

WHO OWNS “YOUR” WATER?

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RECLAIMING WATER AS A PUBLIC GOOD UNDER
INTERNATIONAL TRADE AND INVESTMENT LAW

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WHO OWNS “YOUR” WATER? WATER AND FOREIGN INVESTORS IN THE POST-NAFTA CONTEXT

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RECLAIMING WATER AS A PUBLIC GOOD IN THE POST NAFTA ERA: INTERNATIONAL TRADE AND INVESTMENT LAW CONSIDERATIONS,

3rd World Water Forum, Day Of The Americas, Kyoto, Japan, 19 March 2003. This paper includes a modified version of the first of the above two presentations, and a slightly modified version of the second half of the second paper.

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1. Water and NAFTA: The First Trade and Water Debate

The NAFTA debate on water began just as soon as the ink was dry. The chief source of concern was Canada. Would NAFTA mean that Canada had to export water from its lakes and rivers to the United States if the US demanded it? This issue became so serious in 1992-93, that Canada demanded an interpretive note from its NAFTA partners ensuring that it could not be compelled to export freshwater. The key text of the NAFTA statement of September 1993 states that:¹

Unless water, in any form, has entered into commerce and become a good or product, it is not covered by the provisions of any trade agreement including the NAFTA. And nothing in the NAFTA would oblige any NAFTA Party to either exploit its water for commercial use, or to begin exporting water in any form.

The Statement went on to say that water in its natural state was governed by other transboundary agreements between Mexico and the United States and Canada and the United States.

As often happens when controversies are addressed after an agreement is signed, the statement leaves as much open to question as it seeks to make certain. First, it is clear that if water has entered into commerce and become a good or a product it is covered by NAFTA. This is so even, for example if it is sold through a water diversion project. (It is important to note here that this means when water is sold, not shared on a non-commercial basis between states under other international agreements.) Second, while the statement says that water in its natural state in lakes and rivers is not a good or product, this does not mean that rights to use or take the water may not be subject to NAFTA. The impacts of NAFTA on these issues are noted below.

Following this initial concern, the issues around NAFTA and water lay dormant for several years. Now, however, with access to water a serious issue for millions, with water rights a major investment, and with foreign investment becoming a dominant part of water and wastewater management in many countries, it is imperative that water managers have a basic understanding of how NAFTA and other trade or investment agreements can impact on water management at the local level.

2. NAFTA, WTO and Water: The State of the Law in Brief

2.1 Water Sold as a Product

There is no doubt that when water is sold in a package – a bottle, bag, tanker, etc. – it becomes a good in commerce. When this happens, all the rules on trade come into play. So imports and exports of bottled water, for example, cannot be constrained without due consideration for trade rules. In many cases, this may mean that no legal constraints on exporting water in such forms would be allowed, though there may be some exceptions to this general rule. This applies both under NAFTA and WTO rules.

Important questions arise as to whether a single licence or permit to export water from freshwater sources, especially water in bulk containers like ships, large floating bags or tankers means that water as a whole, or perhaps water from that state or province has now entered into commerce. If it has, then this would mean that other potential sellers of water could ask for equal, non-discriminatory access to that freshwater resource, thereby allowing or even requiring water to be sold in bulk to other purchasers. This poses an obvious and significant risk for freshwater management, especially if demands for water continue to rise as they are.

There is no definitive answer, but the fear of a single export leading to broader rights was so significant in the Canadian province of Ontario in 1998, that it became a factor in withdrawing a permit after it was issued.² In this context, it may be noted that at least three NAFTA cases not

related to water issues have now said that the right to export can be a protected right as part of a business operation under Chapter 11 of NAFTA.³

2.2 Provision of Water-Related Services

An equally important concern in the management of water is the provision of drinking water and wastewater services. In many countries, this is considered a government or public service. However, there are several countries that have privatized these services, and others that are continually being pressured to do so in WTO processes, through World Bank programs, and in other aid contexts.

For most countries, trade law does not require the privatization of these services. This is so today under NAFTA and under the General Agreement on Trade in Services (GATS) at the WTO.⁴ Whether this will continue to be the case after the Doha Round of WTO negotiations, and the FTAA negotiations, is not clear now. Some states have already indicated they will try to require this of others during the WTO negotiations on services. Negotiators, all levels of government and civil society must follow these issues carefully, including the small details in definitions, etc.

Whether trade law requires access to be given to foreign service providers or not, parts of it become relevant if a state chooses to open these services to the private sector. In particular, the provisions in NAFTA's Chapter 11 on Investment and a multitude of Bilateral Investment Agreements (BITS) would then become applicable. Under the investment provisions, once a previously public-run sector is opened, and unless there is a specific reservation that excludes that sector from the investment rules of an agreement, foreign companies must be given equal opportunities to provide the service in question. They have the right to bid in a non-discriminatory way, to establish the necessary service base if they win, and then to collect profits, etc. The same applies for countries that have listed (or might list) water services as a sector for liberalization under the GATS.

