James Van Loon
Walkerton Inquiry

Dear Mr. Van Loon;

Attached is the legal Opinion of the potential impact of international trade disciplines on proposals to establish a public private partnership (P3) to design, build and operate a water filtration plant in the Seymour Reservoir. The opinion was prepared for CUPE by Steven Shrybman of *Sack Goldblatt Mitchell* and we believe that it merits consideration by the Inquiry and all interested parties.

The opinion concludes that the federal government's commitments to NAFTA and the WTO mean that an array of municipal government initiatives and actions are now subject to obligations and constraints arising from these commitments. The disciplines which are most relevant to the Seymour P3 are those pertaining to services and investment. Basically, the private sector partner's role in the project would be seen as an *investment* according to NAFTA, and any law, regulation, procedure, requirement or practice by the Greater Vancouver Regional District (GVRD) or any other Canadian government that might affect the contract, would be considered a *measure* and subject to the disciplines of NAFTA. Similarly, the requirements of the GATS may apply to the GVRD and other governments and whatever exemption may apply for water services under the GATS could be compromised by the P3.

Clearly, the opinion raises serious questions about the potential risks of P3s in the water sector when Canada is a signatory to these international trade and investment agreements.

CUPE requests that the Inquiry consider the opinion and make it available through its website.

If you have any other questions, please feel free to contact me.

Ron Crawley

A Legal Opinion Concerning the Potential Impact of International Trade Disciplines on Proposals to Establish A Public-Private Partnership to Design Build and Operate a Water Filtration Plant in the Seymour Reservoir

Prepared for the **Canadian Union of Public Employees**

by

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TABLE OF CONTENTS

THE POTENTIAL IMPACT OF INTERNATIONAL TRADE DISCIPLINES ON PROPOSALS TO ESTABLISH A PUBLIC-PRIVATE PARTNERSHIP TO DESIGN BUILD AND OPERATE A WATER FILTRATION PLANT IN THE SEYMOUR RESERVOIR

Summary of Conclusions

1. A diverse array of municipal government initiatives and actions are now subject to a complex web of international obligations and constraints that arise from commitments made by the federal government under NAFTA and the WTO. These have dramatically expanded the application of international trade and investment law to the exercise of municipal government authority.

2. Several of these trade and investment disciplines are explicitly relevant to government measures which may affect the Seymour project, from planning and assessment through construction and operation. These include international rules concerning investment, services, procurement, subsidies, intellectual property, and technical regulations. Of these, arguably the two most important concern investment and services.

3. If concluded, the interest of a private partner to a contract to design, build and operate the Seymour project would be an *investment* according to the NAFTA definition. Conversely, a law, regulation, procedure, requirement or practice of the Greater Vancouver Regional District (GVRD) or another Canadian government that might affect that contract would be a *measure* under NAFTA and accordingly subject to the broad disciplines of that regime.

4. Similarly, the requirements of the GATS apply to GVRD and other government measures that may affect the Seymour project, unless the supply of water services by the GVRD is considered exempt from the application of this WTO Agreement. However, whatever claim to exempt status water services might now enjoy would be compromised by entering into a private sector partnership to deliver such services. In this regard, the risks are substantially greater for a contract that involves the operation, rather than simply the design and construction, of a water treatment plant.

5. Failure to comply with the obligations of these international agreements may provoke trade challenges or foreign investor claims. While these may be brought only against the federal government, British Columbia and its municipalities will nevertheless be under substantial pressure to comply with the requirements of NAFTA and the WTO.

6. Because they can be invoked unilaterally by foreign investors, NAFTA investment disciplines present a particular threat to government measures concerning the Seymour DBO undertaking. These extraordinary enforcement procedures may be invoked to challenge government measures simply because they diminish the profitability of a foreign investment in the Seymour undertaking.

7. When considered in light of these binding international obligations current proposals for the Seymour project present significant risks to public policy and law concerning the delivery of water services, including the risks of:

- transforming what otherwise would have been a contractual dispute, such as a decision by the GVRD to terminate the DBO contract, into a claim for damages to be resolved by a commercial arbitration tribunal and in accordance with international, not Canadian, law and procedures;

- eliminating the possibility of ensuring that local economic benefits result from the Seymour project by including purchasing and other local preferences as conditions to the DBO contract, and,

- subjecting environmental and public health measures - from safe drinking water standards to the remedial orders of local health officials - to the rigours of international trade adjudication or commercial arbitration.

11. By entering into a partnership with a private sector proponent for the supply of municipal water services, the GVRD would also weaken the claim that such public services be regarded as exempt from the full application of NAFTA investment and WTO services rules. Depending upon the character and extent of federal government participation in the project, these repercussions may extend beyond the provincial borders.

12. Similarly, if the Seymour project represents a departure from past practice that is advantageous to certain investors and service suppliers - such as the right to bid on major infrastructure projects, or to have the bidding process subsidized by government - it will establish a new precedent (standard of *National Treatment*) that it and other BC municipalities would be obliged to follow in like circumstances.

13. Finally, with few exceptions, the risks that NAFTA and WTO requirements pose for the Seymour project can be obviated or entirely avoided by proceeding with this project as a public sector undertaking.

Introduction

Legal disputes are not uncommon in the context of large infrastructure projects. But in the past such disputes would be resolved on well-settled legal terrain and in accordance with principles of contract and tort law that were reasonably predictable and well understood. Moreover, litigation would take place in accordance with Canadian judicial norms and procedures.

However, the advent of binding international trade and investment agreements has fundamentally altered this reality. Now such disputes may be resolved by international tribunals and in accordance with complex legal obligations and liabilities which often have no analogue in Canadian law.

Over the past ten years, the landscape of international trade and investment has undergone a dramatic transformation. During this period the ambit of international trade rules has grown to encompass broad spheres of policy, programs and law that have heretofore been entirely matters of domestic and local concern.

Furthermore, unlike the treaties they supercede, the new generation of international trade agreements are truly binding and enforceable. Moreover, under NAFTA investment rules, corporations now have the unilateral right to invoke binding international arbitration to enforce agreements to which they are not parties and under which they do not owe any obligations.

The extension of these disciplines to provincial and municipal governments also represents a significant departure from the historic norms of international trade law. The combined effect of these developments has superimposed, on municipal government decision-making, broad constraints that may be ignored only at the risk of retaliatory trade sanctions or damage awards.

To complicate matters, international trade rules concerning investment, services, procurement, intellectual property and technical regulations are complex, often unprecedented, and largely untested. This complexity is only made worse by rules that often overlap or conflict. However, the consequences of misapprehending or failing to comply with these requirements is likely to be punishing, costly, and difficult to correct.

Adding to the difficulty of assessing the impact of current trade disciplines is the fact that these rules continue to evolve and be developed. Thus, the domestic public policy landscape is still being transformed by these international agreements, and new trade initiatives may come to fruition during the life of the contract that is currently being considered by the Greater Vancouver Regional District (GVRD).

One obvious consequence of these international developments has been to transform the nature and complexity of the risks associated with projects such as the Seymour water filtration plant. Whatever one=s view of the merits of the federal government=s pursuit of trade liberalization, there can be no doubt that the result has substantially constrained the prerogatives of local government and exposed municipalities to the considerable risks associated with an international trade challenge or foreign investor claim.

