

April 10, 2012

Mr. Paul Moist
National President
Canadian Union of Public Employees
1375 St. Laurent
Ottawa, Ontario
K1G 0Z7

Dear Mr. Moist:

**Re: Canada-European Union: Comprehensive
Economic and Trade Agreement (CETA)**

SUMMARY:

You have asked for our assessment of the reservations (exceptions) Canada has proposed in regard to the services and investment rules of the Canada-EU CETA.

Given the far-reaching and serious consequences of this proposed international agreement, it is best to use plain terms to describe its effects. Our key conclusions are that:

1. CETA represents a dramatic expansion of the application of international rules to spheres of provincial and local governance that have never before been subject to the constraints on public policy and law international trade regimes impose. While CETA rules are similar to those of NAFTA and the GATS, they will have far broader application because Canada proposes to abandon most of the reservations (exceptions or safeguards) that have until now sheltered sub-national governments from the full application of such international rules.
2. Because provincial governments have primary jurisdiction under s.92 (13) of the Canadian Constitution to regulate investment in and the provision of public services - from drinking water treatment and delivery to health care – CETA would effectively expand federal authority into this sphere of provincial authority. Thus, under CETA, provinces would no longer be able to exercise their respective mandates without having to operate within the strict policy and regulatory boundaries of an international treaty



they have no authority to amend. The right to amend CETA is exclusively a federal prerogative which may be exercised whether supported by the provinces or not.

3. A related quasi-constitutional consequence of CETA arises from the very disparate approach the provinces have adopted to reserving their policy and regulatory options. For example, some provinces are seeking to preserve their right to promote renewable power, maintain supply management for agricultural commodities, or establish water conservation measures – many others are not. The result would fragment Canada’s constitutional landscape by creating ‘have’ and ‘have-not’ provinces, where the scarce resource will be the capacity to govern.
4. In terms of tri-lateral trade relations with the US and Mexico, CETA may be seen as a form of unilateral disarmament. This is because under NAFTA, and with few exceptions, Canada is obliged to provide *Most-Favoured-Nation (MFN)* treatment to US and Mexican investors and service providers. With CETA, Canada is proposing to accord EU investors and services providers far more expansive rights than those accorded their US and Mexican counterparts. Canada would therefore be required to provide this ‘most-favoured’ treatment to its NAFTA partners, even though neither is making reciprocal commitments.
5. The reservations proposed by the EU are far more robust and extensive than those put forward by Canada. Thus, the EU is seeking to preserve much greater scope for measures that would otherwise violate CETA constraints, such as standards for: child care services; the maintenance of public sector water and energy monopolies; or environmental protection. For this purpose, the EU has, for example, put forward broad reservations for public services, monopolies, and regulations concerning water, health care, education, energy and many other services. For most of these services and entities, Canada has proposed no reservations whatsoever. For many others its proposals are perfunctory.
6. Among the specific deficiencies of Canada’s present proposed reservations is their failure to exempt key areas of public policy and law, including those necessary to:
 - (i) regulate health care services when these are provided on a commercial basis or in competition with other service providers. In the Canadian context these would include services provided by physicians, private clinics, ambulances, home and long-term care providers, and health insurance companies;
 - (ii) regulate early learning and child care services provided on a commercial basis, including regulations to limit the number of such facilities, mandate local control, and ensure that staff are properly qualified;
 - (iii) establish and maintain public monopolies for such diverse enterprises as electricity transmission and distribution, scientific and technical consulting, and certain environmental services;

- (iv) maintain public control of water services and water resources; or to
 - (v) protect the environment in regard to manufacturing, industrial activities, and land use.
7. Local government measures, including those of related entities, from school boards to municipal utilities, are grandfathered under CETA. But Canada has stipulated that this exemption “will be subject to the ratchet mechanism”, which precludes new initiatives or reform to current measures that would limit, even incrementally, the rights of foreign investors and services providers.

These examples, which are described in more detail below, do not represent a comprehensive list of the consequences of Canada’s present proposals. Rather, they illustrate the problems with an approach that appears to reflect a willingness to make sweeping concessions to favour EU-based companies, without expecting much in return.

Given the patent deficiency of Canada’s proposals, and in light of the EU’s unwillingness to similarly abandon its domestic policy and regulatory prerogatives, it would be prudent for provincial and territorial governments to reconsider their support for Canada’s list of proposed reservations. One should be mindful in this regard of the federal government’s commitment to de-regulation and privatization. It may, for this reason, regard CETA, which embodies these policies, as a useful means for entrenching them and be less concerned about ensuring a reasonable balance of benefits.

It is critical then for provincial and territorial governments to appreciate that CETA proposals represent a sea-change that would, if implemented, have a pervasive, unprecedented and constraining influence on provincial and territorial government authority. It is unfortunate therefore that many provinces and territories have reserved few areas of public policy and law from the full application of CETA rules. Moreover, and as noted, the disparities among provincial and territorial proposals would fundamentally transform and fragment the Canadian constitutional landscape. For as more than one international law expert has pointed out (Schwartz, Schneiderman), the pervasive influence and virtually permanent character of international investment and services rules are akin to quasi-constitutional constraints on the exercise of government authority.

It is important, therefore, that there is time for provincial and territorial governments to reconsider their present course. In this regard, Canada has stipulated a number of conditions to its offer, including that:

It obtain a satisfactory offer from the EU representing an appropriate balance of market openness relative to Canada’s offer with respect to the scope of non-conforming measures listed in Annex I and II.

As noted, a comparison of EU and Canadian proposals indicates that this is clearly not the case. Moreover, of the two approaches, the EU’s is far better at preserving the capacity of governments to govern in the public interest.

