

**CANADA'S INTERNATIONAL TRADE OBLIGATIONS
AND MUNICIPAL GOVERNMENT AUTHORITY**

RESPONSE TO THE CANADIAN COUNCIL FOR PUBLIC-PRIVATE PARTNERSHIPS

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

by

Steven Shrybman
SACK GOLDBLATT MITCHELL

312 Cooper St.
Ottawa, Ontario K2P 0G7

20 Dundas Street West, Suite 1130
Toronto, Ontario M5G 2G8

On September 20, 2001, the Canadian Council for Public-Private Partnerships (CCPPP) presented a brief to the Walkerton Inquiry taking issue with a legal opinion the Canadian Union of Public Employees had previously tabled. The CUPE opinion was the one we had prepared concerning a proposed public-private partnership to design, build and operate a water filtration plant for the Greater Vancouver Regional District (GVRD), but also relevant to similar projects elsewhere in Canada.

When the GVRD announced this summer that it would significantly reduce the role of its private partner, it cited concerns about the potential adverse impact of Canada's international trade obligations on public control of the project - concerns which CUPE and our opinion had raised.

Not surprisingly, the CCPPP disagrees with some of the views we have expressed. As its members are the principal beneficiaries of initiatives to privatize or contract out public services, it is understandable that it would want to discount concerns that might interfere with such projects. CUPE, of course, has a competing interest in preserving the integrity of public sector services and believes that there are very good public policy reasons for doing so.

In light of the dramatic expansion of the scope of international trade agreements over the past few years, our opinion stressed the need for municipal officials to now take Canada's trade obligations into account when considering partnerships with the private sector to establish infrastructure or provide municipal services. Accordingly we welcome this debate, and hope that it will foster a better understanding of the nature and extent of the international commitments that Canada has made which explicitly limit public policy and legislative prerogatives of municipal governments.

A Significant Omission by the CCPPP

Before responding to the specific assertions of the CCPPP legal opinion we want to make two general observations. The first concerns the failure of the CCPPP to acknowledge the most telling evidence against its position - the recent judgment of the Supreme Court of British Columbia in the *Metalclad* case.

We recited the critical passage from Mr. Justice Tysoe's ruling, noting that under NAFTA, the concept of expropriation had been given a meaning that extended well beyond any recognized under Canadian law, to include *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. A definition [that was] sufficiently broad to include a legitimate rezoning by a municipality or other zoning authority* [our emphasis]. Nevertheless the Judge concluded that the Tribunal's definition of expropriation was a question of law with which he was not entitled to interfere.

Mr. Justice Tysoe's decision is even more important for the fact that it is the only judicial authority concerning the nature and extent of NAFTA investment disciplines, and the powers of investor-state tribunals. The failure of the CCPPP to address this aspect of the judgment is also remarkable because the law firm it retained to prepare its opinion, Fasken Martineau DuMoulin, represented Metalclad in those court proceedings.¹

Rather than acknowledge this seminal judgment by a Canadian court of superior jurisdiction, the CCPPP opinion instead refers to the jurisprudence of the Iran-US Claims Tribunal of dubious relevance to NAFTA disciplines. The CCPPP opinion also admonishes that "[m]ost right thinking Canadians would agree that the state should not confiscate private property without compensating its owner." This of course begs the critical question - namely, the proper scope to be accorded such concepts as confiscation or expropriation.

Given its failure to avert to this important judicial precedent on this point, we are left to conclude that CCPPP supports the expansive interpretation accorded "expropriation" that the Metalclad case leaves us with.

¹ CUPE was denied the right to participate in those proceedings as Amicus Intervenor.

Another related omission of the CCPPP opinion concerns its failure to note the failure of the NAFTA Commission to address the *Metalclad* judgment when it recently had an opportunity to do so. Thus the CCPPP points to a Commission statement concerning other NAFTA investment disciplines in order to assuage municipal concerns, but neglects to point out that the Commission ignored the issue of expropriation in the wake of Mr. Justice Tysoe's startling assessment.

More Smoke than Fire

The second observation we make is to note that, with one important exception,² there is less substantive disagreement with the points we make than the tone of the CCPPP opinion suggests.

For example, we observed that if foreign corporations invoke NAFTA dispute procedures, concerning an investment made pursuant to a public-private partnership, the municipality involved would have no right to participate in the arbitral proceedings that would determine the claim for damages. While the CCPPP opinion characterizes this point as "the most extraordinary claim" we make, it immediately acknowledges that indeed a municipality would have no such participatory rights. It is difficult to find any actual disagreement with the point we make here, notwithstanding the rhetorical tone of the CCPPP response.