Increasingly, foreign investors are relying on a set of five rights, the full description of which is beyond this paper:

- The right to receive national treatment
- The right to receive most-favoured nation treatment
- The right to be treated in accordance with minimum international standards
- The right not to be subject to performance requirements
- The right to fair treatment and full compensation regarding expropriation

Under NAFTA's Chapter 11 and most of the BITS, each of these investor rights is subject to a special set of remedies available only to foreign investors, the so-called investor-state arbitration process.⁵ These foreign investor rights and remedies basically displace the domestic legal regimes today in so far as the investor's rights are concerned. They can turn to these agreements to claim and litigate their rights without using domestic legal systems first, and without reference to domestic law as the primary issue.

The scope of the above rights may include the purchase of water rights on a non-discriminatory basis with local and historic users of water, and to protect their economic interests in their project. But they may also ensure rights that are greater than local users have if contracts and laws relating to these matters are not clearly set out. For example, if indigenous peoples' or local farmers' rights of access are not recognized in law, the foreign investor may seek to displace them using its international rights and processes.

These processes are often conducted in near total secrecy as well. At least four water-related cases are known to have been started in the past five years under investor-state arbitration procedures, and it is suspected others have already begun or will begin soon, but remain shrouded in secrecy.⁶

2.3 Rights to Use Water

Rights relating to water may not only concern water services or products per se. Such rights may also arise under international investment agreements when a foreign investor opens a facility that must draw water to operate, whether in the agricultural or industrial sectors. Reductions in the allowed or anticipated level of water usage may be considered an expropriation by an investor, and subject to challenge under investment agreements. Again, this could result in traditional users of the water being displaced. Even a very significant rise in water rates might trigger such a suit, and some NAFTA cases suggest a large increase could be a legitimate basis for a claim.

2.4 Pollution Controls

Finally, changes to water pollution rules can lead to claims by foreign investors that their rights are being breached. For example, if new anti-pollution rules significantly impact the operation of an investment, it may be able to claim compensation for this under expropriation protections of investment agreements. While many observers reject this interpretation of the law on expropriation, it is clear that arguments on these lines have not been foreclosed by the NAFTA cases that have made decisions on related issues.¹ If this approach were successful in future investment cases, it would mean that countries will have to pay foreign investors compensation if they wish them to stop polluting. This issue has become widely known today, usually under the rubric of the “right to regulate.” Negotiators of investment rules must be very conscious of this concern.

3. Consequences

While a state will not lose jurisdiction in a strict legal sense over its water due to trade or investment regimes, two things are clear. First, there is a significant risk that the existing agreements place very strong limits on how that jurisdiction can be exercised, and in whose interests it must be exercised. Second, ongoing negotiations on trade and investment, including in the services sector, may place even greater restrictions on the ability of governments to manage water resources and services. These agreements can therefore have significant impacts on local and regional water management decisions, and on traditional users of water resources.

One must note that it is not the trade or investment rules that create contracts between foreign investors and local authorities or fully define the locally applicable laws on access to water or maintaining water quality. And trade law generally does not, today, mandate the privatization of public services. (The role of international banks and aid is not discussed here.) However, if contracts and extant laws and regulations do not expressly recognize and give priority to the rights and needs of local citizens, or are not sufficient to ensure long-term water quality management, the existing international trade and investment rules will reinforce any weaknesses and imbalances by ensuring the investor’s rights can be enforced under international law, and outside of national legal systems. This makes subsequent changes in contract terms and local or national laws more difficult, and potentially too costly to undertake. The net result can be a locking-in of weak and ineffective local water management practices and regimes, at the expense of local users and to the benefit of foreign investors, traders or other outside stakeholders.

In addition, the ability of foreign investors to utilize the investor-state arbitration process and litigate issues strictly under international law as opposed to domestic law can distort national dispute resolution processes. When a foreign investor can engage a legal process that is secretive and lacks recognition of domestic legal and social contexts, where others can only seek

¹ The most restrictive view on this issue in the NAFTA cases is found in the most recent decision that addresses expropriation in detail the *Feldman v. Mexico* case. (See www.naftalaw.org) This sets out a broader recognition of the right to regulate without compensation than all previous cases to address the issue. While consistent with most governmental views on this issue, it is not clear, however, whether this case will achieve a precedential status in this area.

to resolve disputes within that local context, there is an obvious risk of an imbalance in the respective position of foreign and domestic users of the resource.

