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TRADE IMPLICATIONS OF GOVERNANCE CHANGES TO PUBLIC MONOPOLIES AND SERVICES: PROPOSED ALTERATIONS TO TOTONTO'S DEPARTMENT OF WATER AND WASTEWATER SERVICES AS A CASE STUDY

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Abstract: this Case Study examines current NAFTA and expected GATS obligations and dispute settlement mechanisms should the City of Toronto council vote to change the governance structure of the present Department of Water and Wastewater Services into a Municipal Service Board, Commission or Corporation. The focus is on trade obligations concerning public monopolies, free trade in services and investor state disputes.

I. Introduction

Having reviewed the May 31st 2002 Chiel Administrator's Office Staff Report on Recommended Governance Structure for Water and Wastewater Services,[1] this Case Study examines current NAFTA and expected GATS obligations and dispute settlement mechanisms should the City of Toronto council vote to change the governance structure of the present Department of Water and Wastewater Services into a Municipal Service Board, Commission or Corporation. In summary, the Staff Report recommends: that control of Water and Wastewater be given to an appointed Municipal Services Board; that City Council hold on to the right to set the water rate and the budget for the new Board; that City continue to work toward creating a water corporation; and that City staff would have until November 2002 to design an implementation plan. Only after a vote is take to change the governance structure, did the Staff Report suggest that the trade implications of the change be examined, in conjunction with the implementation report.

Despite the Staff Report's acknowledgement of the uncertainty about the trade implications of the various governance structures purposed, it recommended removing these services from an in-house Department to a third party Municipal Service Board pursuant to the Municipal Act, 2001, without the benefit on a trade-related legal opinion or on a Sustainability Impact Assessment.[2] This Case Study compares the proposed governance structures with current and emerging trade and investment obligations. Generally speaking our preliminary findings indicate serious public interests' are at stake, requiring enhanced public accountability, not less. The international and regional trade implications should be examined and addressed ***before Council takes a decision*** to restructure the current Water and Wastewater Department (W&WW) into a third party board, commission or corporation. We recommend that the City of Toronto decision to restructure be delayed until the public accountability gap and trade concerns are adequately addressed at public consultations, with due regard to the public and national interests at stake.

Are main finding are as follows:

- As responsibility moves from a directly elected governance system to a third party water utility board, commission or corporation, without provision made otherwise, the opportunity to ensure timely public access to information and public accountability diminishes accordingly. It would be contrary to the public interest to diminish rather than to enhance public accountability in any governance change.
- Contrary to the Staff Report recommendation, it would be more prudent to conduct a trade review first, subject to peer review and public consultations, prior to taking a decision on governance that would be difficult and costly to reverse.
- The International Joint Commission (IJC) recognizes that the waters of the Great Lakes are, for the most part, a non-renewable resource.
- Water is the subject of human rights as well as a public trust since the 1867 Constitution Act recognizes that the provinces hold non-renewable resources subject to any Trusts, putting into doubt the constitutional authority of a province or local government to delegate decision-making and operations to the private sector over public access to and the use of water resources.
- NAFTA obligations are triggers as soon as a government "designates" a new public monopoly service - including the "redesignation" of that service from a Department W &WW to a board, commission or corporation. Retreating back to a public monopoly is difficult and costly.

[1] For CAO Staff Report, see www.city.toronto.on.ca/involved/utilitystudy
[2] Sustainability Impact Assessment of Trade Agreements, CIELAP (Forthcoming)

- NAFTA's Chapter 11 entitled "Investment, Services and Related Matters" specifically links obligations under Chapter 15 on Public Monopolies and Chapter 12 on Services with a powerfully effective investor led dispute settlement mechanism. It must be stressed that these rights and claims are only available to foreign service providers and investors, not domestic corporations.
- NAFTA obligations would allow direct foreign investor disputes about how the new public monopoly would operate, as well as about what level of environmental and public health standards are acceptable.
- Under NAFTA Chapter 11, investors can sue governments if a later environmental regulation on water quality standards set by City Council, for example, reduces the expected profit the investor anticipated.[3] The current Methanex dispute by a Canadian corporation against the State of California for banning a gas additive – MTBE – because it contaminates water supplies is a case in point.[4] The amount of the expropriation claim is in the billions of dollars.
- NAFTA investor disputes do not take place in an open court but rather behind closed doors away from public and media oversight. Indeed, it was the threat that NAFTA could limit the region's ability to set water standards that caused Greater Vancouver District Water Board to reject a plan in June 2001 to allow a public-private partnership to design, build and operate a $117 million filtration plant.
- Current reservations from free trade in service and investment obligations would be lost once a public service is supplied in whole or in part by a private firm even if provided on a a not-for-profit, i.e., non-commercial, basis.

- It is unlikely that government and corporate partnership or concession agreements can contract out of NAFTA or the domestic legislation that implement trade obligations. These contracts are governed not only by the rules of domestic contract law, but by international investment and services treaties.
- The general exception to trade disciplines found in the goods agreement, the 1947 GATT, for government measures related to the conservation of exhaustible natural resources has been removed from the NAFTA services and investment obligations as well as the GATS agreement. Therefore government regulation of services to conserve water supplies would not likely be protected under the GATS and would be subject to state-to-state disputes.
- The limited scope for services provided under "government authority" and without the benefit of a "conservation of exhaustible natural resources" exception, suggests that a host of government measures, from robust drinking water quality testing, stream habitat protection to water export controls, would have no safeguard whatsoever from trade and investment disputes at a trade forum, creating a "chilling effect" on otherwise responsive elected officials to the public interest.
- Absent provision otherwise, the necessity for the government measure, the adequacy of whatever due notice and process was afforded and the rationale for deviations from lower international standards or for determinations of non-equivalency will all become disputable. Even non-discriminatory domestic regulations could be subject to dispute and prohibited unless they are no more "burdensome than necessary".

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[3] Article 1110: Expropriation and Compensation 1. No Party shall 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 the general principles of treatment provided in Article 1105; and (d) upon payment of compensation (emphasis added).

[4] See details of case by Christine Elwell "NAFTA Effects on Water", www.sierraclub.ca/national.

- The likely and significant trade and investment consequences that are triggered by a hasty and ill - considered governance change to the City's W&WW Department must be contrary to the public interest and environmental protection mandate of governments.
- Given the tragedy in Walkerton, the Hamilton experience and the fact that NAFTA and at least 144 foreign service providers and investors could compete for Toronto W&WW service operations at the lowest possible level of environmental and public health protection, it is incumbent upon City Staff and Council to undertake a through analysis of the trade and investment implications of restructuring Toronto's water service system, ***before Council takes a decision to restructure.***

II. Public Accountability

It is important to set out some background information. Currently the operations and the process governing the W&WW are required by law to be open and transparent. All meetings, decisions and policies must be open to the public. All information is available to the public through the Municipal Freedom and Information and Privacy Act.[5] None of the governance options considered is required to meet the same measures of openness and transparency as the current design.

Indeed this fundamental change in public accountability is acknowledged in the meeting notes of the Environmental Groups Workshop on March 5th, 2002. In answer to the question what does a "stronger business orientation mean" it was said: "It is away from the political process, meetings don't have to be public and it is not bound by the Municipal Freedom of Information and Protection of Privacy Act, with closed Board of Director's meetings".