However, having acknowledged the validity of our point, the CCPPP opinion offers the assurance that it is the federal government policy to consult with sub-national governments implicated by such claims. However, in doing so it ignores the cases we cite in which the federal government was rebuked by arbitral tribunals for sharing confidential information with the provinces.³ In other words, when it comes to sharing information with sub-national governments, it is the tribunal, not the federal government, that will decide.

In fact, a review of the CCPPP opinion reveals that most of our conclusions have gone unchallenged (see attached summary of our views). For example, there is no disagreement about the fundamental point we make about the application of international trade disciplines to local governments, and the need for municipalities to be cognizant of these obligations. Indeed, the CCPPP indicates that it would be prudent for municipalities to comply with the international commitments Canada has made. Yet we suspect that the need to observe such constraints would come as an unwelcome surprise to many in local government.

The Role of Contract

This brings us to a point about which there is substantive disagreement between the views expressed by the CCPPP opinion and our own - notably, the extent to which the risks of trade challenges and

² That exception concerns the relevance of a P3 contract in an investor-state dispute, an issue we consider further below.

³ 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.

foreign investor claims can be ameliorated by skillful drafting of public-private partnership contracts (P3 contracts).

The CCPPP position is that *a properly drafted contract would eliminate the possibility that any public health or regulatory measure could be challenged as an expropriation*, and that such a contract *could avoid any claim for expropriation under NAFTA*. We strongly disagree, and believe their view is flatly contradicted by the NAFTA text, the cases we have cited, and by the federal governments acknowledgement that no such bar exists to foreign investor claims. It is simply not possible for municipal governments through contractual, or any other means, either to deny a private sector partner recourse to NAFTA dispute procedures, or to alter in any way the rights foreign investors have been accorded by this treaty.

Claims in Contract vs. Claims Under NAFTA

Much of the opinion presented by the CCPPP is devoted to refuting the view, which is wrongly ascribed to us, that an investor state claim might be made simply to seek damages for breach of a P3 contract. This is not our view, and we said so rather plainly when introducing the case of Desona vs. Mexico:⁴

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.

Rather our point, which is explicitly confirmed by Desona and other CGE cases, is that a breach of contract may also violate the provisions of NAFTA investment disciplines and give rise to a claim for damages on that account.

Take, for example, a dispute concerning a decision by a municipal government to cancel a P3 contract for non-performance, i.e. for cause. That dispute might obviously give rise to a claim by either party for damages under the contract. But on the same facts, a foreign investor might also invoke NAFTA investor-state procedures claiming damages for expropriation.

Moreover, in such a case, a foreign investor would have the right to choose its forum and might well prefer taking its claim to an international tribunal before which its public partner would have no right to standing. While the private partner can not pursue damages in both venues simultaneously, it is quite clear from the *Desona*, *Metaclad* and *CGE* cases, that it might go to court and, if unsuccessful, then seek recourse under NAFTA.

Alternatively, a NAFTA claim concerning an investment made in consequence of a public-private partnership, might have nothing at all to do with its contract with the municipality, but rather concern the actions of government or public officials that arise quite independently of it. For example, this might occur in a case where the claim related to an environmental or public health measure, such as

⁴ 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.

those challenged successfully in the *Ethyl*, the *SD Myers* cases, or the one currently under fire in the *Methanex* case.⁵

A P3 Contract Can Not Bar Recourse to NAFTA Enforcement Procedures

A more fundamental problem with the CCPPP opinion is its conclusion that clever contract drafting *would eliminate the possibility that any public health or regulatory measure could be challenged as an expropriation*. There are few things that are certain about NAFTA investment rules, but one of them is that there is nothing a municipal, provincial or federal governments can do to deny foreign investors recourse to NAFTA's private enforcement procedures. In fact, Canada has declared only one exception to the invocation of NAFTA enforcement procedures.⁶ In every other case, it has extended its prior and unilateral consent to be bound by the investor-state suit procedures.⁷

Indeed, the federal government has acknowledged the unconstrained access accorded foreign investors to these dispute procedures in a series of Q and A's it tabled when it amended the *International Boundary Waters Treaty Act* to address the problem of water exports - it conceded:

Canada cannot prevent other countries, or, in the case of Chapter 11 of the NAFTA, private investors, from challenging its laws and regulations before dispute settlement or arbitration panels.