Given the clearly discernible and overwhelmingly adverse consequences that CETA will have for the governance capacity of provincial, territorial and local governments, it would be judicious for provincial and territorial governments to withhold their support for this federal initiative until a thorough and public assessment of its risks, costs and benefits might be carried out.

Finally by way of introduction, we should note that the following assessment is based on documents which we understand to have been leaked. The Canadian proposals described below are dated October 12, 2011, and those of the EU, dated February 28, 2012. It is unfortunate that an international agreement of such far-reaching and virtually permanent effect has so far proceeded without an opportunity for informed public discussion or debate.

PART I: THE IMPORTANCE OF CETA RESERVATIONS

The Impact of Inadequate Reservations for Provincial and Territorial Measures

As many know, the advent of international ‘trade rules’ concerning investment and services has seriously limited the domestic policy and regulatory prerogatives of governments that affect investment and services, and the vast majority of provincial and territorial measures do so. The extent to which these international regimes constrain government action is a consequence of i) the rules themselves, and ii) the extent to which government measures have been made exempt (reserved) from them. While the investment and services rules of NAFTA and the GATS are broadly framed, for the most part, pre-existing provincial, territorial and municipal government actions have largely been exempted from having to comply with them.

CETA rules concerning investment, services and procurement are much like those set out under NAFTA and the GATS. However, under CETA the reservations of NAFTA and the GATS are to be dramatically reduced in scope, or simply eliminated. In consequence, the policy and regulatory options of provincial, territorial and municipal governments will be curtailed to a much greater extent than has been the case under these earlier free trade agreements. This is most obvious with respect to international rules concerning procurement, which until now have not applied to sub-national governments. But it is also the case for many other areas of provincial and territorial policy and law.

This expansion of the application of international services and investment rules is accomplished by making CETA provisions applicable to virtually all sub-national government measures unless those measures are explicitly reserved. The ‘top-down’ application of CETA rules inverts the approach under the GATS, which limited the application of key provisions of that agreement to service sectors that were explicitly committed (volunteered) by the federal government with provincial and territorial governments being afforded the further opportunity to exempt measures or sub-sectors to limit the application of GATS rules in covered service sectors.

In the case of NAFTA, all existing measures of sub-national governments were reserved for as long as they would be maintained. Under CETA, the vast majority of such measures must now

comply with CETA rules because relatively few reservations have been taken for them. In other words, the top-down approach to listing reservations for provincial and territorial measures represents a dramatic reduction of the scope of protection afforded to such measures under NAFTA and the GATS. Moreover, NAFTA *MFN* rules oblige Canada to accord the US and Mexican investors and service companies the same preferential treatment that is now to be offered to their European counterparts, even though neither of Canada's southern neighbours is making any reciprocal concession.

The following assessment considers the reservations proposed by Canada and the EU respectively. These fall into two categories. The first – under Annex II - preserves the future prerogatives of government with respect to the particular sector in question. These reservations are described as “unbound” because they leave governments free to adopt and formulate policy and law that may restrict the rights accorded foreign companies and investors. The other category, set out in Annex I, are reservations that are “bound” because they exempt existing measures only if these are maintained to preserve that status, and prohibit amendments that decrease their conformity with CETA requirements. In other word, reform of Annex I measures is a one-way street leading towards greater liberalization, a process characterized as the “ratchet effect” in the terminology of international trade law.

The Disparity Between EU and Canadian Proposed Reservations

A comparison of Canadian and EU proposed reservations reveals the latter to be far more inclusive. For example, the EU is proposing broad Annex II reservations for all public services; public monopolies whether commercial or otherwise (such as urban transit); news services; water distribution for “household, industrial, commercial and other users”; supply services for “all commercial and industrial workers, nursing and other personnel”; research and development in virtually all sectors; retail pharmaceutical sales; education services at the primary, secondary, higher and adult education levels; health care and social services; financial services; energy distribution services (such as pipelines and transmission systems); and several others.

In most of these service areas, Canada has proposed no reservations, and in others its proposals are perfunctory compared to those delineated by the EU. While one may expect some divergence between the proposals of Canada and the EU, the differences here are stark, and it is also remarkable that Canada's opening position is simply to effectively abandon broad areas of public policy and law that the EU has indicated it has no intention of giving up.

It is beyond the scope of this assessment to provide a point by point comparison of these divergent proposals, but the following analysis provides several examples of how much more willing Canada has been to abandon its right to fashion government measures to meet the challenges ahead.

The Unreciprocated Expansion of NAFTA Investor Rights

Another highly problematic aspect of present CETA proposals is a consequence of Canada's *Most-Favoured-Nation (MFN)* obligations under existing trade agreements. We use NAFTA

MFN provisions to illustrate the problem, but similar commitments have been made by Canada in other international trade agreements.

In this regard: NAFTA **Article 1103: *Most-Favored-Nation Treatment***, provides:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

NAFTA Article 1103 which concerns investment, is replicated by NAFTA Article 1203, which concerns services.

In the vernacular, the *MFN* treatment rule is simply translated as: favour one, favour all. Thus the *MFN* rule means treating one's trading partners equally according to the principle of non-discrimination.

Therefore under NAFTA, and unless a reservation was taken in that trade agreement from the *MFN* obligation, US and Mexican investors and service providers are entitled to the most favourable treatment Canada may accord their counterparts in other nations, including under any future trade agreement such as CETA. Moreover, NAFTA investors and service providers are entitled to the benefits of *MFN* even though the US and Mexico are not, as is true in the present case, making any reciprocal commitments.