Unlike the City of Toronto with a directly accountable W&WW Department, recall that in Walkerton, Ontario there was a Public Utility Commission (PUC) in place, an option considered in the Report. Recall as well Justice O'Connor's findings in the Walkerton Inquiry that the PUC commissioners were not aware of the improper treatment and monitoring practices of the PUC operators. Moreover the commissioners had failed to properly respond to a Ministry of Environment inspection report that set out significant concerns about water quality and that identified several operating deficiencies at the PUC.[6]

Consequently as responsibility moves from a directly elected system of W&WW to a third party utility commission or corporation, without provision made otherwise, the opportunity to ensure timely access to information and public accountability diminishes accordingly. In summary it would be contrary to the public interest to diminish rather than to enhance public accountability in any governance change.

III. International Trade Implications

Changing the governance structure of the W&WW also has tremendous trade implications that could be triggered the day Council takes a decision to establish a water utility board, commission or corporation. The Staff Report recalled a Council Motion in October 2001 to, inter alia, exclude local governments from the General Agreement on Trade in Services (GATS) measures because the move to global competition in government procurement of goods and services "may have the effect of limiting the ability of Council to enact the policies and regulations it desires". While the Report indicated the "possibility that any Toronto services or regulations could be challenged under GATS cannot be

[5] add
[6] See Walkerton Inquiry Summary,

dismissed with certainty", a review by CAO staff "revealed no indication in the provisions of whether NAFTA or GATS that the structure of governance under which the City maintains a service has any bearing on the degree of vulnerability which may be experienced". [7] This Case Study will outline clear and specific NAFTA provisions that would be triggered the day Council decides to designate.

The concern about investor disputes at the Greater Vancouver Regional District Water Board was distinguished because it related to a purposed public-private partnership in the full design and operation of a $117 million filtration plant, whereas the recommended governance model for the City of Toronto is Municipal Service Board with continued public ownership of the water system, with only aspects of the operations to be contracted out to private service providers. This distinction was made to suggest that trade obligations about national treatment, market access and investor disputes concerning environmental standard setting by governments would not attach to this model. The hope is that cleverly drafted concession contracts with private operators will avoid trade obligations and the Canadian domestic legislation that implements these requirements.

The only recommendation offered in the Staff Report to Council is that once Council approves of a governance model, it can ask the City Solicitor to review the trade implications and report back some 5 months later when the implementation report is filed, see p. 17 of the Report. With respect, would it not be more prudent to conduct the trade review first, subject to peer review and public consultations, prior to taking a decision on governance that would be difficult and costly to reverse? Given that international investors can sue under NAFTA's Chapter 11 for failed profit expectations should Council later determine, based on the Solicitor's trade review or other developments, to not proceed with external restructuring or to increase water-related standards, Council should proceed with extreme caution given the exhaustible nature of this public resource.

A. Water is an Exhaustible Resource

The International Joint Commission (IJC) maintains that the waters of the Great Lakes are, for the most part, a non-renewable resource.[8] They are composed of numerous aquifers (groundwater) that have filled with water over the centuries, waters that flow in the tributaries of the Great Lakes, and waters that fill the lakes themselves. Although the total volume in the lakes is vast, the IJC states that on average less than one percent of the waters of the Great Lakes —approximately 613 billion litres per day is reported to be renewed annually by precipitation, surface water runoff, and inflow from groundwater sources.

The one percent renewable value is declining. Based on findings from the Canadian Centre for Climate Modelling and Analysis[9], by 2030 the renewable portion will decline to 4/5 percent, and by 2050 it will further decline to 3/4 percent. Thus if water is a renewable resource, it is only to the extent that the base water levels and quality, the natural capital, remain constant in the region.

Current climate change impact assessments, based on equilibrium 2 x CO2 scenarios, suggest global warming will result in a lowering of water supplies and lake levels and in a reduction of outflows from

[7] Staff Report, supra fn. 1, p. ?

[8] IJC, Final Report, Section 2, p.6 for reference to Levels Reference Study Board (1993) Levels Reference Study, Great Lakes- St. Lawrence River basin, submitted to IJC, March 31, 1993, see www.ijc.org.

[9] Environment Canada, see Christine Elwell, "NAFTA Effects on Water", prepared for the Commission for Environmental Cooperation, www.sierraclub.ca/nationa, and Toledo Journal of Great Lakes' Law, Science and Policy, Legal Institute of the Great Lakes, Vol 3:151, Spring 2001, p. 161-162.

the Basin. Based on projections using several state-of-the-art models[10], experts from the U.S. National Oceanic and Atmospheric Administration (NOAA) and Environment Canada believe that global warming could result in a lowering of lake level regimes by up to 70 centimetres or 2.2 feet by 2030, a development that would cause severe economic, environmental, and social impacts throughout the Great Lakes region. Identified impacts include: losses in hydroelectricity power generation, reduced shipping, increased dredging, flood damage, infrastructure declines (e.g. docking facilities, shoreline properties) and risks to human health[11]. Existing regulation plans for the Great Lakes are not designed for expected climate change scenarios with low net basin supplies and connecting channel flows, with in stream flows decreases of up to 50 percent.[12]

The decrease in lake levels will vary with location. By 2030 Lake Ontario levels decline by up to 1.30 metres, a dramatic decrease in water availability. By 2030 water levels in the freshwater portion of the St. Lawrence River may decrease by a meter (3.3 feet), a 23 percent reduction in mean flow. A decrease in water quality is expected because of the resurfacing and dredging of buried contaminated sediments, with less water available for dilution of toxic substances.

B. Water and Sustainable Water Management as a Public Trust

Council is advised to proceed with great caution in contemplating any governance changes to the W&WW Department not only because water is an essential and exhaustible natural resource but because water is also the subject of a human right, and a possible public trust. The debate over whether access to safe drinking water is a human right or a "need" subject to market forces of supply and demand flared up at the 2000 Hague Ministerial on Water Security in the 21st Century. A report of the UN Sub-Commission on the Promotion and Protection of Human Rights agreed that access to water is a human right and an absence or insufficiency of drinking water threatened the maintenance of international peace and security. Many conflicts are in progress due to the lack of drinking water, and more conflicts would erupt.[13]

In addition to a human rights dialogue, there is also an important legal tradition that has aided civil societies for over a thousand years in promoting practical divisions between public and private. Modern courts have found the public trust doctrine to be pivotal in several water development cases. From the time of the codification of law in the Roman Empire (Justinian Institutes, Mid-Sixth Century), certain resources have been treated as so important to civic society that the exercise of private property rights cannot be allowed to interfere with public access and uses. These resources belong to the public but are held in trust by the sovereign for specific purposes. Over time, it has been learned that there must be very strict limits on the sovereign or these resources might be sold for private gain.[14]

1. The Canadian Constitution

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[10] L. Mortsch 2000, Climate Change Impacts on Hydrology, Water Resource Management and the People of the Great Lakes – St. Lawrence system, Canadian Water Resources Journal, 25 (2)

[11] Environment Canada, Canada Country Study, Climate Change Impacts,Vol V11, p. 4: Extreme hydrological events, such as floods and intense rainfall may cause overflows of storm and sewage sewers leading to the contamination of drinking water (eg crytosporidium). Excessive precipitation creates breeding sites for insects and rodents that carry diseases.