It is also important to acknowledge that while the complex and arcane world of international trade law represents new terrain for most municipal officials, that is not the case for the private sector partners with which the GVRD is considering a long term contractual relationship. The transnational corporations currently on the GVRD shortlist should be considered sophisticated and experienced when it comes to matters of international trade and investment.

The following opinion offers only a limited survey of the international trade and investment rules that apply to the Seymour project. It focuses on the two areas of trade liberalization that are arguably most relevant to this project: the investment provisions of NAFTA, and the services disciplines of the World Trade Organization (WTO); the former because they are amenable to private enforcement, the latter because of the comprehensive reach of the General Agreement on Trade in Services= (GATS) disciplines.

A more complete assessment would have also examined the trade in goods, procurement, subsidies, technical barriers to trade, and intellectual property provisions of NAFTA and the related agreements of the WTO. Nor have we considered the potential impact of the Agreement on Internal Trade, which replicates many of the provisions of its international analogues and which has been established by federal-provincial agreement. Without having a more complete picture of the terms being considered for this project, such a review would be premature. Accordingly, this assessment offers an illustrative rather than exhaustive review of the diverse problems, risks and issues that a more thorough analysis would reveal.

Because of the complexity and unprecedented nature of the rules we consider, it is reasonable to expect that opinions will differ about their meaning and application. The speculative nature of this exercise explains the controversy that surrounds some of the issues

we address. However, a number of trade rulings, tribunal awards, and a recent judgment by the BC Supreme Court provide much more concrete evidence of the nature of the obligations delineated by these regimes, and of the consequences that will follow from non-compliance.
In our view, the fiduciary obligations of municipal officials, and their obligation to exercise due diligence in the exercise of their authority, requires a thorough assessment of the risks posed by international trade and investment agreements for a project such as the present one. The implications of these regimes for the Seymour project have been described as insignificant by the GVRD. Without having access to the legal advice it apparently is relying upon, or the terms of the contract that it is proposing to negotiate, it is impossible to assess the validity of this claim.

However, even without being privy to this information, and notwithstanding the limited ambit of the following assessment, we believe that the risks posed by Canada=s commitments under NAFTA and the WTO as these obligations affect the Seymour project, are both substantial and real.

THE FACTS

Our understanding of the facts of this matter are as follows.

The GVRD is proposing a partnership with the private sector to design, build and operate a water filtration plant at the Seymour reservoir (the DBO contract). The projected costs and operating revenues associated with the project are $150 million and $120 million respectively over the 20-year life of the DBO contract. The project would be the largest of its kind in North America.

The shortlist of companies now being considered as potential partners includes four corporations:

- U.S. Filter Operating Services Inc., which is owned by French-based Vivendi;
- Earthtech Canada Inc., a subsidiary of Tyco International;
- Aquavan Water Group, Joint Venture of Bechtel Canada Inc. and Thames Water Group; and,

- Atlantic to Pacific Water Group, joint venture of BC Gas and CH2M Waterworks Canada, owned by its U.S. Parent, CH2M Hill.

The only entirely Canadian consortium to have been in the running - a partnership between Alberta based Epcor and the Ontario Clean Water Agency - was recently eliminated from competition. The GVRD is now in the process of allocating a payment of $100,000 for the final bidders to defray their costs in developing stage 2 proposals for the project.

It is not uncommon for BC municipalities to contract out the design and construction of significant infrastructure projects. The innovative feature of the Seymour project is that it would also assign the operation of a major drinking water supply facility to the private sector for a period of as long as 20 years. This is a difference in kind as well as degree. Not only would such an arrangement substantially increase private sector involvement with the project, but it would also significantly increase the risks associated with such a relationship. These would be qualitatively different from those associated with a more limited role for the private sector in supplying one of Canada=s most important public services, safe drinking water.

We also understand that concerns have already been voiced about the impact of NAFTA and WTO disciplines on the project, including specific allegations that the GVRD tendering process fails to comply with the procurement rules of NAFTA[1]. Concerns have also been raised by Burnaby City Council about the proposed Seymour project and the *risks associated with NAFTA, GATS and other international trade agreements*, and about *the virtual impossibility of regaining local control of water distribution after the asset has been contracted to foreign companies.*[2]

In response, the Chair of the Board of Directors of the GVRD has stated that:

[1] Letter from J. Huggett, P.Eng to the City of Surrey, 7 October, 2000.

[2] Resolution of the Burnaby City Council, April 9, 2001.

> *The GVRD's solicitors have assessed the impact of NAFTA, GATS and other international trade agreements on the Seymour DBO contract. It has* [sic] *determined that no issues of significance are expected to arise. GVRD will not lose control of the operations of the plant. The proposed contract agreement will provide GVRD with complete control to terminate the operating contract at its sole discretion for whatever reason.* [3]

However, requests for access to the legal opinion upon which the GVRD appears to be relying have been declined.

[3] Letter from George Puil, Mayor and Council, GVRD Member Municipalities, to Mayor Douglas Drummond, City of Burnaby, April 19,2001.

It is relevant to recognize that among the remaining bidders are corporations that dominate world water markets. It is also apparent that their interest in the Seymour project is very much a part of efforts to expand their global positions in a market that is estimated to be worth $U.S. 300 billion.[4]

These same corporations are often key players in business associations and trade advisory groups that have played a fundamental role in promoting trade liberalization goals founded on principles of privatization and de-regulation. They may fairly be considered to have some authorship of the trade rules that may come to bear on this GVRD initiative. They may also be familiar with the enforcement mechanisms these agreements provide. In fact, International investment disciplines have been invoked on more than one occasion when disputes have arisen between international water service corporations and governments.[5]

In our view this context is important because for the GVRD=s potential private sector partners, the Seymour project may represent an important strategic precedent. On the other hand, for most municipalities international trade law is still an arcane subject remote from the day to day matters of local government. In our view, this mismatch in resources and

[4] Schwab Capital Markets and Trading Group: Investing in the Water Industry, *We Have Only Just Begun*, May 8-9, 2000 Industry Overview.

[5] For instance, General des Eaux, a subsidiary of Vivendi, invoked a bi-lateral investment treaty with provisions similar to those in NAFTA to claim damages against Argentina arising from a concession agreement for the provision of water and sewer services; see *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (Case No. ARB/97/3). This case is described infra. In addition, according to recent newspaper accounts, International Water Ltd., which is described as an affiliate of the Bechtel Group, may be contemplating a claim for damages against Bolivia under the provisions of a bilateral investment treaty that country has with the Netherlands, concerning its interest in a contract to provide water services in Bolivia - *Soaking the Poor,* San Francisco Bay Guardian, Dec. 13, 2000; *Cochabamba=s Water Rebellion*, San Francisco Chronicle, Sunday Feb. 11, 2001.

expertise among the potential partners to the Seymour project needs to be acknowledged and addressed.

ASSESSMENT

MUNICIPAL OBLIGATIONS UNDER NAFTA AND THE WTO

Explicit Obligations

Under Canadian constitutional arrangements, federal authority to implement a treaty is limited to matters that fall within its sphere of constitutional competence. Nevertheless, many NAFTA and WTO disciplines explicitly refer to the obligations of provincial and municipal governments. Furthermore, Canada is bound under international law by such commitments even where they fall exclusively within the domain of provincial constitutional authority. While provincial and municipal governments may not as a matter of strict constitutional law be bound by these obligations, there are several reasons why it would be very difficult for them to ignore these Anon-binding@ obligations.

