

# INTERNATIONAL ECONOMIC LAW: WATER FOR MONEY'S SAKE?

September 2004

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**I Seminario Latino-Americano de Politicas Publicas em  
Recursos Hidricos**

**Brasilia, Brazil  
22 September 2004**

## ACKNOWLEDGEMENTS

This paper is a further elaboration of ideas first considered in two papers prepared with the support of the Inter-American Development Bank and United Nations Economic Commission for Latin America and the Caribbean:

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

presented at Water For The Americas In The 21<sup>st</sup> Century, Mexico City, October 9, 2002;  
and

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

3<sup>rd</sup> World Water Forum, Day Of The Americas, Kyoto, Japan, 19 March 2003.

This paper was prepared with the financial support of the World Bank for presentation at the *I Seminario Latino-Americano de Politicas Publicas em Recursos Hidricos*, Brasilia, Brazil, 22 September 2004

The support of these organizations in this work is gratefully acknowledged. The assistance of Reuben East, University of Ottawa Law School, is much appreciated. The views expressed here do not necessarily reflect those of the above agencies. All content is solely the responsibility of the author, and all errors of omission and commission are, of course, likewise solely the responsibility of the author.

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## INTERNATIONAL ECONOMIC LAW: WATER FOR MONEY'S SAKE?

Howard Mann<sup>1</sup>

### 1. INTRODUCTION

The issue that frames this discussion is: in whose interest and for whose benefit does international economic law address water management issues? The title is actually derived from an old rock song of the 1980's which contains the refrain, "Art for art's sake, money for God's sake". The question posed in this paper is: for whose sake is water addressed in today's international economic law?

The need for the sound management of increasingly scarce water resources is well known. The issue for discussion here is what do specific aspects of international law have to say about meeting this need? What values and demands take priority on water uses under international economic law?

International law has, for well over a century, addressed issues concerning shared waterways – rivers or lakes that either form a boundary between states or cross a boundary. In more recent decades, this has expanded to include notions of water basin management among several states that share a common river basin. International law today seeks to apportion roles, responsibilities and rights among the states that share such waterways. Over the years, international law in this area has moved from narrow concepts of riparian rights to broader concepts of equitable rights between states, and from protecting navigable uses to ensuring adequate water quantity and quality for the wide range of non-navigational uses of water: drinking and other human uses, agriculture, sewage treatment, small and large industry.<sup>2</sup> This is the most traditional domain of

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<sup>2</sup> Several recent works describe the current state of the law and dispute settlement in this state-state area. See, e.g., Ibrahim Kaya, *Equitable Utilization: The Law of the Non-Navigational Uses of International*

international law in relation to water: state-to-state rights and obligations in relation to shared water resources.

International law today also addresses water issues from a human rights perspective: does international law create a right to safe, clean water for drinking, subsistence, agricultural, or even industrial uses? If so, what is the scope of that right? Clearly, with water becoming a scarcer commodity, the human right to safe, clean water is going to continue to grow as a factor in water use and allocation decisions. As international human rights law is generally aimed at placing obligations on states to protect the human rights of their citizens, ensuring the right of all people to clean water will become as much of a benchmark as a challenge in this field.

Other branches of international law also deal, in varying ways, with water today: the laws of war seek to prevent states from using water as a weapon, for example. And agreements to reduce or prevent acid rain developed, in large part, in order to protect lakes that were being polluted from distant sources of pollution.

This paper considers the different ways in which two critical branches of international economic law – international trade law and international investment law – can impact water management decision-making at the local or national level. First, how trade law may lead to impacts on access to freshwater resources through trade in those resources is considered. It is this issue that initially sparked the trade law and water debate in 1993. Second, the paper will look at how international trade and investment agreements are creating new rights of access by foreign corporations to provide water services. Known as “services liberalization” and “privatization”, both trade and investment agreements play a role here. Third, the role of international investment law and how it protects foreign investors and their access to water resources or to provide water services in certain circumstances will be reviewed. An important part of this and the previous section is the so-called investor-state dispute settlement arbitration process, which allows individual investors to seek to enforce their rights under international law and outside of

domestic legal processes. This dispute settlement right has been exercised in several ways to date, including several claims to damages arising from changes in domestic water service situations,<sup>3</sup> a claim that a pollution control measure aimed at protecting groundwater violated investor rights,<sup>4</sup> and a very recent claim under the North American Free Trade Agreement (NAFTA) Chapter 11 that Mexico must allow more water to flow into Texas from the Rio Grande for farmers in Texas to access as they are, it is claimed, the owners of the legal rights to this water flow.<sup>5</sup>

These areas of international economic law are substantially different from the traditional role of international law relating to water. Whereas traditional sources have created rights between states, and sought increasingly to secure an equitable distribution of water uses from available resources, with a growing emphasis on meeting basic human needs, these areas of international economic law are increasingly creating foreign rights to access water resources in other states, whether to provide services or to exploit the available water for other economic purposes.

Finally, the political and policy pressures that are being created by the ongoing negotiations at the multilateral, regional and bilateral levels to expand the scope of all the areas of law noted above will be considered, and what this means for basic issues of water management and access by all to vital water services. Some specific recommendations to address the key problems identified are included in Annex 1.

How well this growing part of international law responds to the critical human demands for water, and concepts of equity and the human right to safe water supplies is part of the investigation below. The goal of this paper is, however, rather modest: to ensure that the challenges to sound water management posed by developments in international economic law are understood so that they can be addressed through legal, administrative and policy

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<sup>3</sup> This issue is returned to in more detail below.

<sup>4</sup> *Methanex v. United States of America*, under NAFTA's Chapter 11, written documents available at [www.naftalaw.org](http://www.naftalaw.org), oral hearings completed in June 2004, decision pending.

<sup>5</sup> *Texas Water Claims, Notice of Intent to Submit a Claim to Arbitration under NAFTA Chapter 11*, August 27, 2004, at [www.naftalaw.org](http://www.naftalaw.org)

measures that allow their benefits to be captured but their risks to be eliminated, or at least mitigated.

## 2. TRADE IN WATER

The first significant debate on trade and water took place under the NAFTA regime, 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:

*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.*<sup>6</sup>

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

The NAFTA water statement left as much open to question as it possibly could have while addressing the political crisis the protection of Canada's water raised. First and foremost, 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 or other economic agreements. Third, the apparently categorical governmental view that trade law does not address water in its natural forms

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<sup>6</sup> 1993 Statement by the Governments of Canada, Mexico and the United States. This statement does not appear to have a formal name or number, but is referred to on many occasions by Canada and the United States. The author has a copy of the statement.

has since been pulled back from in other important official statements. The bilateral International Joint Commission, for example, stated that

“The Commission's initial analysis indicates that it would appear unlikely that water in its natural state (e.g., in a lake, river, or aquifer) is included within the scope of any of these trade agreements since it is not a product or good, and indeed the NAFTA parties have issued a statement to this effect. When water is "captured" and enters into commerce, it may, however, attract obligations under GATT, the FTA, and NAFTA.”<sup>7</sup>

How broad “captured” is as a concept is not established.