[12] Environment Canada, Canada Country Study, Climate Change Impacts, Vol V11, p. 72 and 76.

[13] Financial Times, Friday, August 25, 2000, WTO PROTESTS TO UN OVER 'NIGHTMARE' REPORT The report also described the WTO as a "nightmare" for poor countries as fewer people stood to gain from current trends of globalization.

[14] For further discussion and references aee, Elwell, NAFTA Effects on Water, supra, fn, p. ?

It must be recognized that the environment is not an independent matter of legislation under the *Constitution Act, 1867* and that it is a constitutionally abstruse matter that does not comfortably fit within the existing division of powers without considerable overlap and uncertainty.[15] Four powers set out in section 92 of the Constitution provide the provinces with a broad jurisdiction over drinking water safety; local works and undertakings (s. 92(10)); property and civil rights in the province (s.92(13)); matters of a local or private nature (s. 92(16)); and municipal institutions in the province (s.92(8)).

In addition, section 109 gives the provinces jurisdiction over natural resources.

Section 109: All Lands, Mines, Minerals, and Royalties belonging to the several Provinces of Canada, Nova Scotia, and New Brunswick at the Union, and all Sums then due or payable for such Lands, Mines, Minerals, or Royalties, shall belong to the several Provinces of Ontario, Quebec, Nova Scotia, and New Brunswick in which the same are situate or arise, subject to any Trusts existing in respect thereof, and to any Interest other than that of the Province in the same. (emphasis added)

Section 92A of the Constitution Act 1982, provides the provinces with exclusive jurisdiction over the development, conservation, and management of non-renewable resources. Note also that shared jurisdiction in these areas is emphasized by s. 36 of the *Constitution Act, 1982*, which commits both levels of government to provide essential public services of measurable quality to all Canadians.

It would be useful to conduct a full analysis of whether the 1867 Constitution Act recognizes that the provinces hold non-renewable resources, such as water, in trust on behalf of the public, and First Nations, and if so, whether a province has the constitutional authority to delegate decision-making and operations to the private sector over public access to and the use of water resources.

IV. Current NAFTA Obligations

While most of the debate in Canada has been over bulk water exports and whether or not water as a good is covered by trade obligations, there is no doubt that water as a service and as an investment is caught by current obligations under the NAFTA and emerging obligations under the General Agreement on Trade in Services WTO regime. Indeed the International Joint Commission conceded that the investor-state dispute mechanism under NAFTA Chapter 11 gives private investors of one NAFTA country the right to commence proceedings against another NAFTA country for injuries to the rights accorded private investors under the agreement.[16] In all other cases, a government Party to the agreement, often on behalf of their national corporations, must bring claims under the WTO agreements or the NAFTA.

In this Case Study, only certain trade obligations will be highlighted in order to stress that a through study of trade implications is required ***before Council takes a decision to restructure the W&WW Department.*** The focus below is on trade obligations concerning public monopolies, free trade in services and investor state disputes. This review does not deal with NAFTA/GATTs/GATS technical barriers to trade, subsidies, intellectual property rights or financial services that would otherwise be relevant subjects for a complete trade review and Sustainability Impact Assessment..

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[15] See R. Foerster, 2002, "Constitutional jurisdiction over the safety of drinking water," Walkerton Inquiry Commissioned Paper 2, pp. 3–14, in Walkerton Inquiry: A Summary and A Response, CIELAP, 2002, www.cielap.org/what's new.
[16] IJC Final Report, supra fn., Section 10, see Elwell, NAFTA Effects on Water, p. 176-180.

A Extent of NAFTA Obligations – Cities are covered

Unless otherwise exempt, most NAFTA and WTO disciplines apply to federal, provincial and local government measures. While challenges or claims can only be made against the federal government, it is obliged under NAFTA 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".[17] Express provisions are directed at public monopolies.

1. Chapter 15: Competition Policy, State Monopolies and Enterprises

Up until now, NAFTA Chapter 15 has remained one of the least developed under the NAFTA regime. Competition policy concerns the economic regulation of the marketplace. When governments engage in anti-competitive practices, it is often to protect the wider public interest, by the use of public monopolies to provide public services and subsidies. The basic obligation in Article 1501 is that the Parties will prescribe anti-competitive business conduct and take appropriate action. The failure to meet this government obligation is not the subject for disputes under this Chapter. Rather, disputes over the competitive practices of state monopolies are to be conducted by private investors under Chapter 11 as an investor-state dispute.

Chapter 15 sets out disciplines to ensure that any privately owned or any government monopoly that the government maintains or designates, act in a manner consistent with NAFTA requirements in the exercise of any regulatory, administrative or other government authority that has been delegated to it. These rule changes have increased citizen concerns about the commodification and privatization of water and water services. The NAFTA model of public works, should they persist, is based on state enterprises operating on commercial considerations alone rather than on the basis of sustainable water management with a focus on public health and environmental protection

a. Designation of Public Monopolies Trigger NAFTA

Currently under Chapter 15 when a government "designates" a monopoly service - which could include the "redesignation" of that service from a Department W &WW to a board, commission or corporation - a number of important obligations are triggered. The word "designates" is defined as: 1. To indicate or specify; point out. 2. To give a name or title to; characterize. 3. To select and set aside for a duty, an office, or a purpose.[18] A Council decision taken as early as June 18th, 2002 to designate a Municipal Service Board to deal with water and wastewater services is likely subject to NAFTA obligations and direct investor disputes, including the regulation by which the new public monopoly would operate.

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[17] NAFTA, Dec. 1992, 33 ILM 649-680 and see Christine Elwell, "NAFTA Law and Institution: Case Book", Queen's University Faculty of Law, www.queensu.ca/law/texts, 1999, Part B.

[18] The American Heritage® Dictionary of the English Language, Fourth Edition Copyright © 2000 by Houghton Mifflin Company. 1. To mark out and make known; to point out; to name; to indicate; to show; to distinguish by marks or description; to specify; as, to designate the boundaries of a country; to designate the rioters who are to be arrested. 2. To call by a distinctive title; to name. 3. To indicate or set apart for a purpose or duty; -- with to or for; to designate an officer for or to the command of a post or station, Source: Webster's Revised Unabridged Dictionary, © 1996, 1998 MICRA, Inc.

Some of the most important trade obligations that are triggered when this designation occurs include: that the entity "act solely in accordance with commercial consideration in the purchase and sale of the monopoly good or service" (Article 1502.3)[19], that it must afford national treatment to and must not discriminate against NAFTA service providers (Article 1503.3)[20] and NAFTA investors (Article 1116.1.b).[21]

b. No Retreat from the Designation

In addition to the investor claims under NAFTA, GATS obligations also arise should a future Council directive reverse a decision to designate a Municipal Service Board, commission or corporation. Under Article V111 of the GATS – Monopolies – it is provided that where monopoly rights are granted regarding the supply of a service covered by specific commitments, a Member shall submit to arbitration any claims for compensation by other WTO members on behalf of their affected service providers. Failure to comply would justify the imposition of retaliatory trade sanctions. Only where "no affected Members had requested arbitration" would Member be free to re-establish a public sector enterprise without the threat of compensation claims.

