

The Canadian Council for Public-Private Partnerships

Submission to the Walkerton Inquiry

Part 2

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Comments of Fasken Martineau DuMoulin LLP on the Shrybman Opinion.

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## Introduction

At the request of the Chair of the Expert Meeting on “Implications of Public and Private Operation for the Safety of Drinking Water”, in the course of Part 2 of the Walkerton Inquiry, the Canadian Council for Public-Private Partnerships (“CCPPP”) hereby submits comments, prepared for the CCPPP by Fasken Martineau DuMoulin LLP<sup>1</sup>, on the document entitled “A Legal Opinion Concerning the Potential Impact of International Trade Disciplines on Proposals to Establish a Public-Private Partnership to Design Build and Operate a Water Filtration Plant in the Seymour Reservoir”, dated May 31, 2001, prepared for the Canadian Union of Public Employees by Steven Shrybman of Sack Goldblatt Mitchell (the “Shrybman Opinion”).

In the pages that follow, we critically examine the claims made in the Shrybman Opinion and indicate why those claims are faulty. NAFTA and other trade agreements are not the threat that the Shrybman Opinion would have us believe. Those agreements provide a moderate level of protection to investors and their investments while maintaining a municipalities freedom to enact measures designed to protect the interests of their citizens. Chapter Eleven of NAFTA, is designed to promote economic growth and the exchange of technology by encouraging the free flow of investments within the NAFTA countries. It does this by providing a certain level of protection to those investments. It protects Canadian investors and their investments in Mexico and the United States and also protects American and Mexican investors and their investments in Canada. It protects investors from abusive action by the host state. It does not protect investors against the normal disappointments of business, nor does it offer a protection to investors from the normal regulatory activity of government.

The concepts enshrined in Chapter Eleven are not new. Traditionally, measures to encourage investment by protecting investors against abusive state action such as uncompensated expropriation have been set out in bilateral investment treaties (“BITs”). There are currently twenty-nine BITs in force between Canada and other countries. The United States has negotiated forty-six BITs. In a report issued last year, the United Nations Council for Trade and Development stated that there were 1,857 BITs in force world-wide.<sup>2</sup> Clearly, BITs are not unique or even rare but are in widespread use and have been for some time.

We have reviewed the Shrybman Opinion in light of the current state of international law and the following is a summary of our conclusions:

- The threat of an investor claim based on expropriation under Chapter Eleven of NAFTA is not a risk for a municipality engaging in public-private partnerships in water treatment because by means of a contract all issues relating to claims based on expropriation can be adequately addressed in a manner that satisfies the concerns of both the investor and the municipality. A properly drafted contract can eliminate the application of NAFTA with respect to expropriation. In that regard, international tribunals, including a NAFTA

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<sup>2</sup> Bilateral Investment Treaties 1959-1999, UNCTAD, Geneva December 2000.

Chapter Eleven Tribunal<sup>3</sup>, have recognised that contract provisions can effectively exclude a claim for expropriation.

- A municipal or provincial government's right to enact water quality standards or operating conditions is not inhibited by any provision of NAFTA.
- NAFTA does not inhibit a municipality from returning a particular service to the public sector even after it has been contracted out.
- The GATS is not applicable to design-build-operate contracts for the supply of water because the supply of water in Canada is a service supplied in the exercise of governmental authority, even if the private sector participates in the supply.
- Even if any aspect of a design-build-operate contract for the supply of water were subject to GATS, it would be subject only to the minimal obligations of most favoured nation treatment and transparency, obligations which are easily met by Canadian municipalities.

A major flaw in the Shrybman Opinion is its assumptions that municipalities need the freedom to violate rules in international trade agreements in order to be able to deliver public services and that municipalities are unable to work within the rules and continue to provide public services. There is no reasonable basis for those assumptions. A brief review of the obligations contained in Chapter Eleven will illustrate that they are not aimed at restricting the normal activities of municipal governments but at protecting investors against a type of egregious conduct rarely seen in Canada.

To put things in perspective, since NAFTA was signed in 1994, there have only been fifteen investor-state challenges. When one considers the huge amount of foreign investment in Mexico, the United States and Canada, that low number graphically illustrates how Chapter Eleven is not a practical concern. Rather, it is an exceptional remedy for exceptional cases.