This was similar to the government of Canada view in 2000-2001 on its own proposed legislation on water exports. In 2001, Canada adopted a regulatory licensing approach for exports rather than a direct prohibition in order, in its view, not to trigger the application of trade law to an effort designed to prevent the commercialization of freshwater resources.<sup>8</sup>

Thus, the key issue of whether trade law can compel states to sell freshwater, through diversions, bulk exports, bottling, or other means, remains a live one. Bottling is the easiest to answer. There is no doubt that when water is sold in a package – a bottle, can, etc. – it becomes a good in commerce. The same holds true if it is sold in a bulk container like a ship or large floatable bag. When this happens, all the rules on trade come into play. Imports and exports of bottled water, for example, cannot be constrained without due consideration for trade rules such as non-discrimination as regards the place of consumption. In many cases, this may mean that no legal constraints on exporting water in such forms would be allowed. This does not mean that any potential exporter would have a right to draw water from any source for export: water draws on any one water source could be subject to the environmental limits and controls appropriate to that source. However, the fact that the water is being exported as opposed to domestically

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<sup>7</sup> Source: Protection of the Waters of the Great Lakes: Interim Report to the Governments of Canada and the United States”, online: International Joint Commission, [www.icj.org/php/publications/html/interimreport/interimreporte.html](http://www.icj.org/php/publications/html/interimreport/interimreporte.html).

<sup>8</sup> Bill C-6, An Act to Amend the International Boundary Waters Treaty Act, Legislative Summary, Library of Parliament, Parliamentary Research Branch, 12 February 2001, at p. 10-11, available at <http://www.parl.gc.ca/37/1/parlbus/chambus/house/bills/summaries/c6-e.pdf>

consumed could not be a factor in a decision under trade law.<sup>9</sup> Domestic consumption requirements for withdrawals of this type cannot be imposed.

An important question arises as to whether a single license or permit to export water from freshwater sources, especially water in bulk containers like ships, large floating bags, tankers, or canal-type diversions means that water as a whole, 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 to other purchasers. This poses an obvious and significant risk for freshwater management, especially as demands for water continue to rise. To forestall this risk, it is imperative that all water withdrawals, including those for domestic consumption in any packaged form, be permitted in accordance with the environmental conditions that prevail for the use of that water source. A failure to account for the environmental sustainability of the water resource – and for other equitable use considerations of local users – would make it harder to impose conditions relating to such concerns later on should pressures to export freshwater from the same source arise.

There is no definitive answer on this “tripwire” problem. As a result, some jurisdictions have laboured to prevent the initial large scale export of water in bulk from taking place. The Canadian province of Ontario in 1998, for example, made it clear that this was a factor in withdrawing a bulk water export permit after it was issued.<sup>10</sup> Others, however, have established regulatory schemes instead of prohibitions, including the government of Canada in its 2001 amendments to the International Boundary Waters Treaty Act to

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<sup>9</sup> Trade law has made significant strides in recognizing that environmental and human health issues are important aspects of regulating business conduct, and integrating this recognition into trade disciplines. However, it remains very unclear whether export-oriented pressures can be used as a factor in limiting withdrawals on water, as opposed to an export-domestic use neutrality. For a more general review of trade and environment issues see John H. Knox, “The Judicial Resolution of Conflicts between Trade and the Environment” 28 *Harv. Envtl. L. Rev.* 1, 2004; Howard Mann and Stephen Porter, *The State of Trade and Environment Law, 2003*, at <http://www.iisd.org/publications/publication.asp?pno=570>

<sup>10</sup> Notice of Withdrawal of Licence, issued by Paul Odom, Director, Ministry of the Environment, Ontario to Nova Group, July 7, 1998.

address water exports.<sup>11</sup> Similarly, the Great Lake States and Provinces in Canada and the United States have all signed a draft agreement that they say will enhance the basin through the conditions and requirements it sets out for permitting any exports.<sup>12</sup> Critics suggest, however, that this approach was in both cases due, at least in part, to the kind of governmental view of trade law reflected upon above, and that it in fact creates the exact risk it notionally seeks to foreclose.<sup>13</sup>

What is also not clear is whether selling water to private water service companies for public consumption or sanitation purposes (i.e. privatization or concession agreements for water or sanitary services) would amount to a commercialization of water, or simply a new form of delivering a public service. For the service provider, the water is an essential commercial need, paid and utilized on commercial terms. From a consumer's perspective, this may simply be a different way to deliver the same public service. If this were to constitute a commercialization measure, then it could lead to the same tripwire problem described above, and become an entry issue for potential competitors in water supply or related services.

In short, there remains significant uncertainty as to how trade law will or will not constrain governmental abilities to prohibit or to restrict exports of freshwater resources. This uncertainty is compounded by elements of international investment law which have led to rulings, in at least three cases in recent years, that the right to export products can be seen as part of the set of protected rights of foreign investors.<sup>14</sup> This may allow private investors to enforce certain aspects of trade law through the private investor rights

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<sup>11</sup> Bill C-6, An Act to Amend the International Boundary Waters Treaty Act, Legislative Summary, Library of Parliament, Parliamentary Research Branch, 12 February 2001, available at <http://www.parl.gc.ca/37/1/parlbus/chambus/house/bills/summaries/c6-e.pdf>

<sup>12</sup> The *Great Lakes Charter Annex, 2001*, <http://www.cglg.org/1pdfs/Annex2001.pdf>; (Draft) *Great Lakes Basin Sustainable Water Resources Agreement*, at <http://www.cglg.org/1projects/water/docs/7-19-04Agreement-PublicRelease.pdf>.

<sup>13</sup> In addition, some critics maintain the scheme set up in the agreement will act as an export licensing scheme and in fact trigger the very trade law impacts described above. See, for example, Sierra Club of Canada, comments, at <http://www.sierraclub.ca/national/postings/scc-comments-proposed-annex.pdf> and Andrew Nikiforuk, "Political Diversions: Annex 2001 and the Future of the Great Lakes", Munk Centre for International Studies, University of Toronto, June 2004, at [http://www.powi.ca/nikiforuk\\_June2004.pdf](http://www.powi.ca/nikiforuk_June2004.pdf)

<sup>14</sup> These three cases are *Pope & Talbot Inc. v. Can.* (U.S.-Can.) NAFTA (June 1, 2000); *S.D. Myers, Inc. v. Can.* (U.S.-Can.), NAFTA/UNCITRAL Tribunal, (Nov. 13, 2000); *Marvin Feldman v. Mexico*, (US-Mexico) NAFTA, Final Award, 16 December 2002, all available at [www.naftalaw.org](http://www.naftalaw.org).

and remedies discussed below, even if states may not be tempted to initiate a case against another state to compel it to export water.