4. How to Reclaim Ownership of Your Water

Foreign investment is a critical factor for development today, and foreign investment may have a key role to play in the development of some water services.⁷ But care must be taken that the international law framework for this investment is well understood and fully reflects the importance of water as a sustainer of life and how water resources are managed. As already noted, the most critical effects of these agreements are twofold: the direct limits on sovereign activity that they create; and that they tend to lock in for extended periods of time the weaknesses that prevail in a water management system at the time the agreements are put in place. This makes mistakes much more difficult to recover from after the fact.

Several steps can be suggested to prevent loss of control over water, while remaining attractive to foreign investment if and where it is needed. The suggestions below are divided into three categories: international measures, national measures and transparency.

International Level Measures

1. Clearer rules in trade and investment agreements: This is an essential element today. Too often, trade and investment agreements have begun to have unintended consequences. This has been most salient in the NAFTA investment context, and states are now just beginning to draft new agreements with this experience in mind.⁸ The lessons learned from NAFTA must highlight the need for much greater clarity and specificity of trade rules and investor rights. This applies generally, and in relation to specific areas of major concern, such as water. Clarity and specificity is an essential requirement for the regional and hemispheric negotiations now underway in the Americas, such as the FTAA and US-Central America Free Trade Agreement negotiations, EU-ACP negotiations on investment, and Mercosur-European trade negotiations. It will be an essential element of any WTO negotiations in this area, including on the investment-related provisions of GATS.
2. Part of the negotiating process must focus on the details, including how they relate to water issues: definitions, scope, the right of governments to regulate, and the rights of local and indigenous peoples, must all be addressed and the impacts of proposed investor rights on these issues considered. Negotiators and their political masters should no longer stumble into the range of unforeseen impacts that the NAFTA and current BIT experience is leading to.
3. The same careful standards must be applied to the negotiation of Bilateral Investment Agreements (BITs) as to multilateral or regional agreements. BIT negotiations tend to fly under the radar today, but are progressing in many jurisdictions. They contain many of the same provisions as major trade and investment agreements, and establish rights for foreign investors that are enforceable in usually secret international arbitrations. In effect, what the OECD was unable to accomplish with its aborted negotiations on a Multilateral Agreement on Investment is now being accomplished in many respects by BITS negotiations. As noted above, at least four such investor-led arbitrations against host governments related to water management are known to be in progress today.
4. In all these negotiations, it is time to consider water as a special resource, and differentiate its treatment from other harvestable natural resources. Water, in essence, needs special and differential treatment. This is critical where negotiations place weaker economic powers into an eventual agreement with stronger powers.

Domestic Measures

5. Because the effects of poor water management laws, policies and administration tend to get locked in by trade and investment agreements, it is essential that these areas be improved significantly **before** entering into these agreements, or at least before they are made

applicable in relation to water. In practice, however, hundreds of bilateral and regional agreements on investment and on trade are already applicable around the world. So what can be done in practice to prevent the locking in of weak domestic laws and administrative practices? The most effective answer is to avoid creating the combination of investment agreements and privatization of water and water rights that allows foreign investors to protect all the benefits that accrue to them as a result of decisions made by weak and often corrupted regimes. It is this combination of domestic and international processes that can be most challenging to effective and sustainable local water management. Such combinations should be avoided until the water management regimes at the relevant governmental levels have achieved the legal and administrative standards necessary to protect all water users and the resource itself. (One may note here that the international agreements apply their standards to all levels of government once they enter into force for a country.)

- a. In this context, it is worth noting that the *Report of the World Panel on Financing Water Infrastructure*⁹ identified weak domestic regimes as the principle cause of the problem in water management, including inadequate national government attention to water services, political interference in water management, inadequate legal frameworks, lack of transparency in awarding contracts, non-existent or weak regulators, and other related issues.
 - b. The view that these aspects of water management need to be addressed before the weaknesses are locked in was also stated recently in relation to the privatization process, in a report prepared by the Economic Commission for Latin America and the Caribbean: "An appropriate regulatory framework must therefore, be in place before private sector participation is introduced in the provision of water supply and sewage services."¹⁰ The potential impacts of trade and investment regimes add one more degree of urgency for doing this.
6. Thus, clear and committed national, state and provincial, and local laws and regulations must be developed to clarify community water needs, for all the people in the community, and ensure respect for them. Sound administration must be put in place to back this up. It is here that domestic interests and the rights of foreign investors must first be balanced, prior to the combination of investment agreements and privatization coming into effect and limiting possible options in this regard.
 7. Where time periods or other limitations on licenses, permits contracts, etc, may be warranted, they must be clear on their face. Otherwise, longer-term investor rights may be created than intended.

