

Full of Holes

Newly leaked documents show Canada is opening the door widely to private water companies in trade negotiations with European Union.

OVERVIEW

On January 25, 2012, leaked documents related to the ongoing Canada-European Union trade negotiations were made available online.ⁱ These documents show the initial services and investment offers to the European Union (EU) from the federal, provincial and territorial governments. The Canadian Union of Public Employees and the Council of Canadians note with great concern that no province or territory has safeguarded water services (drinking water and wastewater) from their initial Comprehensive Economic and Trade Agreement (CETA) offers.

This confirms the warning in our 2010 report, *Public Water for Sale: How Canada Will Privatize our Public Water Systems*, that access to Canadian water and wastewater services is a key incentive for the EU in the CETA negotiations. We described how CETA could mark the first time that Canada has allowed our drinking water to be fully covered under an international trade treaty and the first instance that a trade agreement has covered municipal procurement of water services.

By not excluding water services from CETA, it signals to private water firms not just in Europe but from any other country with which Canada has an existing trade agreement that Canada is open for business. The EU trade deal as proposed would lock in existing privatization and encourage the further commercialization of water and wastewater services while complicating regulation of the sector.

The EU and its member states understand this very well. The EU Commission, in its services and investment offer to Canada, is protecting the EU's own water and wastewater services by proposing to reserve 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, including the provision of drinking water, water management, and waste water management."ⁱⁱ

Canada is seeking a blanket exemption for existing municipal measures that do not conform to CETA rules, for example municipal monopolies on water delivery and treatment. But there is no room for new or restored public services in the text we have seen. Since Canadian provinces and the federal government have made similar reservations related to energy, fisheries and telecommunications, we question why they chose not to do the same for a sector as crucial as water services.

When CUPE and the Council of Canadians brought their concerns to the attention of the federal government over the past year, often through our members and local activist chapters, we were dismissed with assurances that nothing in CETA could force water privatization in Canada and the sale of its water in bulk to Europe. The Harper government appeared to willfully misunderstand or misrepresent our rigorously documented case against water service liberalization, perhaps to avoid having to answer questions. Our 2010 report suggested a reason for Harper's obfuscation: his government was privatizing water services already and would embrace any trade deal that could lock-in that privatization.

While the Canadian federal government is promoting the privatization of water services through public-private partnerships, outsourcing and contracting out, governments in Europe and around the world are going in the opposite direction. Privatized water services are being remunicipalized because of poor service levels, high costs and lack of democratic accountability. If Canada does not exclude drinking water and wastewater services from CETA, it will take away the policy space for municipal, regional or provincial governments to reverse the privatization of their water services in the future.

It is clear from the newly leaked documents that the provinces have failed to heed or understand our caution and have extended a new "right to profit" to EU-based and other private investors of water services in Canada. We are asking all provincial governments to correct this mistake by fully excluding drinking water and wastewater services from their Canada-EU trade offers. We also urge the provinces to withdraw their support from the CETA negotiations until the public and other elected officials have had a chance to review these offers.

What is the status of the CETA negotiations?

Canada and the European Union have been negotiating a Comprehensive Economic and Trade Agreement, or trade deal, for over two years. The proposed agreement goes much further than the NAFTA did in areas including intellectual property rights, public procurement and the types of service sectors that will be covered by strict investment rules that restrict how governments make policy or regulate in those sectors. There have been nine full rounds of negotiations involving provincial and territorial governments, the most recent occurring in Ottawa in October 2011. Services and investment offers were exchanged just before the last round.

Chief negotiators from Canada and the EU continue to meet, trying to come to an agreement on the most contentious issues. Both sides have said they would like to sign a deal in the first half of 2012.

What are the newly leaked documents about?

The documents are Canada's initial services and investment offer and list the areas or sectors that the Canadian government wants excluded from the restrictions that will be imposed by the trade agreement on government policy and regulation. Also listed are the measures or the specific aspect of the sector to be excluded. Everything else is subject to liberalization, which can be understood as deregulation or re-regulation on market-based terms favourable to multinational investment. Because the services and investment commitments in the CETA are based on a "negative" list approach, if you don't see an area or sector listed in these exceptions it is automatically included for liberalization in the agreement.

As with most free trade deals, the federal and provincial/territorial offers are split into an Annex I and Annex II. Annex I reservations carve out existing measures that would otherwise not conform with investment and services rules in CETA. They are bound, which means that measures in this annex can only be amended to make them more CETA-consistent (i.e. they can only lead to more and not less liberalization of the sector or measure). A measure or policy in Annex I which is later amended or eliminated cannot be restored. This type of reservation or exclusion shows how trade deals are designed to ratchet up the level of liberalization in an economy over time.

Annex II reservations on the other hand are unbound (i.e. not subject to the ratchet effect) and therefore somewhat stronger than Annex I. They protect not only existing non-conforming, or CETA-infracting measures in this case, but allow governments to take new measures that would otherwise be inconsistent with the CETA rules on services and investment. For example, when negotiating NAFTA, the Canadian government, under pressure from groups like the Canadian Health Coalition, included health under a list of exempted social services in Annex II. Along with the sectors they wish to exclude, countries will list precisely which of the trade deals' rules do not apply (ex. market access, national treatment, bans on performance requirements on new investment, etc.).

There are problems with relying on Annex II protections for social services since this does not totally protect them from trade challenges. Trade expert Scott Sinclair notes, no reservations are permitted against the expropriation or minimum standards of treatment clauses, which are two of the most problematic provisions in investor-state arbitrations. As long as Canada and the EU agree to include an investor-state dispute settlement process in the CETA, measures affecting any sector in Canada, including health and education, where there is some degree of private sector involvement are vulnerable to corporate lawsuits demanding compensation for lost profits.ⁱⁱⁱ

What are the consequences of not protecting water services in CETA?