### **3. INTERNATIONAL ECONOMIC LAW AND THE “LIBERALIZATION” OF WATER SERVICES**

One of the underlying principles of international economic law today is that the progressive movement towards more free trade in goods and services, and free movement of capital between states is in itself a valid objective. Free trade and free movement of capital, it is argued will lead to higher levels of growth, and as a result to higher levels of development.

The language for the promotion of free trade in services is the “progressive liberalization” of the service sectors. This implies freeing the service sectors of limitations on the provision of services from outside or on foreign investment or foreign ownership of service companies inside the liberalizing state. The latter is often preceded by the privatization of sectors that are in public hands: water and sewage, electricity, telephone, and others. Once included for liberalization, other states party to the agreement can use the dispute settlement processes of the agreement to enforce the commitment and ensure that their businesses are able to enter that market.<sup>15</sup> In other words, including a service sector for liberalization creates a right for foreign investors to enter that service market, subject only to any specific limits imposed when it is included. The most common limitation is that foreign investors will not receive absolute rights, but national treatment rights, i.e. the same legal rights as domestic investors receive, but other limitations can and do frequently arise.

At least five different sources of law or policy are at work promoting such liberalization in service sectors:

- The WTO’s General Agreement on Trade in Services, GATS;

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<sup>15</sup> This is seen, for example, in Mexico’s successful effort to open the US trucking service market to Mexican truckers. See *In The Matter of Cross-Border Trucking Services, Final Report of the Panel*, February 6, 2001, available at [www.naftalaw.org](http://www.naftalaw.org)

- WTO Accession Agreements for states that were not original members of the WTO in 1995, mainly developing states;
- International investment agreements, whether bilateral or regional in nature;
- Regional Free Trade Agreements, which are increasingly being driven by larger economic actors to be “WTO plus” agreements, i.e. to go beyond the existing obligations from the WTO; and
- The World Bank, which through various means is understood to promote privatization and hence the liberalization of many service sectors.

Of these, the first four are the subject of some discussion below. The work of the World Bank, however, is beyond the scope of the paper *per se*, though in its work both it and the states involved must be very cognizant of the international law implications they are creating. This is often not the case today.

### **3.1 The GATS<sup>16</sup>**

In the water services context, the primary issue is “trade” in services by way of what the GATS calls “commercial presence”: when a foreign service provider establishes a business presence in the new state where it will provide the service in question. In more common language, this means making an investment.<sup>17</sup>

There are two approaches to liberalization of services in a trade law agreement as it relates to services and to investment in services. One is a bottom up approach, where only sectors listed by a state are covered. The second is a top down approach, where all sectors are considered covered by an agreement except those specifically excluded in a schedule. The bottom up approach is used in the GATS. The top down approach is used in the NAFTA chapter on Services and on investment, and replicated in several other bilateral or regional agreements in the hemisphere.

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<sup>16</sup> *General Agreement on Trade in Services, Annex, Marrakech Agreement establishing World Trade Organization*. Available at [www.wto.org](http://www.wto.org)

<sup>17</sup> Indeed, negotiators of the GATS during the Uruguay Round have confirmed informally that they originally intended to use the word “investment” but that for political reasons this was not allowed. Commercial presence was the term used to cover investment without using that word.

The GATS in general seeks to promote liberalization of all service sectors through a process of requests and offers during the negotiation of the agreement, and now its revision in the Doha Round. The requests and offers are essentially bilateral processes that ultimately translate into GATS schedules for each WTO Member state.

One additional note here: generally speaking, when a state lists a service sector, all levels of government are bound, unless a limitation on the listing is included. Consequently, sectors with large state or municipal involvement will be covered by a listing.

There is much myth around how the GATS or its equivalent agreements address water and water related services. To date, no country has listed its water sectors as being subject to liberalization in a GATS schedule.<sup>18</sup> Hence, they are not covered to date.

Even when a sector is listed, there are a range of mechanisms that WTO Members can employ to protect certain policy prerogatives. Some broadly worded exclusions for publicly provided services are available, though these lack proper definition and hence are subject to some debate as to their full scope. States can also establish specific conditions for a sector, imposing limits on the scope of a sector being included, establishing universal service obligations, and grandfathering inconsistent laws or regulations.<sup>19</sup> What is critical is that any such limitations or conditions must be made clearly and expressly. Indeed, a recent WTO decision, the Mexican telecommunications case, has indicated that both what is stated and what is not stated will be strictly adhered to.<sup>20</sup> This means that high degrees of expertise and foresight are needed to preserve policy and legal space in any listed sector. A failure to establish limits and conditions will lead a dispute settlement body to rule that none were intended.

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<sup>18</sup> World Bank, *Global Economic Prospects, 2004, Realizing the Development Promise of the Doha Agenda*, page xxi.

<sup>19</sup> Elizabeth Tuerk, Aaron Ostrovsky, Robert Speed, "GATS and Water: Retaining Policy Space to Serve the Poor", forthcoming, Chapter 6 in Edith Brown Weiss, Laurence Boisson DeChazournes and Nathalie Bernasconi-Osterwalder, eds., *Water and International Economic Law*, Oxford University Press, forthcoming.

<sup>20</sup> *Mexico - Measures Affecting Telecommunications Services*, Report of the Panel, 2 April 2004, WT/DS204/R.

This places a high burden on capacity building. Given the disparity in legal capacity in GATS and similar trade negotiations, the higher risk level clearly falls on developing countries in this regard, as seen in the Mexican telecommunications case.

While the current state of GATS is such that there are no water sectors expressly included, and there is a broad legal capacity to generate conditions or limitations on listed service sectors, both of these elements are subject to change under the Doha Round negotiations. The expansion of services liberalization was foreseen in the original Doha Declaration. The most recent negotiating document, the July 2004 WTO statement that resumed the Doha Round negotiations after Cancun, includes a specific statement that no sectors are to be *a priori* excluded from negotiations.<sup>21</sup> Hence, all public utility and service sectors are subject to negotiations and the pressures that come with them.

Accompanying the liberalization commitments of the GATS negotiations is a second tranche of GATS-based negotiations. The original GATS of 1994 included a built-in negotiation on “disciplines” or rules for making regulations that apply to listed sectors.<sup>22</sup> Negotiations on such limits continue in the Doha Round. One proposal would see states limited to taking measures to ensure “the quality” of a service. How this would relate to critical issues such as universal service obligations and pricing levels in the water sector is not clear. As a result, the inclusion of water and water-related services (or any other public sector service) in a schedule by a WTO Member will require an increased level of care and skill to ensure the results from the combined negotiations on liberalization and disciplines on regulation making are what is intended and appropriate policy space is left. There is no track record for the WTO or any other organization in providing levels of technical assistance that will ensure this need is met.