All Necessary Measures[6]

To begin with, the federal government is obliged under Article 105 to:

> ... *ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments.*

It is unclear what Aall necessary measures@ might mean given the particular features of Canadian constitutional arrangements. A reduction in federal transfer payments, program support, or infrastructure funding represent obvious examples of the steps that might be taken by Canada to honour its obligations under this Article.

[6] We will consider the ambit of municipal government obligations under the GATS infra.

However, pressure on the province to comply with Canada=s international trade and investment obligations is probably most easily exerted behind closed doors. Here the federal government enjoys the considerable leverage associated with having to defend provincial interests in the international sphere. Examples such as the Pacific Salmon Treaty and the Softwood Lumber Agreement illustrate the dependence of the province=s economy on the federal government to champion provincial interests. Furthermore, BC=s reluctance to comply with its explicit obligations under NAFTA and the WTO would not be lost on its trading partners who have the capacity to strategically target BC interests with retaliatory trade sanctions.

It is simply not realistic, in our view, to imagine that the province could ignore an adverse trade ruling or damage award arising from its failure to observe the constraints imposed by NAFTA or WTO agreements. In other words, the dependence of the provincial economy on international trade and the inter-dependence of provincial and federal agendas when it comes to trade and investment impart a *de facto* obligation on the province to honour the commitments made by the federal government.

Finally in this regard, any lingering doubts there might have been about the application of international trade regimes to municipalities have now been put to rest by international investor claims that have specifically targeted local government.

Metalclad Inc. vs. Mexico [ICSID Additional Facility Rules]

Closest to home is the recent judgment of the BC Supreme Court in an appeal by Mexico of a NAFTA award that it pay more than $U.S. 16 million in damages to a U.S. hazardous waste company - Metalclad Corporation. The judgment was the first in any NAFTA jurisdiction to review an award made pursuant to the Treaty=s investment rules.

The Tribunal that decided the Metalclad claim ruled that a local municipality had no right to deny the company a permit to built a hazardous waste facility because of environmental and public health concerns, or because the company had built much of its project before applying for a local construction permit. Ignoring the evidence of Mexico=s constitutional law experts, including the ex-chief justice of the Supreme Court, the tribunal ruled that the local government had acted beyond its authority in refusing a permit on these grounds. By doing so, the Tribunal concluded that it had expropriated the company=s investment.

The tribunal also found Mexico in breach of its obligations under Article 1105 of NAFTA, which obliges it to accord foreign investments *treatment in accordance with international law*.

The Tribunal faulted Mexico for failing to provide a more transparent regulatory process for a project that would be just as fraught with legal controversy in Canada or the United States.

Finally, the Tribunal objected to a decision by the state government to establish an ecological preserve that included the company=s site. In its view, this also represented an unlawful taking of Metalclad=s property.

In passing, the Tribunal left no doubt about the obligations of the federal government for the actions of local government, reminding Mexico of its obligations under Article 105, and going even further by imposing on the federal government a positive obligation to interfere with the exercise of municipal government authority where a complaint is made that the local government was acting in breach of NAFTA provisions.[7]

Mexico=s appeal provided a critical test of how our courts would deal with NAFTA-based arbitral awards. While the Judge had some critical things to say about the way the Tribunal went about its work, he ultimately found in favour of the company and sustained the damage award, subject only to a modest adjustment.

The most troubling aspect of Mr. Justice Tysoe=s ruling was his decision to show the Tribunal=s decision the same deference that is common to awards arising from private commercial disputes. **In the leading BC case on this question, *Quintette Coal Limited v. Nippon Steel Corp*, Mr. Justice Gibbs described the courts= role this way:**

> ***It is appropriate for the court to adopt, as a matter of policy, a standard which seeks to preserve the autonomy of the forum selected by the parties and to minimize judicial intervention when reviewing international commercial arbitration awards.***[8]

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[7] *Metalclad Corporation vs. The United Mexican States*, Final Award of Tribunal, Aug.25, 2000, Paragraph 104.

[8] **(1990), 50 B.C.L.R. (2d) 207 (C.A.).**

As we know however, NAFTA investor claims are not typical commercial disputes but routinely concern issues of broad public consequence - from water export controls and environmental standards to public postal services.

Nevertheless, one aspect of Mr. Justice Tysoe=s judgment is helpful because it overrules the Tribunal=s expansive reading of Article 1105. The judge also found that the Tribunal=s erroneous interpretation of Article 1105 tainted its criticism of the municipality=s failure to issue a construction permit to Metalclad. This effectively overturned the Tribunal=s ruling insofar as it concerned the actions of the municipality. It is important however, to recognize that the judge did not exonerate the actions of the local government or conclude that its actions were not expropriative.

This is clear from the judge=s decision to uphold the Tribunal=s findings that by creating an ecological preserve, the State government had expropriated the Company=s property. This is how the judge described the Tribunal=s view of NAFTA=s expropriation provision:

> ***The Tribunal gave an extremely broad definition of expropriation for the purposes of Article 1110. In addition to the more conventional notion of expropriation involving a taking of property, the Tribunal held that expropriation under the NAFTA includes covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably to be expected economic benefit of property. This definition is sufficiently broad to include a legitimate rezoning by a municipality or other zoning authority. However the definition of expropriation is a question of law with which this Court is not entitled to interfere under the International Commercial Arbitration Act.*** **[emphasis added]**

The Tribunal=s view represents a stark contrast to the meaning of expropriation under Canadian law which has consistently refused to treat the exercise of municipal land-use authority as giving rise to such claims.

There are other aspects of this case that are relevant to municipal government, including the way in which the court addressed Mexico=s allegations of corruption and bribery against the company.[9]

[9] The judge acknowledged Mexico=s allegations that the company had made very substantial payments ($U.S. 150,000 in stock, and $U.S. 20,000 in cash) to the wife of a federal official who had played a key role in issuing federal approvals for the company=s project but found the evidence inconclusive that these payments were actually bribes paid on behalf of Metaclad, again deferring to the Tribunal=s judgment about the credibility of the federal official involved. Submissions of the United Mexican States, October 27, 2000.

For present purposes however the Metalclad case is particularly important for two reasons. First, it demonstrates the enormous breadth of NAFTA=s expropriation rule. Second, it shows the wide latitude international arbitral tribunals will be allowed to interpret NAFTA investment disciplines as they see fit. As the law now stands, Canadian governments at all levels are vulnerable to such claims for taking measures that would never be considered acts of expropriation under Canadian law.

There are any number of ways in which NAFTA rules may be offended by the government measures affecting directly or indirectly the design, construction or operation of the Seymour water filtration plant. Thus, the failure to provide timely approvals, the imposition of public health or environmental orders, the early termination of a contract for alleged non-compliance or performance failure, or new regulatory standards might all be characterized as expropriation under the broad definition now accepted by the court.

The BC Supreme Court has clearly substantiated the validity of concerns that have been expressed about the impact of NAFTA investment rules but which the federal government remains reluctant even now to concede. In fact, only days after the release of Mr. Justice Tysoe=s ruling, the Prime Minister described NAFTA investment rules as working Apretty well.@

We also note that notwithstanding the Metalclad victory, some business groups have characterized the BC Supreme Court ruling as a defeat and have called upon governments to strengthen the investment disciplines in NAFTA. They have also insisted that similar requirements be maintained as a necessary elements of the FTAA initiative.[10]

Finally, we note that the courts of other jurisdictions may adopt a different view of their authority to review NAFTA-based awards. These may be more interventionist than the approach adopted by Judge Tysoe, or less so. In each instance the judge will be guided, as was the BC Court by the domestic law of that jurisdiction.

