the City is to provide AS Tallinna Vesi with a stable operating environment and the possibility to implement the strategic plans by flexible management decisions. [emphasis added]

l) To this end, one of the objectives of the City of Tallinn in the privatisation process was to "to develop a stable and transparent tariff regulation".[38] The Explanatory Memorandum, approved by the City prior to privatisation, stated:[39]

Stable tariff policy

One of the most important objectives of the City is to ensure the stability of water tariffs in the future…

According to the PWSSA, the price of the service must ensure: (i) coverage of the production expenses, (ii) compliance with the

[38] Exhibit C-9 at page 135.
[39] Exhibit C-9 at pages 139-143.

> quality and safety requirements, (iii) compliance with the environmental protection requirements, and (iv) justified profitability…
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> Therefore, it is necessary to establish a longer-term, transparent tariff mechanism that allows for compliance with the requirements established by the laws and contracts and ensures the financing of investments, while making AS Tallinna Vesi increase efficiency. The tariff level is directly related to the required service level and the resultant investment needs, and the tariff must also allow for achieving justified profitability for the investor ..
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> A clearly determined procedure for the calculation of the subscription fee, the connection procedure and agreement on the financing of the development, and maintenance of storm water are also required [for] a stable tariff policy. [emphasis added]

m) An Order from the Government of Estonia dated 1 August 2000 approving an exception for the term of the "exclusive right of water companies to be appointed in the administrative territory of the City of Tallinn" also emphasised the importance of stability and reinforced the expectation. The Order allowed the City of Tallinn to grant an "exclusive right" term of up to 15 years in acknowledgement of "the need to ensure a stable development of water industry in Tallinn and a return on investments to be made in the networks and equipment."[40]

n) The Tariff Formula was restated in the various contractual amendments, which were executed by the City of Tallinn and the Claimants over the course of the eight years following privatisation. Thus, the Amendments of 2002 and 2007 were consistent with the Claimants' original expectations that the underlying principles of the regulatory regime and the Privatisation Agreements would be respected. They reaffirmed the State's acceptance of ASTV's projected profit levels as "justified". The only change was to the length of time over which that profit would be realised.

35. In my view, the contractual clauses which refer to potential regulatory change do not have the effect of denying the Claimants' expectation of a reasonable degree of stability in the fundamental elements of the tariff regime, given the other representations made by the State during the course of the negotiations. The emphasis of tariff stability and the acknowledgment that the agreed profit levels constituted "justified profitability" under PSSWA are important and cannot be overridden by clauses 7 and 10 of the Services Agreement (set out in paragraph 34 (i) and (j) above), which were not themselves inconsistent with these expectations. This is where I depart from my colleagues who view those clauses as a reason to deny any form of stability regarding the fundamentals of the tariff regime, at least with regard to how that regime applied to the Claimants.

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[40] Exhibit C-412.

36. I would have found that the anti-stabilisation provisions of the Services Agreement must be read in conjunction with other representations made by the City of Tallinn during the contractual negotiations. These were representations made to the investor to induce it to enter into the investment and this is the basis upon which UUTBV prepared its bid and entered negotiations. Nothing in the Services Agreement is inconsistent with the representations made by the City during negotiations; it was understood by both Parties that regulatory freeze was not the objective, but that this does not mean that stability of the underlying principles was abandoned.

37. For the reasons given above, I am satisfied that the Claimants' investment would not have been obtained but for the State's assurances (in the form of its pre-contractual representations and its contractual commitments) that (i) the Claimants' projected levels of profitability were justified; (ii) the key characteristics of the regulatory regime would remain fundamentally stable; and (iii) the regulator would operate in a manner that respected the agreed tariff regime to the extent allowed by law.

38. I note that this interpretation of the negotiating position is consistent with arguments advanced by Estonia in this arbitration. The Respondent's contention was not that it could introduce wholesale changes into the regulatory regime, but that the changes it made did not affect the stability of the overall regime:[41]

> As the ECA had repeatedly explained to ASTV, the Commission confirmed that the AMB did not change the components of the water tariffs compared to the 1999 PWSSA and did thus not affect the stability of the regulatory regime.

39. Therefore, in my view, the more pertinent question to ask is whether the State's actions breached the Claimants' legitimate expectations regarding stability in the underlying regime. For obvious reasons, the majority never addressed this point, having found that no legitimate expectation existed for the State to breach.

Breach of legitimate expectations

40. On the basis that the Claimants held legitimate expectations, I now consider whether Estonia's conduct breached those expectations, resulting in a violation of its Treaty obligations.

41. I note that, in my view, the change of regulator would not itself constitute a breach of the Claimants' legitimate expectations, nor would simply amending the PWSSA. To this extent I agree with the findings stated at paragraphs 775, 785 and 790 of the Award. The State had a clear right to evolve the statutory regime, as set out in clause 10(1)(a) (amongst others) of the Services Agreement. The issue to be addressed is whether the changes introduced by the AMB caused any fundamental alteration to the underlying

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[41] Counter-Memorial, para 246.

principles of the regime with the consequence that the Claimants' investment was significantly undermined.

42. The AMB amended the PWSSA so that justified profitability was revised to mean "justified profitability *on the capital invested by the water undertaking*". I agree with the finding at paragraph 801 of the Award:

> … the Tribunal is persuaded that the phrase "capital invested *by the water undertaking*" sought to exclude privatisation value from the calculation of tariffs. Although this might not have been the sole purpose of this amendment to the draft AMB, the evidence nonetheless indicates that this was an important reason for the amendment, and was directed specifically at ASTV. As to the Respondent's argument that such modification did not alter the state of Estonian law, the Tribunal rejects that proposition and agrees in this respect with the Estonian Supreme Court.

43. The Tallinn Circuit Court found that "if the earlier PWSSA §14 (3)(4) allowed [reliance] *inter alia* on an undertaking's privatisation value … then the current §14(2)(5) should be taken to mean … that the privatisation value of an undertaking cannot be treated as invested capital."[42] This was affirmed by the Estonian Supreme Court.[43]

44. Hence, in my view, by implementing this amendment the State deliberately sought to undermine the regime agreed with ASTV in the Services Agreement. Through the Services Agreement the State had specifically agreed that the concept of "justified profitability" under the PWSSA took into account UUTBV's upfront investment and allowed the Claimants to make a return on that investment in the latter phase of the mandate through its tariffs. Consequently, the new approach taken in the AMB altered one of the fundamental principles of the tariff regime and, in my view, undermined the Claimants' legitimate expectation that the tariff regime would remain fundamentally stable.

45. The Respondent acknowledged the significant impact on ASTV, but submitted that targeting ASTV in this manner was justified as a result of excessive profits that "patently violated the requirements of the law and established illegal tariffs that had to be re-regulated."[44] The Respondent further submitted that ASTV would remain profitable under the revised lower tariffs demanded by the ECA. The Claimants denied the Respondent's arguments of excessive profitability and noted that ASTV's consumer tariffs were below average.[45] The Claimants, in my view, persuasively argued that any perception of excessive profitability is based on ignoring the privatisation value and is therefore not a true reflection of the overall profitability of the investment.