### **3.2 *WTO Accession Agreements***

While perhaps not particularly critical for Latin American, the WTO does today have a second process by which service sector obligations can be included in a member's

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<sup>21</sup> World Trade Organization, Doha Work Programme, decision Adopted by the General Council on August 1, 2004, WT/L/579, 2 August 2004, Annex C, para d.

<sup>22</sup> GATS, Article VI:4, reiterated in Doha Work Programme, *ibid*, Annex C, para. E.

commitments. This is through the WTO Accession process, where commitments in excess of those made in the GATS 1994 schedules are being sought in many cases, and achieved in some.

The WTO Accession process has involved such large economies as China (completed) and Russia (still in progress), and numerous developing countries. In Latin America, Ecuador and Panama have completed their accession negotiations and are now WTO members. There are no ongoing accession negotiations with Latin American or Caribbean states.

For the sake of completeness, however, one should note that accession negotiations, which take place through a series of bilateral and group negotiations under WTO auspices, do include negotiations on services liberalization and some agreements have included liberalization commitments for public service sectors.

### ***3.3 International Investment Agreements and Bilateral/Regional Free Trade Agreements***

The GATS is not the only international negotiation on services liberalization. Services liberalization is also being done in investment negotiations and the agreements that result from them. These can include bilateral investment treaties (BITs), regional agreements, and investment sections of Regional and Bilateral Free Trade Agreements. Investment agreements can include what trade policy calls service liberalization commitments and what investment policy calls “pre-establishment rights” or “rights of establishment”.

The most common understanding of international investment agreements is that they apply after an investment has been started, or is operational, a subject returned to shortly below. But, many investment agreements also include pre-establishment rights. These create rights for foreign investors from the countries that are party to the agreements to establish businesses in the covered sectors, usually under the same rules that would apply to domestic investors (“National treatment”). However, there are also some

circumstances where foreign investor rights can both legally and pragmatically exceed domestic rights, for example if the right to establish is not made subject to national treatment or if, in practice, only foreign companies have the financial or technical resources for a large service sector investment.

Just like trade law, commitments can be made by express listing (the bottom up approach) or by a general inclusion of all sectors subject to a listing out (the top-down approach). The NAFTA and the current US Model Bilateral Investment Treaty take a top-down approach, reflective of their aggressive position on promoting all areas of investment liberalization. Most other regional or bilateral agreements appear to be more cautious, employing a bottom up listing approach when including pre-establishment rights at all.

Regional and bilateral free trade agreements continue to gain negotiating steam, notwithstanding the stalled Free Trade Agreement of the Americas (FTAA) process. Beyond the NAFTA, at least seven Agreements or frameworks integrating trade and investment obligations already exist within the Americas,<sup>23</sup> and the demand for more such agreements continues unabated. Increasingly, these are also being developed between developing countries on a bilateral as well as regional basis. When negotiations are between developed and developing countries, the demands for market access for goods and agricultural products by developing countries are often now being met by demands for investment market access by developed countries. For some, this is based on an economic philosophy that argues that liberalization is good for all.<sup>24</sup> For others it is being driven by a need to find less mature investment markets for service sector

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<sup>23</sup> US-Chile FTA, Canada-Chile FTA; US-CAFTA FTA; Canada-CAFTA FTA, EU-Chile FTA, MERCOSUR, Andean Pact, at a minimum.

<sup>24</sup> This is not the place to debate the rationale of services liberalization, but one may note some recent studies that suggest this belief is, at best, overstated, and that the primary benefits accrue, as often as not, to the service exporter. In a Latin American context see, Bouzas, Roberto and Chudnovsky, Daniel, *Foreign Direct Investment and Sustainable Development: The Argentine Experience*, March 2004, [http://www.iisd.org/pdf/2004/investment\\_country\\_report\\_argentina.pdf](http://www.iisd.org/pdf/2004/investment_country_report_argentina.pdf); Da Motta Viegas, Pedro, *Foreign Direct Investment in Brazil: regulation, flows and contribution to development*, May 2004; [http://www.iisd.org/pdf/2004/investment\\_country\\_report\\_brazil.pdf](http://www.iisd.org/pdf/2004/investment_country_report_brazil.pdf); United Nations Economic Commission for Latin America and the Caribbean, *Foreign Investment in Latin America and the Caribbean*, 2003

businesses that have little scope for real expansion at home. For some, perhaps it is a combination of both factors.

Whatever the driver, when market access for agricultural and non-agricultural goods is placed into a negotiating context with increased access for foreign investors, final agreements can reflect greater concerns for the benefits of the former than the risks of the latter. These risks are, for all practical purposes, the same as for the risks associated with GATS liberalization negotiations: the loss of policy space to ensure essential services are available for all, a declining ability to offset rich and poor service areas and higher and lower return service delivery modes,<sup>25</sup> and ensuring disadvantaged groups have equal access to essential services under a human rights concept. A failure to fully address and mitigate these risks in an agreement can be very difficult to overcome later.

A critical reason for the difficulty in overcoming any negotiating failures in an investment agreement or an investment chapter of a free trade agreement is that private investors will almost always have access to special investor-state dispute settlement processes, as discussed below. These dispute settlement processes can and do allow for the overriding of domestic law when it is deemed to conflict with the international law rights granted to a foreign investor, thus privileging them with additional rights and remedies outside the domestic legal context. This includes the ability to seek damages for any infringement of pre-investment rights granted in an agreement.

To date, it does not appear that significant liberalization or pre-establishment rights for the water services sector has been seen in investment agreements, but the present author is unaware at any effort to carefully review the over 2200 agreements that exist to consider this specific issue. However, as pressures to expand investment liberalization generally and services liberalization specifically in bilateral and regional FTA or investment negotiations increase, one can expect the ethos of the Doha GATS negotiations to prevail, that no sector should be *a priori* excluded from a negotiation.

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<sup>25</sup> This is what Mexico was ruled to have lost in the Mexico - Telecommunications case at the WTO, *supra*.

#### 4. INTERNATIONAL INVESTMENT LAW AND THE PROTECTION OF FOREIGN RIGHTS

It has been noted that international investment agreements can and do provide rights of establishment for foreign investors into domestic economies, including the services sectors. Although investment agreements have not been a leading vehicle to date for water services and related liberalization, they are a powerful and increasingly frequently used instrument for post-investment enforcement of rights.

The basic rights have been explored in a large variety of writings in the last few years:

- National treatment and its (lack of clear) scope to date;
- Most favored nation treatment;
- Prohibitions on performance requirements (states cannot impose minimum domestic purchase or sale requirements, etc.);
- Minimum international standards of treatment;
- Prohibition of expropriation without full compensation.

