



# **A Legal Opinion Concerning Water Export Controls and Canadian Obligations Under NAFTA and the WTO**

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The following is an abridged version of a legal opinion prepared for the Council of Canadians. It addresses 5 questions concerning the potential for conflict between Canadian efforts to restrict the export of water, and the commitments Canada has made under NAFTA and the WTO. It also considers the most appropriate course of action for Canada to ensure that our water resources are adequately protected from unconstrained export demands.

Recent proposals to export Canadian water, and an investor-state suit under NAFTA concerning BC's water export control measures, have revived Canadian concerns about the loss of public control over this vital resource. In response, the federal government has announced several initiatives including the negotiation of a federal provincial accord to ban bulk water exports, and strengthening the Boundary Waters Treaty Act. However, its strategy appears to have been determined by a reluctance to confront the reality that under NAFTA and WTO rules, water export controls are prohibited. Moreover, under NAFTA, Canada is also precluded from denying US investors and service providers the same access to Canadian water it allows Canadian companies, communities, and residents.

But instead of seeking amendments to these agreements, Canada is attempting to finesse these trade constraints by taking the approach that water in its "natural state" is not a tradable "good" and therefore not subject to international trade rules. There are several reasons to doubt the validity of this assertion. For instance under both US and international law, water in its natural state is considered a commercial good. Moreover a very large portion of Canadian water resources would already have to be considered as having entered into commerce, because it is being used to generate power, irrigate crops, support industry and service individual consumers.

Furthermore, by focusing attention on water as a tradeable commodity, the federal government is ignoring the fact that under NAFTA, water is both an investment and service even if it is not considered to be a "good". Indeed Canada's most onerous trade obligations are found in NAFTA's investment chapter, not in the trade- in-goods provisions of either NAFTA or the WTO. Moreover, by putting its powerful enforcement machinery at the disposal of countless foreign investors, NAFTA leaves Canadian water resources, and measures established to protect them, entirely vulnerable to foreign investor claims.

Unfortunately, rather than recognize and confront these problems directly, the federal government seems to be hoping that if it ignores them, they'll go away. This is particularly problematic because of the consequences of under-estimating the effect of NAFTA rules, not the least of which is the fact that an error would be difficult, if not impossible, to reverse. This is because the *National Treatment* and proportional sharing rules of NAFTA make it virtually impossible for Canada to restrict water exports once they are underway.

Given the confidence with which Canada asserts its position, it is also only fair to point out its recent and dismal track record in defending Canadian cultural, and research and development programs from trade challenges. As you many will know, in spite of assurances very much like the ones it now offers concerning water export controls, Canada recently lost two important WTO cases concerning important cultural and technology programs.

Finally by way of introduction, we should note one important qualification to our opinion. This has to do with the difficulty of predicting the outcome of trade disputes and investor claims concerning Canadian water protection measures. Many of the international trade, investment and services provisions of NAFTA and the World Trade Organization that might give rise to such disputes and claims are unprecedented and have yet to be considered by either trade tribunals or the courts. Moreover, the water export control measures that have been adopted by some provinces, or which are now being considered by other Canadian governments, are also innovative and similarly untested.

Accordingly, it is extremely difficult to anticipate the views of trade dispute panels or tribunals that will be called upon to address the novel issues that are certain to arise in a trade challenge or investor

claim concerning water export control measures. Therefore, given the seriousness of underestimating the risk of adverse rulings, it is incumbent on the federal government to exercise considerable prudence to avoid putting Canadian water resources entirely at the mercy of international market forces.

### **Question 1: What are the constraints on Canadian policy and legislative options concerning water exports arising in consequence of Canada's obligations under the WTO and NAFTA?**

The basic architecture of both NAFTA and the World Trade Organization is common to both Agreements and can be found in the General Agreement on Tariffs and Trade 1994 (the GATT)<sup>1</sup>. There are several provisions of the GATT that impose constraints upon government policy, programs, and legislative options as these may pertain to water. While NAFTA and the WTO share several common elements, there are also important differences between these two regimes and of the two, the NAFTA is far more problematic for reasons we describe below.

Nevertheless, the most likely source of conflict between water export control measures and trade disciplines arises under Article XI of GATT (common to both the WTO and NAFTA) which imposes a blanket prohibition against the use of quantitative export controls on any product *destined for the territory of any other contracting party*.