Of course the right to invoke these procedures is no guarantee of success, but the CCPPP assurance that municipalities can *eliminate* the possibility of foreign investor claims concerning P3 investments, is plainly wrong.

Moreover, we note that on every occasion that this assurance is offered by the CCPPP (we counted four), it is limited to claims arising under NAFTA expropriation provisions. We gather that this is tacit acknowledgment that the provision of a public-private partnership agreement would be irrelevant to any other claim arising under Chapter 11.

P3 Contracts May Violate NAFTA Constraints

In fact, with one exception, the terms of a P3 contract are likely to be irrelevant to any NAFTA claim concerning investments arising from, or even in contemplation of, such a partnership. That exception would concern provisions of a P3 contract which themselves violated NAFTA investor guarantees. This would be the case for example, where a P3 contract stipulated that its private partner give

⁵ Methanex, a Canadian company, is claiming \$970 million in damages because it alleges that ground-water protection measures established by California and other states offend NAFTA expropriation and other rules, and have prevented it from marketing a fuel additive it manufactures.

⁶ Annex 1138:3 for *A decision by Canada following a review under the Investment Canada Act*.

⁷ Article 1122:1.

preferential treatment to local goods or services in breach of NAFTA prohibitions against such performance or offset requirements.⁸

This being said, we note that an argument exists that a P3 contract would represent local government procurement, and therefore be exempt from this particular NAFTA prohibition. However, for reasons we explore in detail elsewhere, we believe such contracts would not be considered local government procurement.⁹ We also note that the CCPPP is uncharacteristically equivocal on this point noting only that:

There is a serious question as to where the Chapter Eleven's prohibition on performance requirements ends and where municipalities right to conduct procurement free of NAFTA constraints begins.

Related to this point is the CCPPP's incorrect assertion that a P3 relationship could not give rise to claims by third parties, such as sub-contractors excluded by such local preferences. We referred to the claim by a Quebec based steel company concerning the US "Buy America" requirements to illustrate this point. In response the CCPPP opinion erroneously states that "the status of ADF as subcontractor is totally irrelevant to its claim."

But the investment at issue in that case arose entirely from the company's status as a subcontractor to a contract to build a highway interchange. The "Buy America" provisions at issue had been included in the subcontract agreement because federal law required this as a condition of federal funding. Yes, the ADF claim was made against the federal government, but this will always be the case under NAFTA. It is simply undeniable that a third party subcontractor can invoke NAFTA investment rules concerning requirements of a P3 contract to which it is not even a party. Moreover, unlike the *Desona* case, we believe that the ADF claim has a reasonable chance of success.¹⁰

To sum up on this point: we believe that while careful contract drafting may ameliorate the risk of disputes arising between a municipality and its private partner, the contract can not:

- i) bar recourse by a private partner to NAFTA enforcement procedures to claim damages for violations of NAFTA rules which may or may not also represent a breach of such a contract;
- ii) exonerate provisions of the contract itself which may offend NAFTA constraints;

⁸ See Articles 1004, and 1106.

⁹ See our opinion concerning a proposed P3 agreement to provide sewage treatment facilities for the Halifax Region - Sep. 2001.

¹⁰ NOTICE OF ARBITRATION before the International Centre for Settlement of Investment Disputes (ICSID) ADF GROUP INC. vs. THE GOVERNMENT OF THE UNITED STATES OF AMERICA, at para. 14 and 15.

iii) prevent claims by third parties alleging that their investor rights have been violated by the P3 contract or government measures affecting it; or otherwise

iv) prevent the invocation of NAFTA enforcement procedures concerning government measures, such as public health orders, or environmental standards that may have nothing whatsoever to do with the terms of a P3 contract.

Conclusion

There are two final points we would make in response to the CCPPP opinion. The first is that the controversies we have identified will ultimately be resolved, not by Canadian governments, but by investment panels of international trade tribunals. Moreover, the tenor of the cases to date strongly suggest that the trade liberalization objectives of NAFTA and WTO Agreements will be given broad application, often to the prejudice of competing and legitimate public policy goals such as those concerning the provision of universal services at affordable costs.

The second point is to respond to the criticism that our opinion has overstated the risks associated with the application of international trade disciplines to public-private partnerships. We agree that the picture we present is one that engenders considerable and unpredictable risks of proceeding with P3 undertakings in the new and untested environment framed by international trade, investment and services disciplines which apply to municipal governments. However discomfiting, as the cases we cite clearly illustrate, this is the new world within which municipal governments must now function.

**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.
8. 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.
9. 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.
10. 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.