A number of observations flow from this overview. A restructured Toronto W&WW board, commission or corporation would be limited to commercial considerations in the supply of services, while the current, directly accountable to Council Water Department is be able to require the best level of service at an affordable price, the best laboratories to detect new pathogens, and the best training for its workers. A redesignation locks in a business-orientated, strictly commercial approach, that does not necessarily address wider public interests. The conclusion that a strictly commercial approach to water supply and services is inappropriate for such an essential and non-renewable resource is reinforced when one considers that current GATS negotiations would remove a recognized government exemption from trade disciplines, to regulate for the conservation of exhaustible natural resources, see below. Reversing these decisions will be difficult and costly.

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[19] **Competition Policy, Monopolies and State Enterprises** Article 1502: Monopolies and State Enterprises 1. Nothing in this Agreement shall prevent a Party from designating a monopoly. ..3. Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates: (a) acts in a manner that is not inconsistent with the Party's obligations under this Agreement whenever such monopoly exercises any regulatory, administrative, or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charge (b) ...acts solely in accordance with commercial considerations in its purchase or sale of the monopoly good or service in the relevant market, including with regard to price, quality, availability, marketability, transportation and other terms and conditions of purchase or sale; (c) provides non-discriminatory treatment to investments of investors, to goods, and to service providers of another Party in its purchase or sale of the monopoly good or service in the relevant market; and (d) does not use its monopoly position to engage, either directly or indirectly, including through its dealings with its parent, subsidiary, or other enterprise with common ownership, in anticompetitive practices in a non-monopolized market in its territory that adversely affect an investment of an investor of another Party, including through the discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct. 4. Paragraph 3 shall not apply to the procurement by governmental agencies of a good or service for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods or provisions of services for commercial sale (emphasis added).

[20] Article 1503: State Enterprises1. Nothing in this Agreement shall prevent a Party from maintaining or establishing a state enterprise...3. Each Party shall ensure that any state enterprise that it maintains or establishes accords nondiscriminatory treatment in the sale of its goods or services to investments in the Party's territory of investors of another Party.

[21] See below p.

In summary, the NAFTA ethic that state enterprises act solely in accordance with commercial considerations, and do not discriminate against NAFTA investors and service providers in terms of the numbers and scale, remains counter intuitive to the environmental ethic of conservation and the human right to clean and affordable water supplies. The effects of these NAFTA imposed rule change are compounded by efforts at the global level to negotiate the free trade in services in GATS at the WTO.

c. The Hamilton Experience

Once a redesignation of the W&WW Department occurs, any goods or services offered by that entity become immediately available to bids for supply by NAFTA service providers and investors. We review these obligations next. But first one needs only to consider the situation in Hamilton where since 1994, the City has gone through four different water and sewage operators to realize how distant and unaccountable private sector participation in this essential service can become. While Hamilton's Council gave the operations contract to a local company, Philip Utility Corporation, by 1999 it was sold to the U.S. Azurix Corporation, a subsidiary of Enron Corporation, which was subsequently sold to American Water Works.[22] During those 8 years of operations over $200,000 in fines were imposed for spills under Ontario's Water Resources Act that were cleaned up by public tax dollars. Most recently American Water Works was sold to RWE AG of Essen Germany, the third largest Water company in the world [23]– that is four companies since 1994.

2. Chapter 12 NAFTA Trade in Services

The Services provisions of NAFTA apply to all services unless explicitly exempt or subject to a specific reservation. Unlike the GATS, NAFTA provides no general exclusion for services delivered in the exercise of government authority. Chapter 12 impose disciplines with respect to National Treatment[24], Most Favoured Nation Treatment, Transparency and Market Access as well as non-discriminatory measures – policies and laws that treat domestic and foreign service providers precisely in the same manner. Importantly, the application of general exceptions in the 1947 General Agreement on Tariffs and Trade Agreement Articles XX (b) and (g) – necessary to protect human health and conserve natural resources - are not available to defend government measures that may offend NAFTA services rules.[25]

Canada, Mexico and the US all declared reservations for certain social services under NAFTA. Canada has reserved under Article 1201: ... the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.

a. Designation Threatens Reservations

[22] "Water Treatment Plant sold to US company", The Hamilton Spectator, August 7, 2001.
[23] "American Water Works purchased by German Utilities Company", Stoney Creek News, Sept. 19, 2001.
[24] Article 1202: National Treatment1. Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers.
2. The treatment accorded by a Party under paragraph 1 means, with respect to a state or province treatment no less favorable than the most favorable treatment accorded, in like circumstances, by such state or province to service providers of the Party of it forms a part.
[25] NAFTA Chapter 21 – Exceptions, Article 2101.

In a recent paper by Steven Shrybman, "Thirst for Control" he asks: "Do public water services fall within the parameters of this [NAFTA Services] reservation? and replies: This would appear unlikely, as the reservation fails to mention water, sewage, waste and other environmental services - and the wording of this reservation suggests that it was intended to be exhaustive.[26] However, even if inclusion of water supply and services can be implied, contracting with the private sector to provide a "social service" is likely to remove that service from the reservation.[27]

He quotes the US view by the United States Trade Representative: "The reservation in Annex II U-5 [the US equivalent to Canada's] is intended to cover services which are similar to those provided by a government, such as child care or drug treatment programs. If those services are supplied by a private firm, on a profit or not-for-profit basis, Chapter Eleven (Investment) and Chapter Twelve (Services) apply." Indeed the US may hold that the participation of a private partner would negate the "social services" reservation even if the service was provided on a not-for-profit, i.e., non-commercial, basis.

Thus NAFTA allowed Canada to declare various reservations that would excuse compliance with certain provisions of Chapter 11 and 12. Pursuant to these provisions, on January 1, 1996 a sweeping reservation was declared for all non-conforming provincial measures as were in place on January 1, 1994. A non-conforming measure is a law, program or practice that would not otherwise be consistent with NAFTA obligations, such as the laws and public institutions in place to perform express social services.

To be sustained, however, such non-conforming measures must be maintained or promptly renewed. Moreover, while amendments to non-conforming measures are allowed, these must not decrease the conformity of the measures with NAFTA service (Article 1206) and investment (Article 1108) disciplines. There is no opportunity under NAFTA to have public services re-established once abandoned. Any such privatization initiatives as contemplated in a restructured W&WW Department may undo the application of the exemption for the social service of water supply, should this specific exemption exist. For water, the most important reservation is the one for non-conforming provincial measures, which again, according to Shrybman, has been maintained or promptly renewed since that time.

3. NAFTA Investor-State Disputes Become Available

Not only is water a service, it an investment – for example, in water treatment and supply infrastructure - and is therefore subject to the rights of foreign investors under NAFTA. Moreover, the access to and use of water is also critical to many investments. NAFTA's Chapter 11 entitled "Investment, Services and Related Matters" specifically links obligations under Chapter 15 on Public Monopolies and Chapter 12 on Services with a powerfully effective investor led dispute settlement

[26] Steven Shrybman, Thirst for Control, Sack, Goldblatt and Mitchell, January 2002, p72.

[27] Article 1206: Reservations Articles 1202, 1203 and 1205 do not apply to: (a) any existing non-conforming measure that is maintained by: (i) a Party at the federal level, as described in its
Schedule to Annex I, (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as described by a Party in its Schedule to Annex I, or (iii) a local government;
(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or
(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1202, 1203 and 1205.(emphasis added)

mechanism.[28] It must be stressed that these rights and claims are only available to foreign service providers and investors, not domestic corporations.