A concept that is increasingly motivating decisions in arbitral rulings in relation to these disciplines is the “legitimate or reasonable expectations” of an investor. This appears to have been applied in varying contexts, concerning at least the national treatment, minimum international standards, and expropriation obligations of a state.<sup>26</sup> These expectations can be derived from two things: the laws, regulations and policies in place before an investment is made, and statements of government officials surrounding an investment. This language, coming from arbitral decisions as opposed to textual provisions of international investment agreements (IIAs), places a high emphasis on the investor’s economic expectations, not governmental or societal expectations relating to social welfare, human health or environmental protection. While this may not fully exclude the social and other welfare interests of a government, it certainly limits the ability of a government to override a finding of any given “legitimate expectation” for a public welfare purpose.

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<sup>26</sup> One example of a broad ranging application of this idea is found in *Tecnicas Medioambientales Tecmed v. United Mexican States*, Case No ARB(AF)/00/2 Award, May 29, 2003.

Over the last few years, the state of the law relating to each of these disciplines has become increasingly broadened by investor-state arbitration tribunals that have invoked these provisions to protect their rights in relation to an investment. Today, in this author's view, it is fair to say that it is not possible to define with certainty the precise scope of any of them (with the possible exception of the performance requirement obligations).<sup>27</sup> Thus, rather than look at the details of these disciplines, the sections below will consider different ways in which they may apply to water management and water rights issues, and how some of the uncertainties can impact water management decisions at a domestic level. As an important key to understanding these impacts lies in the nature of the dispute settlement system that comes with the investor rights, this issue is turned to first.

#### **4.1 Dispute Settlement and Enforceability**

Almost all IIAs today include a dispute settlement mechanism known as the investor-state arbitration process. This allows private foreign investors to use an international arbitration against the host government in order to challenge government acts as a breach of their IIA rights. The applicable law in such arbitrations is the international law of the agreement in question, and other applicable international law relating to the protection of foreign investments. It remains very unclear whether such arbitration tribunals would apply other sources of international law, such as human rights and international environmental law, when considering the scope of a states rights and obligations.<sup>28</sup>

In addition, it is clear today that these arbitration tribunals will accept onto themselves the authority to interpret and rule on the application of domestic law and any contracts between the investor and the host state, irrespective of whether a domestic court has or

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<sup>27</sup> The views of the author and his colleagues at the International Institute for Sustainable development on the current uncertainties in this area, and how they relate specifically to issues of sustainable development, which is at the heart of the current discussion, can be found in Aaron Cosbey, Howard Mann, Luke Eric Peterson, Konrad von Moltke, *Investment and Sustainable Development: A Guide to the Use and Potential of International Investment Agreements*, 2004, IISD, at <http://www.iisd.org/publications/publication.asp?pno=627> in English and Spanish. See also, UNCTAD, *Review of Investment Disputes Arising from BITS and NAFTA*, forthcoming, 2004.

<sup>28</sup> For a recent discussion of this see Luke Eric Peterson, *International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration*, 2003, at <http://www.iisd.org/publications/publication.asp?pno=577>.

could be involved in such a review.<sup>29</sup> Thus, these arbitration bodies can rule on any issue of law relevant to the dispute. Further, these decisions are not subject to review by domestic courts, but only to limited arbitration review processes that do not usually permit the reversal of general errors in law, even in relation to the interpretation of domestic laws.

In a similar vein, it is clear from the arbitrations that when domestic law and international law under an investment agreement appear to be in contradiction, it is international law that will prevail. This is consistent with the *Vienna Convention on the Law of Treaties*, which says very clearly that the content of domestic law is not a legitimate excuse for breaching international commitments.<sup>30</sup> However, in the context of the linkages between an investment and the domestic legal regime: labour law, health standards, zoning, pollution controls, taxation, and many more, the singular focus of investment agreements on the rights of foreign investors when compared to the complex interaction of many types of laws on domestic investors carries a significant advantage for foreign investors.

The investor-state process can be initiated, usually, by the foreign investment or by an investor, including a minority shareholder in a company. In some cases, both an investment and an investor have initiated proceedings, and in one well known case, this has led to two different results. One was a finding of no fault by the Czech Republic, while the second was a finding of a breach of an investment agreement and an award of over \$300M US to the investment. Despite the conflicting results, the finding of culpability held and the award has been enforced.<sup>31</sup>

Over the past decade, there has been a substantial rise in the use of the investor-state dispute settlement process. This may be due to three factors:

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<sup>29</sup> E.g., *Metalclad Corp. v. Mexico*, Final Award, 2 September 2000, available at [www.naftalaw.org](http://www.naftalaw.org); *Compania de Aguas del Aconquija & Vivendi Universal (formerly Compagnie Generale des Eaux) v. Argentine Republic* (Case No. Arb/97/3), Decision on Annulment, July 3 2002, 41 ILM 1135 (2002).

<sup>30</sup> *Vienna Convention on the Law of Treaties*, (1969) 1155 UNTS 331, Art. 27.

<sup>31</sup> *Ronald S. Lauder v. Czech Republic*, UNCITRAL Arbitration, Final Award, September 2001; *CME Czech Republic v. Czech Republic*, UNCITRAL Arbitration, Partial Award, September 13, 2001; damages upheld in *The Czech Republic v. CME Czech Republic*, B.V., Court of Appeal, Stockholm Sweden, Case No. T-8735-01, 2003.

- The large increase in foreign investment flows in the past decade has undoubtedly spawned more conflicts between investors and host governments, a perfectly understandable phenomena in often complex investment and business environments;
- There are an ever larger number of investment agreements in place today that allow for increased access to the process – over 2100 such agreements are in force according to UNCTAD; and
- The use of the process has itself generated a lot of publicity about its viability and its use as a desirable, from the investor's perspective, alternative to the domestic legal system of the host state.

As previously noted, with the increased use has come increased breadth to the disciplines applicable to states, and hence an increased incentive for investors to continue to look to the agreements to protect their interests.

In addition to using the process for actual disputes – i.e. to challenge measures that have already taken effect and had an impact on an investment – threats of the use of the process are becoming increasingly common as a way to lobby against a new measure being taken. This use of the investor-state process as a sword can have significant impacts on the normal political processes, especially with the uncertainty attached today to the scope of the various obligations. What is known is that investors will use this threat when it is consistent with their interests.<sup>32</sup>

It is important to note that many of the investor-state cases take place in strict privacy, to the point that it is impossible to know with any real precision the number of arbitrations that have taken place or are taking place today. In other cases, the arbitration may be known to be taking place, but the rationale for the dispute and the legal issues remain secret. And in only two investor-state arbitrations to date has any type of non-disputing party involvement been allowed, either as an observer of the hearings or to present additional written briefs as an *amicus curiae*.<sup>33</sup> This level of secrecy means that there may well be instances where cases are not divulged, including in water and related service sectors.