Several trade cases have considered the application of this provision to import controls concerning endangered species, contaminated fuels and hormone treated beef.<sup>2</sup> In each case domestic import restrictions were deemed to violate Article XI constraints. The leading cases that have considered the application of Article XI to export controls, both concerned Canadian restrictions on the export salmon and herring caught off Canada's west coast.<sup>3</sup> In these cases Article XI was given even broader application in striking down these fishery conservation measures.<sup>4</sup> In short, it isn't possible to craft water export control measures that would not violate Article XI constraints — with two qualifications:

1. Under Article XI Canada can impose an export duty or tax (as opposed to ban, embargo or other quantitative limit) to control bulk water exports. With respect to the US however, Canada has abandoned these options under NAFTA.<sup>5</sup>
2. If water in "its natural state" is not considered a "good" or "product," it would not therefore be subject to Article XI.<sup>6</sup> This is the premise upon which current federal strategy concerning water exports is built. But for reasons we elaborate below, this view is very unlikely to prevail in a trade dispute concerning water export controls.

### ***Water as a Good***

While GATT Article XI imposes serious limits on Canada's options for controlling water exports, far more serious constraints arise under NAFTA: two provisions are key.

Under Articles 315 of NAFTA, Canada is precluded from ever reducing "*the proportion of total exports shipments of the specific good [in this case water] made available to that party relative to total supply*". Another way of stating this is to say that the US is entitled to a proportional share of Canadian water resources in perpetuity: once the tap is turned on, it stays on. Flows may be reduced but only if water is also rationed to Canadian consumers and companies.

Also under Article 301 of NAFTA, Canada may be required to provide "national treatment" to water as an export commodity.<sup>7</sup> In other words, Canada would be obliged to treat water bound for export markets in precisely the same way it does water used for domestic consumption. The implications for water export control measures are obvious.

## ***Water As An Investment***

However, the most serious constraints on Canadian sovereign authority to determine how Canadian water resources are utilized arise under Chapter 11 of NAFTA which establishes an extensive array of investor rights including the right to *National Treatment*. In simple terms, Chapter 11 proscribes a long list of policies and laws that might have otherwise been established to regulate foreign investors access to and use of Canadian water. Most importantly Chapter 11 also allows investors from other NAFTA countries to sue Canada to enforce the new rights NAFTA accords them (see discussion below).

### **Guaranteed Access for Foreign Investors**

To begin with, it is absolutely essential to understand that Chapter 11 is not limited in its application to trade in goods.<sup>8</sup> In other words, NAFTA rules concerning investment (and Services) would extend to water, whether water is considered a good, or not. In fact, the federal government has conceded this point:

*Chapter 11 does not prevent NAFTA Parties from prohibiting the removal of water from its natural state. But foreign investors seeking to establish investment, or with established investments, for the removal of water from its natural state would have to be treated in the accordance with the obligations of the Chapter (such as national treatment, minimum standard of treatment and the four requirements for an expropriation, if there is one).*<sup>9</sup> [emphasis added]

In other words Chapter 11 disciplines apply to Canadian water resources, including access rights to water in its natural state. This means that, once governments allow water to be withdrawn from its natural state, as they have done on countless occasions for purposes that range from large scale industrial use to personal consumption, the same rights must be accorded foreign investors.

While the federal government remains silent on the issue of whether water would be subject to the services provisions of NAFTA, for similar reasons, this result is also inescapable. This means that a water services provider operating in Canada would have the same rights to supply water services to US consumers as to Canadians.

The most likely bases upon which foreign investor claims would be made against Canada concerning water export controls, would invoke either or both of Articles 1102 (National Treatment) or Article 1110 (Expropriation).

Under Article 1102 Canada must "*accord to investors of another party treatment no less favourable than it accords, in like circumstances, to its own investors.*" Some have argued that it would be possible to craft measures that might meet the requirements of this provision if water export controls treated US and Canadian investors in the same way, i.e., by denying both water export licenses.

However it is at least equally likely that a Tribunal would interpret "in like circumstances" to reference the character of the water access rights being sought, either with respect to volume or purpose (agricultural, industrial, municipal service, etc.), rather than the nationality or location of the intended beneficiaries of the investment. Accordingly, applications to take water to serve municipal or industrial users, would have to be treated in the same manner regardless of whether those consumers were located in Canada or the US. After all, the intent of NAFTA is to prohibit "discriminatory treatment" based on nationality or residence. Moreover, in a contest between free trade and investment policies on the one hand, and the regulatory authority of governments on the other, trade panels have consistently demonstrated a decided preference for the former.