### **What the Shrybman Opinion Says**

In its essence, the Shrybman Opinion argues that rules contained in Chapter Eleven of NAFTA and (possibly) in the General Agreement on Trade in Services (GATS) are so onerous that municipalities should avoid any private participation in the supply of municipal water services.

The main conclusions of the Shrybman Opinion and a summary of our comments thereon are as follows:

1. *The application of Chapter Eleven to municipal governments allows investors to "challenge government measures simply because they diminish the profitability of a foreign investment in the Seymour undertaking".*

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<sup>3</sup> Robert Azinian and others v. United Mexican States, ICSID Case No. ARB (AF)/97/2, decision of the Tribunal dated November 1, 1999. Note that in the Shrybman Opinion this case is referred to as Desona vs. Mexico.

We do not agree. While an investor may claim compensation under Chapter Eleven if its property is expropriated, there is no provision in Chapter Eleven of NAFTA or elsewhere in NAFTA that allows an investor to challenge a government measure simply because it diminishes the profitability of the investment.

2. *The application of Chapter Eleven to municipal governments eliminates the power of municipal governments to demand “as conditions to the DBO, contract requirements intended to achieve benefits for the local economy during the designing, building or operational phases of the project”.*

We do not agree. While Article 1106 of NAFTA prohibits the imposition of certain performance requirements on investors, it is far from clear that the article applies to municipal procurements.

3. *The General Agreement on Trade and Services (the “GATS”) applies to municipal governments but may not apply to the Seymour project.*

We agree that the GATS applies to some measures taken by municipal governments. However, it is unlikely to apply to measures relating to the Seymour project.

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

We do not agree that NAFTA or WTO requirements pose any risk for municipal governments engaging in public-private partnerships. In addition, the only practical difference between a public-private partnership for water supply and a wholly public project is that the latter will not have access to the pools of capital and expertise available in the private sector.

## **Chapter Eleven of NAFTA**

Chapter Eleven contains three sections: Section A establishes the substantive obligations of the Parties with respect to investors and their investments; Section B contains the dispute resolution mechanisms for disputes arising out of the obligations contained in Section A; and Section C contains important definitions that govern the scope of application of Chapter Eleven. A number of Annexes dealing with specific aspects of the dispute resolution mechanism follow Chapter Eleven.

The substantive obligations contained in Section A deal with expropriation, repatriation of profits, the treatment to be granted an investor or investment, the prohibition of performance requirements, requirements relating to senior management and boards of directors, and transfers relating to investments. In addition, by incorporating some of the obligations contained in Articles 1501, 1502 and 1503, Chapter Eleven also addresses the activities of state enterprises and monopolies.

An investor of a Party who suffers loss or damage as a result of a breach of any of these substantive obligations can bring a claim against the offending Party on its own behalf or on behalf of an enterprise of another Party, which it owns or controls.

Chapter Eleven applies to “measures adopted or maintained by a Party relating to investors of another Party, investments of those investors in the territory of the Party and, with respect to performance requirements and environmental measures, all investments in the territory of the Party.”<sup>4</sup> The measure in question must cause a loss or damage to an eligible investor of a Party or the enterprise of the investor of a Party<sup>5</sup> and must constitute a breach of an obligation under (i) Section A of Chapter Eleven; (ii) Article 1503(2) (which requires each Party to ensure that state enterprises it maintains or establishes do not act in a manner inconsistent with Chapter Eleven or Chapter Fourteen (Financial Services)); or (iii) Article 1502(3)(a) (which requires each Party to ensure that privately-owned monopolies it designates and any government monopoly it maintains or designates act in a manner not inconsistent with the NAFTA).

### **Substantive Obligations and Chapter Eleven of NAFTA**

Before examining the claims made in the Shrybman Opinion, it is useful to set out a clear statement of the obligations contained in Chapter Eleven. Those obligations appear in seven articles of Section A of Chapter Eleven as follows:

#### Article 1102: National Treatment

Article 1102 requires each Party to accord to investors of another Party and their investments treatment at least as favourable as it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion, management, conduct, operation and the sale or disposition of investments. Basically, this prohibits discrimination between Canadian investors and NAFTA investors.

#### Article 1103: Most Favoured Nation (“MFN”) Treatment

Article 1103 provides that MFN treatment applies to investors of another Party and to their investments and that the standard for MFN treatment is the most favourable treatment accorded to investments or investors of any other Party or of a non-Party.