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42 Exhibit C-432, para 26.
43 Supreme Court Decision (12 December 2017).
44 Respondent's Rejoinder Memorial, para 374.
45 Claimants' Reply Memorial, paras 206 et seq.

46. Estonia, in my view, also breached the Claimants' legitimate expectations by failing to take any account of the Services Agreement once the ECA became the regulator. The ECA had reasonably wide discretion in determining tariffs, subject to compliance with the PWSSA. As discussed further below,[46] the ECA was determined that ASTV's tariffs should be reduced. The ECA refused to even read the terms of the Services Agreement and saw no need for any consistency with the previous regime or transitional period. The Methodology – which was determined by the ECA – created a very different model to that previously applied to ASTV and the ECA was not interested in consultation or discussion regarding its preferred approach.

47. As I understand it, within the bounds of the PWSSA, the ECA could have adopted an approach that was more consistent with the State's obligations under the Services Agreement and thus respected the fundamental basis of the original investment. Had the ECA taken a more flexible approach to ASTV, the Claimants' legitimate expectations could have been respected even within the confines of the new regime. The majority's finding that Estonia's unilateral abandonment of its commitments under the Services Agreement was consistent with its international obligations cannot, in my view, by correct.

48. In summary, I consider that the expectations engendered by the repeated and consistent assurances of the State that a stable tariff regime was a priority for the State and that the tariff arrangements set out in the Services Agreement complied with the PWSSA are sufficient to found a breach of the standard of fair and equitable treatment. Estonia willingly created an expectation about the operation of the tariff regulatory mechanism, in the absence of which no investment would have been made. Relying on this commitment, the Claimants undertook significant investment in the Tallinn water service system. In my view, the State cannot now disregard the promises it freely made to induce the investment.

49. For these reasons, I am unable to join my colleagues in finding that there has been no breach of the FET obligation in this regard.

BREACH OF DUE PROCESS

50. While I do not agree with the majority's findings on legitimate expectations, I acknowledge that some of the arguments in that area are finely balanced due to the acknowledgement by the Claimants that the regime would evolve over time.

51. However, I do not consider that such a fine balance is maintained with regard to the Claimants' due process claim. In my view, there were egregious breaches of due process in this case.

52. The Claimants have submitted that, through the actions of the ECA, Estonia failed to afford the Claimants due process in its administrative decision making. The majority have

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[46] See para 97.

concluded that "Estonia did not, under international law, fail to afford due process to Claimants."[47]

53. The majority reaches this conclusion by separating out individual alleged due process violations, addressing and dismissing each issue in turn, without ever seriously seeking to address the cumulative effect of these issues as a whole. In my respectful view, this approach has resulted in a complete failure to appreciate the gravity of the behaviour of the ECA which, when considered in its entirety, shows a clear failure by the Respondent to have regard to its due process obligations under the Treaty.

54. I cannot in good conscience concur with the majority's view that the actions of the ECA, and in particular the closed-minded manner in which the ECA approached ASTV's tariffs, did not constitute a breach of due process. In my view, a very clear and indeed flagrant breach of due process has occurred for the reasons I set out below, with the result that the Respondent is in breach of its FET obligation in this regard.

Law on Due Process

55. The Award sets out at paragraphs 867 – 870 the law relating to breach of the FET obligation through a failure to accord an investor due process. I agree with this analysis.

56. The fact that the allegations concern an administrative (rather than judicial) procedure does not prevent a due process violation being found. This was made clear in *ECE Projektmanagement v. Czech Republic*, where the Tribunal stated that "a failure to accord due process in administrative or judicial proceedings may, if unremedied and of sufficient seriousness, result in a violation of the fair and equitable treatment standard."[48] (emphasis added)

57. In addition to the description of the case law provided in the Award, I would add that violations of due process have been found where tribunals have considered that the offending party had a "willful disregard of the fundamental principles upon which the regulatory framework is based, a complete lack of candor or good faith on the part of the regulator in its dealings with the investor, as well as a total lack of reasoning, would constitute a breach of the minimum standard."[49]

58. Other elements that have been found to constitute a due process violation include a complete lack of transparency and candour in an administrative process[50] and where the

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47 Award, para 901.
48 Exhibit RL-164, ECE *Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtundsechzigste Grundstücksgesellschaft mbH & Co v. Czech Republic*, PCA Case No. 2010-5, Award (19 September 2013), para 4.805.
49 Exhibit CL-110, *TECO Guatemala Holdings LLC v The Republic of Guatemala*, ICSID Case No. ARB/10/17, Award (19 December 2013), para 458.
50 Exhibit CL-115, *Waste Management Inc. v. United Mexican States [II]*, ICSID Case No. ARB(AF)/00/3, Final Award (30 April 2004), para 98.

exercise of power is not "done in a manner which is fair to the interests of an investor."[51]

Parties' Positions

59. Before analysing the due process allegation, I briefly set out the Parties' respective positions.

Claimants' Submissions

60. The Claimants submitted that Estonia breached its FET obligation under the Treaty by failing to afford the Claimants due process in its administrative decision making.

61. The Claimants alleged that the ECA failed to follow due process in: (i) its investigation of ASTV's tariffs leading to the Analysis; (ii) the preparation of the Methodology; and (iii) its treatment of ASTV's 2011 Tariff Application.

62. More specifically, the Claimants claimed that the ECA breached due process by:[52]

a) refusing to process ASTV's tariff application on the basis that it did not comply with guidelines published after the tariff application was submitted;

b) using information obtained under the guise of a market investigation to conduct a targeted analysis of ASTV's tariffs;

c) failing to consult ASTV regarding its tariff-setting process prior to issuing such Analysis in 2009; and

d) failing to engage with the flaws in its Analysis identified by ASTV.

63. According to the Claimants, the Analysis was based on information (improperly) obtained about ASTV under the guise of a market investigation, when the true purpose was to conduct a targeted analysis of ASTV's tariffs (the final Analysis only addressed the tariffs of one water company, ASTV).[53] The Claimants stated that Analysis wrongly depicted ASTV as excessively profitable and called for its tariffs to be reduced by up to 25%.[54]

64. The Claimants contended that they had no time to respond to the Analysis (it was provided only one day prior to publication and was in Estonian, not English). Although the ECA had previously requested financial information from ASTV for the purposes of the Analysis (which ASTV provided), it ultimately based the Analysis only on publicly available data, which skewed the results. Most significantly, the ECA failed to take into account the Services Agreement and the Tariff Formula when preparing its Analysis.

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[51] Exhibit RL-164, *ECE Projektmanagement v. Czech Republic*, para 4.805.
[52] Claimants' Memorial, para 216.
[53] Claimants' Reply Memorial, paras 304 et seq.
[54] Claimants' Reply Memorial, para 304(c).