## **Water Export Controls as Expropriation**

Another likely ground for an investor claim under Chapter 11 can be found in the provisions of Article 1110, which establishes a very broadly worded prohibition against measures that *directly or indirectly [expropriate} an investment ... of an investor of another Contracting Party or take any measure or measures having equivalent effect.* The wording of this Article is very expansive and goes well beyond Canadian legal principles concerning the rights of investors and has already given rise to a wide variety of claims for compensation by US based investors.

While it is true that under Canada's constitution, with the exception of certain northern waters, the provinces own Canadian water resources,<sup>10</sup> these proprietary rights are not unqualified. Countless individuals, public and private corporations have broad rights as riparian users, or as licensees under federal or provincial permits. It is entirely possible that a foreign investor seeking to exercise such rights for the purposes of bulk water export might assert a claim that any denial of the opportunity to do so represents expropriation within the expansive terms of Article 1110.

## **Investor-State Claims**

By far the most problematic feature of NAFTA's investor rights regime is the enforcement tools it places at the disposal of foreign investors. Under NAFTA, trade agreement based actions may arise in two distinct ways. The first occurs when the state-to-state dispute procedures of NAFTA are invoked. For geographic and practical reasons it is unlikely that such a dispute would arise other than at the instance of the US. The other way in which Canadian water conservation measures might be challenged, is by way of investor-state claim. Canada's exposure to such claims imposes far greater risks than those associated with state-to-state disputes for several reasons.

To begin with investor-state claims are more likely to arise because access to these extra-ordinary remedies is virtually unqualified.<sup>11</sup> In addition, foreign investors would not be bound by any bilateral understanding or agreement among the NAFTA parties concerning the application of NAFTA disciplines to water, unless their rights under Chapter 11 were abrogated by explicit amendment. Nor would foreign investors likely feel constrained by any political or diplomatic considerations that might discourage state-initiated complaints. In addition, the broadly framed and unprecedented constraints engendered by these rules, are far more onerous than those established by other elements of Canada's international trade obligations. Finally investor state claims would not be resolved by Canadian courts applying Canadian law, but by international tribunals operating entirely outside the context of Canadian judicial norms.

Indeed **there** are now several instances of these provisions being invoked by US investors to challenge Canadian regulatory initiatives. Among these is the case of Sun Belt Water Inc., which late last year filed notice of intent to submit a claim for more than \$200 million concerning certain actions by the BC government which it asserts unfairly deprived it of the opportunity to export bulk water from British Columbia. BC has the most stringent water export controls in Canada.

The extraordinary nature of the risks engendered by these rules not only underscores the importance of moving quickly to implement federal legislation banning water exports, but it also reinforces the need to negotiate international measures to prevent such claims from arising in the future. Therefore, notwithstanding the risks of state-to-state procedures, Canada's first priority should be to reduce Canada's exposure to investor-state claims concerning water. Unfortunately the federal government has to this point refused to even fully acknowledge the serious problems posed by NAFTA's investment rules.

## ***Water as a Service***

Chapter 12 of NAFTA sets out a comprehensive regime to govern trade and investment in the services sectors. As for the ambit of Chapter 12, Article 1201.1 applies *to cross-border trade in service providers of another Party, including measures respecting: the production, distribution, marketing, sale and delivery of a service*. In other words to a US based water service provider, for example, operating in Canada for the purposes of providing cross-border services to another jurisdiction. Accordingly a US company operating in these circumstances would be entitled to *National Treatment* under Article 1202 and the *Standard of Treatment* set out in Article 1204.