#### Article 1105: Minimum Standard of Treatment

Article 1105 requires each Party to accord to investments of investors of another Party “treatment in accordance with international law, including fair and equitable treatment and full protection and security”. Mr. Justice Tyson of the British Columbia Supreme Court described the scope of Article 1105 in *United Mexican States v. Metalclad*<sup>6</sup> as follows:

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<sup>4</sup> Article 1101.

<sup>5</sup> Articles 1116 and 1117.

<sup>6</sup> *United Mexican States v. Metalclad Corporation*, British Columbia Supreme Court, Docket No. L002904 dated May 2, 2001

What the *Myers* Tribunal correctly pointed out is that in order to qualify as a breach of Article 1105, the treatment in question must fail to accord to international law. Two potential examples are “fair and equitable treatment” and “full protection and security”, but those phrases do not stand on their own. For instance, treatment may be perceived to be unfair or inequitable but it will not constitute a breach of Article 1105 unless it is treatment which is not in accordance with international law. In using the words “international law”, Article 1105 is referring to customary international law which is developed by common practices of countries. It is to be distinguished from conventional international law which is comprised in treaties entered into by countries (including provisions contained in the NAFTA other than Article 1105 and other provisions of Chapter 11).<sup>7</sup>

As if to confirm Mr. Justin Tyson’s opinion that Article 1105 guaranteed only treatment in accordance with customary international law, on July 31, 2001 the NAFTA Free Trade Commission issued an interpretative note on the scope of Article 1105 stating:

“1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.”

#### Article 1106: Performance Requirements

Article 1106 prohibits the imposition or the enforcement of “performance requirements” on the investment of an investor. The list of prohibited performance requirements is specific and not all performance requirements are prohibited. The prohibition applies to requirements or commitments to:

- export given levels or percentages of goods;
- achieve given levels or percentages of domestic content;
- give preference to goods produced or services provided in a Party's territory;
- relate the volume or value of imports to the volume or value of exports or foreign exchange inflows associated with an investment;
- restrict sales of goods or services an investment produces on the basis of exports or foreign exchange earnings by the investment;
- transfer technology, production processes or proprietary knowledge; or
- act as an exclusive supplier of goods or services to a specific region or market.

Article 1106 also prohibits a Party from conditioning the receipt or continued receipt of an advantage related to an investment on compliance with any of the following requirements:

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<sup>7</sup> Ibid., at paragraph 62.

- the achievement of a given level of domestic content;
- the purchase, use or giving a preference to goods produced in the territory of a Party;
- the relation in any way of volume or value of imports to exports or foreign exchange inflows associated with an investment; or
- the restriction of sales of goods or services produced by an investment in the territory of a Party to the volume or value of a Party's exports or foreign exchange earnings.

#### Article 1107: Senior Management and Boards of Directors

Article 1107 (i) prohibits a Party from requiring that senior management positions of an enterprise that is an investment of an investor of another Party be of any particular nationality; and (ii) permits a Party to require that a majority of the board of directors of an enterprise be of a particular nationality or resident in the territory of the Party.

#### Article 1109: Transfers

Article 1109 requires each Party to permit investors to repatriate or transfer, without delay and in a freely usable currency, all profits, fees, and other proceeds resulting from investments in its territory. It also specifies the method for determining the exchange rate for transfers. Article 1109(3) prohibits a Party from requiring its investors to transfer, or penalise its investors for failing to transfer, income, earnings, profits and other proceeds from the territory of another Party.

#### Article 1110: Expropriation and Compensation

Article 1110 prohibits a Party from directly or indirectly nationalising or expropriating an investment of an investor of another Party or taking a measure "equivalent to nationalisation or expropriation" of such investment except (i) for a public purpose; (ii) on a non-discriminatory basis; (iii) in accordance with due process and minimum standards of international law; and (iv) on payment of compensation. It is important to recognise that Article 1110 does not prohibit expropriation, it merely subjects it to certain conditions, notably the obligation to compensate the expropriated investor.

#### ***Does NAFTA apply to the acts of municipal governments?***

The Shrybman Opinion examines the question of whether NAFTA obligations apply to municipal governments and spends a number of pages establishing that they do.