Thus, the standard of judicial review of an arbitral award will depend upon the place of arbitration. Because BC was chosen in the Metalclad case, Mexico=s recourse was to

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[10] Los Angeles Times Saturday, May 5, 2001, *Ruling in Canada Strikes at Companies' NAFTA Trade Suits Court Decision could blunt legal challenges to governments' power.* Also see letter from more than 20 leading U.S. corporations and business groups to The Honorable Robert Zoellick United States Trade Representative, April 19, 2001.

a BC court. In a claim involving a BC municipality, the place of arbitration would inevitably be outside the province, if not the country. This raises the specter of the court of a foreign jurisdiction being the ultimate arbiter of whether the GVRD acted in breach of Canada=s obligations under NAFTA investment disciplines.

NAFTA CHAPTER ELEVEN INVESTMENT DISCIPLINES

The interest of a private partner in a DBO contract with the GVRD will be an Ainvestment@ under NAFTA rules which defines this term to include all forms of investment, including:

> ***interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under***
>
> > ***(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or***
> >
> > ***(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;***

NAFTA investment rules impose certain broad constraints on the capacity of governments to adopt or maintain Ameasures@ relating to investors of another NAFTA party and their investments. Measures are defined by NAFTA to include Aany law, regulation, procedure, requirement or practice.@ Contractual agreements are not explicitly identified as measures by NAFTA. However, unless otherwise exempt, government measures affecting the contract (procurement practices), or incorporated as terms to the contract (local preference requirements), would be subject to NAFTA disciplines.

Moreover, the decision to terminate or renew such contractual arrangements, the imposition of environmental or public health orders, or even the regulation of water quality would each fall within the definition of government measures under NAFTA.

NAFTA investment disciplines apply fully to municipal and local governments, subject to a few limited reservations. The most important of these is a reservation for existing non-conforming measures as defined by Article 1108:1(a)(iii).[11] However, even these

[11] For provincial measures the date upon which non-conforming uses became fixed was January 1, 1996.

measures must comply with several of the more onerous obligations established by NAFTA investment rules which apply without qualification to local government. These include rules concerning *Minimum Standard of Treatment, Expropriation and Compensation* and *Dispute Settlement.*

NAFTA rules concerning *Performance Requirements* and *National Treatment* will also apply to the Seymour project unless such measures can be characterized as non-conforming measures that existed when NAFTA was implemented on January 1, 1994. In our view, there are few if any measures concerning the Seymour project that would qualify under this reservation. A more definitive assessment would require a detailed consideration of the particular measure against any relevant historic benchmark.

The other possible reservation that might become relevant is set by Article 1108:7(a) which stipulates that *National Treatment* and two other provisions of Chapter Eleven do not apply to procurement by a party. However, the features of a public-private partnership are sufficiently distinct from the traditional ambit of public procurement to call into question the application of these disciplines to such an undertaking, although we also note that NAFTA procurement disciplines do not apply to local government.

With these few qualifications in mind, we turn to consider the potential impact of the disciplines for the Seymour project.

Public Health Measures as Expropriation

NAFTA Article 1110 provides that:

> ***1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:***
>
> *(a) for a public purpose;*
> *(b) on a non-discriminatory basis;*
> *(c) in accordance with due process of law and Article 1105(1); and*
> *(d) on payment of compensation in accordance with paragraphs 2 through 6*
>
> ***2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the***

> ***intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.***
>
> ***3. Compensation shall be paid without delay and be fully realizable.***

We have already examined the expansive way in which these provisions may be applied by arbitral panels in our summary of the Metalclad case. This particular provision has been invoked to challenge environmental and public health measures in several other foreign investor claims as well.[12]

The present risk is that Article 1110 would be invoked by a private sector partner to the Seymour Project to challenge environmental or public health measures that may require substantial expenditures to modify, or repair, the Seymour filtration plant. Such measures might include an order by a local health official to remedy a health hazard under the Safe Drinking Water Regulations to the Health Act, or new safe drinking water standards established either by the provincial or federal government. To the extent that such measures might diminish the value of private sector investment in the Seymour plant they are vulnerable to being challenged as offending the constraints of Article 1110.

In response to concerns expressed by the Burnaby Council about the risk of a challenge or claim arising from such regulatory initiatives, the GVRD has responded:

> ***The DBO contract will have provisions to provide fair and equitable costs in the case of future changes in regulations. These costs would be no different, whether GVRD directly operates the plant or it is operated through a service contract.***

---

[12] Ethyl Corp.v.Canada; S.D. Myers v. Canada Partial Award, Nov. 13; and Methanex v. The United States, see the International Institute for Sustainable Development and the World Wildlife Fund, *Private Rights, Public Problems*, 2110.

The extent to which this latter conclusion might be justified would depend upon the precise conditions of the contract between the GVRD and its private sector partner. However, we believe this assessment discounts too readily the costs associated with making a major overhaul of the filtration plant and the potential for disputes to arise about their allocation.

For example, a public health order might concern problems arising from the negligent operation of the filtration plant by the GVRD=s private partner. In this scenario, the GVRD might have no liability for the costs associated with meeting the requirements of the order. It is also significant that such an order might emanate from public health officials responsible to the GVRD, in which case there is likely to be little common interest between the partners. There is also the risk that a private partner might use the threat of investor-state litigation to influence the judgment of public health officials.[13]

As we have seen, if the GVRD=s private partner can claim the status of foreign investor under NAFTA or another investment treaty it would have recourse against unwanted regulatory initiatives, such as new safe drinking water standards, that simply do not exist under Canadian law. Moreover, equating the equanimity with which the GVRD and its private partner might greet such developments overlooks some very important differences between the two. Most obvious is the fact the GVRD=s first obligation is to the public health of its constituents, not the financial return of the shareholders of its transnational parent.

Moreover, for water corporations with multinational businesses there may be broader strategic reasons for wanting to head-off precedent-setting regulations that might inspire other jurisdictions to follow suit, causing attendant re-engineering costs at other facilities. After all, when Canada challenged a ban on asbestos established by the Government of France, it explained its motives as including a concern that other countries might follow the French example.

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[13] Idem. This is precisely the strategy that Ethyl Corporation used in an attempt to discourage federal initiatives to regulate a toxic fuel additive the company produced.

One of the most remarkable features of NAFTA investment disciplines is their application to environment and public health measures that are generally exempt from the application of most other international trade disciplines. The general exception for such measures is found in Article XX(b) of the General Agreement on Tariffs and Trade (GATT) which applies to *environmental measures necessary to protect human, animal or plant life or health.* As interpreted by WTO dispute bodies, the exemption has been given very narrow application (see discussion under the GATS below). However, the important point is that unlike NAFTA disciplines concerning trade in goods, this critical safeguard simply does not apply to NAFTA investment rules [Article 2101].