Thus by greatly expanding the rights of EU investors and service providers under CETA, their US and Mexican counterparts are entitled to the same benefits. Because Canadian NAFTA *MFN* reservations are very limited in scope, CETA may be seen as a unilateral and asymmetrical expansion of NAFTA investment and services rules for the exclusive benefit of investors and service providers from the US and Mexico.

In other words, the US and Mexico are entitled to many of the benefits of CETA, which Canada has billed as breaking new ground on the landscape of trade liberalization, without having to accord Canadian investors and service providers similar rights.

The corollary of this situation is that unless an *MFN* reservation is taken under CETA, Canada will encounter the same problem should it enter into future free trade agreements that further expand the application of international investment and services rules. However, as is the case under NAFTA, Canada has proposed only a limited number of *MFN* reservations.

For the most part, the EU is to be accorded the highest standard of treatment provided domestic investors and service providers (under *National Treatment*) and foreign investors and service providers (*MFN*). One would expect Canada to consider whether making such a commitment is warranted given what it expects to gain under CETA. However, the very lopsided nature of the proposed trade regime, illustrated by the asymmetrical proposals for reservations the EU and Canada have advanced, should raise serious questions about the trade-offs Canada appears to be willing to make to conclude CETA negotiations.

PART II: THE IMPACT OF CETA RULES ON PUBLIC SERVICES

Public Transit, Electricity Systems, Alcohol Sales, and other Public Sector Monopolies

The *Market Access* disciplines of proposed CETA investment and services disciplines preclude government measures that establish public sector service monopolies such as health care insurance and public transit. In some cases, such services are provided on a universal basis and not on a commercial basis or in competition with other service providers, to use the terminology of the GATS reservation. Public health care insurance in Canada is an example of such a service, and provincial and territorial laws typically prohibit private sector insurance companies from providing coverage for insured services within the meaning of the *Canada Health Act*. Such restrictions are clearly incompatible with the *Market Access* rule, and therefore must be protected to be maintained (see discussion below).

In other areas, governments have authorized monopoly service providers that operate on a commercial basis or in competition with other service providers, such as public transit, electricity transmission and distribution, liquor and beer sales, and postal services. These measures too offend the *Market Access* requirement and must therefore be reserved if such monopolies are to endure.

As is true for most areas, the deficiencies of Canadian proposals are readily apparent when compared with those nominated by the EU. We will deal with health and education services below, but consider the situation of public monopolies or quasi-monopolies that are provided on a commercial basis and in competition with other service providers.

The EU has explicitly reserved such measures from *Market Access* under Annex II, thus preserving not only current, but also future policy and regulatory options.

Public utilities exist in sectors such as related scientific and technical consulting services, R&D services on social sciences and humanities, technical testing and analysis services, environmental services, transport services and services auxiliary to all modes of transport. Exclusive rights on such services are often granted to private operators, for instance operators with concessions from public authorities, subject to specific service obligations. Given that public utilities often also exist at the sub-central level, detailed and exhaustive sector-specific scheduling is not practical. This reservation does not apply to telecommunications and to computer and related services. [emphasis added]

Canada has proposed no matching or equivalent reservation, and has nominated only a very small number of such public monopolies under Annex II (e.g. agricultural product marketing). One noteworthy example is postal services which the EU has reserved under Annex II, while Canada's reservation is listed to Annex I. Thus, while the EU has preserved its right to have postal services evolve with the times to meet new challenges and opportunities in the rapidly evolving world of providing postal, courier and related services – Canada has not.

It is important here to note the caution stipulated by the EU reservation, namely that because “*public utilities often also exist at the sub-central level, detailed and exhaustive sector-specific scheduling is not practical*”, hence the rationale for reserving for such utilities and monopolies at the community-wide, or in Canada, national level. Yet precisely the opposite approach has been adopted by Canada, which has put provincial and territorial governments to the ‘impractical’ task of having to identify every public utility that it wishes to save harmless from the application of CETA disciplines.

Another obvious problem with this approach is that it leaves future provincial and territorial government prerogatives entirely at the mercy of the current government, which may now impose its policies on all future governments elected in that province or territory. The very disparate views the provinces and territories have on these issues is readily apparent when one compares their respective proposals for Annex II reservations.

Thus Manitoba has proposed a broad *Market Access* reservation for “agriculture, food, liquor, wine and beer retail trade, fishing, insurance, forestry, energy, and recreational services” which is stated as follows:

Manitoba reserves the right to adopt or maintain any measure limiting market access for services, service providers, investments or investors relating to any of the activities or subsectors noted above.

By comparison, New Brunswick has reserved under *Market Access* only the marketing of agricultural products and gambling services.

Other examples of the disparate approaches adopted by the provinces abound. For example, only a minority of provinces and territories have proposed an Annex II reservation for their electricity system. No province or territory has reserved public transit. Only Ontario has reserved renewable energy under Annex II and has attempted to do so not only for *Market Access*, but for *National Treatment*, *MFN*, *Performance Requirements*, and *Senior Management and Board of Directors*.

Ontario's case provides a cautionary tale concerning the risks of failing to establish Annex II reservations in areas of public policy and law where changing technology, environmental imperatives, or social needs require governments to pursue initiatives that may not have been foreseen. Unfortunately Ontario's failure to preserve its options under WTO or NAFTA¹ rules

¹ *Mesa Power Group LLC v. Government of Canada*: On July 6, 2011, Mesa Power Group LLC, an American-based company, served the Government of Canada with a Notice of Intent to Submit a Claim to Arbitration under

have resulted in it having to defend *Green Energy Act* measures from attack under both NAFTA and WTO rules².