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<sup>32</sup> The best known use has been the invocation of the UK-South Africa BIT by UK investors to ward off the introduction of new minimum domestic, black ownership requirements for all businesses. This has caused delay in the design and implementation of this program of economic empowerment.

<sup>33</sup> These are the *Methanex v. USA* hearings on the merits, June 2004, in Washington DC, and the *UPS v. Canada*, hearing on jurisdiction, 2002. Both of these cases are under NAFTA's Chapter 11 on investment.

In sum, today one must expect IIAs to be used and the dispute settlement process to be invoked whenever a potential dispute arises or a dispute actually materializes. What can such disputes encompass?

#### ***4.2 Protection of Market Access Through Liberalization or Pre-establishment Rights***

While the most common disputes under investor-state arbitrations have arisen after an investment has been made active, the right to make an investment has and is currently the subject of disputes.<sup>34</sup> Existing disputes raise directly the issue of what type of environmental and social conditions and limitations can be placed upon an investment that a foreign investor wishes to make in a sector where the right to establish has been granted. In a water services context, this means what limitations can be placed upon a service provider seeking to provide services to a new market? Can, for example, universal service obligations be imposed? Can differential rates be required? Can service to subsistence or traditional users be guaranteed?

These and other issues, as already argued, raise the question of the conditions of liberalization. When no conditions are added to a liberalization commitment, an investor-state dispute settlement body will be loathe to read them in at a later date. This, as already noted, places a significant responsibility on the negotiators addressing these issues. The absence of conditions also raises the probability of arbitrations being initiated when conditions are raised or imposed after an agreement is concluded but before an investment is actually authorized or permitted.

One type of restriction or limitation common to liberalization obligations is the grandfathering of pre-existing laws and regulations. When laws and regulations exist that

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<sup>34</sup> *Milhaly International Corp v. Democratic Socialist Republic of Sri Lanka*, (ICSID Case No. ARB/00/2); *Glamis Gold Ltd. v. United States of America*, Notice of Intent to Arbitrate, 21 July 2003; Notice Of Arbitration Under The Arbitration Rules Of The United Nations Commission On International Trade Law And The North American Free Trade Agreement, December 10, 2003; *Kenex Ltd. v. United States of America*, Notice of Arbitration, 2 August 2002.

create specific limitations on how sector participants must act, they can be grandfathered and their application preserved even if they may otherwise be inconsistent with the obligations of an agreement. Pre-existing laws that are not grandfathered may be challenged as inconsistent with the agreement in question. New laws or regulations in “liberalized” sectors will always be subject to the strict terms of an agreement, unless their subject matter has been reserved through an express condition of some type.

In short, where a liberalization or pre-establishment obligation is included in an agreement that also has an investor-state process, one can anticipate potential foreign investors utilizing this to try to enforce its right of market access to the strict letter of the agreement and any conditions or limitations it includes. This will include water sectors where rights of establishment are granted.

### **4.3 Protection of Post Access Uses and Benefits in the Water Sector**

In the water services context, the most common use of the investor state dispute settlement process is to promote and protect the investor’s view of its rights relating to post-investment government measures that alter its operations or impact on its profitability.

To date, at least eight water service related arbitrations are known to have been commenced, though none appear to have finished as yet.<sup>35</sup> Seven of these known cases are against Argentina, following changes to operating conditions as a result of the financial crisis in that country. The eighth is the very well known case against Bolivia concerning the Cochibamba water privatization that was eventually annulled.<sup>36</sup> In each case, specific issues and circumstances arise. What is common to all these cases is the

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<sup>35</sup> (1) *Aguas de Aconquija S.A. and Vivendi Universal v. Argentina*, ICSID Arb. No. ARB/97/03; (2) *Azurix corp. v. Argentina*, ICSID Arb. No. ARB/01/12; (3) *Aguas Provinciales de Santa Fe S.A., Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentina*, ICSID Arb No. ARB/03/07; (4) *Aguas Cordobesas S.A., Suez, y Sociedad General de Aguas de Barcelona v. Argentina*, ICSID Arb No. ARB/03/18; (5) *Aguas Argentina S.A., Suez, Sociedad General de Aguas de Barcelona and Vivendi Universal v. Argentina*, ICSDI Arb No. ARB/03/19; (6) *Azurix Corp v. Argentina*, ICSID Arb No ARB/03/30; (7) *SAUR International v. Argentina*, ICSID Arb No ARB/04/4. See Annex 1 and accompanying discussion in Bouzas and Chudnovsky, *supra*.

<sup>36</sup> *Aguas del Tunari v Republic of Bolivia*, ICSID Arbitration ARB/02/03.

use of the investor-state process as the primary dispute settlement option, over domestic tribunals. In at least one case, this has materialized despite an express provision in the privatization and concession contracts that disputes over the implementation of these contracts are subject to local state law.<sup>37</sup>

The details of the existing cases are either not sufficiently known or are too complex to do justice here.<sup>38</sup> What is certain, however, is that changes in the operating conditions of the water license or contract have triggered the arbitrations. This is the key point: *any* changes that substantially impact an authorized foreign investment and its profit levels, can be made subject to an investor-state arbitration even when tied to a period of true national crisis. Of course, not every change will lead to an arbitration, and not every arbitration initiated by an investor will be successful, but on both counts those changes with a significant impact do raise the risk level. Thus, challenges can be brought against changes designed to ensure users not able to pay for water can have access, delivery requirements to poor boroughs or potentially non-paying boroughs, new standards of water quality, and higher standards for sewage treatment before release into waterways.

What are the implications? As international finance institutions continue to promote privatization of water delivery as the approach of choice to in developing countries, this will continue to promote the growth of foreign investment in this sector. The reason is simple: the financial and technical resources to build or manage water services in a private sector context exist in very few companies, all from developed countries. In effect, with very few potential exceptions, when these institutions or others promote privatization they are promoting liberalization of the sector for EU and US investors. These investors have very sophisticated legal departments and advisors, and will aggressively use the investor-state process when it is in their interest. As any change in conditions of operations impacting the profit of an investment can be made the cause of a dispute (this does not mean every case wins of course, several do not), entering into a

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<sup>37</sup> *Compania de Aguas del Aconquija & Vivendi Universal (formerly Compagnie Generale des Eaux) v. Argentine Republic* (Case No. Arb/97/3), Decision on Annulment, July 3 2002, 41 ILM 1135 (2002).