It might nevertheless be argued that such measures would be permitted under Article 1114:1 concerning Environmental Measures, which provides:

> ***Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing <u>any measure otherwise consistent with this Chapter</u> that it considers appropriate to ensure that investment activity in its territory is undertaken <u>in a manner sensitive to environmental concerns</u>.*** **[emphasis added]**

Because this provision only applies to measures Aotherwise consistent@ with Chapter Eleven it would not apply to a measure otherwise found to be in breach of the expropriation or other investment rules. It is also unclear that environmental concerns would include public health measures, which are explicitly referenced in Article 1114:2.[14]

It is, of course, impossible to anticipate the shifting circumstances and regulatory environment within which the DBO contract will exist over its 20-year life. What is clear however, is that a partnership with a private partner introduces the risk that domestic public health and regulatory measures may be challenged under NAFTA investment rules and procedures.

Termination of the DBO Contract as Expropriation

[14] **The omission of a similar reference to health in 1114:1 is likely to be taken as deliberate.**

Another way in which the provisions of Article 1110 can come into play may arise if the GVRD seeks to terminate the DBO contract either during or even at the end of its term. Again, the threat of such litigation is likely to influence the judgment of GVRD officials. In fact, a claim such as this has already arisen under NAFTA investment disciplines, although in this particular instance it was unsuccessful.

Desona vs. Mexico[15]

However broad the application of NAFTA investment disciplines may be, it is clear that they do not provide a remedy for a mere breach of the DBO contract. But an act that might represent a breach of contract may also represent a violation of the NAFTA and found a complaint under Chapter Eleven.

This happened in a case involving a claim for damages against Mexico by U.S. shareholders in a Mexican corporation, Desona. The company=s complaint concerned an administrative order annulling its waste management contract that had been obtained by its municipal partner.

According to the Tribunal convened to decide the claim, Desona had persuaded the city to enter into the contract based on misrepresentations that were Aunconscionable@ and Afraudulent.@ Instead of 70 state-of-the-art vehicles which it had promised in order to service the municipality of two million, Desona managed to muster only two used garbage trucks.

When the company failed so dismally to perform the contract, the municipality had it annulled. Desona appealed to the courts, lost, and appealed again. When it failed for the second time, Desona invoked NAFTA investor-state procedures to claim damages, arguing that the annulment represented expropriation of its interest in the contract and a failure to treat the company in accordance with international law.

Confirming that it was not bound to follow the decision of a Mexican national court, the Tribunal carefully considered but ultimately dismissed Desona=s claim. In doing so the Tribunal impugned the credibility of the U.S. investors and concluded the contract

[15] Robert Azinian ... and the United States of Mexico, International Centre for Settlement of Investment Disputes (Additional Facility) Case No. Arb(AF)/97/2, Nov. 1, 1999.

was established under false pretenses. Nevertheless, and in spite of its characterization of the company=s conduct, the Tribunal declined to award costs against it. While Desona lost, the case illustrates the serious consideration that will be given investor claims even when they lack any merit.
Finally, we note that while Desona was unsuccessful in persuading the Tribunal that the annulment of its contract represented expropriation, similar claims have met with greater success.

Générale des Eaux v. Argentine Republic

In another case with close parallels to the present matter, Compagnie Générale des Eaux (CGE) which we understand to be a subsidiary of Vivendi, together with its Argentinian affiliate Compañía de Aguas del Aconquija (CAA), brought a claim for over U.S. 300 million against Argentina pursuant to the provisions of a bilateral investment agreement with features similar to those in NAFTA.[16] The dispute arose from a Concession Contract that CAA entered into with the provincial government of Tucumán in 1995. That contract grew out of a 1993 decision by the government of Tucumán to privatize its water and sewage facilities.

Disputes soon arose between CGE and the province concerning the Concession Contract and became the subject of extensive publicity and controversy. The intractable nature of these disagreements ultimately drew the governments of France and Argentina into the dispute.

When efforts to settle the dispute failed, the French based conglomerate sued under the investment treaty. The company cited a long list of grievances predominantly directed at the provincial government and its officials. These included complaints that:

- $ **health authorities had improperly issued orders and imposed fines concerning the company=s alleged failure to install proper water testing equipment, or conduct and provide proper water testing;**

- $ **an Ombudsman had improperly deprived CGE of the right to cut off service to non-paying customers, and;**

[16] Compañía de Aguas del Aconquija, S.A.& Claimants v. Argentine Republic, Respondent, ICSID (Case No. ARB/97/3)

- **that the province had failed to allow proper rate increases.**

The first issue the Tribunal addressed was it jurisdiction to consider the complaint in light of an explicit assignment by Concession Contract of such disputes to the exclusive jurisdiction of local administrative tribunals. Rejecting this objection, the Tribunal found that notwithstanding this proviso, it had jurisdiction to hear the CGE claim that Argentina had violated its obligations under the investment treaty and held that:

> ***Neither the forum-selection provision of the Concession Contract nor the provisions of the ICSID Convention and the BIT on which the Argentine Republic relies preclude CGE=s recourse to this Tribunal on the facts presented.***

The Tribunal also confirmed that under international law:

> *it is well established that actions of a political subdivision of a federal state, such as the Province of Tucumán in the federal state of the Argentine Republic, are attributable to the central government. It is equally clear that the internal constitutional structure of a country can not alter these obligations.*

But having found that it had authority to consider the complaint, the Tribunal also found that given the complexity of the 111-page single-spaced Concession Contract, it was impossible for it to distinguish or separate violations of the investment treaty from breaches of the contract without first interpreting and applying the detailed provisions of that contract. It also found that absent a clear and independent breach of the investment treaty by Argentina, the Claimants had a duty to pursue their rights before the domestic tribunals referred to by the Concession Contract before seeking recourse to international arbitration.

It is important in this regard to note that the circumstances of CGE case are distinguishable from those of the present case. For unlike the investment treaty that CGE relied upon, NAFTA investment rules explicitly bind sub-national governments. It would not therefore be necessary for a foreign investor to establish an independent breach by Canada in order to found a claim under NAFTA rules. This is clear from the Desona and Metalclad cases.

The case is important however for what it reveals about the inter-relationship of contracts such as the one now being contemplated for the Seymour project and the provisions of international investment treaties. It makes very clear the fallacy of assuming that a municipal government could rely upon the provisions of a contract with a foreign investor to preclude recourse to international arbitration under NAFTA investment treaties.

The case is also relevant because it is illustrative of the types of disputes that may arise in the present context including those concerning water quality testing, universal service guarantees and rate regulation.

Minimum Standard of Treatment

Another provision of Chapter Eleven which applies to local governments is the obligation under Article 1105 to accord foreign investors a *Minimum Standard of Treatment* which is defined to mean *treatment in accordance with international law, including fair and equitable treatment and full protection and security.* To date, in every NAFTA claim decided in favour of a foreign investor the impugned measure was found to violate this requirement.

However, the interpretation accorded this provision by two of the tribunals to have applied it, has now been criticized by the BC Supreme Court in the Metalclad case. It is unclear how the Court=s ruling will be regarded by future arbitral tribunals that are entirely free to ignore it. Moreover a careful reading of Mr. Justice Tysoe=s reasoning indicates that the Tribunal=s broad reading of this provision would have been sustained had it crafted its reasons somewhat differently.