It is easy enough to imagine governments having to respond to new challenges with respect to urban transit, energy, environmental services, and many other areas where the role of government is essential if societal goals are to be achieved. Yet neither Canada nor most provinces or territories have taken the steps necessary to preserve the capacity of governments to respond to future challenges. In some cases this failure no doubt reflects an ideological commitment to reducing the role of government; in others it may simply be a casualty of the “impractical” demand of having to foresee problems and opportunities that have not yet emerged in diverse areas of public policy and law. In both cases the result is the same, and will effectively disenfranchise Canadians who may wish to mandate governments to pursue initiatives that transgress the broad constraints of CETA investment and services rules.

But as noted in the introduction to this assessment, the most problematic aspect of the present process is that it represents a form of quasi-constitutional reform in which the prerogatives of provincial and territorial governments are to vary dramatically. Certainly provinces and territories may adopt unique approaches to the exercise of their constitutional authority, but it would be unthinkable to amend the *Constitution Act* to differentiate the scope of constitutional power allowed provincial and territorial governments. Yet given the very different reservations proposed by the provinces and territories, this is to be precisely the result under CETA. Thus some provinces and territories would have the right to establish supply management for agricultural commodities, or publicly owned electricity transmission or water distribution monopolies, or renewable energy programs – but other provinces and territories would not.

The question of whether such commitments by the provinces and territories are permitted under the Canadian Constitution is one in our view that bears further consideration.

Health Care Services

No area of public policy and law is more reflective of Canadian values, and more central to meeting societal needs, than Medicare. Public health care is Canada’s largest social program, its biggest public expenditure, and an important aid to international competitiveness. However, it is common ground that there is a fundamental incompatibility between Canada’s health care policies and the principles of trade liberalization. By establishing a public sector health insurance monopoly and by regulating who can provide health care services and on what terms, the provisions of the *Canada Health Act* fundamentally cut against the grain of ‘free trade’.

NAFTA Chapter 11. Mesa Power Group’s complaint concerns measures taken by the Government of Ontario, as they relate to the Feed-in Tariff (FIT) program enabled by the *Green Energy and Green Economy Act*.
<http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/mesa.aspx?lang=eng&view=d>

² Canada — Certain Measures Affecting the Renewable Energy Generation Sector; http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds412_e.htm. Japan has claimed that the measures are inconsistent with Canada's obligations under Article III:4 and III:5 of the GATT 1994. The EU and the US have since joined the case to support Japan.

Where trade agreements seek to open markets to all investors and to all providers of goods and services, under Medicare, health insurance plans must be publicly administered on a not-for-profit basis. Where trade rules, at least ostensibly, aim to foster competition in domestic and international economies, the *Canada Health Act* requires provinces and territories to restrict the rights of private investors and service providers in order to maintain a health care system based on the five principles of public administration, comprehensiveness, universality, portability and accessibility.

These contradictions explain why Canada declared certain safeguards under NAFTA and WTO rules to shield Canadian health care measures from the application of incompatible trade rules. However the scope and effectiveness of this reservation is debated, and very different views on the matter have been expressed by experts (Flood, Schwartz, Johnson), including those of this author in a report commissioned by the Romanow Commission.

Nevertheless, given the opportunity to clarify its position in setting out its reservation for health care services under CETA, Canada has declined to do so. Instead, it has simply reproduced the reservation first formulated in NAFTA in 1993. Thus Canada has proposed the following reservation from *National Treatment, MFN, Senior Management and Boards of Directors* and *Market Access* rules in regard to Cross-Border Trade in Services and Investment under CETA:

Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care. [emphasis added]

There are several problems with this formulation, not the least of which is that Medicare is a public insurance plan, in which health services are often provided on a commercial, albeit regulated basis by physicians, investor owned clinics, and other private institutions. The US has long held the view that this reservation only applies to services similar to those provided by a government and does not apply to services provided by a private company whether on a profit or not-for-profit basis (Kantor 1996).

Apparently mindful of this view, the EU has proposed a reservation for health care services that is far more explicit about the nature of the measures it intends to protect. Thus, with respect to *Foreign Investment*, the EU Annex II reservation from *Market Access, National Treatment, Performance Requirements* and *Senior Management and Boards of Directors*, provides as follows:

The EU reserves the right to adopt or maintain any measure with regard to the provision of health services other than hospital, ambulance or residential health services which are privately funded.

Participation of private operators in the health system is subject to concession. An economic needs test may apply. Main criteria: number of and impact on existing establishments, transport infrastructure, population density, geographic spread, and creation of new employment.

Several member states reserve the right to adopt or maintain any measure with respect to the provision of privately funded hospital, ambulance or residential health services.

With respect to *Cross-Border Services* the EU has reserved the right to:

- *adopt or maintain any measure requiring the establishment of suppliers of health services.*
- *to restrict public funding granted to an EU consumer in relation to the provision of health or social services which are provided outside the territory of the EU.*

The EU also explicitly defines health services to include:

services provided by health professionals to patients to assess, maintain or restore their state of health, where those activities are reserved to a regulated health profession in the Member State in which the services are provided, whether or not provided via health care facilities.

Once again the deficiencies of Canada's approach are readily apparent and would greatly diminish the capacity of provincial and territorial governments to regulate or control the costs of their health care insurance systems. Moreover, by putting forward such a perfunctory reservation for health services "to the extent they are social services established or maintained for a public purpose" Canada would leave the scope of this ill-defined reservation at the mercy of whatever interpretation an international trade or investment tribunal might choose to lend it. Given the consequences, which have the potential to fundamentally undermine the viability of the Medicare model, Canada's failure to define this reservation with more precision must be considered reckless.