65. The Claimants also contended that the ECA's Methodology was not consistent with international best practice and that the ECA failed to undertake any meaningful consultation on the Methodology before it was finalised.

66. The ECA then refused to process ASTV's tariff application on the basis that it did not comply with guidelines that were published after the tariff application was submitted, and which were in any event recommendatory guidelines only – not mandatory requirements.

67. Throughout all of the above events, the Claimants contended, that one of the most serious failings was that the ECA refused to take account of the Services Agreement and the "unique framework" that had been created thereunder.[55]

Respondent's Submissions

68. The Respondent's position was that the Claimants' complaints fall short of the standard required by international law – which sets a "very high threshold".[56]

69. According to the Respondent, the ECA conducted the Analysis in full compliance with the Claimants' procedural rights. The Analysis was a result of a water market investigation conducted by the ECA under the Competition Act. That investigation revealed that, out of the 12 companies surveyed, ASTV was the only one charging excessive prices.[57]

70. As to the timing of the Analysis, the Respondent submitted that the provision of the Analysis one day before publication was entirely appropriate. The recommendations in the Analysis were not binding and there was no requirement to send it to ASTV at all. According to the Respondent, the draft was only provided to ASTV so that it might prepare a stock exchange release.[58]

71. As to the Claimants' other submissions, the Respondent noted that the ECA did take account of confidential information provided by ASTV, but did not include it in the publication as it made no material difference.[59]

72. The Respondent also rejected any assertion that the ECA violated ASTV's due process rights during the tariff application process. The ECA gave ASTV an opportunity to revise its application when it did not comply with guidelines issued by the ECA. The reason that the 2011 Tariff Application was eventually rejected was its failure to comply with mandatory elements of the Methodology and the PWSSA.[60]

Key Facts

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55 Claimants' Reply Memorial, para 305.
56 Respondent's Rejoinder, para 429.
57 Respondent's Counter-Memorial, para 457.
58 Respondent's Counter-Memorial, para 460 and Rejoinder, para 437.
59 Respondent's Rejoinder, para 436.
60 Respondent's Rejoinder, paras 440-442.

73. In my view, the factual chronology is important and revealing on this issue. It is, therefore, pertinent to recall the key facts before embarking on an analysis of the issues, even though some of these facts have already been briefly described in paragraphs 6 – 22 above.

74. At the time that ASTV was privatised, section 14(3) of the 1999 PWSSA stated:

> The price for the service specified in subsection 1 of this section shall be established such that the water undertaking can:
>
> 1) Cover production costs;
>
> 2) Comply with quality and safety requirements;
>
> 3) Comply with environmental protection requirements;
>
> 4) Operate with justified profitability.

75. Prior to privatisation, the City of Tallinn had been concerned about ASTV's infrastructure and environmental compliance.[61] The primary purpose of privatisation was to remedy these issues by improving infrastructure.

76. Following some research undertaken in 2005, the Ministry of Environment became concerned that the tariffs being charged by water utilities in Estonia were not sufficient to cover costs or meet the second and third obligations above. Ms Kroon, now head of the Water Department for the Ministry of Environment, stated in her First Witness Statement:[62]

> Our participation in the Supervisory Boards and discussions with the representatives of the water utility companies revealed that the local municipalities were often not willing to increase tariffs for political reasons …
>
> This had a negative impact on the quality of water supply and sewerage services because the water utility companies could not make investments to maintain or improve their infrastructure …We at the Ministry thus concluded that in order to separate the regulation of water prices from the local municipalities' political agenda, it was necessary to transfer the supervision over water tariffs to an independent state agency.

77. Consequently, in 2006, the Ministry of Environment called for reform to the regulatory regime for water tariffs in order to address these issues. The Ministry proposed an amendment to the PWSSA so that authority over tariff setting be transferred to an independent State agency that would not be afraid to make the necessary tariff increases.

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[61] See Claimant's Reply Memorial, para 23.
[62] Kroon 1st WS, paras 11-12.

78. The first draft of the Ministry's proposed amendments was finalised in June 2008.[63] The proposal included (i) the removal from local councils of the power to set water tariffs, although local municipalities retained this power; and (ii) the ECA and the Environmental Inspectorate would be entitled to examine whether tariffs accorded with the PWSSA. If tariffs did not comply, these two agencies could issue a binding order to increase or lower tariffs accordingly.

79. At the beginning of 2009, the EOKL (the Estonia Homeowners Association) began making public statements about ASTV's tariffs. In January 2009, the EOKL issued a press release asserting that ASTV's profits should be reduced by 20-30%.[64] Further statements followed throughout 2009 and 2010.

80. In late 2008, the ECA decided to investigate the tariffs of water utilities. The ECA wrote to ASTV on 12 February 2009 requesting detailed information in relation to ASTV's accounting practices and profits. The ECA said that "a need has emerged to analyse the competitive situation in the market of water supply"[65] and that it had received applications asking it to check whether water utilities were complying with their obligations under the Competition Act. The ECA told ASTV to indicate any commercially sensitive information that was supplied. ASTV complied with the ECA's request, providing detailed responses to the ECA both in meetings and in correspondence.

81. While the ECA's investigation was ongoing, the AMB was introduced into the Estonian Parliament on 15 October 2009. The AMB proposed that the ECA would become the regulator of water tariffs and that the definition of justified profitability be amended. The members of the EOKL who had criticised ASTV earlier in 2009 also belonged to the political party (the IRL) that sponsored the introduction of the AMB. The AMB replaced the proposal originally put forward by the Ministry of Environment (as noted above, the Ministry of Environment's proposal was aimed at ensuring tariffs were sufficiently high so as to enable water companies to meet environmental and quality requirements).

82. Conversely, the explanatory letter to the AMB made it clear that the reduction of tariffs was the desired aim – and specifically, the reduction of ASTV's tariffs:[66]

> Poor protection of consumers' rights and not following the competition law has in more conspicuous cases led to a situation in which for example the productivity of the assets invested of the leading water undertaking of Tallinn is 19.6%. Taking as the basis the general European practice regarding the justified rate of profit of the water undertaking (7-8%), if the draft bill applies the price of water for the end consumer of Tallinna Vesi

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63 Exhibit R-151.
64 Exhibit C-143.
65 Exhibit C-37.
66 Exhibit C-39, p. 908.

> alone should reduce by ca 24% next year.
>
> Prices of these services influence significantly also consumer prices. Based on the earlier statistics of the Ministry of Finance, a reduction in the prices of Talllinna Vesi by 24% alone would bring about an estimated reduction in CPI by ca 0.2%.
>
> The task of the bill is to mitigate the social and macroeconomic trends that have a wider impact: on one hand unjustifiably high prices of universal services obstruct the competitiveness of Estonian companies and deteriorate in perspective the recovery of the macroeconomic environment. On the other hand, an unjustified price formation of universal services has a strong negative impact on domestic consumers.