Strictly speaking, municipalities are not bound by NAFTA, only the federal government of each Party is bound. However, a violation of NAFTA by a Canadian municipality will be considered a violation by Canada, absent a specific exemption. Basically, under NAFTA as in other international treaties, the conduct of a sub-national government is considered to be conduct of the State. Given that only the federal government is responsible, in international law municipalities cannot be sued under Chapter Eleven.

Even so, while a municipal government is not liable under NAFTA for its acts, prudence suggests that it ought to respect the NAFTA obligations. If it does not, Canada must answer.

### ***Public Health Measures as Expropriation***

The Shrybman Opinion states that there is a risk that Article 1110, which prohibits expropriation without compensation, “would be invoked by a private sector partner to the Seymour Project to challenge environmental or public health measures that may require substantial expenditures to modify, or repair, the Seymour Filtration Plant”. The Shrybman Opinion adds that “to the extent that such measures might diminish the value of a private sector investment in the Seymour Plant, they are vulnerable to being challenged as offending the constraints of Article 1110”.

There are two problems with this claim. First, it understates the test for expropriation and second, it appears to assume that the Seymour Project would operate without any contractual framework.

Under international law it is generally agreed that governments should compensate investors when investments are expropriated<sup>8</sup>. Most right thinking Canadians would agree that the state should not confiscate private property without compensating its owner. It is also generally accepted that governments do not have to compensate investors for economic injuries, which are the consequence of non-discriminatory, *bona fide* regulations. In other words, no compensation is required for regulations that are a legitimate exercise of the so-called government policy power<sup>9</sup>. That principle has, for instance, been adopted in the context of the Iran-United States Claims Tribunal<sup>10</sup>. Whether a legitimate regulatory measure has become a compensatable expropriation is a question of degree, and ultimately the specific circumstances prevailing in each case will be the determining factors. Thus, the Shrybman Opinion’s claim that a measure which diminishes the value of an investment constitutes an expropriation is contradicted by the reality of international law.

The Shrybman Opinion also seems to assume that the Seymour Project will be undertaken without a contract containing the usual provisions that are customarily contained in a properly drafted contract establishing a public-private partnership. The contractual arrangement between the GVRD and the private sector participant would normally address issues such as changes in laws and regulations, termination without cause, actions of government that increase the costs of the investor, changes in safety standards and similar concerns.

In fact, the GVRD recognised that in part and is quoted by the Shrybman Opinion as stating:

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

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<sup>8</sup> R. Higgins, “The Taking of Property by the State” (1982) 167 *Recueil des Cours*, 267.

<sup>9</sup> *Restatement of the Law (Third), Foreign Relations Law of the United States* (St-Paul, American Law Institute, 1987), vol. 1, no. 712; G. Sacerdoti, “Bilateral Treaties and Multilateral Instruments on Investment Protection” (1997) 269 *Recueil des Cours*, 384-385.

<sup>10</sup> G. Aldrich, “What Constitutes a Compensable Taking of Property? The Decisions of the Iran U.S. Claims Tribunal” (1994) 88 *American J.I.L.* 609. However, it should be noted that the tribunal has jurisdiction over not only disputes arising out of expropriation, but also over “other measures affecting property rights”.

The Shrybman Opinion brushes aside the notion that a contract between the municipality and the private sector participant can deal with such issues, stating:

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

Implicitly, the Shrybman Opinion recognises that the contract between GVRD and the private sector participant can fully address such issues to avoid any claim for expropriation under NAFTA. Any measure by the municipality which is contemplated in the contract could not be considered expropriation. For example, if the contract granted the GVRD the right to terminate the contract without cause prior to the expiry of the term, and dealt with the manner in which the investor would be compensated for early termination, early termination could not be viewed as expropriation of the investment giving rise to a claim under NAFTA. It would be a mere contractual issue.

The Shrybman Opinion goes on to state that “if the GVRD private partner can claim the status of a foreign investor under NAFTA or another investment treaty, it would have recourse against unwanted regulatory initiatives, such as new safe drinking water standards, that simply do not exist under Canadian law”. There are two issues here: (i) whether NAFTA gives recourse against “unwanted regulatory initiatives, such as new safe drinking water standards”, and (ii) whether NAFTA recourses are available under Canadian law.