### **Question 2. Is the regulation of water as a "natural resource" an adequate safeguard against trade agreement based challenges or claims against Canadian ban on water exports?**

In an options paper prepared for the Canadian Council of Environment Ministers<sup>12</sup> the federal government indicates that trade considerations lead it to shift its approach from a federal ban on water exports, to a focus on a federal-provincial accord to prohibit bulk removal of water from Canada's drainage basins. The essential premise of this initiative is that by adopting a "watershed approach," Canada can avoid the strictures of its international trade obligations. Unfortunately no analysis or argument is offered to support this assertion other than a statement ostensibly made by the three NAFTA Parties in 1993 (the 1993 Statement) providing:

*Unless water, in any form, has entered into commerce and becomes 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. Water in its natural state in lakes, rivers, reservoirs, aquifers, water basins and the like is not a good or product, is not traded, and therefore is not and never has been subject to the terms of any trade agreement.*

Thus to finesse the prohibition against export controls, the federal government reasons that it must focus its efforts on regulating "water resources" which it argues would not be considered a "good" under NAFTA and GATT rules. 2

Unfortunately there are several reasons to doubt the validity of this analysis.

1. Water in its natural state is considered a commercial good under US law. In fact, US courts have consistently concluded that groundwater is an article of commerce, rejecting the argument that state governments have the authority to discriminate between in-state and out-of-state water use.<sup>13</sup> Summarizing US law on this point, a recent report by a panel of US and Canadian legal experts to the Governors of Great Lakes States concluded that "*arguments that water is not a good are not persuasive*" and "*indeed ... run contrary to the United States own jurisprudence with respect to the characterization of water as an article of commerce...*"<sup>14</sup>
2. Water is also considered a good under international law. The European Court of Justice has interpreted the term "good" to include anything capable of monetary valuation and of being the object of a commercial transaction. It has also held that the term "goods" includes not only the sale of goods, but goods and materials that are supplied as services. In other words, if water is being used to provide a service, such as providing water for public consumption or agricultural irrigation, then it is considered a good under the EC Treaty.<sup>15</sup>
3. A very large proportion of Canadian water resources can already be considered subject to commercial use either because it has been allocated to various users or because it is subject to proprietary claims such as the rights of licensees and riparian users.<sup>16</sup> Therefore even if

one were to accept the dubious proposition that "entered into commerce" is the appropriate standard to determine the application of rules concerning trade in goods, a very substantial proportion of Canadian water resources would have to be viewed as having "entered commerce" and for that reason, subject to these trade disciplines.

4. As many other commentators have noted, water is a "good" under NAFTA and GATT rules because it is explicitly included under GATT tariff headings.<sup>17</sup> While the federal government has argued that this inclusion only concerns water that has been actually removed from its natural state, — for example water bottled for sale — the tariff schedules include no such limitation.
5. The 1993 Statement upon which Canada has placed such great reliance would not, under international law, be binding on a panel or tribunal called upon to resolve a dispute concerning water export control measures. A recent study by the US State Department describes the use of joint statements at international law: *In recent decades, this has become a common means of announcing the results of diplomatic exchanges, stating common positions on policy issues, recording their intended course of action on matters of mutual concern, or making political commitments to one another. These documents are sometimes referred to as non-binding agreements, gentlemen's agreements, joint statements or declarations.*<sup>18</sup> In fact this 1993 Statement is no more than an unsigned document, on blank paper, released as an attachment to a press statement issued by the government of Canada on December 2, 1993. There is no indication that either government offered formal support for it. Yet approval by the US Senate is required under the US Constitution with respect to all international treaties. Given the rather startling degree of informality that surrounds this 1993 Statement it is not certain that it would even rise to the status of a non-binding agreement. Even if it did, it would not alter the substantive provisions of NAFTA, a point the US clearly made in acknowledging the release of the 1993 Statement.<sup>19</sup>

### **Question 3. Is the proposed *Canada-wide Accord for Prohibiting Bulk Water Removal from Watersheds* (the Accord) an effective mechanism for regulating bulk water exports or diversions?**

Draft proposals for this Accord provide in part:

*Federal, provincial and territorial ministers responsible for the environment commit to a Canada-wide approach for the protection of Canadian waters, in part by prohibiting bulk removal of water from Canadian major drainage basins, including for the purposes of export. .... We agree that: Each jurisdiction will determine the approach to be used for achieving the common objective of prohibiting bulk water removal from major drainage basins.* <sup>20</sup>

At first glance, the notion of such an *Accord* would seem like a reasonable approach for dealing with the problem of bulk water exports. In fact, when viewed from the perspective of federal-provincial relations, the *Accord* has certain features to recommend it. It would, for example, offer an opportunity to integrate the efforts of provincial and federal government to ban water exports and diversions. The *Accord* also embraces the concept of watershed management, which has strong appeal from an environmental policy perspective. However on closer scrutiny there are four serious problems with this approach to safeguarding Canadian water.