83. The explanatory letter did not refer to the problems identified by the Ministry of Environment – that is, the under-investment in infrastructure leading to a breach of the environmental and quality obligations of the PWSSA. Instead, its focus was on "fixed justified rates of return" and an "undertaking's obligation to initiate lowering prices if the input prices or other production costs change."[67]

84. Although the ECA's market investigation was intended to target all water companies, on 30 November 2009, the ECA sent ASTV a copy of the "Analysis and Opinion on AS Tallinna Vesi's Price Formation" (defined above as the "Analysis").[68] The Analysis was directed solely at ASTV. This was the only report ever issued by the ECA as a result of its market investigation.

85. ASTV was provided with a copy of the Analysis on the afternoon of 30 November 2009 in the Estonian language. Based on publicly available information (and without utilising the financial information provided by ASTV), the 35 page document concluded that ASTV's profits were 2.18 times higher than they should have been. Specifically, the Analysis concluded that:

a) the manner used by the Tallinn City Government for regulating ASTV's prices was not appropriate to a proper price regulation;

b) ASTV's return on invested assets (which the ECA calculated to be 18.1%) was said to be "not justified" and exceeded the weighted average cost of capital ("**WACC**") by 9.79%; and

c) the ECA found that ASTV's prices would be considerably lower if regulated in accordance with internationally recognised principles.

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[67] Exhibit C-39, p. 908.
[68] Exhibit C-38.

86. Although ASTV asked the ECA for more time to translate and consider the Analysis, Mr Ots (the ECA's director) published the Analysis and held a television interview at 10am the following morning (1 December 2009) during which he said that ASTV, the largest water company in Estonia, should reduce its tariffs by up to 25%.

87. Throughout the early part of 2010, ASTV attempted to engage with the ECA on the Analysis document, seeking to explain to the ECA why ASTV considered the ECA's model to be flawed. Mr Plenderleith (of ASTV) stated in his First Witness Statement that:[69]

> My belief at this stage was that the ECA intended to conduct an objective, apolitical analysis of ASTV's profitability, but that it had used an inappropriate methodology and had not relied on appropriate information. My approach in engaging with the ECA was to ensure that the ECA understood the terms of the privatisation and had factored these into its Analysis properly.

88. It is of importance to note that, based on the Analysis, the Chancellor of Justice issued Recommendation No.8 finding that the City of Tallinn's approach to ASTV was not in compliance with the PWSSA. The Chancellor then brought an action in the Estonian Supreme Court to enforce compliance with his Recommendation, but the action failed as the Court ruled that the Chancellor had exceeded his jurisdiction.[70]

89. The AMB was passed in August 2010 and the ECA became the tariff regulator for water undertakings on 1 November 2010.

90. On 9 November 2010, ASTV applied to the ECA for approval of its annual tariff increases for 2011-2015. Under the Services Agreement, the K-coefficient for 2011 (and all years thereafter) was to be zero, therefore the increase requested by ASTV was based solely on CPI.

91. Three days later (12 November 2010), the ECA published its "Recommended principles for calculating the price for water service"[71] (referred to as the "Methodology") and the associated "Guidelines for the Determination of Weighted Average Cost of Capital 2010".[72] A draft of the Methodology and WACC Guidelines had been circulated in September 2010 upon which ASTV had commented. ASTV also commissioned PricewaterhouseCoopers ("**PwC**") to independently analyse the Methodology and WACC Guidelines. PwC's report identified serious flaws in the ECA's Methodology as compared to international best practice. PwC also noted with regard to the net book value approach taken by the ECA that:

- Methodology should take into account the fact that in case of

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69 Plenderleith 1st WS, para 65.
70 Exhibit C-192.
71 Exhibit C-162.
72 Exhibit C-163.

companies operating in the market, especially if private investors have invested into a company, the owners have proceeded from a certain framework looking out to the future and expectations regarding returns impacted thereby.

…

- As far as we know, in Estonia the privatisation subject of water company of a significant size is only concerning the privatisation of Tallinna Vesi, where the City of Tallinn sold in 2001 through advertised bidding 50.4% of the company's shares to a private investor. One of the decisive factors of the price of transaction was the regulative environment at the time of privatisation.

- The impact of invested capital in the course of privatisation should be taken into account once in the company's history. In case the change of an owner has taken place after the privatisation, between private investors, it is complicated to find out all the circumstances of the transaction, and it is therefore difficult to assess whether the price of transaction reflects the fair market value.

- Our opinion is that using the value based on the replacement value is financially-economically justified in determining the original value of the assets.

- When determining the original value of the assets, the value based on the capital invested at the privatisation may be compared to the net replacement value of assets. From the point of view of protecting consumers, it might be justified to proceed from the lowest value estimated by the two named methods in calculating the justified value of RAB. Such approach would ensure a justified return on invested capital to the investor, protecting at the same time the consumer in the situation, where the return based on e.g. net replacement value would be times higher than the return calculated based on invested capital. According to our knowledge such an approach has been implemented by Ofwat.

92. The Estonian Water Companies Association (known as "**EVEL**") also commented on the draft Methodology and commissioned a report from KPMG.[73] The City of Tallinn produced a report by Oxera.[74] The KPMG report (and covering letter) noted the lack of clarity in the strategic and regulatory objectives of the Methodology and water regulation generally. KPMG identified over 20 areas where the draft Methodology was not consistent with international best practice (using Ofwat as an example).[75] KPMG concluded that:[76]

"The draft regulation, if passed in its current format, will have little meaning

[73] See Exhibits C-177 and C-182.
[74] Exhibit C-179.
[75] Exhibit C-177.
[76] Exhibit C-182, p. 2957.

> if measures such as the WACC and RAB are not placed in appropriate regulatory economic context. Our report suggests that prices, revenues and profits should be controlled such that investors have sufficient incentives to invest in the first place – failure to provide these incentives would lead to under investment in an industry that has high capital expenditure."

93. The ECA did not engage with any these reports or the criticisms made therein prior to publication of the finalised Methodology. As noted at paragraph 118 below, EVEL considered the ECA's consultation process to be "cosmetic" only – the ECA had no intention of engaging with the views provided.

94. ASTV asked the Chancellor of Justice to review the manner in which the ECA handled the consultation process for the draft Methodology and a number of other complaints regarding the review of water tariffs more generally.[77] It is of great significance to note that the Chancellor found a breach of due process had occurred whereby the ECA had failed to properly explain the role of participants in the consultation process, although he dismissed the other complaints made by ASTV.[78]

95. ASTV also submitted a complaint against Estonia to the European Commission in December 2010. The complaint was dismissed, as the Commission concluded that amending the regulatory regime was within Estonia's regulatory powers.[79]

96. The ECA rejected the ASTV's tariff increase application on 2 May 2011. Then on 10 October 2011, the ECA issued Prescription No. 9.2-3/11-001, stating that ASTV was to apply for tariffs that would be 29% lower than its 2010 tariffs.[80] ASTV obtained an injunction in the Estonian courts preventing the Prescription from being applied. This has meant that ASTV's tariffs were effectively frozen at the 2010 level. This remains the case today, despite multiple applications by ASTV to the ECA to increase the tariffs in line with inflation.