To suggest that the NAFTA expropriation provisions is a recourse against regulatory initiatives such as new safe drinking water standards is a gross exaggeration. Article 1114 of NAFTA is devoted to environmental measures and specifically states that:

Nothing in this Chapter shall be construed to prevent a party from adopting, maintaining or enforcing any measure, otherwise consistent with this chapter, that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

Thus, not only does NAFTA not provide a recourse against unwanted regulatory initiatives, it specifically provides for the opposite. Namely, that a Party may adopt, maintain or enforce any measure “it considers appropriate to ensure that all investment activity in its territory is undertaken in a manner sensitive to environmental concerns”.

If the Shrybman Opinion is suggesting that a regulatory initiative could amount to expropriation, then, we reiterate that a properly drafted contract establishing a public-private partnership will contain provisions as to when changes in laws and regulations will entitle an investor to compensation and when they will not, thereby eliminating the application of NAFTA in that regard.

The Shrybman Opinion acknowledges Article 1114 but states that:

Because this provision only applies to measures ‘otherwise consistent’ with Chapter Eleven, it simply would not apply to a measure otherwise found to be in breach of the expropriation or other investment rules.

One needs to recall, however, that there is nothing in Chapter Eleven that prohibits expropriation. Chapter Eleven permits expropriation, but requires the payment of compensation.

The Shrybman Opinion concludes that “over a twenty year contract there is a risk that domestic public health and regulatory measures may be challenged under NAFTA investment rules and procedures”.

Once again, the answer to this is that a properly drafted contract would eliminate the possibility that any public health or regulatory measure could be challenged as an expropriation.

The conclusion in the Shrybman Opinion that NAFTA gives recourses that are not available to other investors is also unsound. Any particular act of a municipality may give rise to various domestic or “international” remedies and it makes no sense to compare the two. By definition, NAFTA remedies are not available to domestic investors.

In the Ethyl case, for example, a federal measure caused the Government of Alberta, supported by Saskatchewan, Nova Scotia and Quebec, to seek a remedy under the Agreement on Internal Trade (“AIT”), an agreement between the federal and provincial governments<sup>11</sup>. At the same time, an investor challenged the same federal measure under Chapter Eleven of NAFTA.<sup>12</sup> The Government of Alberta was successful under the provisions of the AIT and Canada,, faced with its loss against Alberta, settled the investor’s claim under NAFTA. Thus, the same measure gave rise to both domestic and NAFTA remedies.

### ***Termination of the DBO Contract as Expropriation***

In this section, the Shrybman Opinion makes the extraordinary claim that:

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

Once again, the Shrybman Opinion assumes that a contract establishing a public-private partnership would not provide for termination “either during or even at the end of its term”. Of course, it is easy to raise fears of litigation if one assumes that contracts do not provide for such fundamental provisions. Clearly, any properly drafted contract would provide for early

<sup>11</sup> Report of Article 1704 Panel concerning a dispute between Alberta and Canada regarding the Manganese-based Fuel Additives Act, dated June 12, 1998.

<sup>12</sup> Ethyl Corporation v. Government of Canada, Notice of Arbitration dated April 14, 1997.

termination as discussed above. As for termination of a contract “at the end of its term”, it is absurd to suggest that a contract would not contain provisions dealing with its termination at term. Therefore, NAFTA would not be applicable.

The Shrybman Opinion refers to the case of *Desona v. Mexico*<sup>13</sup> to support the view that termination of a contract may be seen as expropriation. The case involved a concession contract granted to a group of American investors that was subsequently annulled by a Mexican municipal authority. The Shrybman Opinion claims that this was a case of mere breach of contract that was turned into an expropriation case. In fact, in rejecting the investors’ claim, the Tribunal made it quite clear that NAFTA does not extend to protect investors from mere claims of breach of contract. The Tribunal stated:

To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and still not be in a position to state a claim under NAFTA. It is a fact of life everywhere that individuals may be disappointed in their dealings with the public authorities, and disappointed once again when national courts reject their complaints. It may safely be assumed that many Mexican parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.<sup>14</sup>

And later:

The problem is that the claimant’s fundamental complaint is that they are the victims of a breach of the Concession Contract. *NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime*, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes. *The claimants simply could not prevail merely by persuading the arbitral tribunal that they Ayuntamiento of Naucalpan breached the Concession Contract.*<sup>15</sup>

The fact that the American investors could file an action and have it dismissed in no uncertain terms is not grounds, as the Shrybman Opinion would have it, for concluding that NAFTA provides a remedy for breach of contract. The case clearly states the opposite, namely, that a breach of contract claim cannot give rise to a Chapter Eleven claim. Termination of a properly drafted contract which provides for termination cannot be considered expropriation.