Investor-State Procedures

The provisions of Section B of Chapter Eleven provide foreign investors with the extraordinary right to invoke international dispute resolution processes to enforce their rights under the Chapter. Accordingly, under Articles 1121 and 1122, foreign investors of a NAFTA party have a virtually unqualified right[17] to sue national governments for

[17] Apart from establishing the status of foreign investor, the only precondition to submitting a claim for arbitration under NAFTA is that the disputing investor waive its right to pursue a related claim for damages in court, see Art. 1121:1.

any alleged breach of the expansive and broadly-worded investor rights they are granted by this trade agreement. These disputes are then decided, not by our courts or judges, but by international arbitration panels [Article 1120] operating under the auspices of institutions such as the World Bank.[18]

18 **For example, the International Center for the Settlement of Investment Disputes (ICSID) was established under the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* and is overseen by an Administrative Council and a Secretariat. The Administrative Council is chaired by the World Bank's President and consists of one representative of each State which has ratified the Convention.**

Tribunals operate, not in accordance with domestic legal principles and procedures, but under international law and according to procedures established for resolving international commercial disputes.[19] In many ways these procedures are antithetical to the principles of open, participatory and democratic decision-making that are the hallmarks of Canada=s legal system. For example, Article 24 of the ICSID Arbitration Rules (Additional Facility) provides:

> ***The deliberations of the Tribunal shall take place in private and remain secret.***

Moreover, the secrecy of these international arbitral processes is often described as one of its most attractive features for the business community.[20]

It is also important for the GVRD to appreciate that in the event that a claim is made concerning the DBO contract, it would have no right to participate in the arbitral proceedings. Indeed even gaining access to the pleadings or evidence of the proceedings may not be possible. As a general matter, claims to confidentiality are taken very seriously by international arbitral tribunals when asserted by disputing foreign investors. So strict is the protection of the confidentiality of the proceedings that Canada was chastised in two cases for sharing information with provincial governments, notwithstanding their direct interest in the proceedings.[21]

It bears emphasis that investor-state enforcement represents a rather significant departure from the norms of international law in two key ways:

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[19] **These are the regimes established pursuant to the ICSID convention, and UNCITRAL Arbitration Rules, recourse to which is provided by Article 1120.**

[20] A. Redfern, M. Hunter & M. Smith, *Law and Practice of International Commercial Arbitration*, 3rd ed. (London: Sweet & Maxwell, 1999), 430-432.

[21] Pope and Talbot v. Canada, Decision of Feb. 14, 2000, at para 6, and S.D. Myers and the Government of Canada, Procedural Order No. 16, May 13, 2000, at para. 14.

- **by providing corporations with the right to directly enforce an international treaty to which they are not parties and under which they have no obligations; and,**

- **by extending international commercial arbitration procedures to claims that have no foundation in contract, and which may only obliquely be considered commercial in character.**

Thus, under Article 1122 Canada has unilaterally consented to international arbitration for claims arising under the Chapter, notwithstanding the absence of any contractual relationship with the claimant. Nor do investors have any obligation to exhaust domestic remedies before resorting to international dispute resolution [Article 1121].

Two other significant requirements of Chapter Eleven may also come into play with respect to the Seymour project. These are the *National Treatment* requirements of Article 1102 and the constraints on *Performance Requirements* set out in Article 1106. Both apply to local government measures [Article 1108:1(a)(ii)] unless they qualify as existing non- conforming measures on January 1, 1994, or in the case of *National Treatment*, the measure is one concerning procurement [Article 1108:7]. Given the innovative character of the Seymour undertaking and of the public-private partnership that is being considered for it, it is unlikely in our view that a claim to this reservation could be sustained.

National Treatment
Even should local government measures concerning the Seymour project be exempt from *National Treatment* obligations, the same would not necessarily be true for provincial and federal measures that may impinge on this GVRD initiative. Without having more information about the nature of federal and provincial participation in the Seymour project it is impossible to assess whether either or both provisions might impact this GVRD initiative. As we shall see, the impact of similar requirements of the GATS is also relevant to the Seymour project because of the explicit extension of these disciplines to local government.

With this qualification in mind, Article 1102: *National Treatment* provides:

> ***1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.***

> *YYY*
> ***3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.***

The interpretation and application of this provision has varied significantly from case to case.[22] However, there is a real risk that by entering into a DBO contract to supply potable water, the Seymour project may establish a new *National Treatment* benchmark that governments would be obliged to follow for other capital projects. The establishment of preferences for Canadian companies, or non-profit proponents, would then be difficult to reconcile with such new *National Treatment* obligations.

Performance Requirements

Article 1106 provides in part:

> ***1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:***
>
> *YY..*
>
> ***(b) to achieve a given level or percentage of domestic content;***
> ***(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;***
>
> ***3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:***
>
> ***(a) to achieve a given level or percentage of domestic content;***
> ***(b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;***

Unless such requirements can claim the unlikely status of non-conforming measures, they would violate the constraints imposed by these NAFTA prohibitions. In this case the GVRD could not impose or enforce contract requirements intended to achieve

[22] **See Pope & Talbot and S.D. Myers cases, noted above.**

benefits for the local economy during the design, building or operational phases of the project. This same constraint would apply to provincial or federal requirements along the same lines.

ADF vs. The United States

It is also relevant that a claim based on Article 1106 might be brought by someone other than the primary contractor. This recently occurred in an investor-state claim brought by a Canadian company, the ADF Group Inc., against the U.S.

This Quebec-based company subcontracted to provide certain steel products to a highway construction project for the Virginia Department of Transportation through its Florida-based subsidiary. Funding for the project was contingent upon the recipient State complying with the requirements of the Federal Highway Administration, including its ABuy America@provisions. These federal requirements were further stipulated as terms to the contracts that had been negotiated with the Virginia Department of Transportation.

A dispute arose concerning ADF=s plans to do certain fabrication work at its Quebec factory on steel supplied from its U.S. facility. When U.S. officials refused to authorize work outside the country, the company incurred substantial costs and delays in sub-contracting to U.S.-based fabricators. It was also at risk of being sued by the main project contractor should a $U.S. 10 million Ano excuse@ bonus be lost because of ADF=s default.

In July last year ADF issued a notice of its intention to claim $U.S. 90 million in damages, alleging several breaches by the U.S. of its obligations under NAFTA. The gist of that claim is that the provisions of the U.S. ABuy America@ program and the contractual provisions that gave them expression offended the *National Treatment, Performance Requirement* and *Minimum Standard of Treatment* provisions of Chapter Eleven. The case has yet to be determined.

While the facts of the ADF case are distinguishable from the those of the Seymour project, the principles are not.

THE GATS

The other international trade agreement that has specifically been raised in relation to the Seymour project is the General Agreement on Trade in Services (the GATS) of the WTO. The GATS is built on the same basic policy framework as the investment rules of NAFTA and includes similar requirements with respect to *National Treatment, Most Favoured Nation Treatment* and *Transparency.*

However, the GATS includes no analogues to NAFTA rules concerning expropriation or, most significantly, the investor-state suit mechanism. On the other hand, the GATS is broader in its application. No other trade agreement has sought to extend the ambit of international trade disciplines so extensively to non-discriminatory domestic policy, law and programs. Nor does any other WTO Agreement approach the complexity of GATS disciplines or the byzantine classification systems it relies upon.

Also problematic is the failure of the GATS to define many of the broad concepts it seeks to establish as binding disciplines. Furthermore, the two WTO disputes which have called for an interpretation of GATS rules indicate that they will be given very broad application.[23]

All Government Measures

The GATS applies to all *measures* by Members *affecting trade* in services [Article I]. The term Ameasure@ is defined even more expansively than under NAFTA to mean *any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form* [Article XXVIII].