1. The Accord would of itself do nothing to actually prohibit export initiatives that might be undertaken by provincial governments, municipalities, Crown agencies, corporations or even private parties. This would require legislation, and when it comes to international trade, it is the federal government, and not the provinces that has the constitutional authority to regulate.<sup>21</sup> While jurisdiction over water resources in Canada is shared, the same is not true

for federal powers concerning international and inter-provincial trade. This should justifiably raise questions about the purposes of an Accord which appears to shift responsibility to provincial governments for matters with respect to which they have little constitutional authority.

2. The Accord is not legally binding on the provinces. Thus governments, perhaps upon a change of political administration, would be free to abandon obligations they may have agreed to. Furthermore, the ability of governments to extricate themselves from such commitments is likely to be formally expressed in the Accord itself because the federal government has indicated that it would use a similar accord concerning the environment as prototype for this initiative. Under that arrangement, "a government may withdraw from the Accord six months after giving notice."<sup>22</sup>
3. Third, by indicating that provinces will be free to develop their own approach to achieving the goals of the Accord, the federal government is setting the stage for a patchwork of policies and regulations across the country. While this problematic from a public policy point of view, it is even more so when the principle of *National Treatment* is considered. We consider the implications of differential provincial policies from this perspective below.
4. By entering into an Accord, provincial governments may actually be exposing themselves to claims that they provide national treatment with respect to any licenses or permits to provincial water resources. This raises the spectre of an export approval sanctioned by another province or the federal government setting a standard with respect to which all other provinces must then conform (see discussion under Question 4).

For these reasons, an Accord would not represent a credible or durable guarantee against bulk water exports, and would not therefore, be an adequate substitute for legislation that would establish enforceable sanctions against such exports. Moreover, while an Accord would itself do nothing to actually prohibit water exports, it might well undermine this objective by exposing Canada to investor-state claims that would not otherwise arise, or that would be easier to defend against should they be brought.

While ecosystem-based watershed management is a desired outcome from an environmental policy perspective, in the context of *National Treatment*, proportional sharing, and investor-state litigation it invites the potential for serious and largely unpredictable consequences because of Canada's obligations under NAFTA. Moreover the concept of watershed or ecosystem management is not one that NAFTA recognizes. This means that it might not be possible to distinguish between in-basin and out-of-basin users, investors or service providers without offending the NAFTA's National Treatment obligations. Thus by entering into an ecosystem based management regime for international waters, such as the Great Lakes, Canada may be opening the door to claims by investors or services providers located outside of the basin that they be accorded 'treatment no less favorable'. While a Tribunal convened to determine such a claim might conclude that out-of-basin claimants are not 'in like circumstances' with those within the basin, there is no reason to be confident about such an outcome. Ultimately, the success or failure of efforts to chart a safe course through the landmines established by these trade and investment regimes will only be determined after-the-fact by trade panels and tribunals operating entirely outside the context of Canadian law and legal institutions.

#### **Question 4. Would the export of water from one Canadian province have implications for other provinces and/or the federal government.**

The federal Options Paper we have noted specifically addresses this issue and concludes:

*If legislation permits bulk removal of water in one province and a project is approved, this does not mean that other provinces have to follow suit.* <sup>23</sup>

For the reasons we have just related, we don't agree. However, having considered this question in the context of a prospective Accord, we should also note two other ways in which water exports from one



Canadian jurisdiction will, in our view, clearly impact on others.

The first has to do with the possibility of a *National Treatment* complaint being made to challenge federal measures intended to prohibit bulk water exports should the government have previously acquiesced to such exports. Because federal authority to prohibit water exports is clear under Canadian constitutional law, a failure to exercise that power to prevent exports in some cases would certainly support a claim that National Treatment rules would preclude export constraints in others. In other words, by failing to prohibit water exports in any case, the federal government would be precluded from according 'less favorable treatment' to all other export users. It is important therefore to stress the importance of swift federal action to prohibit water exports.

The second has to do with the impacts of the proportional sharing provisions of NAFTA which we have described above. These commitments are not confined to the territory of a provincial government that may issue such export permits. In other words, the claim to an ongoing share of Canadian water resources that might be asserted under Article 315 would persist notwithstanding the unwillingness or inability of the granting jurisdiction to maintain export flows. In the case that water is drawn from inter-provincial watersheds or groundwater regimes the implications are obvious. However, quite apart from these direct impacts, it is entirely possible that proportional guarantees would exert pressure on the water resources of provinces not party to the original export commitments, particularly if shortages arise in the province or territory that was. Accordingly we must pointedly disagree with federal assertions on this point.