Under NAFTA Chapter 11, investors can sue governments if a later environmental regulation on water quality standards set by City Council, for example, reduces the expected profit the investor anticipated.[29] The current Methanex dispute by a Canadian corporation against the State of California for banning a gas additive – MTBE – because it contaminates water supplies is a case in point.[30] The amount of the expropriation claim is in the billions of dollars.

This dispute, however, will not take place in an open court but rather behind closed doors away from public and media oversight. If the intent of W&WW restructuring is to save taxpayer dollars, it is incumbent upon the CAO Staff to conduct a cost benefit analysis of potential savings compared to the likely investor disputes in the future should the Council ever wish to improve standards or reverse a decision on W&WW Department governance changes.

Indeed, it was the threat that NAFTA could limit the region's ability to set water standards that caused Greater Vancouver District Water Board to reject a plan in June 2001 to allow a public-private partnership to design, build and operate a $117 million filtration plant. A senior engineering report summarized the situation this way: "No perspective gains in efficiency would be worth any perspective risk of losing control of the water system to multinational corporations using trade treaties for their own private goals".[31] It is unlikely that global corporations will adequately take into account local water conservation objectives as well as other public interests such as the human right to clean and affordable water supplies compared to directly accountable elected officials.

c. No Contracting Out of NAFTA

Some may argue that it is possible with clever contract wording to oust the application of NAFTA Chapter 11 in a partnership agreement or joint venture between a transnational water corporation and a local government. In this model the former contracts to design, build and operate water plants and delivery systems, usually for several decades, while the later retains public ownership. But by virtue of NAFTA Article 1122 all NAFTA Parties agreed to submit investor claims to international arbitration.[32] Also by virtue Article 1105, disputes are conducted in accordance with international standards of investment treatment, not the domestic law of contract or based on domestic competition policy.[33]

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[28] Article 1116: Claim by an Investor of a Party on Behalf of Itself 1. An investor of a Party may submit to arbitration under this Subchapter a claim that another Party has breached: (a) a provision of Subchapter A; or (b) Article 1502(3)(a) (Monopolies and State Enterprises) or Article 1503(2) (State Enterprises) here the alleged breach pertains to the obligations of Subchapter A, and that the investor has incurred loss or damage by reason of, or arising out of, that breach.

[29] Article 1110: Expropriation and Compensation 1. No Party shall 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 the general principles of treatment provided in Article 1105; and (d) upon payment of compensation (emphasis added).

[30] See details of case by Christine Elwell "NAFTA Effects on Water", www.sierraclub.ca/national.

[31] "Trade Pact Deters Privatization Plan", Vancouver Sun, June 21, 2001

[32] Article 1122: Consent to Arbitration1. Each Party consents to the submission of a claim to arbitration in accordance with the provisions of this Subchapter. 2. The consent given by paragraph 1 and the submission by a disputing investor of a claim to arbitration in accordance with the provisions of this Subchapter shall satisfy the requirement of: (a) Chapter II of the ICSID Convention (Jurisdiction of the
Center) and the Additional Facility Rules for written consent of the parties; (b) Article II of the New York Convention for an agreement in writing; and (c) Article I of the Inter-American Convention.

[33] Article 1105: Minimum Standard of Treatment1. Each Party shall accord to investments of investors of

There is no need for an investor to pursue domestic remedies in domestic courts; indeed the investor must waive their rights to make a claim in a domestic court before it may seek international arbitration.[34]

For all of these reasons, partnership or concession agreements are governed not only by the rules of domestic contract law, but by international investment and services treaties as well, and in a conflict, the latter prevails. Again according to Steven Shrybman, "This means that when a government enters into a typical P3 contract, it will also be entering into a foreign-investment relationship, whether it appreciates that fact or not."[35] It does not seem likely that a municipality and a private service operator or investor may contract out of NAFTA, nor the domestic legislation that implements trade obligations.[36]

d. A Sampling of Water-related Investment Disputes

Governments need to regulate water because it is an essential and exhaustible natural resource. As owners of water resources, governments are crucial to equitable resource allocation, with a public service mandate to ensure safe and universal access to water, as well as conservation measures. In each of these aspects, government's moderate economic growth and corporate profit and therefore its measures to achieve these goals are all currently targets of investor and foreign service providers disputes.

Importantly from a public accountability and interest perspective, when investor claims do arise, they are decided, not by national courts or judges, but by private tribunals operating under international law and in accordance with procedures established for resolving private commercial claims, not disputes over questions of public policy and law. The tribunals deliberate in camera. No media is present.

In addition to the Methanex case referred to above[37], there have also been a number of other water-related investor disputes. U.S.-based Sun Belt Water Inc. claims against Canada, for US$10 billion, because a Canadian province, British Columbia, interfered with its plans to export water to California. Even though Sun Belt had never actually exported water, it claims that the water export ban expropriated its future profits.

Another example is the U.S. Metalclad Corporation, that successfully claimed against Mexico, for more than US$15 million, because an impoverished rural municipality refused to grant it a building permit for a 650,000-ton/annum hazardous waste facility on land already so contaminated by toxic wastes that local groundwater was compromised.

In summary, it is important to remember that once the NAFTA public service reservation has been removed in the area of water services and related investment, by for example the designation of a new public monopoly such as a Municipal Service Board, with the capacity to contract out those services, there is little room left to retreat. In addition to losing the reservation, compensation claims by unhappy

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another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security...(emphasis added)

[34] NAFTA Article 1121 Conditions Precedent to Submission of a Claim to Arbitration.and more generally see C. Chinkin, Third Parties in International Law, (Oxford: Clarendon Press, 1993) M. Sornarajah, The Settlement of Foreign Investment Disputes, Kluwer International Law, 2000

[35] Shrybman, supra fn 24, p.75.

[36] See Elwell, supra fn 15NAFTA Law and Institutions, Part 1,

[37] See p.

investors and service providers because of new regulations that effect conditions of competition, including high environmental health standards become immediately available for private and effective arbitration. The likely trade and investment consequences that are triggered by a hasty and ill - considered governance change to the City's W&WW Department must be contrary to the public interest mandate of governments as well as an affront to the recognized public trust in exhaustible natural resources.

In conclusion, it would appear that the Staff Report clearly misappreciated the plain words of the NAFTA text on the scope and extent of current obligations triggered by the designation of new public monopolies, as well as the nature of free trade in services as well as investor-state disputes. Given that contracting out of NAFTA by clever wording in partnership agreements is unlikely to be effective, and that investor disputes and claims become available the day Council decides to designate a Municipal Service Board or otherwise restructure the current W&WW Department, extreme caution is urgently recommended. A full trade analysis and Sustainability Impact Assessment, that is subject to peer review and public consultations are required ***before Council takes any decision*** related to the W&WW Department.

V. Emerging GATS Obligations

The General Agreement on Trade in Services (GATS) and the current GATS negotiations at the WTO require special attention from an environmental policy perspective. The GATS is both a trade and an investment agreement with potentially far reaching implications, *inter alia* for local, national and global policy options for social and ecological regulation. In this Case Study only a brief review is provided to indicate that a through analysis is required despite the CAO Staff Report assurances that the purposed Municipal Service Board is not vulnerable to trade obligations.