Public Hospitals and Private Clinics

It is also important to note the failure of Canada to reserve its right to license and regulate hospitals and private clinics. Public hospitals are largely private institutions operating on a not-for-profit basis. Clinics are typically investor-owned enterprises operating on a for-profit and commercial basis, and such health care facilities are proliferating in many provinces. A growing number of these clinics provide necessary health care services on a privately funded basis, often co-mingling those services with those funded under provincial and territorial health care insurance plans. As noted, the EU has explicitly reserved its right to regulate publicly funded hospitals, clinics, ambulance and home care services on a community wide basis, and several EU members have also reserved their right to do so with respect to such services when privately funded. Canada has done neither.

Nevertheless, it is likely that Canada's health reservation would preserve and allow for progressive reform of public hospital regulation because the services provided by such institutions are at the very core of the Canada's health care system. However it is equally probable that its health reservation would not encompass the licensing or regulation of investor-owned clinics, certainly not those providing health care services that are wholly or partially privately funded. Therefore measures by a province or territory to limit the proliferation of such clinics or the character or volume of health care services they may provide would violate *Market Access*. Measures that favour the delivery of necessary health care services in public hospitals would almost certainly offend the requirement for *National Treatment*. Similar issues arise with respect to ambulance and home services, which again are largely reserved by EU but not Canadian proposals.

In simple terms, the patent deficiency of Canada's reservation for health care services clearly exposes provincial and territorial measures that are necessary to the ongoing viability of their health care insurance plans to the risk of both trade challenges and foreign investor claims. In effect, Canada is playing Russian roulette with its most important social program.

In our view, Canada's perfunctory health reservation is clearly insufficient to preserve provincial and territorial policy and regulatory options with respect to their Medicare regimes. Yet the provinces are gambling the future of their health care systems on the bet that Canada's reservation will be effective, for unlike their EU counterparts, not one province or territory has reserved any health care measure under either Annex I or II.

If the risks of this approach were unclear to provincial and territorial governments, the more explicit and detailed nature of the EU reservation for health care services should disabuse them of confidence in Canada's approach, and persuade them to insist that Canada revise its proposals to bring them in line with those of the EU.

Education, Early Learning and Child Care Services

Canada's Annex II reservation for education services is identical to its proposal for health services (as set out above) and once again is far less comprehensive than the EU's. However, unlike health care services, primary and secondary education services are predominantly provided by publicly funded and not-for-profit institutions, and so to this extent are more likely to be considered "*social services established or maintained for a public purpose*".

In contrast to their approach to health care, the provinces and territories have proposed Annex I reservations for a variety of measures relating to the provision of privately funded education services. As is the case for other provincial and territorial reservations, the approach adopted by the provinces and territories varies considerably.

Also problematic is the failure of either level of government to reserve measures relating to early learning and child care services where for-profit services abound, including those provided by a growing number of international child care companies.

As we have seen, it is very unlikely that Canada's social services reservation would apply to measures concerning for-profit and private providers of child care services.

Therefore efforts to regulate the number or location of child care facilities are likely to offend the *Market Access* requirement. Measures that favoured, either directly or indirectly, publicly funded not-for-profit service providers would likely fail the *National Treatment* test. Regulations requiring some measure of community control would be difficult to reconcile with restrictions imposed by the *Senior Management and Boards of Directors* rule. Finally, and perhaps most importantly: facility, safety and staff training standards may be assailed as violating the prohibition on *Performance Requirements*. Many, but not all provinces and territories have such measures in place, yet none have proposed an Annex I reservation to provide shelter for them. Moreover, as community needs evolve there are good reasons for governments to preserve their policy and regulatory options to address them by insisting on an Annex II reservation for that purpose.

Accordingly, the prudent course for provincial and territorial governments would be to insist that Canada amend its proposed Annex II child care reservation to include i) measures related to private and for-profit child care service providers; and ii) measures concerning privately funded education services other than primary, secondary, higher and adult education services, as has the EU.

Water Related Reservations

One of the more stark contrasts between proposed EU and Canadian reservations concerns water. The EU has put forward a broad *Market Access* and *National Treatment* reservation for water collection, purification and distribution services as follows:

The EU reserves the right to adopt or maintain any measure at any level of government with respect to services relating to the collection, purification and distribution of water to household, industrial, commercial or other users, including the provision of drinking water, and water management. This reservation does not apply to the treatment of wastewater.

In contrast, Canada has proposed no reservation for water services, and only the Yukon has proposed any water – related reservation and that only in regard to energy development and distribution systems.

Public Ownership and Control of Water Services

The failure of Canadian governments to reserve drinking water treatment and distribution systems, as has the EU, would impose significant constraints on the ability of Canadian governments to maintain public control of this essential service. While local government measures are grandfathered under CETA, provincial and territorial measures related to water distribution are not, and provincial and territorial governments or utilities often provide water services to local communities.

Moreover, the mandate of local governments to establish and operate water utilities is one accorded under provincial and territorial law, and these are subject to CETA disciplines. In addition, water management, which is again explicitly reserved by the EU, is predominantly a provincial and territorial responsibility in Canada. For these and other reasons, grandfathering local government measures related to the establishment and operation of municipal water utilities is by no means an adequate or proper safeguard of public control of water or water services. We address broader questions concerning public control of water resources, and measures to protect and conserve water, below.

However in addition to these issues, the ability of governments to maintain public control of drinking water treatment and distribution services is clearly also at risk under CETA proposals. This is because efforts to maintain public utilities, where these operate as monopolies, would arguably offend the requirement of *Market Access*. Where water systems are privatized, efforts to establish water standards or water rates have been challenged as infringing investor rights under international investment rules very much like those proposed for CETA . Development approval requirements concerning the costs of establishing and operating water service infrastructure may be assailed as offending *National Treatment* on the grounds that these are more onerous than those required of other developers. Finally, attempts by governments to reward domestic innovation in providing water services may be challenged for offending the prohibition against establishing *Performance Requirements*.