**Question 5. Are the safeguards provided by Article XX(g) of the GATT adequate to protect Canadian water export control measures from trade challenge and/or investor state claims?**

Article XX: *General Exceptions*, provides in part:

*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:*

*..... (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production and consumption;*

While several international trade panels that have considered the meaning of these provisions, it is still unclear whether it is possible to craft conservation measures to satisfy the requirements of Article XX(g). While legal experts may differ, certain facts are undeniable.

First, every challenge to a resource conservation measure that has been mounted under NAFTA and WTO has succeeded. Second, in no case has a trade panel or appeal tribunal been willing to uphold a conservation measure on the grounds that it fell within the ambit of Article XX. Moreover, in every case, these trade bodies have found several reasons for dismissing the applicability of Article XX exceptions. In fact, in the *Shrimp-Turtle case*, which is taken by many as the high water mark for trade jurisprudence concerning conservation measures, the WTO's penultimate appellate body found no less than seven distinct grounds upon which to impugn US marine mammal conservation measures.<sup>24</sup> To further complicate matters, trade rulings often express inconsistent and contradictory approaches to the same issues, a problem that has even drawn stern comment from the

WTO itself.<sup>25</sup>

For these reasons we believe that the challenge of crafting water export controls to satisfy Article XX requirements would be extremely difficult if not impossible. It would not therefore be reasonable to build Canada's strategy for protecting water resources upon the premise that by dint its own ingenuity, it will succeed where all others have failed.

More to the point however, the entire exercise is moot for three reasons. The first is that, the provisions of Article XX are specifically excluded from application to the Investment and Services rules of NAFTA. These provisions are, as we have also noted, the most problematic constraints on Canada's ability to ban bulk water exports or diversion. Furthermore Article 315 (proportional sharing), also explicitly limits the application of Article XX. Finally, the wording of Article XX(g), notably that export controls be "made effective in conjunction with restrictions on domestic production and consumption," explicitly precludes the possibility of Canada imposing export restrictions to manage water resources sustainably so as to avoid the need for domestic restrictions.

### **Question 6. What would represent the most effective strategy for establishing a ban on bulk water exports or diversions from Canada?**

#### **Federal Legislation to Ban Water Exports**

The best federal approach for preventing bulk water removals from Canada is the enactment of federal legislation designed specifically for this purpose. In fact, such legislation is essential if water protection objectives are to be realized. Moreover as noted, delay in promulgating this legislation may significantly increase Canada's exposure to trade disputes, or investor claims, particularly if water export initiatives proceed in the absence of a federal statutory prohibition. This may, in turn, create *National Treatment* obligations that undermine the prerogatives of provincial governments (see Question 4).

Furthermore for reasons we have noted, no matter how carefully designed, Canadian measures to prevent bulk water exports or diversion projects would still be vulnerable to trade challenges and/or investor-state claims. However, the potential for such disputes should not be an excuse for inaction. To do otherwise would not only increase the risk of trade challenges and investor claims, but would also concede legal ground that Canada might yet successfully defend.

#### **International Initiatives**

Once water export controls are in place, the next step would be for Canada to negotiate international measures to both strengthen these domestic initiatives, and avert the risk of trade challenges and investor claims to them. First, Canada should negotiate an exclusion, exception or waiver for water export controls from the constraints imposed by NAFTA and the WTO. Second, Canada should also negotiate an international agreement concerning water that would explicitly supercede Canadian trade and investment obligations and take precedence in the event of conflicts with them.

#### **Protection from WTO Based Claims**

As we have seen, the most problematic conflicts between water export controls and Canadian trade and investment commitments arise under, and are unique to, NAFTA. While the general prohibition against export controls established by GATT Article XI is problematic, WTO rules allow the imposition of export taxes on water resources. As noted, such taxes are prohibited under NAFTA. More to the point however, because pressure on Canadian water resources is most likely to come from the US, the availability of effective safeguard measures under the WTO is of little avail in attempting to protect Canadian water resources from US claims. For these reasons, efforts to protect

water from trade agreement based claims should be firmly fixed on NAFTA.