<sup>38</sup> Some of the background is digested in Luke Eric Peterson, *Research Note: Emerging Bilateral Investment Treaty Arbitration and Sustainable Development (current as of August 2003)*, section 2, at [http://www.iisd.org/pdf/2003/trade\\_bits\\_disputes.pdf](http://www.iisd.org/pdf/2003/trade_bits_disputes.pdf)

privatization and foreign investment process *requires as a preliminary and precautionary measure to achieve the social and environmental objectives of developing countries* that the laws and regulations and policies that will be applied to those processes are completed and in place. Proposed changes after the fact can and will trigger threats of the use of the investor-state process to either dissuade a government from making changes or to reduce the social welfare objectives that they embody. Changes imposed after the fact can and will lead to challenges based on one or more of the above noted disciplines contained in the IIAs.

One might also note here that even if it appears that the state whose services are being opened to foreign investors does not have an IIA with the home state of the investing company, this no longer prevents the use of this process. The reason is because a variety of tribunals have allowed investors with an otherwise limited connection to a jurisdiction to establish holding companies or joint venture headquarters in other countries that do have an agreement in force. This new form of “home state shopping” has begun to raise eyebrows, and one recent decision and a dissent in another case have sought to impose some limitations.<sup>39</sup> Nonetheless, this approach by investors can be expected to grow in the coming years. Thus, given the relatively small number of international players in this field, their legal sophistication and large resources, one should anticipate that every investment in this sector will be covered by IIA obligations and remedies, and that these will be used when it is in the interest of the investor to do so.

Finally, there is a growing concern that contractual clauses that give precedence to domestic courts to resolve any legal disputes are not being fully respected by arbitration tribunals. While the full extent of the problem is not clear yet, several instances have seen contractual choices of domestic dispute settlement essentially overturned to allow foreign investors to use the international arbitration process instead. The legal reasoning is beyond the scope of this paper, though it is worth noting here that the leading case to

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<sup>39</sup> *Hussein Nuaman Soufraki v. United Arab Emirates*, ICSID Case No. ARB/02/07, decision on Jurisdiction, July 7, 2004; *Tokios Tokelès v. Ukraine*, ICSID Arb No. ARB/02/18, decision on Jurisdiction, April 29, 2004, but note Dissenting Opinion on Jurisdiction, April 29, 2004.

have done this is actually in the water service sector, involving Vivendi and Argentina.<sup>40</sup> The impact of this approach, however, is again to increase the likelihood of such cases going to international arbitration instead of domestic courts, or even in addition to domestic courts. Contractual clauses and agreements can be written to preclude this being done, but as the issue is new, few will have done so in an effective way to date.

#### ***4.4 Protection of Acquired “Rights” In Non-Water Sectors***

Issues also arise outside the water services sector under investment agreements that can have a significant impact on water management decisions. Two separate issues can be identified:

- Water quantity and allocation issues for foreign investors, and
- Impacts on water quality by foreign investors.

By accepting a foreign investment, host states accept that they will provide the means for them to operate, even if no formal authorization is required, for example to draw water for industrial uses. This becomes, one might argue, part of the “legitimate expectation” of the foreign investor. When significant quantities of water are required for the operation involved, this means that foreign investors will have acquired international law rights to access that water, even if it conflicts with existing or future local needs for potable water, agriculture, small scale industry, subsistence uses, etc. Unless water allocation issues are clearly spelled out, and the relationship of such allocations to other users and uses made clear, the investor should be understood as having an acquired right under international law to the quantity of water the investment requires, at least in the form in which it was originally authorized or begun.

The impact of this is simple: the foreign investor will be able to protect its allocation by recourse to the international agreement and the resulting threat of significant financial costs, and do so through mechanisms unavailable to domestic users. Moreover, in contexts when many other users may not have clearly established legal rights to their water use – subsistence farmers, indigenous peoples, villages in traditional tribal lands,

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<sup>40</sup> *Compania de Aguas del Aconquija & Vivendi Universal (formerly Compagnie Generale des Eaux) v. Argentine Republic* (Case No. Arb/97/3), Decision on Annulment, July 3 2002, 41 ILM 1135 (2002).

and so on – the international law rights will be matched against what many would qualify as non-legal claims.

Whether a foreign investor is in the agricultural sector using water for irrigation, in the textile business drawing water for stone washing denim, in the cement or chemicals sectors, IIAs can lead to the right to use water prevailing over other uses. It is, therefore, critical that the impacts on water quantity and allocations be fully considered before an investment is initiated, though the responsibility for doing this is often not clear, and has never yet been set out in an IIA. As a reflection of one of the major concerns of civil society groups with IIAs in general, that they establish rights with no responsibilities for the investors, this example stands as one of the most troubling given the critical importance of water resources.

The operations of foreign investors may, like domestic businesses, pollute local waters. In keeping with the well recognized “polluter pays principle”, one can expect that new regulatory measures to reduce pollution loads will be developed over time and such new laws will not be compensable. However, the obligations under an IIA, in particular the national treatment, minimum international standards, and expropriation provisions, may all lead to a different conclusion today. While there is no existing case where a simple change in environmental or human health standards has been held to constitute a breach of an IIA, none have ruled out such a finding either. The arbitrations that are emerging are mixed, at best, inconsistent at worst.<sup>41</sup> Thus, the potential for governments to have to pay the polluter to stop polluting remains real.<sup>42</sup> Indeed, international investment lawyers are already looking at ways to make claims for mandatory CO2 reductions under national and international climate change regimes.

Moreover, many claims in relation to changes in regulations for human health or environmental purposes can be brought under obligations relating to national treatment or

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<sup>41</sup> This issue is one of the focal points of the discussion on the impacts of IIAs on sustainable development in Cosbey et al, *supra*, n. 27.

<sup>42</sup> For example, the author is aware through personal discussions that some international investment lawyers are already looking at ways to make investment treaty claims for mandatory CO2 reductions that might be imposed under national and international climate change regimes.

the procedural elements of minimum international standards obligations. The former can be especially relevant when one major actor is responsible for significant levels of pollution and that actor is a foreign investor. If new regulations impact that investor to a higher degree – not unusual in such a scenario – then a claim to *de jure* or *de facto* differences in treatment may be attempted. The latter can be used whenever an investor feels either that a process leading to a new regulation has not been subject to enough notice or consultation, similar to OECD standards of government operation. Thus, the lack of capacity of many developing countries to meet these standards poses a clear risk for them when imposing new measures on a foreign investor.

Finally, the issue of whether a new regulation can constitute an expropriation if it has a significant economic impact is one of the most controversial in international investment arbitration today. Quite simply, there is no clear answer to this. Investors continue to press such claims while states continue to defend them, and arbitrators continue to issue decisions that leave room to argue both ways. Host states cannot know with certainty today whether the treaties they have already signed will lead to such claims, or whether they will be successful. For future treaties, there is a trend to better articulate the linkages between IIA obligations and regulations. This is itself a positive development, but its implementation is disjointed and often inconsistent in terms of the concepts and strategies being applied. Greater focus is required here.