It would be necessary for any government wishing to preserve the right to maintain publicly owned and regulated water services to follow the EU lead and reserve their rights to do so.

The Only Provincial and Territorial Water-Related Reservations Concern Energy Projects

Moreover, with only a few narrow exceptions, the provinces and territories have done nothing to preserve their dominion over water as a natural resource or a public trust, or to protect their rights to regulate water use in the public interest.

Thus only three provinces and territories have water-related reservations, and these concern the use of water for power generation purposes. For example, Newfoundland and Labrador has reserved measures taken under the *Water Resources Act* but this reservation only concerns the use of water for power generation purposes such as measures that:

provide for the granting of the lands or waters within the domain of the Province for any good, source or force of energy from which it is possible to produce electricity, including but not limited to the installation of wind turbines and hydroelectric developments;

and goes on to illustrate the types of regulation being reserved:

Without limiting the generality of the foregoing, such measures may involve discretionary decisions based on various factors, limitations on investment or market access, imposition of performance requirements and/or discrimination in favour of Newfoundland and Labrador persons, investors and service providers.

Nova Scotia and Québec have proposed similar reservations. However, Québec’s reservation is significantly broader, and importantly includes the right to prohibit electricity exports as a condition of licensing hydro-electric and other forms of power generation (see discussion of the AbitibiBowater case below). Its reservation is stated this way:

Every lease, sale or grant of water powers which belong to Québec or in which it has rights of ownership or other rights and every contract, permit, or grant authorizing the installation or the passage of transmission lines in or over or the construction of a wind farm on the domain of the State shall contain a clause prohibiting the exportation of electric power from Québec. The Government may nevertheless authorize, by order, on the conditions and in the cases it determines, any contract for the exportation of electric power from Québec.

Only the Yukon Proposes to Reserve Rights to Regulate the Use of and Protect Water

Only the Yukon has nominated a reservation (Annex I) to preserve its policy and regulatory options in regard to water. Its reservation is for a sector it defines as “Ores and minerals; electricity, gas and water” and for the “Sub-Sector: Water”. It is to reserve from *National Treatment, Most-Favoured- Nation Treatment, Performance Requirements, Senior Management and Boards of Directors*.³ The Yukon government specifically reserves the following measures under the *Waters Act*:

The Minister is allowed to give policy direction to the Yukon Water Board in respect of any of the board’s functions, including the issuance of licences for water use; and

the requirement for a licence issued by the Yukon Water Board for most commercial and industrial uses of water, and most deposits of waste into water.

The Yukon government is also unique in reserving its right to “establish, amend or revoke a resource management plan” and to “establish, amend or revoke a water management plan.” (ss.66 and 70 of the *Environment Act*).

In sum, with only these qualified and limited exceptions, Canadian provinces and territories are apparently willing to expose all current and future measures relating to the management, allocation, protection, and conservation of Canadian waters to challenge for non-compliance with the very broadly framed constraints of CETA investment and services rules.

The failure of the provinces and territories to do so is particularly problematic in light of Canada’s recent settlement of a claim that challenged the right of government to maintain public ownership of water resources and to ensure that such resources are used in a manner that produces a public benefit for Canadians.

³ Statutes reserved include the *Waters Act*, RSY 2002, c.19; the *Environment Act*, s. 66-70; and the *Yukon Environmental and Socio-Economic Assessment Act*.

The *AbitibiBowater* case so clearly illustrates the pitfalls of failing to reserve the right to regulate water use that it is worth describing in some detail.

Establishing Propriety Rights to Water: *AbitibiBowater v. Canada*

In 2010, AbitibiBowater brought a claim against Canada under the investor state suit provisions of NAFTA, seeking \$500 million in compensation on account of Newfoundland and Labrador legislation that expropriated the company's assets in a paper mill and related hydro power plant, and providing for the reversion of its water and timber rights to the province as the owner of those resources. That legislation allowed for, but did not commit Newfoundland and Labrador to paying compensation for the rights, lands and assets being reclaimed or expropriated from the company.

It is clear that Newfoundland and Labrador was expropriating certain private property owned or leased by AbitibiBowater, including its mill, but under Canadian law the company had no proprietary interest in provincial water and forest resources, only a permit to use them for certain purposes. The water and forest lands at issue were not deeded to the company, and its right to maintain or transfer them were subject to provincial law. Typically, provincial statutes authorizing water taking permits and forest licenses allow the province to impose conditions on those grants and authorize the responsible Minister to rescind licenses where it is in the public interest to do so.

As for expropriation, Canadian governments are entitled to take private property to achieve a public purpose, such as highway construction. Unlike the United States, private property is not protected under the Constitution, and the proposal that Canada follow the US model was rejected when the Constitution was repatriated in 1982. In the case of expropriation, governments are free to determine the extent to which compensation will be paid for expropriated property. Proposed CETA investment rules would negate this prerogative. Thus the CETA rule on *Expropriation and Compensation* provides in part that:

A Contracting Party shall not expropriate ... an investment in its territory of an investor of another Contracting Party except ... accompanied by payment of prompt, adequate and effective compensation ... equivalent to the fair market value of the expropriated investment ...

In other words, under CETA (and NAFTA), foreign investors have an unqualified right to compensation when governments expropriate their property, and that compensation must reflect the fair market value of the property at issue.