My Analysis

97. When considered as a whole, the factual background set out above in paragraphs 6 – 22 and 73 – 96 (and further in the Award at paragraphs 123 – 306) clearly indicates, in my view, that certain elements within the Estonian political sphere had decided around 2009 that ASTV's profits were too high and needed to be reduced. A concerted effort was then made to ensure that this reduction materialised.

98. As I understand it, ASTV was the only water company singled out in the discussions about

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77 Exhibit C-189.
78 Exhibit C-215.
79 Exhibit C-219.
80 Exhibit C-44.

profitability levels, despite the fact that its tariffs were similar to other water utilities. Indeed, they were below-average.[81] This was so even though ASTV was also one of the few water companies that had invested in the company's infrastructure in compliance with the environmental and quality obligations in the PWSSA. Unfortunately, as Mr Ots himself stated, the ECA did not supervise the quality of water services provided by Estonian water utility companies.[82] Its focus was therefore primarily on price.

Mr Ots' oral evidence

99. In considering the specific issues relating to due process, I found the oral evidence given during the hearing by Mr Ots, the Director General of the ECA, particularly revealing and strongly supportive of the Claimants' contention that there had been in this case a very clear breach of due process.

100. I note below some of the relevant passages from the transcript:

a) It is of critical importance to note that Mr Ots conceded that he did not review the Services Agreement, Shareholders Agreement or Business Plan in undertaking the 2009 Analysis.[83] He stated that, at the time of the Analysis, he had "no knowledge" of the Privatisation Agreements,[84] although the ECA referred to them in the Analysis.[85]

b) Moreover, in Mr Ots' view, consideration of the Privatisation Agreements was unnecessary:[86]

> THE PRESIDENT: Right. I am not sure how to put this, but would those contracts have been relevant to you in your analysis? The analysis per se, the 2009 analysis.
>
> A: (In English) Not at all.
>
> THE PRESIDENT: It would not have been relevant?
>
> A: (In English) Not relevant.

c) Mr Ots agreed that he did not give ASTV an opportunity to discuss the Analysis (which concluded that ASTV was excessively profitable) with him before it was made public on 1 December 2009.[87]

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[81] Claimants' Reply Memorial, para 206.
[82] Ots 2nd WS, para 43.
[83] Transcript, Day 4, 101–105.
[84] Transcript, Day 4, 142:13.
[85] See also, Ots 1st WS, para 37.
[86] Transcript, Day 4, 142: 25-143: 5 (see also Transcript, Day 4, 111 and Transcript, Day 3, 181–182).
[87] Transcript, Day 3, 181: 18-21.

d) Mr Ots excused the lack of opportunity to comment on the Analysis (while all the time maintaining that ASTV's comments would never have changed his mind in any case) by saying that the Analysis was non-binding and therefore not subject to usual due process requirements.[88] However, he then went on to say that it was not wrong to use that Analysis to form an official conclusion that ASTV was in breach of competition law and to give almost no notice for ASTV to prepare its stock exchange announcements before making such a conclusion public.[89] As noted at paragraph 88 above, the Chancellor of Justice then used that Analysis as the basis for his Recommendation No.8.

e) Moreover, Mr Ots acknowledged that he had concluded as a result of this non-binding Analysis that "ASTV was charging excessive tariffs".[90] He also said that in his mind there was no possibility that a more detailed investigation would have changed his opinion that ASTV was charging excessive tariffs.[91]

> MR WEINIGER: […] Then I was going to take you to paragraph 36 of your first statement, and see if you would agree that based on your initial investigation, you had already concluded that ASTV was charging excessive tariffs?
>
> A: Yes.
>
> Q: If we look at paragraph 36 again of your first witness statement, was this a preliminary conclusion that ASTV was charging excessive tariffs?
>
> A: Exactly, there was a preliminary conclusion.
>
> Q: Was there a possibility that a more detailed analysis would have led to a conclusion that ASTV was not in fact excessively profitable?
>
> A: No.

f) Mr Ots agreed that he used a one-year regulatory period for his analysis even though no other country took this approach.[92] He also agreed that such a 12-month period was not a requirement under the PWSSA.[93] The use of this short timeframe effectively meant that a "snapshot" of profitability was taken which did not account for previous expenditure. In relation to the Claimants, whose investment had been front loaded, this meant that the overall profitability of the investment was misrepresented.

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88 Transcript, Day 3, 182: 3-13.
89 Transcript, Day 3, 172-184.
90 Transcript, Day 3, 185: 20-24.
91 Transcript, Day 3, 185: 20-186: 7.
92 Transcript, Day 3, 168: 17.
93 Transcript, Day 3, 173: 25.

g) Although Mr Ots acknowledged during the oral hearing that there was value in looking at international best practice in water regulation,[94] Mr Ots rejected the UK Ofwat (economic regulator of the water sector in England and Wales) approach, even though he had used England in the Analysis for comparison.[95] During the hearing, Mr Ots was critical of the Owfat approach[96] and said that the ECA rejected any comparison with European water regulation bodies, even though the entire privatisation process had been driven by the need to comply with European standards.

h) Mr Ots admitted that his intention was to instigate a complete change in the regulatory approach:[97]

> MR WEINIGER: When the Competition Authority began regulating ASTV, would it not have been a positive thing for the Competition Authority to act consistently with the way that regulation had previously been managed?
>
> A: No.

Thus, Mr Ots did not consider that any consistency with the old approach was needed. There was no transition period or consideration of the Privatisation Agreements whatsoever.[98]

i) The Claimants further summarised parts of Mr Ots' evidence in their post-hearing brief:[99]

> Estonia's actions in issuing the Decision and the Prescription were also founded on severe breaches of due process. Estonia's conduct throughout this period was characterised by a conscious disregard for the Claimants' substantive and procedural rights and a refusal to engage with the Claimants and their regulator, illustrated by Mr Ots' unapologetic declaration that in conducting the Analysis "*we definitely did not ask Tallinna Vesi as to what kind of regulatory practice was applied*" (Day 3/180/4–6), despite his admission that "*we have had no detailed understanding* [of] *what's ongoing*" in relation to ASTV's regulation (Day 4/159–160), yet nevertheless refusing to engage with ASTV and its regulator as was appropriate on the basis that he was "*certain that ASTV's comments on the Analysis would not have affected our results*" (Day 3/181/1–6).