### **Protection from NAFTA Based Claims**

As noted, the preferred option would involve negotiating a broad exception for such measures such as the general exception for National Security measures provided by NAFTA Article 2102. This would imbed in NAFTA broad protection from the various constraints imposed by this regime on Canada's ability to establish effective water export controls. Far less effective, but still of some value, would be exemptions specific to certain elements of NAFTA, such as those concerning investment and services. Given the particular problems presented by the investment and services provisions of NAFTA, addressing these aspects of NAFTA would be helpful.

### **Protection from Claims Arising under NAFTA Chapter 11**

For reasons we have discussed, particular attention must be paid to reducing the risks of investor-state claims being made in consequence of water export controls. The most effective approach would establish a blanket carve out for such measures under NAFTA, or if that isn't possible, under Chapter 11: *Investment*. There are however, two other, albeit less effective strategies, that would still represent an improvement over the status quo. The are:

- an interpretative note issued by the Commission clarifying that the definition of investment set out in the Chapter was not intended to include any claim to water; or,
- an addition to Annex 1138.2 to exclude from dispute settlement under the Chapter, federal and/or provincial legislation banning bulk water exports.

Of the two, the latter approach is more likely to be effective because it should substantially reduce the possibility of investor-state challenges to Canadian water export control measures.

### **A General Exception for Water under NAFTA**

While state-state disputes concerning water may be less likely to arise than investor-state claims, they nevertheless pose a significant risk to water export control measures and must be addressed if the integrity of those measures is to be assured. For this reason, and for the purposes of comprehensiveness, the better course to addressing potential trade conflicts on a Chapter by Chapter basis, would be to negotiate a general exception for water protection measures in accordance with the provisions of Chapter 21. In this regard the very broad exception established under Article 2102 with respect to *National Security* provides a useful prototype. To paraphrase and expand slightly upon the terms of this Article, this exception would provide that:

Nothing in this Agreement shall be construed to prevent or in any other way limit a Party from taking any action that it considers necessary for the protection or conservation of water in any form including:

- relating to the extraction or trade of water for export or by diversion; or,
- relating to the implementation of national policies or international agreements respecting the conservation or protection of water.

Furthermore, any action taken by Party in furtherance of these objectives will not be subject to the dispute settlement provisions of Section B of Chapter 11, and of Chapter 20.

The obvious advantage to such an approach is that it provides an exception for water export

measures from all provisions of NAFTA. With the usual caveat about the need for caution, we believe that if properly drafted, such a general exception would likely provide effective protection from NAFTA-based challenges to Canadian water export measures. The possibility of a US state-to-state challenge under the WTO could then be addressed by imposing an export tax on Canadian water that would effectively preclude exports. Should this course not be desirable for other policy reasons, a similar exception or carve out would need to be negotiated under the WTO.

### **An International Agreement on Water Sovereignty**

To further re-establish Canadian sovereignty with respect to water, it is also important for Canada to negotiate a bi-lateral agreement with the US concerning water conservation that would explicitly recognize the sovereign authority of both Canada and the US to ban, embargo or tax water exports, in whatever form, or mode of withdrawal. That treaty should include a clause asserting the paramountcy of its provisions should conflicts arise with other international agreements including those concerning trade, investment and services. While present discussions concerning amendments to the Boundary Water Treaties Act represent a step in this direction, the BWTA applies only to certain Canadian waters, does not engender a meaningful enforcement regime and would not prevail should conflicts arise with NAFTA or WTO rules.<sup>26</sup>

### **In Conclusion**

Unfortunately the course of action that prudence dictates Canada take to protect its water resources from unconstrained export demands, stands in sharp contrast to the approach adopted by the Federal government.

It is discouraging that the federal government appears willing to abandon its responsibilities to steward Canadian water resources rather than seek amendments to the trade agreements that it now concedes drastically limit its options to do so. Instead it is attempting to finesse those trade constraints by adopting a strategy that is very unlikely to survive a trade challenge of foreign investor claim.

We hope this opinion will shed greater light on the nature of the constitutional and trade considerations that should guide the development of Canadian policy and law concerning the export of Canadian water resources.