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<sup>13</sup> Op.cit. at footnote 2. The case is more usually referred to as Azinian v. United Mexican States.

<sup>14</sup> Ibid., at paragraph 83.

<sup>15</sup> Ibid., at paragraph 62.

To further support this argument, the Shrybman Opinion refers to *Générale des eaux v. Argentine Republic*,<sup>16</sup> another case involving a breach of a concession contract. The interesting question in that case was whether the Tribunal had jurisdiction because the concession contract provided for review of disputes before the Argentine Courts. In addition, the bilateral investment treaty between Argentina and France provided for international arbitration of investor-state disputes. The investors sought international arbitration claiming both breaches of the contract and independent breaches of the bilateral investment treaty by Argentina, which was not a party to the contract. The Tribunal held that it had jurisdiction to deal with the allegations of breach of the bilateral investment treaty, but had no jurisdiction to deal with issues relating to breach of contract.

The Tribunal held that, because of the crucial connection between the terms of the concession contract and the alleged violations of the bilateral investment treaty, the Argentine Republic could not be held liable unless and until the investors had exhausted all of their contractual rights in the Argentine court and, having done that, *could demonstrate to the Tribunal that they had been denied either procedurally or substantively their rights by the Argentine courts*. The failure of the Claimant to follow the contractual remedies and seek relief in the local Argentinean Courts was fatal to its claim of a violation of the BIT. The Tribunal stated:

“However, since Claimants failed to seek relief from the Tucuman administrative courts, and since there is no evidence before this Tribunal that these courts would have denied Claimants’ procedural or substantive justice, there is no basis on this ground to hold the Argentine Republic liable under the BIT”.<sup>17</sup>

Thus, while the Tribunal held that it had jurisdiction to examine the claim, it clearly favoured the contractual remedies to the point of dismissing all claims against Argentina that involved the contract because the claimants had not exhausted their remedies in the Argentine courts or demonstrated that they would not get a fair hearing in the Argentine courts.

The Shrybman Opinion tries to distinguish the case from a dispute that could arise under the Seymour Project, stating that under NAFTA “it would not be necessary for a foreign investor to establish an independent breach by Canada in order to found a claim under NAFTA rules”. The Shrybman Opinion relies on the Desona/Azinian and Metalclad cases as support for that proposition. Those cases do not support that proposition.

As noted previously, in the Desona/Azinian case the Tribunal clearly stated that breaches of contract do not give rise to NAFTA claims. In Metalclad, the investor was alleging an independent breach of NAFTA wholly unrelated to any contractual breach. In Metalclad, there was no contract between the municipality and Metalclad and the investor claimed that the municipality’s denial of a construction permit was a breach of NAFTA.

Thus, of the three cases cited by the Shrybman Opinion in support of the proposition that a contractual relationship cannot exclude a NAFTA expropriation claim, the Tribunal clearly

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<sup>16</sup> *Générale des eaux v. Argentine Republic*, ICSID Case No. ARB/97/3, award of the Tribunal dated November 21, 2000.

<sup>17</sup> *Ibid* at page 28.

stated in one case that breach of contract does not give rise to a NAFTA claim, in another case that there was no contractual relationship with the investor and in *Générale des eaux*, that it did not have jurisdiction to hear the breach of contract claims. The Shrybman Opinion is clearly wrong on this point.

### ***Minimum Standard of Treatment***

In the next section, the Shrybman Opinion refers to the minimum standard of treatment and notes that “to date, in every NAFTA claim decided in favour of a foreign investor, the impugned measure was found to violate this requirement”.

The Shrybman Opinion does not explain how the minimum standard of Article 1105 relates to the Seymour Project or suggest how it may be an obstacle to the efficient operation of the Project. Therefore, we assume that the Shrybman Opinion does not see any difficulty arising out of Article 1105.

We note also that the NAFTA Commission has recently issued an interpretative opinion under Article 1105 stating that Article 1105 guarantees a minimum standard of treatment under customary international law. There is no history of Canadian municipalities engaging in conduct so offensive as to constitute a violation of the rules of customary international law.