101. Mr Ots' oral evidence during the hearing as to his unwillingness to veer from his stated

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94 Transcript, Day 3, 175: 19-25.
95 Transcript, Day 3, 178: 25.
96 Transcript, Day 3, 177: 15.
97 Transcript, Day 4, 116: 21.
98 Transcript, Day 4, 116-117.
99 Claimants' Post-Hearing Brief, para 466.

path of reducing ASTV's tariffs is also borne out in his written evidence. For example, he stated at paragraph 12 of his Second Witness Statement that "I am also certain that ASTV's comments on the analysis would not have affected our results".[100]

102. Mr Ots maintained this view despite admitting in his written evidence that "the data available to us during the investigation was not sufficient to assess ASTV's costs in detail."[101] Overall, Mr Ots was dismissive of due process considerations at least in relation to the Analysis as, in his view, the non-binding document was "not subject to any specific rules of due process under Estonian Law."[102]

103. Addressing what he saw as the inadequate regulation of water utilities appears to have been a personal passion of Mr Ots, as he explained in his First Witness Statement.[103] Mr Ots was also clear that Tallinn was his focus.[104]

Failure to consider all relevant information

104. Consistent with the proposition that the ECA had made up its mind to pursue a tariff reduction for ASTV regardless of the evidence, is the ECA's seeming determination to ignore relevant evidence that proved problematic to its desired outcome.

105. Mr Ots acknowledged that the ECA did not have detailed costs information for ASTV[105] and the Analysis itself was "prepared on the basis of publicly accessible data" only.[106] The Claimants alleged that using the more detailed confidential data provided by ASTV would have been more accurate,[107] although Mr Ots maintained that the outcome would not have changed in any significant manner.[108] The fact that the ECA lacked detailed information on some aspects of the investigation and failed to use more accurate data on other aspects, demonstrates in my view a lack of rigour in the ECA's approach to the Analysis. This in turn supports the contention that the ECA's primary driver from an early stage was to ensure that ASTV's tariffs were reduced, rather than any genuine attempt to engage with the relevant issues.

106. This is particularly true regarding the ECA's determination to completely ignore the Services Agreement. Despite the fact that it had never seen the Services Agreement (or any of the Privatisation Agreements), the ECA saw fit to criticise the tariff methodology adopted in that Agreement:

> "The [E]CA deems it necessary to note in the first place that, leaving aside the actual justifiability of ASTV's prices, barely the manner used by Tallinn

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[100] He confirmed this position during his oral evidence at Transcript, Day 3, 181: 3-6.
[101] Ots 1st WS, para 39.
[102] Ots 1st WS, para 45.
[103] Ots 1st WS, para 8.
[104] Ots 1st WS, para 26.
[105] See para 1.102 above.
[106] Exhibit C-38, p. 876.
[107] Claimants' Memorial, para 164.
[108] Ots 1st WS, para 47.

> City Government for regulating the prices is not appropriate to a proper price regulation. For the purpose of an effective price formation, the assessment of the extent ASTV's prices are based on the costs, should be done in line with the law and the price regulation procedure, but Tallinn City Government is following the agreement signed upon the privatisation of ASTV in establishing the water supply and sewerage prices (CPI, K-coefficient) instead. The [E]CA notes that due to the fundamental differences of the tariff formation mechanisms included in the procedure and the agreement, it is actually not possible to apply them in a parallel way and the two mechanisms would lead to the same tariff rates only in case of an unlikely coincidence. As Tallinn City Government has decided to proceed namely from the agreement signed upon the privatisation of ASTV, then inevitably it has not been sufficiently analysed to what extent the prices of ASTV are based on the costs."

107. Coming to such a conclusion without having reviewed the Agreement at issue is questionable enough, but then the ECA made the Analysis public which places in my view an even stronger obligation on the ECA to have properly considered all the information that was available to it (or would have been made available if requested). The damage done to ASTV by making the Analysis public, and the subsequent press comments by Mr Ots, should not be underestimated. I agree with Mr Plenderleith (of ASTV) that it was "extremely irresponsible and unprofessional" for the ECA to make strong negative public statements about a listed company when it had not sought to properly inform itself of all of the relevant information that might affect those statements and had not obtained relevant information from the official regulator which, at that stage, was still the City of Tallinn.[109]

108. The failure to consider all relevant information before making damaging public statements strongly supports, in my view, the Claimants' contention that due process was violated in this case.

Lack of notice

109. The Claimants also contended that the lack of time between receiving the Analysis and the ECA publishing the document and making statements to the press regarding its content was a breach of due process.

110. The Analysis was provided to ASTV at around 1.30pm on 30 November 2009 in Estonian with a cover letter that stated a public announcement would be made at 10.00am the next morning. The majority of ASTV's board did not speak Estonian and ASTV asked for more

[109] Plenderleith 1st WS, para 68.

time to allow the document to be translated, but the ECA refused.[110]

111. The Respondent contended that the ECA had no obligation to give ASTV any notice regarding the Analysis and its decision to do so (by giving one day's advance notice) was to allow ASTV to prepare a stock exchange release.[111] Nonetheless, the immense damage that publicly releasing a document of this nature could do to the reputation of a company seems to have been appreciated by the ECA, as indicated by the fact that it understood a stock exchange release would be necessary.[112] Mr Ots also noted in his written evidence that the "Analysis clearly touched upon an issue of significant public interest and prompted several newspaper articles."[113] This appreciation belies the dismissive attitude of Mr Ots towards any due process requirements when preparing and/or publishing the Analysis.

112. The fact that the ECA gave ASTV less than 24 hours to have the Analysis translated and reviewed, as well as prepare ASTV's position, is not, in my view, consistent with the ECA's due process obligations. As noted by Mr Plenderleith:[114]

> ASTV is a publicly listed company with a very high profile in Estonia. I was surprised and dismayed that the ECA acted in this unnecessary and procedurally unfair manner, particularly when ASTV had been entirely cooperative with its request for information.

113. The lack of notice is combined with the fact that the ECA did not inform ASTV during the course of the investigation that it had significant concerns regarding ASTV's profitability or tariff levels, despite the fact that the parties communicated on several occasions. Although Mr Ots disputes this, saying that the parties were clearly not in agreement as to the approach to tariff regulation during a meeting on 3 November 2009, he stops short of saying that he told ASTV directly that the ECA would be recommending drastic tariff reductions in the Analysis.[115] Based on the evidence before me, I accept Mr Plenderleith's position expressed in his Second Witness Statement that "I clearly recall being staggered by the conclusions and recommendations of the ECA."[116] This is consistent with the evidence contained in relevant contemporary board papers.

114. I acknowledge that the lack of notice on its own may not be enough to found a due process violation under international law, but when combined with the other due process failures discussed in this section, it is evident to me that the overall due process failure in this case was significant in scale.

Failure to take account of comments

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110 Plenderleith 1st WS, para 63.
111 Rejoinder, para 180; Ots 1st WS, paras 44-46; Ots 2nd WS, para 12.
112 Ots 1st WS, para 48.
113 Ots 1st WS, para 51.
114 Plenderleith 1st WS, para 63.
115 Mr Ots 1st WS, para 49; Mr Ots 2nd WS, para 11.
116 Plenderleith 2nd WS, para 14.

115. The Claimants allege that the Analysis was considerably flawed. While I have sympathy with this contention, the fact that the Analysis may have been flawed does not – of itself – constitute or even indicate a breach of due process.

116. However, the ECA's seemingly concerted effort not to take into account or engage meaningfully with any kind of criticism of the Analysis and, later, the Methodology is an important factor when considering the due process claim.