As the CAO Staff GATS report indicates[38], the purpose of the GATS agreement is to liberate the global trade in services. It is also designed for the removal and elimination of barriers to trade in services, including water and wastewater services. As in the case of NAFTA, the principles of national treatment, non-discrimination and transparency will apply for the benefit of foreign services providers and investors from over 144 countries. The objective of the GATS is to produce rules that limit governments from both providing services as well as regulating services. The Canadian government has placed environmental services, related water and sewage services, as well as the testing and reporting of water quality on the negotiating table.

With respect to government regulation of services, the agreement seeks to impose a "necessity test" so that regulation is "not more burdensome than necessary to ensure the quality of the services". The word "quality" is defined in terms of reliability and efficiency not in terms of environmental or public health quality standards.

It should also be noted that the general exception to trade disciplines found in the goods agreement, the 1947 GATT, for government measures related to the conservation of exhaustible natural resources has

[38] CAO Staff Report September 6, 2001 to the Policy Finance Committee on the implications of GATS for Toronto and other Canadian municipalities, resulting in a Council Motion in October, 2001 to, inter alia, exclude local governments from GATS measures. One of the chief concerns identified in the report was the move to open up to global competition government procurement of goods and services "which may have the effect of limiting the ability of Council to enact the policies and regulations it desires".

been removed from the GATS agreement. Therefore government regulation to conserve water supplies would not be protected under the GATS and would be subject to state-to-state disputes.

Most fundamentally, it will be unelected trade panels that decide if the government regulation is GATS-legal, not the local officials who are accountable to the public. That trade agreements purport to replace the decision-making authority and capacity of government is remarkable. That the Council would proceed with a vote to replace the Department of W&WW with an entity that could trigger these and other trade obligations for generations to come without a details analysis is also quite remarkable.

1. Current Scope of Commitments

GATS Article I provides: "This Agreement applies to measures by Members affecting trade in services". "Members" there are some 144 nation signatories to GATS WTO Agreements and "Measure" is defined by Article XXVIII as: any action by a Member, "whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form". A "Measure" means virtually any government action that affects directly or indirectly, the provision of services by the private sector.

GATS Article I.3 stipulates that it applies to all levels government, including local municipalities, and even to: "non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities"

Article I: 2, defines "trade in services" to mean the supply of a service:

a) from the territory of one Member into the territory of any other Member [cross – border supply];

b) in the territory of one Member to the service consumer of any other Member [to consumers abroad];

c) by a service supplier of one Member, through commercial presence in the territory of any other Member [commercial presence]; and

d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member [presence of natural persons].

Importantly, Subsection (c) entitles foreign service suppliers to establish local service businesses and investments.

2. GATS is an Investment Agreement

GATS is not just a traditional trade agreement, but also a multilateral investment agreement, because commercial presence (foreign direct investment) of service companies is considered "mode 3" of trade in services in the GATS context. However, given it's central principles (Most-Favored Nation and National Treatment) the GATS is not an appropriate framework for an international investment regime

from an environmental policy point of view.[39] GATS does not fulfill the requirements of an environment and development oriented investment regime and therefore is not an appropriate framework of future investment disciplines. Rather than the WTO regimes, the Centre for International Environmental Law recommends negotiations begin about a binding "Sustainable International Investment regime" in the UN context (e. g. at the occasion of the upcoming World Summit on Sustainable Development in Johannesburg in 2002).

3. The Classification of Services

The extent to which liberalization commitments and government measures may be subject to GATS constraints depends on which services have been listed to that country's Schedule of Specific Commitments. The listing process allows a country to specify which GATS disciplines it is willing to embrace for a particular sector. Commitments can be of three types: Market Access, National Treatment and Additional Commitments[40].

But the discussions concerning the classification of services are considered dangerous: Detailed sectorial impact assessment must be undertaken prior to further negotiations. Special attention should be given to environmentally sensitive sectors such as tourism, transport, energy and environmental services in water, energy and hazardous waste.

Yet at the new round of trade negotiations, launched in Doha November 2001, Members agreed to initiate negotiations immediately on the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services. EU has proposed to reclassify water supply as an environmental service.

But as the Centre for International Environmental Law recommends so-called environmental services should only be liberalized further in the light of the results of detailed impact assessments. Questionable services, such as waste incineration services should be excluded from further liberalization and "end-of-the-pipe" services should not gain market advantages over integrated environmental services.[41]

a. Status of Water Services under GATS

While the WTO correctly says that no country has committed water-supply services, dozens of Members have made commitments to other water-related services, including: environmental services, pollution control, waste-water and sewage treatment; general construction work for civil engineering, including construction for waterways, harbours, dams and other water works, for long distance and local pipelines; engineering and project management services for water supply and sanitation works; and technical testing and analysis services (e.g., water quality) including quality control and inspection (e.g., water and waste-water works).[42]

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[39] IISD add

[40] . Canada's commitments are listed in Schedules to the GATS (GATS/SC/16; 15 April 1994) and can be found at the following Web site: http://strategis.ic.gc.ca/SSG/sk00079e.html.

[41] Assessment of Trade in Services in the Context of the Current GATS Negotiations in the WTO (November, 2001) (Tuerk & Krajewski) http://www.ciel.org/Publications/pubtae.html [TE01-8]

[42] Michelle Swenarchuk, From Global to Local: GATS Impacts on Canadian Municipalities, 2002, Canadian Centre for Policy Alternative and the Canadian Environmental Law Association, see www.cela.ca., Annex A Canadian Sector-Specific Commitments, p. 33.

In other words, while the supply of drinking water is not yet a committed service, virtually every aspect of designing, building and operating water supply infrastructure is the subject of services commitments made by many WTO member countries. A search of the Central Products Classifications Code (CPC Code) kept by the United Nations Statistics Division using "water" reveals hundreds of sub classifications that relate to water – from bottled water to dam construction.[43] In terms of water supply, the most important product category relates to: ores and minerals; electricity, gas and water - which is further defined to include water, and natural water.[44] While this Code is specific to products, not services, it has been adopted as a way to describe the sectors for which commitments are being made.

Finally, Canada, among others, has listed a number of general limitations in its Schedule of Commitments, including three that specifically identify public sector service delivery of such services as welfare, health care and education. Note that water and wastewater services are not specified.

From an environmental and public interest perspective, it is especially important to recognize the access to clean and affordable water as a human right in the context of current GATS negotiations and to not liberalize the water sector according to the interests of multinational companies.

4. Limited Exceptions

In addition to careful listing, Members can attempt to avoid GATS obligations by invoking a limited exemption where a service is supplied in the exercise of government authority. This is defined by Article I.3(c) as: any service, which is supplied neither on a commercial basis, nor in competition with one or more service suppliers. The GATS provides no definition of the terms "commercial basis" and "in competition with one or more service providers." There is great uncertainty. But it will be decisions of WTO dispute bodies with the full reach of GATS disciplines that will cause the intentions to become clear.

According to Michelle Swenarchuk, this "government authority" exception would not include public-sector services such as water or sewage services if offered commercially or in competition with the private sector. Today, public services are often a mix of monopolized and competitive services, or may be delivered in partnership with for-profit companies, or offered on a cost recovery basis. It would therefore be difficult to identify a public service clearly exempt according to this definition.[45]

a. No Conservation Laws Apply

Before highlighting some of the most important GATS obligations, it is important to note that GATS contains a general exception clause in Art. XIV which is similar to Article XX of GATT, 1947.[46]

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[43] Shrybman, supra fn 24, p. 37.