This explains why AbitibiBowater filed an arbitration claim under NAFTA investment rules rather than seeking recourse in the Canadian courts. However, in addition to claiming compensation for the physical assets taken by the province, the company also claimed

compensation for the expropriation of specific “Water and Waterpower Rights”⁴ and of certain “Timber Rights and Rights to Land”.⁵

Rather than defend Newfoundland and Labrador’s right to determine the use of such public resources, the federal government agreed to settle the company’s claim for \$130 million. Importantly, the terms of settlement reveal that Canada made no effort to exclude claims made on account of the loss of its water and Crown timber rights. It will now be necessary for any government facing a similar claim to argue that Canada did not, in settling the AbitibiBowater claim, create a *National Treatment* standard that must be accorded other foreign investors.

The seriousness of the precedent created by the *AbitibiBowater* case is obvious. Yet as noted, only a handful of provinces and territories have taken steps to reserve their rights to regulate the use of water resources for energy generation purposes. Alberta is among those that have not, which means that any attempt to curtail access to, or restrict the use of provincial water resources for the purposes of oil sands production, for example, could readily be challenged for offending *Market Access*, *National Treatment*, or *Expropriation* rules.

Moreover, virtually any measure taken to regulate the use of water, or activities that may degrade or pollute water resources, would be vulnerable to trade challenge under CETA, for only the Yukon has reserved its rights to maintain such measures.

Environmental Measures

Another glaring omission from the list of proposed Canadian reservations is the failure of any province or territory to list reservations for their respective environmental laws under either of the Annexes, the Yukon being the only exception.⁶

Yet virtually all provincial and territorial governments have established environmental protection and environmental assessment statutes. These impose significant obligations on commercial and industrial enterprises with respect to waste management; pollution reduction, abatement and control; resource conservation; habitat protection; and environmental planning.

⁴ These included water rights in relation to Grand Falls, Bishop's Falls, Star Lake, Buchans Charter Lease Section 8, and even a potential hydroelectric generation at Red Indian Falls (estimated 44MW capacity) and the Badger Chutes (estimated 22 MW capacity) on Exploits River.

⁵ These included the following claims: (1) 2000 square miles generally Charter Lease Section 8 comprising the Red Indian Lake watershed in west-central Newfoundland (2) 1619 hectares in the vicinity of 1907 Lease Section 3 (3) 965,585 hectares at various locations Non-Renewable Licenses in central Newfoundland (4) 111,163 hectares located in central Private Reid Lots and western Newfoundland, including in particular the Reid Lot 59 lands (including the Grand Falls Mill, Grand Falls House, the AbitibiBowater Mill Manager's House, the Ambient Air Monitoring Station, and considerable additional lands suitable for residential and commercial development) (5) 72,782 hectares located in central Crown Reid Lots – 725 hectares comprised of lots on Victoria River.

⁶ Yukon has proposed a limited but important reservation under the *Environment Act*, and the *Yukon Environmental and Socio-Economic Assessment Act* for water planning and management measures.

Moreover, environmental standards have often been the subject of international trade and investment challenges. Even as this opinion is written there are important international disputes targeting Ontario's *Green Energy Act*, an initiative that seeks to address an environmental imperative, namely the reduction of greenhouse gas emissions.

In this regard, Ontario has committed to shutting down its coal-fired power plants, a key source of greenhouse gas emissions for Canada. To encourage the development of renewable energy to fill the substantial generation gap that will result it has embarked upon various initiatives, the most prominent being the *Green Energy Act*, which also promotes the development of Canadian technology and green industry.

We learned more than two decades ago that it is folly to treat the environment and the economy as two separate worlds, and many governments have endeavoured to integrate the two under the banner of sustainable development. As we know, there will inevitably be winners and losers under any environmental regulatory regime. The manufacturer of the efficient device will profit, and outmoded technology will fall by the wayside. Unfortunately the existence of any domestic winners has sponsored international trade complaints assailing the measures for being protectionist, a claim that trade adjudicators have often been ready to accept. These are the unfortunate realities of contemporary international trade rules and dispute processes.

The current Canadian government clearly sees international trade rules as a tool for discouraging *bona fide* environmental initiatives by others. Thus it has threatened to challenge a proposed *Fuel Quality Directive* being considered by the EU that would distinguish between various sources of energy depending on their carbon footprint. Renewable energy wins under such a system, synthetic crude oil from Western Canada loses, hence Canada's threatened WTO action. In an integrated global economy there will invariably be foreign investors and service providers that are impacted by environmental, energy or conservation measures and who, under CETA, would be accorded the right to challenge such measures before largely sympathetic and unaccountable international tribunals.

Both Ontario's *Green Energy Act* and the EU's proposed *Fuel Quality Directive* are recent initiatives that respond to an evolving understanding of the need to find innovative ways to address the challenge of global warming. They perfectly illustrate the need for public policy and law to evolve in order to meet new challenges, or find new ways of meeting known challenges. Yet, unless reserved under Annex II, governments will have very little scope for such initiatives.

PART III: THE UNCERTAIN EFFECT OF CETA RESERVATIONS

We have addressed some of the ground that Canada is ceding under its proposed Annex II CETA reservations. Here we consider the effectiveness of proposed reservations where these have been listed.

To begin with, the proposed Annex II reservations listed by the provinces and territories are most often limited to *Market Access*. Recall that NAFTA included no specific *Market Access* obligation, and that all existing non-conforming provincial measures maintained at the provincial level were reserved under NAFTA (Annex VII). Thus the proposed Annex II reservations for provincial and territorial measures concern the expanded terrain encompassed by CETA.