Article I:3 of the GATS further stipulates that it applies to all levels of government, including local municipalities, and even to:

[23] **See WTO disputes concerning Canada=s Auto Pact: *Canada - Certain Measures Affecting the Automotive Industry*, AB-2000-2; and Europe=s preferential tariff treatment of bananas imported from certain former colonies under the Lome Convention: *European Communities - Regime for the Importation, Sale and Distribution of Bananas* B AB 1997-3.**

> ***non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;***

Moreover, as defined by WTO dispute bodies, the term Aaffecting trade in services@ is intended to capture any measure that even incidentally affects services. This explains how the Autopact, which is obviously an agreement about the trade in goods, could nevertheless be found by the WTO to have offended the GATS. By this definition, it would be difficult to identify any government measure that would not be subject to the constraints imposed by this particular WTO Agreement.

Water as a Public Service

The only general exception under the GATS is for services supplied *in the exercise of government authority* - a term which Article I:3(c) defines this way:

> ***a service supplied in the exercise of governmental authority means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.* [emphasis added]**

Unfortunately, the GATS does not specify the terms of this definition, which has fueled debate about the scope of this exemption. In a paper on environmental services, the WTO Services Secretariat acknowledges the ambiguity of these terms, and recounts very different views of their meaning.[24] A recent paper by British Columbia=s Ministry of Employment and Investment provides an excellent review of the various and inconsistent interpretations that have been proffered about the meaning of this GATS article.[25]

As we shall see, both design and construction services associated with the Seymour project are explicitly subject to GATS disciplines. It is with respect to the supply of water, *per se*, that uncertainty exists. It could be argued that by maintaining public ownership of the Seymour plant, water service is being supplied neither on a

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[24] GATS 2000, Environmental Services Proposal from the EC and their Member States, Dec. 2000.

[25] Ministry of Employment and Investment, *GATS and Public Service Systems*, Discussion Paper 02 April 2001.

commercial basis nor in competition with other suppliers. However, it is very clear that the private partner=s interest in the DBO contract would be purely commercial. The structure of user charges or fees might also impart a commercial character to such services.

The key questions then, are whether GVRD water supply services are now exempt under GATS disciplines and if so, whether the establishment of a public-private partnership for water treatment and supply would be sufficient to remove that status. Moreover, in deciding whether public water services are being delivered Ain competition with one or more service providers,@ would the frame of reference for this determination be local, regional, provincial or national? Would the existence of any private sector water services provider, or public-private partner be sufficient to introduce the element of competition to the entire domain of water services, or just taint those of the local jurisdiction?

It is difficult to predict how a WTO dispute panel would answer these and other questions. We do know however, that WTO dispute bodies have demonstrated a great propensity for giving GATS disciplines a very expansive reading.

In our view, the status of water services is currently uncertain under the GATS and would certainly vary from jurisdiction to jurisdiction. For example, in both France and England water services have been privatized for some time. **However, to the degree that such services may now be exempt from GATS disciplines, that status would clearly be put at risk by the participation of private-sector water service corporations as partners to the DBO contract currently being considered.**

Finally, we note that under the GATS Atrade in services@ is defined so expansively as to include: 1) cross-border supply; 2) supply to consumers abroad; 3) supply through commercial presence; and, 4) supply by presence of natural persons. Obviously, only one of these modes of service supply actually involves cross-border trade in services.

Comprehensive Coverage

While the ambition of the GATS is to establish a comprehensive code that will apply to all services, several of this Agreement=s more onerous provisions apply only to services which have been specifically and voluntarily submitted to GATS disciplines. Thus only certain GATS provisions apply to all services unless, as we have noted, they are deemed to be delivered in the exercise of government authority. These include the obligations concerning *Most Favoured Nation Treatment* [Article II], *Transparency* [Article III] , and *Domestic Regulation* [Article VI].

Domestic Regulation and Safe Drinking Water Standards

Article VI requirements concerning domestic regulation now apply to listed services, but formal efforts to expand the application of these disciplines is ongoing. The significance of these particular disciplines arises from their application to non-discriminatory domestic measures of general application. In other words, notwithstanding their inherent fairness, such initiatives are prohibited unless they:

- **are based on objective and transparent criteria;**
- **are no more Aburdensome than necessary@;**
- **do not, in the case of licensing, restrict the supply of the service; and,**
- **are administered in a reasonable, objective, and impartial manner.**

The criteria delineated by these provisions are imprecise, subjective, and redundant. This makes the task of anticipating and steering clear of these constraints difficult.

As noted, Article VI prohibits measures which are more Aburdensome than necessary to ensure the quality of the service@ and Article XIV allows as exceptions from GATS disciplines only those measures which are *necessary to protect human, animal or plant life or health*. According to international trade law, the test of Anecessity@ requires a nation to demonstrate that, *inter alia,* it has implemented the least trade restrictive method of achieving a legitimate objective.

Take for example, the challenge of developing drinking water standards, particularly in light of scientific uncertainty about the precise point at which human health may be compromised by exposure to a particular toxic substance or pathogen. As we have seen, a DBO contractor may balk at the costs of meeting new regulatory standards and turn instead to international dispute resolution.

If such a challenge is brought under the GATS an international trade tribunal would be invited to second guess the judgment of legislators and parliamentarians about whether some other and less Aburdensome@ approach might have been adopted to protect public health. Perhaps more chlorine might have been used; or better watershed management practices adopted; or perhaps, public health officials could be more vigilant in issuing boil water advisories.

Conversely, a government seeking to defend such health protection measures would have to demonstrate: (1) that it canvassed every option which might have been adopted to improve water quality, (2) subjected each to an assessment of its impact on

international trade in services, and (3) opted for the approach that was least restrictive of the rights of foreign service providers.

Furthermore, if the resolution of similar disputes is to guide, it is likely that a tribunal called upon to judge such standards may have little regard to the precautionary principle as a justification for public health measures at issue. Moreover, trade panels have demonstrated a remarkable alacrity for over-ruling public officials and lawmakers on the difficult policy, ethical and scientific questions that arise in determining appropriate standards for public health and environmental protection.

National Treatment, Market Access and Monopolies

As noted, the more onerous constraints imposed by the GATS apply only where specific sectoral commitments have been made. These include the requirement to provide *National Treatment* [Article XVII] and *Market Access* [Article XVI] to foreign services. This latter requirement prohibits six different categories of non-discriminatory regulatory controls which might otherwise apply to the provision of services, including measures *which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.* It is likely, in our view, that this provision would prohibit a requirement to restrict the supply of a service to a public corporation or agency operating on a not-for-profit basis.

Another provision of the GATS to be noted is Article VIII concerning monopolies, which in Canadian parlance means Crown corporations and municipal utilities that provide exclusive services. These provisions oblige such institutions and agencies to comply with the GATS and furthermore, to avoid taking advantage of their monopoly position to compete with the private sector. We will return to consider this particular requirement under the heading Aprivatization@ below.

Canada=s Commitments

As noted, the extent to which government prerogatives may be subject to GATS constraints depends upon the services it has listed to GATS schedules. The listing process allows a country to specify which precise GATS disciplines it is willing to embrace with respect to a particular sector. Members may also qualify or limit their commitments to: certain modes of supply (e.g. cross-border); a certain time frame; or with respect to particular types of regulatory elements (e.g. controls on the number of service suppliers).