[44] Category 1 also references another UN statistical code – ISIC Rev.3 that includes a classification for the "Collection, purification and distribution of water."

[45] Swenarchuk, supra fn40, p 32.

[46] Under the General Agreement on Tariffs and Trade (GATT), governments may use certain listed exceptions to justify departing from its broad constraints. These are set out in Article XX. Two of these exceptions, which are particularly important for environmental, public health and conservation purposes, concern measures that violate the GATT but: [are] necessary to protect human, animal or plant life or health, [GATT Article XX (b)] or; [relate] to the conservation of exhaustible natural resources if such

However the GATS exception is much narrower with respect to environmental exceptions, since GATS has no provision similar to Art. XX (g) of GATT concerning measures "relating to the conservation of exhaustible natural resources". Only Art. XIV (b) GATS allows WTO members to use measures otherwise inconsistent with GATS obligations, if they are "necessary to protect human, animal or plant life or health" There are no plans in the current GATS negotiations in the Council on Trade in Services to expand the scope to specify natural resource conservation or environmental protection and the "necessity tests" under the WTO regime have proven to be environmentally ineffective.[47]

While the GATT Art. XX (g) has yet to be successfully invoked, the WTO has been willing to at least accord it theoretical support. Thus no government can use conservation to justify interfering with the rights of foreign services providers. According to Steven Shrybman, "The implications of this omission for measures to limit demands on water resources is obvious". According to Michelle Swenarchuk, this "government authority" exception would not include public-sector services such as water or sewage services if offered commercially or in competition with the private sector. Today, public services are often a mix of monopolized and competitive services, or may be delivered in partnership with for-profit companies, or offered on a cost recovery basis. It would therefore be difficult to identify a public service clearly exempt according to this definition.[48]

In summary, with the limited scope for services provided under "government authority" and without the benefit of a "conservation of exhaustible natural resources" exception, a host of government measures, from robust drinking water quality testing, stream habitat protection to water export controls, have no safeguard whatsoever and would be open to disputes at a trade forum, creating a "chilling effect" on otherwise responsive elected officials to the public interest.

5. Basic Obligations

It must be observed that the GATS is a very complex agreement. It contains some rules that apply to all service sectors of all WTO Members. These include Transparency and the Most Favoured Nation rule (treating all member countries the same)[49] It also contains other rules which apply specifically to services which countries specify in its Lists of Schedules, including National Treatment and Market Access.

Concerning **Market Access**, GATS contains a list of quantitative and other restrictions which might be viewed as prohibited trade barriers. Article XVI Market Access: prohibits six different categories of non-discriminatory regulatory controls. These include limitations on the number of service suppliers or service operations; the total value of service transactions; the types of legal entity or joint ventures through which a service supplier may supply a service; and limits or aggregate foreign investment.

Yet such measures can be important environmental policy tools for the protection of vulnerable regions, exhaustible resources and access to them by local communities. For example, as the Basel

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measures are made effective in conjunction with restrictions on domestic production and consumption [GATT Article XX (g)]

[47] See Towards Coherent Environmental and Economic Governance: Legal and Practical Approaches to MEA-WTO Linkages (CIEL/EIIEEP, November, 2001) (Stilwell &Tarasofsky), http://www.ciel.org/Publications/pubtae.html and Elwell, NAFTA Law and Institutions, supra fn 15.

[48] Swenarchuk, supra fn40, p 32.

[49] Consider how current service obligations for NAFTA Parties extend the scope of GATS obligations.

Convention on Hazardous Waste recognizes, it makes very good environmental sense to require that domestically generated hazardous waste be treated domestically rather than exported abroad. But a domestic law such as this might not last long under the Market Access provisions of GATS.

Indeed, some speculate that the Market Access provisions could constrain non-discriminatory measures to limit water-resource demands by the industry since the GATS does not have an exception for government regulation related to conservation. [50]

GATS also contains the principle of National Treatment. Article XVII National Treatment: Governments must provide foreign service providers with the most favourable treatment accorded domestic providers. Note that this provision makes no distinction between public non-profit service delivery and private for-profit suppliers. Therefore it has been argued that the obligation to provide foreign investors with National Treatment is a right to establish businesses and operate them on the most favourable terms allowed any domestic enterprise, including those in the public sector. [51]

While this principle is a key element of the multilateral trading system it contains a number of problems from an environmental perspective: For example, the distinction between "like" and "not-like" services and service suppliers remains unclear regarding different environmental implications of services (e.g. the difference between environmentally sound and unsound energy or hazardous waste services).

Yet clear exceptions from **National Treatment** and the Most Favoured Nation rules must be possible for environmental reasons - Exceptions from these principles should be possible for environmental policy measures not only for specific sectors but also more generally under the Market Access and National Treatment commitments. For example, the Most Favoured Nation principle (Art. II GATS) must not put limitations on the implementation of Multilateral Environmental Agreements (such as the flexible mechanisms of the Kyoto-Protocol). It should be possible to treat the energy-intensive goods and services of a WTO member differently depending upon whether it has implemented the Kyoto Protocol to the Climate Change Convention and thus, has internalized the environmental costs of production into the process.

Article VI **Domestic Regulation:** Domestic regulation is one of the most sensitive subjects in current GATS negotiations. It applies to all measures of general application affecting trade in services whether these are discriminatory or not, that is even when foreign and domestic service providers are treated in exactly the same way. The proposed "necessity test" purports to only permit laws that are "no more burdensome on trade than necessary" to ensure the quality of the service. The word quality will not likely mean up or downstream protection of environmental quality but rather will focus on narrow considerations of reliability, accuracy and consumer safety.

The safeguard of local, regional, national and international environmental policy regulation possibilities must be ensured in the context of the negotiations about "domestic regulation"- There is no need for stronger GATS-disciplines concerning "domestic regulation" from an environmental perspective; rather these disciplines already threaten to restrict regulatory options for environmental policy.

[50] Shrybman, supra fn 24, p 44.
[51] Swenarchuk, supra, fn 40, p. 4-5.

In summary, in effect the necessity test will second-guess whether the law or regulation by any level of government is necessary at all. Absent provision otherwise, the **necessity** for the government measure, the **adequacy** of whatever due notice and process was afforded and the **rationale for deviations from lower international standards** or for determinations of non-**equivalency** will all become disputable. Even non-discriminatory domestic regulations could be subject to dispute and prohibited unless they are no more "burdensome than necessary". If this proposal is accepted, it is likely that environmental regulations will be eradicated in WTO dispute settlement proceedings because of the trade restrictive effects of domestic regulations.

The call from the Centre for International Environmental Law is:

- Because of environmental and democracy implications no new domestic regulation disciplines should be introduced;
- The "necessity test" proposal should be rejected;
- If a new agreement concerning services and domestic regulation cannot be avoided, environmental protection and human rights must be recognized as legitimate policy objectives unconstrained by GATS disciplines;
- Any new rules on domestic regulation should only apply to specific sectors and should not contain general disciplines applicable to all sectors.[52]

For further clarity and in order to guarantee a great amount of autonomy to regulate these services, CIEL recommends that "public services" should be exclude from the GATS in general. Since the exclusion concerning "services supplied in the exercise of governmental authority" (Art. I: 3 GATS) depends too much on a non-commercial and non-competitive supply of these services, the clause should be redrafted to recognize and approve the current mix of delivery of government services.