Finally, the same issues raised in this section in terms of regulatory changes can be applicable to water service investors if the standards applicable to them are changed. Water emission quality standards for sewage services, potable water standards, reduced draws on water sources, pollution prevention requirements, etc., can all change in time. Yet, even technical adjustments to standards on these lines can, due to today's uncertainties, lead to claims under an IIA. To the extent a contract or representation by a government official has suggested that standards would not be changed, this can add to the case for an investor, irrespective of the motives or circumstances causing the change to be made. The greater the impact on the investor, the higher the chances of the claim succeeding.

## **5. INTERNATIONAL ECONOMIC LAW: POLITICAL AND POLICY PRESSURES ON DOMESTIC WATER MANAGEMENT**

Where the more traditional sources of international law relating to freshwater have moved in recent decades to give greater weight to human needs for water, little suggests today that this basic requirement has been reflected to date in international economic law as it impacts on water management and uses. It is true that the WTO dispute settlement system, by dint of the efforts of the Appellate Body, has made significant strides in addressing the linkages between trade and environment.<sup>43</sup> This does suggest some additional consideration on an issue as vital as water may be forthcoming in the event of a state to state dispute in the WTO. The reality is, however, that such a challenge will be rare. Much more prevalent and immediate are the types of issues being raised by IIAs today, and the access to international arbitration processes that they include. With a variety of negotiations taking place to expand the scope of trade and investment law, the challenges this poses in relation to water management are only likely to grow.

One of the most critical challenges is going to be political in nature: with market access for goods into developed countries being set up as tradable for market access into developing countries on investment, including in services, the pressure to trade one against the other will increase. Measuring the true benefits of one against the other is complex, and negotiating pressures can truncate if not eliminate time for proper analysis and reflection. Securing a broad agreement on market access for goods or agricultural products can, therefore, lead to pressures to give up an equally broad deal on investment issues. The political pressure can be expected to be real and significant.

For developing countries, one option is to work together, as was done in Cancún at the 2003 WTO Ministerial meeting. This approach would, however, require limiting bilateral or regional negotiations with major powers, or at least coordinating positions in relation to such negotiations.

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<sup>43</sup> See note 9, *supra*.

In the WTO context now, with investment *per se* off the agenda, much of this trade-off will fall to the services liberalization negotiations under the GATS Council.

Infrastructure services of all kinds will be involved, including water and water-related services. With the second tranche of negotiations addressing other regulatory disciplines on services, this remains an area to watch very closely.

A second issue that arises is the need for significant capacity building in relation to international negotiations in the economic field. If this paper has attempted to show one thing, it is that international economic law is connected to water management issues in several critical ways. Ignoring them as tangential or unrelated is no longer an acceptable alternative, especially in the face of the rapid growth in water shortages. Yet, training for negotiators and other policy makers, academics, civil society groups, and others on these linkages in order to ensure acceptable outcomes appears to be completely unavailable. In addition, it is less than clear that training in issues such as better defining the obligations in an IIA or in both tranches of the GATS negotiations, better articulating the relationship to regulations, and so on is taking place in a manner that will have a significant impact.

Similarly, the capacity to address inadequacies or incompleteness in the domestic law and administration of water services and other water-related aspects of trade and investment agreements is also limited in many cases. When the international economic regime, including the promotion of privatization and foreign investment by international financial institutions, leads to agreements and obligations before this capacity is available and effectively used, the likelihood of conflicts arising are significantly increased. Again, while there are signs of international institutions recognizing this issue, training and capacity building to ensure the necessary domestic measures are taken prior to developments through international negotiations or banks does not appear to be a key target.

Both the above lead to the ability to summarize many of the challenges in a single word today: sequencing. The clearest signal that emerges from international investment law today is that foreign investors will react strongly to changes in laws and regulations that impact their economic welfare. The social or health aspects underlying the changes may

be of little concern to them. With changes in domestic law carrying the elevated risks of challenges, getting a sound legal and administrative basis in place before liberalizing and privatizing services, especially in crucial areas such as water, is indeed critical. It is here, in this author's view, that capacity building is an essential requirement, and that democratic principles of transparency and accountability must come to the fore.

It is worth noting that the *Report of the World Panel on Financing Water Infrastructure*<sup>44</sup> 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. 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."<sup>45</sup> The potential impacts of trade and investment regimes add one more degree of urgency for doing this.

In practice, however, over 2000 bilateral and regional agreements on investment and on trade are already applicable around the world. So what can be done 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 perhaps even corrupted regimes. It is this combination of domestic and international processes and timing 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

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<sup>44</sup> *Report of the World Panel on Financing Water Infrastructure*, Executive Summary, p. 2., Third World Water Forum, Kyoto, Japan, March 2003.

<sup>45</sup> 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.

governmental levels have achieved the legal and administrative standards necessary to protect all water users and the resource itself.

Annex 1 provides some more specific recommendations, derived largely from a paper on this same subject prepared about a year ago. The developments in international investment arbitrations and agreements confirm, in this author's view, the issues raised then, and the direction of the recommendations to respond to them. Over the past five or six years, since international economic law and water management issues have begun to achieve some degree of public attention, nothing has occurred to alleviate the concerns that have been raised. Quite the contrary: the decisions and directions from international investment arbitrations seem to confirm that civil society concerns were not misplaced. The wholesale inclusion of public sector services, including water services, in the Doha Round negotiations on services liberalization, without any recognition of the need for additional reflections in this area, serves to confirm the concerns.

## **ANNEX 1: STEPS TO MAINTAIN AND ENHANCE NATIONAL CONTROL OVER WATER POLICY IN THE FACE OF INTERNATIONAL ECONOMIC LAW**

### ***International Level Measures***

1. Clearer rules in trade and investment agreements: This is an essential element today. Too often, trade and investment agreements have led to unintended consequences. That greater clarity can be achieved is clear from the efforts already being made in some negotiations to do so.<sup>46</sup>
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.
3. The same careful standards must be applied to the negotiation of Bilateral Investment Agreements (BITs) as to multilateral or regional agreements. BIT negotiations still 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 the investor-state process. This importance is magnified by home state forum shopping by foreign investors.
4. In all these negotiations, it is time to consider water as a special resource, and differentiate its treatment from other 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.

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<sup>46</sup> 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](http://www.ustr.gov) for the text, released to the public on 7 March 2003.

6. It must be recognized early that international agreements apply, in most cases, to all levels of government. Thus, the same domestic responses are required by whatever level of government is responsible for each different aspect of water management.
7. 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.
8. 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***

9. 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 the consequences 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.
10. 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. As a starting point, the request and offer process of the GATS and of accession negotiations, and in bilateral services and investment negotiations must, therefore take place in a transparent way. All disputes under these agreements must also be conducted in a transparent way.