### ***Investor-State Arbitral Proceedings***

In this section, the Shrybman Opinion expresses objections to the investor state arbitral proceedings. Perhaps the most extraordinary claim the Shrybman paper makes in this section is that in any NAFTA dispute concerning the design-build-operate contract GVRD “would have no right to participate in the arbitral proceedings”.

Of course, GVRD would not be a party to any Chapter Eleven action because no investor could take action against GVRD under NAFTA. Actions filed by investors are filed against the federal government and not against municipalities or provincial governments.

That being said, it is common practice for the federal government to consult with all interested parties in NAFTA claims. The statement that GVRD would have no right to participate is inaccurate. Only parties to a dispute have an automatic right to participate in court cases, all others need to ask for permission.

However, the established practice in Chapter Eleven litigation is for sub-national governments involved in the dispute to actively participate in the action as they are the ones most closely involved. Their precise role as members of the litigation team varies from case to case.

### ***National Treatment***

In this section, the Shrybman Opinion concludes that there is a “real risk that by entering into a DBO contract to supply potable water, the Seymour Project may establish a new *National Treatment* benchmark that governments would be obliged to follow for other capital projects”.

That is not correct. The national treatment obligation is circumscribed by a requirement that it be applied only between investors “in like circumstances” and by the fact that at the municipal level, it means treatment afforded by that municipality. Thus, at most the Seymour Project may establish a standard against which to measure the GVRD treatment of investors in DBO contracts to supply water within the GVRD territory at some point in the future.

### ***Performance Requirements***

The Shrybman Opinion states that Article 1106 restricts the GVRD’s ability to impose performance requirements on investors. It is impossible to make such a bold statement with any assurance.

A municipality would normally enforce such performance requirements in the context of a procurement and municipal procurements are not subject to NAFTA. There is therefore a serious question as to where Chapter Eleven’s prohibition on performance requirements ends and where the municipalities right to conduct procurements free of NAFTA constraints begins. In addition, Article 1108 excludes “procurement by a Party” from Chapter Eleven discipline. Although the full scope of that exclusion has not been tested, many would argue that it covers municipal procurements such that municipalities can demand performance requirements as a condition of a contract.

### ***ADF v. United States***

The Shrybman Opinion cites this case as authority for the proposition that a sub-contractor could bring a case for violation of Chapter Eleven and states that while the “facts of the ADF case are distinguishable from those of the Seymour Project, the principles are not”.

In the ADF case, a steel fabricator from Quebec brought an action against the U.S. government for violation of NAFTA arising out of the imposition of Buy America provisions in federal highway contracts. The status of ADF as sub-contractor is totally irrelevant to its claim; nothing turns on that status.

ADF’s ability to bring a claim against the U.S. government is based on its status as an investor, and its claim that the U.S. government violated its obligations under NAFTA.

### ***The General Agreement on Trade in Services (GATS)***

The Shrybman Opinion also takes issue with alleged risks arising out of the GATS. Before examining its claims in that area, it is useful to briefly examine the nature of the GATS. In the analysis that follows, we will not discuss the GATS rules relating to monopoly suppliers because they are not applicable to the Seymour Project.

The GATS seeks to establish a minimum set of obligations relating to measures taken by Members that affect trade in services. Trade in services is broadly defined to mean the supply of services through any of four modes of delivery: the cross-border supply of a service, the movement of the consumer to the country of the supplier, the movement of the supplier to the country of the consumer (i.e. a commercial presence in another Member) and the temporary movement of natural persons employed by the supplier to the country of the consumer.

Most, but not all, services are covered by GATS, and not all covered services benefit from the same treatment. There is a set of general obligations which apply to all covered services and, in addition, a set of specific commitments respecting market access which have been made only in respect of some services. The core general commitments require a most favored nation treatment, for service suppliers and services transparency and set out rules governing monopolies and exclusive service suppliers.

Specific commitments in respect of particular services are set out in each Party's Schedule of Commitments and we will refer to those services as "listed services". The core commitments relating to scheduled services are market access obligations, a national treatment obligation and other practices such as qualifications, standards and licensing. Where no specific commitments have been made, the services do not appear in the Party's schedule and we will refer to them as "non-listed services".