In summary, by requiring that regulations be no more burdensome than necessary, the GATS empowers the judgement of international trade adjudicators to overturn those of accountable elected representatives, contrary to the public interest and the conservation ethic.

6. Public Monopolies

As in the case of NAFTA Chapter 15, the GATS purports to regulate public monopolies. Article VIII Monopolies and Exclusive Service Suppliers requires that publicly owned or controlled monopolies, such as municipal water utilities, and others licensed to provide exclusive services comply with the constraints imposed by the GATS. This provision imposes many of the same constraints on public sector service providers that limit the options of government. Public-sector service providers cannot "abuse [their] monopoly position to act… in a manner inconsistent with [their] commitments."

Subsection 4 of this Article effectively requires that private-sector service providers be compensated when monopolies are "granted" with respect to services they provided or expected to provide. Thus compensation is payable when a government wishes to return a service to the public sector. Recall as well under the NAFTA investor-state dispute procedure, a NAFTA investor could sue for lost profit expectations, see above.

[52] CIEL, supra fn 39.

7. Government Procurement

The last area to recommend further examination is regarding disciplines on government procurement. Currently the GATS does not apply to procurement by government of services "purchased for governmental purposes and not with a view to commercial resale" (Article X111). But the scope of this exception is unknown. So many government services are provided for some kind of fee, e.g. water rates, day care that the exception may in fact be meaningless. Many governments also use procurement as a policy tool e.g. fair wages requirements or green power procurement to kick-start the industry.

Indeed government procurement of services has potentially important environmental functions. This concerns the environmental quality of services as well as production processes and the suppliers of these services. Future GATS negotiations and negotiations in the context of the plurilateral Agreement on Government Procurement that tend to restrict government procurement will have serious environmental implications, e.g. restrictions on government purchasing of green power to deal with climate change and local smog.

There is no need for stronger disciplines concerning government procurement in the GATS context from an environmental perspective. A fair Sustainability Impact Assessment would likely show the need to preserve the largest possible room for government procurement aimed at environmental goals. Negotiations on market access in government procurement of services should be rejected.

VI. Conclusion

Given the tragedy in Walkerton, the Hamilton experience and the fact that NAFTA and at least 144 foreign service providers and investors could compete for Toronto W&WW service operations at the lowest possible level of environmental and public health protection, it is incumbent upon City Staff and Council to undertake a through analysis of the trade and investment implications of restructuring Toronto's water service system, ***before Council takes a decision to restructure.***

Our brief analysis indicates that:

- As responsibility moves from a directly elected governance system to a third party water utility board, commission or corporation, without provision made otherwise, the opportunity to ensure timely public access to information and public accountability diminishes accordingly. It would be contrary to the public interest to diminish rather than to enhance public accountability in any governance change.
- Contrary to the Staff Report recommendation, it would be more prudent to conduct a trade review first, subject to peer review and public consultations, prior to taking a decision on governance that would be difficult and costly to reverse.
- The International Joint Commission (IJC) recognizes that the waters of the Great Lakes are, for the most part, a non-renewable resource.
- Water is the subject of human rights as well as a public trust since the 1867 Constitution Act recognizes that the provinces hold non-renewable resources subject to any Trusts, putting into doubt the constitutional authority of a province or local government to delegate decision-making and operations to the private sector over public access to and the use of water resources.
- NAFTA obligations are triggers as soon as a government "designates" a new public monopoly service - including the "redesignation" of that service from a Department W &WW to a board, commission or corporation. Retreating back to a public monopoly is difficult and costly.

- NAFTA's Chapter 11 entitled "Investment, Services and Related Matters" specifically links obligations under Chapter 15 on Public Monopolies and Chapter 12 on Services with a powerfully effective investor led dispute settlement mechanism. It must be stressed that these rights and claims are only available to foreign service providers and investors, not domestic corporations.
- NAFTA obligations would allow direct foreign investor disputes about how the new public monopoly would operate, as well as about what level of environmental and public health standards are acceptable.
- Under NAFTA Chapter 11, investors can sue governments if a later environmental regulation on water quality standards set by City Council, for example, reduces the expected profit the investor anticipated.[53] The current Methanex dispute by a Canadian corporation against the State of California for banning a gas additive – MTBE – because it contaminates water supplies is a case in point.[54] The amount of the expropriation claim is in the billions of dollars.
- NAFTA investor disputes do not take place in an open court but rather behind closed doors away from public and media oversight. Indeed, it was the threat that NAFTA could limit the region's ability to set water standards that caused Greater Vancouver District Water Board to reject a plan in June 2001 to allow a public-private partnership to design, build and operate a $117 million filtration plant.
- Current reservations from free trade in service and investment obligations would be lost once a public service is supplied in whole or in part by a private firm even if provided on a a not-for-profit, i.e., non-commercial, basis.
- It is unlikely that government and corporate partnership or concession agreements can contract out of NAFTA or the domestic legislation that implement trade obligations. These contracts are governed not only by the rules of domestic contract law, but by international investment and services treaties.
- The general exception to trade disciplines found in the goods agreement, the 1947 GATT, for government measures related to the conservation of exhaustible natural resources has been removed from the NAFTA services and investment obligations as well as the GATS agreement. Therefore government regulation of services to conserve water supplies would not likely be protected under the GATS and would be subject to state-to-state disputes.
- The limited scope for services provided under "government authority" and without the benefit of a "conservation of exhaustible natural resources" exception, suggests that a host of government measures, from robust drinking water quality testing, stream habitat protection to water export controls, would have no safeguard whatsoever from trade and investment disputes at a trade forum, creating a "chilling effect" on otherwise responsive elected officials to the public interest.
- Absent provision otherwise, the necessity for the government measure, the adequacy of whatever due notice and process was afforded and the rationale for deviations from lower international standards or for determinations of non-equivalency will all become disputable. Even non-discriminatory domestic regulations could be subject to dispute and prohibited unless they are no more "burdensome than necessary".
- The likely and significant trade and investment consequences that are triggered by a hasty and ill - considered governance change to the City's W&WW Department must be contrary to the public interest and environmental protection mandate of governments.

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[53] Article 1110: Expropriation and Compensation 1. No Party shall 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 the general principles of treatment provided in Article 1105; and (d) upon payment of compensation (emphasis added).

[54] See details of case by Christine Elwell "NAFTA Effects on Water", www.sierraclub.ca/national.

- Given the tragedy in Walkerton, the Hamilton experience and the fact that NAFTA and at least 144 foreign service providers and investors could compete for Toronto W&WW service operations at the lowest possible level of environmental and public health protection, it is incumbent upon City Staff and Council to undertake a through analysis of the trade and investment implications of restructuring Toronto's water service system, ***before Council takes a decision to restructure.***

Given the significant public interests and trusts at stake, Council should be advise to delay any restructuring recommendations until these fundamental questions about public accountability and trade consequences both under NAFTA and the GATS are examined, and subject to peer review and public consultations.