117. Mr Plenderleith gave evidence regarding ASTV's attempts to engage with the ECA on the Analysis and explain to the ECA the flaws that ASTV perceived to exist. Mr Plenderleith stated in his First Witness Statement that Mr Ots did not engage constructively or professionally with ASTV on the "theoretically unsound manner" in which ASTV considered the Analysis had been conducted.[117]

118. It was not just ASTV that had this experience when attempting to engage with the ECA on tariffs. Later, when the ECA released its draft Methodology, EVEL (the Estonian Association of Water Companies) wrote a letter to the ECA which makes astonishing and telling reading regarding the ECA's attitude to engaging with suggested amendments. In its letter, EVEL wrote:[118]

> In the light of the draft regulation submitted by the [E]CA on 21.10.10 and the abovementioned comments we regard it unreasoned that the [E]CA has made a reference to EVEL in the paragraph 'Objective and scope' of the regulation, according to which the [E]CA has asked for an opinion from EVEL, at the same time not taking into account a significant part and main issues of our opinion.
>
> This reference is even stranger, considering that as an association incorporating all larger water companies, the members of EVEL in cooperation with KPMG did a very extensive and thorough work for analysing the initial draft regulation. As a result of this we submitted the comments with justifications and explanations, adhering to the very short time limit (20 days), on more than 23 pages for establishing a regulation that takes into account the specific characters of the water sector. For us it is incomprehensible that the [E]CA submits a new version of the regulation after 25 days mainly with cosmetic amendments, no considerable changes with regard to the content, on 12 pages and with no comments.
>
> Based on the abovementioned, a question may easily be raised if the [E]CA is not asking from the relevant parties of the Estonian water sector to comment on various versions of the regulation only for formality and in order to create

[117] Plenderleith 1st WS, para 70.
[118] Exhibit C-183.

an impression of going through the procedural approvals." [emphasis added]

119. The letter goes on to plead with the ECA to start acting "professionally" and to reconsider the recommendations EVEL had made.

120. ASTV also wrote its own letter about the same time, stating:[119]

> "On 19 October myself and Siiri Lahe had a further meeting with you to discuss how the [E]CA would or had considered the terms and conditions of our privatisation contract and if and how the [E]CA would fully protect the purchasing power of invested capital from the impact of inflation. Regarding the first point, you stated that you hadn't seen or read the contract and were not aware of the details. However we informed you that the Services Agreement is a document that is publicly available and that all the key company information is also contained in the IPO documentation the company produced when listing on the Tallinn Stock Exchange in 2005. Regarding the second point, you stated that the [E]CA will fully protect invested capital from inflation and that this will be done through the WACC calculation of by enabling companies to index the RAB by CPI each year.
>
> Given all of the above I was astonished to read the latest daft of the [E]CA's methodology did not include any of the amendments raised by the company, nor did it contain any responses to the points and questions we included in our previous letter. Furthermore, in spite of your verbal commitment at our meeting on 19 October the key regulatory principle of fully protecting investing capital from the impact of inflation has once again been omitted from the methodology[.]
>
> Additionally, you have requested that ASTV submit its comments to the latest draft by the close of the working day on 27 October. This gives the company less than three working days to respond. This is not in accordance with any form of best practice principles and certainly does not allow sufficient time for the discussion and analysis of regulatory best practice.
>
> I appreciate that in trying to work within such a short time frame the [E]CA was only fulfilling an administrative requirement established by the AMB when requesting comments from the water industry and never intended to engage in meaningful dialogue. It seems that the [E]CA is task-oriented to forcefully establishing a kind of methodology by 01.11.2010, without any regard to comments from the industry that you are going to be regulating. Such conduct is aimed at establishing not a reasonable, but some sort of a pre-determined, regulation that does not accord with best practice principles and indicates not

[119] Exhibit C-184.

only a breach of due process, but also a probable bending to political will." [emphasis added]

121. As noted in paragraphs 91 – 92 above, both KPMG (for EVEL) and PwC (for ASTV) produced comments on the draft Methodology that were provided to ECA. PwC provided 8 pages of comments as to where and how the Methodology differed from best practice regulation for privatised companies and suggested ways in which it could be improved.[120] KPMG produced four pages explaining international models that could be adopted by the ECA and warning that failure to provide the right incentives would deter investment in the future.[121]

122. During his oral evidence, Mr Ots made it clear that he considered the ECA's proposed Methodology to be correct and that anyone who disagreed should be disregarded. He did not agree, for example, that the participation of industry participants added value to the process;[122] he ignored KPMG's advice which outlined international best practice;[123] he did not accept PwC's criticism of his preferred methodology;[124] and he continued to assert his Methodology was consistent with international best practice despite being shown evidence to the contrary.[125]

123. It is clear from Mr Ots' evidence and the behaviour of the ECA at the time, that the ECA had no interest in meaningful engagement with any party that did not agree with its proposed Methodology. It is of great significance that the Chancellor of Justice subsequently upheld a complaint from ASTV that the ECA had breached due process by failing to properly set out the basis upon which it would engage with interested parties on the Methodology.[126]

124. The attitude of the ECA towards Ofwat and other examples of best practice regarding price regulation is also consistent with the closed-minded approach taken by the ECA to tariff regulation.

125. It is notable that in the Analysis the ECA consistently used England (and, specifically, Ofwat) as the primary international comparator to be measured against:[127]

> Price regulation has long-term traditions and price regulation theory has been established, which the majority of the regulators of developed countries take as the basis (incl. *Ofwat, The Water Services Regulation Authority*) …

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120 Exhibit C-181.
121 Exhibit C-182, p. 2957.
122 Transcript, Day 3, 192: 7-21.
123 Transcript, Day 3, 190: 19-191: 17.
124 Transcript, Day 3, 207: 17-21.
125 Ots 1st WS, para 102; Transcript, Day 3, 177:15 and 206-212.
126 Exhibit C-215.
127 Exhibit C-38, pp. 875, 901 and 903.

> As a comparison the [E]CA presents the average returns of invested assets … of the financials of the water sector of England and Wales, prepared by Ofwat …
>
> This is also confirmed by the fact that the average operating profit margins of water companies in England and Wales regulated by Ofwat as well as the operating profit margin of United Utilities are considerably lower.

126. However, when interested parties such as EVEL and ASTV pointed out that the ECA's Methodology was not consistent with international best practice, including Ofwat, the ECA completely changed course and became critical of the Ofwat approach, dismissing it as irrelevant.[128] The ECA similarly dismissed ASTV's references to Ofwat in support of its 2011 Tariff Application.

127. Overall, in my view, the ECA's refusal to engage in genuine discussion regarding criticisms of the Analysis and the Methodology is a breach of due process and supports the conclusion that the ECA was closed-minded in its approach to ASTV's tariffs.