## **Endnotes**

1. The GATT forms the substructure for many WTO Agreements (e.g. services and investment) and is adopted in its entirety by Article 309 of NAFTA.
2. GATT, Analytical Index: Guide to Law and Practice, Updated 6th Edition (1995) pp. 315-354. And see WTO Appellate Body decisions in; United States – Standards for Reformulated and Conventional Gasoline, WTO Doc. WT/DSR/R (Jan. 29, 1996), 35 I.L.M. 274; and see United States – Import Prohibition of Certain Shrimp and Shrimp Products, AB-1998-4 (the Shrimp-Turtle case).
3. Canada -- Measures Affecting Exports of Unprocessed Herring and Salmon, L/6268, adopted March 1988, 35S/98.

4. In the Matter of Canada's Landing Requirement for Pacific Coast Salmon and Herring, October 16, 1989.
5. See NAFTA Articles 302: Tariff Elimination, 309.2 Import and Export Restrictions and Article 314: Export Taxes.
6. We do not believe that permanent water export control measures can plausibly be brought within the ambit of Article XI.2 which vitiates the application of subparagraph 1.
7. The National Treatment requirements of Article III of GATT are restricted in their application to import measures only. Article 301 of NAFTA adopts this provision by reference. However Annex 301.3: Exceptions to Articles 301 and 309, specifically excepts export controls on such products as logs and fish. This suggests that unlike the GATT, under NAFTA National Treatment applies to exports as well.
8. Section C, Article 1139: Definitions.
9. Unpublished, *Options Paper for Canadian Council of Ministers of the Environment*, discussing various options for the Minister's CCME meeting, May 19-20, 1999 – see discussion of International Trade Considerations, attached.
10. See for example J. Owen Saunders, *Trade and the Defence of Non-economic Values: The 11. Regulation of Water Exports*, in *Trading Canada's Natural Resources*, Saunders, ed. Banff Conference on Natural Resources Law (3rd: 1987 Banff, Alberta), 1987.
12. Under Article 1122, Canada offers unilateral consent to binding arbitration in all cases where a foreign investor satisfies the very modest prerequisites for initiating such extra-ordinary procedures.
13. *Supra*, footnote 9.
14. See *Sporhase v. Nebraska*, 458 U.S. 941 (1982); and, *City of El Paso v. Reynolds*, 563 F. Supp. 379 (D.N.M. 1983)
15. Report to the Council of Great Lakes Governors: *Governing the Withdrawal of Water from the Great Lakes*, Lohead, Asarch, Barutski, Monahan, Taylor, and Schenkkan, May 18, 1999.
16. See, *Commission v. Italy*, Case 7/68) and *Commission v. Ireland Re Dundalk Water Supply* (Case 45/87).
17. In British Columbia for example, as of 1993, approximately 40,000 licenses for the withdrawal of surface water were in existence in the province, and many provincial water sources are identified by the BC Ministry of Environment as being over-taxed. In the Great Lakes, the largest single use of water is for the very commercial purpose of generating hydroelectric power and is estimated to exceed one trillion gallons per day. In Ontario, millions of litres of water are withdrawn from groundwater aquifers by commercial water bottling companies, each day.
18. See *NAFTA and Water Exports*, the Canadian Environmental Law Association, 1993, and references cited therein.
19. A 1995 Memorandum by the Assistant Legal Adviser for Treaty Affairs, US State Department.
20. See press statement issued by the Office of the United States Trade Representative, December 2, 1993. Referring to the 1993 statement and others the USTR states: "None of these statements change

the NAFTA in any way"

21. Supra footnote # 2.

22. In the case of certain northern waters, the federal government has direct proprietary interest. The federal government also has extensive constitutional authority to legislate with respect to the use of water for navigation purposes (s. 91(10)) and for fisheries (s. 91(12)) of the Constitution Act. For present purposes the federal government's trade and commerce powers 91(2), and its jurisdiction with respect to works and undertakings extending beyond the limits of the provinces 91(29) and 92(10)(a) are of particular relevance.

23. A Canada-Wide Accord on Environmental Harmonization, the Canadian Council of Ministers of the Environment, January 1998. Section 6 Administration.

24. Supra, footnote 9.

25. See The US Shrimp Turtle Appellate Body Report, in Bridges which is published by the International Centre for Trade and Development, November-December 1998.

26. Supra, footnote 2.

27. Under NAFTA Article 104 and Annex 104 certain international and bilateral agreements are accorded certain protections from the full application of trade disciplines - the BWTA is not listed among them.

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