### Exceptions to Coverage

The GATS contains several significant exclusions. For present purposes, the most important exclusion is found in Article I, which defines "services" as excluding services "supplied in the exercise of governmental authority". The supply of water by a municipality, whether achieved through a fully public system or through a public-private partnership would be considered a supply of a service in the exercise of governmental authority. Therefore, the supply of water through the Seymour Project would not be subject to even the minimal obligations of the GATS.

### Non-listed Services

All covered services are subject to the core general obligation to provide most favored nation treatment. That means that a municipality must accord to services and service providers of any WTO Member country, treatment "no less favorable than it accords to like services and service suppliers of any other country."<sup>18</sup> Members of free trade areas (such as NAFTA) or customs unions are exempted from the MFN obligations for preferences granted to their regional partners.<sup>19</sup>

In addition to the MFN obligation, the GATS imposes a transparency obligation affecting all covered services and service suppliers. That transparency obligation requires that measures affecting trade in the affected service must be published or otherwise made publicly available to permit service suppliers to better understand the conditions under which they conduct business.

### Listed Services

In its Schedule of Commitments under GATS, Canada has made specific market access commitments in respect of several service areas but has made no commitments respecting cold water distribution. However, for the sake of completeness, we will review the relevant obligations relating to listed services.

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<sup>18</sup> GATS Article II (The exceptions to the MFN obligation are not relevant here).

<sup>19</sup> GATS Article V.

### Market Access: GATS Article XVI

A municipality cannot limit access to the listed service sectors and cannot enact measures which have the effect of limiting any service supplier's ability to supply listed services in that sector.

### National Treatment: GATS Article XVII

In the listed service sectors, municipalities would be obliged to accord to listed services and service suppliers of any other WTO Member, treatment no less favorable than it accords to its own services and service suppliers.

### **The Shrybman Opinion Respecting GATS**

At the outset, it should be noted that it is unclear precisely what difficulty the Shrybman Opinion has with the application of the GATS to any aspect of municipal activities in water treatment. It clearly states that "a review of the schedule of commitments made by Canada indicates that no commitments have yet been made that specifically refer to water supply and water treatment".

In any event, it appears clear that the GATS is not applicable to the Seymour Project and, even if it were, the minimal obligations of national treatment and transparency pose no difficulty for any municipality.

The Shrybman Opinion spends more time discussing perceived future problems relating to the supposed U.S. and EU agendas in the services area than with any current issue. Certainly, the Shrybman Opinion raises no issues under the GATS that would require a municipality's withdrawal from public-private partnerships as a response.

Thus, apart from raising fears about the possible future direction of the GATS negotiations, there is nothing in the Shrybman Opinion that would indicate that a municipality ought to avoid public-private partnerships in order to better its position under the GATS or that the GATS presents any serious obstacle to a municipality conducting business fairly and openly with private sector partners.

### **CONCLUSION**

The Shrybman Opinion is advocacy in favour of withdrawal from public-private partnerships, designed to convince public officials that the only way to deal with international trade agreements is to avoid public-private partnerships and build up the public service.

We have attempted to indicate the specific areas where we consider that the Shrybman Opinion is in error or is deficient. In our opinion, a municipal government can quite easily meet any of the obligations that may be imposed on it by international trade agreements and contract efficiently and beneficially with the private sector. Perhaps the most telling evidence of that is found in the real world experience, rather than exaggerated suppositions. While the Shrybman Opinion cites Chapter Eleven of NAFTA as perhaps the most dangerous of all instruments, the reality is that since 1994 there have been only fifteen active cases throughout the NAFTA

territory. When one considers the billions of dollars of investments and contracting that goes on, on a daily basis, the insignificance of the risk of a possible Chapter Eleven action becomes apparent. In addition, if the international trade agreements represented a real constraint on municipal governments, then we would have seen a reaction from municipal governments on the issue of public-private partnerships before now or an increase in claims being made against municipal governments. That is not happening. In fact, public-private partnerships are widely seen as the answer to delivering public services in an efficient manner.

The United States is subject to all of the constraints of NAFTA and yet does not appear to be having any difficulty in managing its private-public partnerships. Similarly, the European Union, which is subject in the same way to the GATS discipline, is likewise establishing public-private partnerships on many fronts with no apparent difficulty.

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