My view

128. In the light of the telling contemporaneous documentation, together with Mr Ots' oral evidence and the general chronology of events over this period, I find it extraordinary – and quite without any evidentiary support – that my colleagues should conclude at paragraph 911 that there was "no compelling factual or legal evidence" of a breach of due process regarding the methodology, or more broadly that the ECA's conduct throughout the period from 2009-2011 did not breach any due process requirements despite then acknowledging the "relatively closed-minded approach" taken by the ECA.[129]

129. To my mind, all of the evidence most strongly supports that opposite conclusion – a clear breach of due process has occurred in the ECA's dealings with ASTV and its tariff regulation. Mr Ots made it clear during his oral evidence that he had made up his mind at a very early stage that ASTV's tariffs had to be reduced and that he was not open to any discussion on this fact – he would not change his mind. When this is combined with the fact that the initial non-binding investigation did not consider all relevant information and that ASTV had no opportunity to comment on its content, the breaches of due process are manifest. This cannot simply be dismissed out of hand, as the majority appear to do.

130. In my view, Mr Ots' evidence during the hearing, together with the ECA's conduct, reveal without any doubt a complete unwillingness on the part of Mr Ots and the ECA to even consider ASTV's position on a fair, reasonable and transparent basis. Mr Ots had made

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[128] See Ots 1st WS, para 102; Transcript, Day 3, 177:15.
[129] Award, para 910.

up his mind very early on that ASTV's profitability was too high and approached his regulatory task with a firm outcome in mind. He was resolutely unreceptive to any ideas or arguments that were contrary to his own beliefs. In summary, my overall impression of Mr Ots and the ECA's position aligns with the evidence provided by Mr Plenderleith:[130]

> It was apparent to me that a decision had been made by the ECA that it would take the position that ASTV's tariffs needed to be lowered by 20-25%, and it had no interest whatsoever in revising this position in any way.

131. I note that the majority agree that the ECA was close-minded in its approach. Paragraph 910 of the Award states:

> The Tribunal also takes note, once again, of certain elements of Mr Ots' evidence which, in its view, suggests a relatively closed-minded approach to the work of the ECA:
>
> - Mr Ots testified that he did not agree that a regulatory system is best implemented with the involvement of all industry participants.
>
> - Mr Ots recognized that the AMB does not mandate a one-year regulatory period and that no other country takes this approach, as per Dr Hern's expert report.
>
> - Mr Ots was highly critical of the Ofwat approach but accepted that the ECA is required to monitor and be aware of the international situation.
>
> - Mr Ots explained that he sought to instigate a change in regulatory approach, and that he did not deem it necessary to ensure a certain consistency with the previous regime.

132. However, despite this, for reasons that are not clear to me, the majority conclude that the "generally unreceptive attitude on the part of Mr Ots and the ECA does not, however, mean that due process was breached."[131]

133. For my part, I consider that approaching a decision having effectively predetermined the outcome, while deliberately ignoring relevant evidence that may challenge or affect that outcome, constitutes a fundamental breach of basic due process rights. Indeed, it is difficult to imagine a more severe breach of due process than predetermination of the outcome. The evidence of Mr Ots during the hearing was clear and unapologetic in this respect.

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[130] Plenderleith 1st WS, para 72.
[131] Award, para 889.

134. Moreover, the close-mindedness of the ECA must then be combined with the single day afforded to the Claimants to consider their position on the Analysis. This perfunctory and completely inadequate timeframe was clearly unrealistic and insufficient. This is especially so when viewed in the context of the following factors:

a) despite many months of discussions, at no point prior to the issue of the Analysis had the ECA indicated that it would recommend a drastic reduction in ASTV's tariffs;[132] and

b) not only was the Analysis published, but Mr Ots made damaging statements to the press regarding ASTV's tariff rates which attracted significant media interest.

This behaviour at best lacks transparency and at worst was deliberately deceptive. There was no proper opportunity for ASTV to comment on the Analysis and Mr Ots made it clear that any comments by ASTV would have been disregarded in any case.

135. Again, the majority dismiss the lack of opportunity to comment upon the Analysis as failing to constitute a breach of Estonian or international law.[133] It is not clear why or how the majority can reach this conclusion, nor is it clear why the lack of opportunity to comment was never considered by the majority in conjunction with the closed-minded approach of the ECA to the Analysis.

136. As mentioned above, the Analysis was also based on incomplete information (including with regard to costs) and the ECA never reviewed the Services Agreement, despite being highly critical of it in the Analysis. The ECA saw no value in consistency and no need to even consider as relevant the State's obligations under the Privatisation Agreements.

137. The Analysis then formed the basis of the ECA's subsequent actions and the pattern of behaviour continued. Having publicly stated during the press conference following the release of the Analysis that ASTV should reduce its tariffs by up to 25%, it is unsurprising that this is effectively what was ordered by the ECA in October 2011.[134]

138. To my mind, there is no doubt that the ECA's actions in considering and addressing ASTV's tariffs offend against the requirement to afford due process and "demonstrate a complete lack of candor or good faith on the part of the regulator"[135] and a "lack of transparency."[136] The process as a whole was not conducted "in a manner which is fair to the interests of an investor".[137] This was more than just an imperfect procedure, but was "manifestly unfair or unreasonable".[138]

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[132] Plenderleith 2nd WS, paras 11-14.
[133] Award, para 900.
[134] Exhibit C-44.
[135] Exhibit CL-110, *TECO v. Guatemala*, paras 457-458.
[136] Exhibit CL-115, *Waste Management Inc. v. United Mexican States [II]*, para 98.
[137] Exhibit RL-164, *ECE Projektmanagement v. Czech Republic*, para 4.805.
[138] See Exhibit RL-154, *AES Summit Generation Limited and AES-Tisza Erömü Kft v. The Republic of Hungary*, ICSID Case No. ARB/07/22 (23 September 2010); Claimant's Reply, para 303.

139. For these reasons, I cannot join the majority's decision on this cause of action and I would find that the evidence demonstrates that that ECA dealings with ASTV were conducted in a seriously flawed manner that was unfair, inequitable and a breach of due process. The Respondent was therefore in breach of its due process obligations contained within the FET protections afforded to the Claimants under the BIT.

CONCLUSION

140. In conclusion, I most strongly disagree with my colleagues with regard to their findings on legitimate expectations and due process.

141. I am of the firm view that the Claimants should have succeeded in their FET claim. I would have found a breach of legitimate expectations and a flagrant breach of the obligation to accord the Claimants due process.

142. Accordingly, I would have granted the Claimants' requested relief, including:

a) a declaration that Estonia has breached Article 3(1) of the BIT by failing to ensure the fair and equitable treatment of the Claimants' investments;

b) an order that Estonia pay to the Claimants the sum of €65 million (as appropriately updated as at the date of the Award).[139]

[signed]

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Sir David A.R. Williams KNZM, QC

Date: June 20, 2019

[139] The compensation assumes that tariffs will remain frozen until 2020 and was last updated in the Claimants' Post-Hearing Brief, para 578. See Claimants' Reply Memorial para 604 regarding the requirement to adjust figures for CPI as at the date of the Award.