Transparency

8. Finally, the principle of transparency must be addressed. This applies at all phases of water management, and for all negotiations impacting upon water management and conservation. In the awarding of contracts, developing of national and local laws and regulations and the administration of water systems and rules, transparency must be a critical factor. The absence of transparency allows corruption and inadequacy to flourish, and its results to be locked in for long periods of time. Domestic actors, financial institutions, development banks, and foreign investors are all players today in allowing the consequences of non-transparency to endure. All share the responsibility for reversing this problem.
9. The same transparency must also be applied at the international level, to all aspects of the negotiation, implementation and dispute resolution processes of international agreements that impact public goods like water.
10. All disputes under international investment agreements between investors and states must be fully open to public scrutiny. Secrecy can no longer be an option in any new agreements, and existing ones must be adjusted to address this.
11. Finally, the offers and requests for liberalization in services will in many ways answer the question of "Who owns your water?" The request and offer process should, indeed must, therefore take place in a transparent way.

5. Conclusions

This paper has sought to show the risks trade law and investment agreements create to traditional conceptions of a state “owning” its own water resources, and local citizens and users having priority rights of access and use. While a state will not lose jurisdiction in a strict legal sense over its water, it is clear that there is a significant risk of existing agreements placing very strong limits on how that jurisdiction is used, and of new agreements placing even greater restrictions. These agreements can therefore have significant impacts on local and regional water management decisions, and on traditional users of water resources.

While international trade and investment agreements can create opportunities for improved water management, there is absolutely no guarantee that they will do so. Indeed, to date they have likely created more risks to sound water management than benefits, by imposing a penalty on all countries that have not fully prepared for them. That penalty is in the form of significant increased risks to water supply and water quality management. These risks can be reduced, almost eliminated, but only if negotiators act with focus and purpose to do so. Win-win situations will not be arrived at by good luck but by good preparations.

Whether from a pure water management perspective, a financing perspective, a privatization perspective, or a trade and investment law perspective, the first priority for addressing existing and potential problems appears to be the domestic water management framework, including its legal and administrative components. It seems incongruous in the face of such a consensus that privatization and trade negotiations proceed so rapidly and expansively today, as if they are the answer, when the focal point of addressing the widely understood core problem receives less attention and a lower priority. This is especially so when the privatization, trade and investment negotiations lock-in and exacerbate the negative impacts of the existing weak regimes.

The global water financing report released in March 2003, on the eve of the Third World Water Forum, suggests creating a revolving fund for absorbing the high legal costs of negotiating water financing. As a non-expert on water privatization financing, I can only speculate as to whether a better use for lawyers and this fund for water management purposes might be the development of sound and effective water administrations where they are most needed, instead of the legal and financial capitals of the world.

¹ 1993 Statement by the Governments of Canada, Mexico and the United States. This statement does not appear to have a formal name or number.

² Notice of Withdrawal of Licence, issued by Paul Odom, Director, Ministry of the Environment, Ontario to Nova Group, July 7, 1998.

³ These three cases are *Pope & Talbot v. Canada*, *S.D. Meyers v. Canada*, and *Feldman v. Mexico*, all available at www.naftalaw.org. There is one NAFTA case on water export issues that was commenced, but it has never been pursued, and it is doubtful at this time it will be. This is *Sunbelt Water v. Canada*. See <http://www.dfait-maeci.gc.ca/tna-nac/gov-e.asp>

⁴ There are a few exceptions to this, for some developing countries that were compelled to liberalize their water sectors as part of their accession negotiations to the WTO, after the Uruguay Round negotiations were completed.

⁵ A full description of the rights and the investor state process can be found in “Private Rights, Public Problems: A Guide to NAFTA’s Controversial Chapter on Investor Rights”, International Institute for Sustainable Development/WWF-US, 2001, at www.iisd.org/trade/private_rights.htm.

⁶ Luke Eric Peterson, *Research Note: Emerging Investment Treaty Arbitrations and Sustainable Development*, soon to be available at www.iisd.org

⁷ See, e.g., Report of the World Panel on Financing Water Infrastructure, Chaired by Michel Camdessus, March, 2003.

⁸ The United States-Singapore Free Trade Agreement, Chapter 15 on Investment and Chapter 18 on Environment, are examples of some more recent thinking in this regard, if not conceptually new thinking. See, www.ustr.gov for the text, released to the public on 7 March 2003.

⁹ *Report of the World Panel on Financing Water Infrastructure*, Executive Summary, p. 2.

¹⁰ Andrei S. Jouravlev, *Water Utility Regulation: Issues and options for Latin America and the Caribbean*, Economic Commission for Latin America and the Caribbean, LC/R.2032 11 October 2000, p. 6.