However, the obvious difficulty with this approach is that the *Market Access* reservation is very unlikely to be effective, because new measures in these reserved sectors will often also offend *National Treatment* and other CETA disciplines.

Take, for example, measures by British Columbia to limit imports of electricity to ensure that there is sufficient and economically viable provincial generation to meet provincial needs, and hence provide the province with some measure of energy security. Measures taken under the *Clean Energy Act*, the *Utilities Commission Act*, and *Hydro Power and Authority Act* are reserved under Annex I from *National Treatment*, *Performance Requirement* and *Market Access*.⁷ The obvious problem is that any new measures taken under these regimes⁸ will be reserved only from CETA *Market Access* disciplines.

A similar problem exists for Ontario's promotion of local economic development under the *Crown Forest Sustainability Act*, 1994, s.30, s.34, which notably did not exist when NAFTA went into effect in 1994. Thus, under Annex I, Ontario has proposed a reservation from CETA *National Treatment* and *Performance Requirements* for measures described this way:

Every licence that authorizes the harvesting of Crown timber is generally subject to the condition that the timber shall be manufactured in Canada into lumber, pulp, or other products.

The Minister may amend a forest resource licence in accordance with regulation 167/95; which requires the submission of a forest management plan relating to social and economic objectives. The needs and benefits of the local communities will be given priorities into the planning effort and objective setting and achievement before broader non-local communities.

Apparently recognizing the futility of doing so, Ontario has not bothered to list such measures among its Annex II reservations.

⁷ BC Hydro imports and exports electricity, but to the extent that the law requires BC Hydro to have available enough generating capability within the province to meet domestic power needs, the demand for imported electricity is limited.

⁸ See BC Annex II reservation.

However, assuming that such a reservation is effective to cover existing non-conforming measures under the *Crown Forest Sustainability Act*, any attempt to strengthen the local benefits provisions would not be permitted because there is no Annex II reservation that would permit such a progressive reform. Ontario confronts precisely the same difficulties with regard to the value-added processing requirements of the *Mining Act*, 1990, s. 91.⁹

Québec is similarly exposed to trade challenges and foreign investor claims with respect to its attempts to reserve measures taken under the *Forest Act* (R.S.Q., c. F-4.1) for measures that:

All timber harvested in the domain of the State, including biomass volumes, must be completely processed in Québec. However, the Government may, on the conditions it determines, authorize the shipment outside Québec of incompletely processed timber from the domain of the State if it appears to be contrary to the public interest to do otherwise.

Just as problematic for the Province is its attempt to preserve various measures concerning the regulation of electric power in the province including the following measures:

Hydro-Québec, municipal electric power systems, and private electric power systems are holders of exclusive electric power distribution rights.

Every lease, sale or grant of water powers which belong to Québec or in which it has rights of ownership or other rights and every contract, permit, or grant authorizing the installation or the passage of transmission lines in or over or the construction of a wind farm on the domain of the State shall contain a clause prohibiting the exportation of electric power from Québec. The Government may nevertheless authorize, by order, on the conditions and in the cases it determines, any contract for the exportation of electric power from Québec.

Contracts relating to the exportation of electric power by Hydro-Québec, including wheeling under a transportation service agreement, must be submitted for to the Government for authorization in the cases determined by the Government and are subject to such conditions as the Government may then determine.

But the right to export goods (which would certainly include energy goods) has been determined to be a protected investor right under NAFTA rules in a ruling against Canada that it did not appeal (*Pope and Talbot v. Canada*). Moreover, Québec's attempt to preserve its rights to regulate in this sector arguably comes too late to protect measures related to renewable power which would not have been in place in 1994.

⁹ Under the Ontario *Mining Act* the province requires that "All ores or minerals raised or removed from lands, claims or mining rights in Ontario must be treated and refined in Canada to yield refined metal or other product suitable for direct use in the arts without further treatment; unless the Lieutenant Governor in Council exempts any lands, claims or mining rights from the operation of this requirement.

This clearly illustrates the problem of freezing public policy in law in time, and so tying the hands of governments to deal with future challenges and opportunities.

While Québec attempts to create a shield for new energy initiatives in the future by reserving energy and electricity under Annex II, it does so only in relation to CETA *Market Access* rules.¹⁰ But its Annex I reservation for existing non-conforming measures is taken from *National Treatment* and *Performance Requirements*, clearly indicating that its Annex II reservation will not suffice to preserve its rights to address the energy challenges of the future, including those relating to energy security and climate change.

In other words, the provinces should have clearly established Annex II reservations under NAFTA, and for unexplained reasons, failed to do so. Now that the implications of this failure are becoming more apparent, they are attempting to close the barn door after the horses have bolted.

CONCLUSION

This opinion provides an assessment of some of the consequences that will follow from dramatically expanding the reach of an international trade agreement to include provincial and territorial government measures that heretofore have been exempt from constraints imposed by such regimes. Because property and civil rights are provincial responsibilities under the Constitution, most Canadian public policy and law relating to investment and services is provincial and territorial. By adopting a top-down approach to the application of CETA disciplines, the provinces and territories have been put to the impractical (and arguably impossible) task of identifying an exhaustive and detailed list of provincial and territorial measures they wish to reserve their governance rights in regard to.

The modest and inconsistent approaches adopted by many provinces and territories in response to this challenge will leave large areas of domestic and policy and law vulnerable to challenge under CETA rules.

However, it is beyond the scope of this opinion to delve into the myriad problems that may ensue as a result. Therefore the preceding analysis can only be taken as offering a few illustrative examples of the problems that can be foreseen if Canada proceeds further down its present path.

Sincerely,



Steven Shrybman

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¹⁰ Québec Annex II reservations.