The classification regime adopted by Canada for the purposes of listing service sector commitments under the GATS is the Provisional Central Products Classifications Code (CPC Code) that is kept by the United Nations Statistics Division.

A review of the schedule of commitments made by Canada indicates that no commitments have yet been made that specifically refer to water supply and water treatment. But it is clear that Canada is under considerable pressure to include core water supply services among those sectors fully committed under the GATS. Indeed the European Community has tabled proposals for the full commitment of environmental services including Awater for human use.@[26]

The European Community has also proposed establishing a Acluster@ approach to environmental services negotiations which specifically includes Apotable water treatment, purification and distribution, including monitoring@ as one of the classes of services which it believes would benefit from such a negotiating approach. No doubt the EC has the strategic interests of its resident water service corporations, which now dominate global markets, firmly in mind. Two of Europe=s water giants are currently on the GVRD=s short list.

But while Canada has made no commitment of water supply services, it has made commitments of water-related service sectors these include sewage treatment, as well as the design, project engineering and construction of dams, pipelines and other water infrastructure.

This means that the design and construction services supplied for the Seymour project are subject to virtually all GATS disciplines. Because these services may be provided by any one of four modes of service delivery, the GATS would preclude the stipulation of local preferences in the DBO contract. This constraint is similar to, but arguably broader than those engendered by the NAFTA Article 1106 concerning performance requirements. But unlike that provision of NAFTA investment rules, these GATS constraints apply to local government measures whether non-conforming or not.

The Privatization of Water Services

[26] GATS 2000, Environmental Services Proposal from the EC and their Member States, Dec. 2000.

The privatization or Apro competitive@ bias of the WTO is apparent throughout its discussion papers and background notes. For example, in listing explicit barriers to trade in environmental services, the WTO secretariat begins by identifying public service monopolies. Then, noting a trend towards privatization, the secretariat lists a number of barriers to foreign participation in the new markets created when public sector service delivery is abandoned. These include limitations on: foreign investment and the extent of foreign ownership; the type of legal entity required to provide the service; the scope of operations; the requirement to form a joint venture; and even local hiring requirements.[27]

The privatization objectives of the GATS are woven into the fabric of this trade regime in a manner which is subtle and indirect. With one exception, no provision of the GATS squarely challenges the right of governments to choose or maintain public sector services. Rather, the corrosive influence of GATS disciplines is on the underlying policies, programs, regulatory and funding arrangements upon which the maintenance of public services depends. Key in this regard are the following provisions:

> **Article VIII - Monopolies and Exclusive Service Suppliers: which imposes many of the same constraints on public sector service providers as apply to government. This provision also requires that private sector service providers be compensated where monopoly rights are created with respect to the supply of service. This requirement may make it simply too costly to terminate the DBO contract for the purpose of reestablishing a public sector monopoly. Indeed, the compensation requirement might come into play even in the case where the GVRD simply fails to renew the contract at the end of its term.**
>
> **Article XVI - Market Access: prohibits, inter alia, *measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service.* This would apparently preclude any specification that particular services be provided by governments, Crown Corporations or public agencies.**

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[27] WTO Council for Trade in Services, *Environmental Services, Background Note by the Secretariat,* S/C/W/46, at p.14.

Article XVII - National Treatment: by failing to distinguish between private and public sector services suppliers, the GATS refuses to provide any latitude for policies, programs and funding arrangements which may explicitly or effectively favour public sector service providers.

Procurement

Under Article XIII of the GATS, procurement measures are specifically excluded from certain GATS disciplines - *Most Favoured Nation*, *Market Access* and *National Treatment* - unless such services are purchased for commercial resale or to support the supply of commercial services. While this definition introduces some of the uncertainty that attends the definition of commercial, it nevertheless provides a safeguard for procurement measures from these particular GATS disciplines.

It is not clear however whether a public-private partnership to provide goods and services would qualify as government procurement. The very notion of partnership fits poorly with the arms length character of the typical purchase and sale procurement relationship. A more precise answer would require knowing the details of the contract the GVRD proposes to negotiate with its prospective private partner.

It is also important to note that most GATS disciplines apply to procurement measures notwithstanding this reservation. Furthermore, Article XIII stipulates that multilateral negotiations on procurement must proceed under the GATS.

Subsidies

As is the case for procurement, GATS rules explicitly establish a mandate for multilateral disciplines concerning subsidies. Article XV states that: *Members recognize that, in certain circumstances, subsidies may have distortive effects on trade in services*, and further stipulates that *Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade distortive effects*. The development of disciplines concerning subsidies are part of the negotiating mandate established in the March 2001 negotiating guidelines.

The important point is that because subsidies are measures as defined by the GATS they must be allocated in accordance with *National Treatment* in sectors where specific commitments have been made. In such cases, any intention to restrict the availability of

subsidies to public or not-for-profit services providers must be specifically indicated in a country=s schedule of commitments.[28]

The scheduling guidelines make it clear that governments must list limitations on their national treatment commitments if they want to retain Adiscriminatory@ public subsidies:

> ***Article XVII [National Treatment] applies to subsidies in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to >enter into negotiations with a view to developing the necessary multilateral disciplines= to counter the distortive effects caused by subsidies and does not contain a definition of subsidy. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article.***[29]

As noted, even in the absence of specific commitments, *Most Favoured Nation Treatment* must be accorded with respect to subsidy allocations in all sectors where no specific MFN exemption has been lodged. This means that if a subsidy is extended to a service provider from one country, it must be provided on a discriminatory basis to all WTO members. Moreover, Article XV(2) further stipulates that:

> ***Any member which considers that it is adversely affected by a subsidy of another member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic treatment.***

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[28] While GATS subsidies rules are the subject of competing claims and controversy, these basic facts are readily conceded by the WTO GATS Secretariat, see: *GATS - Fact and Fiction*, WTO 2001.

[29] S/L/92**,** 28 March 2001, *Under the General Agreement on Trade in Services (GATS)*, adopted by the Council for Trade in Services on 23 March 2001.

Progressive Liberalization - Changing the Rules of The Game

This final point serves to underscore another important dimension of the challenge of anticipating the potential impact of GATS disciplines, and has to do with the dynamic and evolving character of this regime. Indeed, the objective of progressive liberalization is codified by Article XIX which provides:

> ***In pursuance of the objectives of this Agreement, Members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.***

It will be very difficult to sustain the public, not-for-profit character of water services in the face of any further expansion of the GATS regime.

SUMMARY

Having included a summary of findings as part of the introduction to this opinion, we will not repeat the exercise here. We conclude, therefore, by simply repeating the point that our assessment of this proposed GVRD undertaking is far from complete. Not only have we not touched on several important aspects of the NAFTA and WTO that are relevant to this project, but even our consideration of NAFTA investment and WTO services disciplines is necessarily preliminary, in the absence of more details about the Seymour project.

Nevertheless, we trust that this assessment has achieved three objectives. The first is to reveal the considerable constraints that Canada=s international trade commitments now impose on public policy, programmatic and legal options available to all levels of government concerning the delivery and regulation of water services. The second is to expose the onerous nature of the consequences of failing to scrupulously observe these disciplines, and in particular the vulnerability of such measures to foreign investor damage claims. Finally, we believe that this assessment makes clear the considerable additional risks associated with proceeding with the Seymour project in partnership with the private sector, rather than preserving the intact integrity of water supply as a public service delivered by public institutions, and on a purely not-for-profit basis.