As CUPE and the Council of Canadians explained in *Public Water for Sale*, the regulation of sectors or measures not carved out of the CETA would be forced to fit within the strict rules of investment liberalization, which include:

- An outright ban, regardless of nationality of the firm, on any limitations on the number of investments, whether in the form of quotas, monopolies, exclusive service suppliers or the requirement of an economic needs test;
- A ban on limitations on the total value of transactions or assets, the total number of operations, or the total quantity of output;
- A ban on any limitations on the participation of foreign capital (maximum percentage limits on foreign shareholders or the total value of foreign investment); and
- A probation of measures requiring a certain type of legal entity or joint venture to perform a given economic activity in a committed sector, or measures limiting the total number of persons that can be employed in a particular sector.

The result of these services commitments, we wrote, is that investment in a committed sector, defined very broadly, becomes locked in and is protected with a strong dispute resolution system. The public would lose even more room to challenge the role of multinational corporations in their communities while European investors gain new rights to sue local governments if a policy is ever deemed a threat to their profits. For example, we explained:

...cost overruns, exorbitant rate hikes or lacklustre service that frequently accompany water privatizations become difficult or very expensive to fix without infringing on the rights of water corporations under these services and investment provisions. To commit a service sector in a free trade deal is to commit to private delivery. Governments' ability to regulate in these sectors is also restricted; committed sectors become venues for profit-making removed to a large extent from effective public control.^{iv}

Countries such as Argentina, Bolivia, Tanzania, Germany, Canada and others have found themselves before non-transparent investment tribunals for government decisions related to the management of water services or the protection of source water. Claims can run into the hundreds of millions of dollars and are increasing with each new investment treaty. With European firms dominating the global water and wastewater sector, and with any new CETA investment protections for these firms automatically extended to American and Mexican water companies under NAFTA's Most Favoured Nation clause, Canada is opening itself wide to corporate lawsuits by not protecting water services in the Canada-EU deal.

Hamilton: A case study in the problems with privatization and investment protection

For an example of how this could pan out in Canada, we can look to the City of Hamilton, Ontario's experience with private water. After awarding a ten-year contract to Philips Utilities Management Corporation for water and wastewater treatment in 1995, the community faced a decade of environmental disasters and financial upheaval.

The workforce was cut in half within eighteen months of the contract being awarded (despite promises of new jobs), millions of litres of raw sewage spilled into the Hamilton Harbour, homes were flooded and major additional costs were incurred.

Numerous charges were laid over the years by the Ontario Ministry of the Environment against the contractor for not meeting effluent standards. The private water contract changed corporate hands four times, including Azurix Corp., a subsidiary of Enron which was sold to American Water in 2001. Azurix was one of the firms that sued Argentina under a bilateral investment treatment at the International Center for the Settlement of Investment Disputes (ICSID) in 2001. In 2004, Hamilton City Council ended its experiment with privatization and brought operation of its water and wastewater systems back in-house.^v

Had water and wastewater services been covered in existing Canadian trade agreements, the private firm operating Hamilton's water services would have had venues with which to frustrate efforts to clean up their act. Had the contract been for longer than 10 years – most private-public partnerships for water services in Canada are for 20-30 years – then efforts to remunicipalize before the end of the contract would have been vulnerable to excessive claims of lost future profits. As mentioned above, private water firms have and will continue to use the means at their disposal in trade and investment agreements to bully governments into agreeing to their terms.

Pressure to privatize in Canada

European water firms, including Veolia Environment and GDF Suez, are already making inroads into private water in Canada through public-private partnerships endorsed by federal and provincial government policy and funded with public dollars. The strategy appears to be to starve municipalities of infrastructure cash until they are forced to consider the P3 option. In our report in 2010, CUPE and the Council of Canadians informed political leaders that:

In the absence of proper funding, new water regulations render our municipal and territorial drinking and sanitation facilities increasingly vulnerable under this trade and investment agreement. Requirements to consider public private partnerships and incentives such as federal funding for municipal P3s further entrench opportunities for private water companies in Canada.

Since that report was released, PPP (Public-Private Partnership) Canada funding has become the only available federal funding for municipalities, effectively tying municipal infrastructure projects to the P3 model.

PPP Canada is further prioritizing water and wastewater projects for P3 funding; four out of the last five projects announced since July 2011 were water related projects.^{vi}

In a 2011 water, wastewater and biosolids market study commissioned by PPP Canada and obtained through an access to information request, consultants OPUS DaytonKnight conclude that significant investment in the wastewater sector is considered to be the highest of the three sectors over the next five to ten years for the following reasons:

1. Significant regulatory change is on the horizon;
2. Required improvements have been deferred to date in many communities due to funding constraints;
3. Specifically to the P3 delivery model in the sector, it incorporates a return on investment component to the supplier, which is significantly less political and [with less] social implications to the public.

The PPP Canada-commissioned report suggests that given public opposition to water sector P3s, “Incremental advancement of P3 use in each of the sectors is likely to occur over time. Uptake in the wastewater sector is likely to lead the other two because it has less of the political headwinds...”

Public opposition to the idea of return on investment on public resources, popularly referred to as *profit*, is a well informed position and central to a debate about whose interests are being served by large corporations, particularly in the water sector. Is it the public or is it the shareholders? Around the world and in Canada, Auditors General and other authorities have questioned the wisdom of “opening up the P3 market” and have been highly critical of their purported benefits for taxpayers and communities (see Appendix A).

The influence of European water corporations in Canada is growing. In the summary document of the program agreement signed on April 20, 2011, between the City of Winnipeg and Veolia Environment, both parties claimed:

The Reserved Powers section permits the City to make unilateral decisions in certain areas without incurring financial penalty although it may require an adjustment of the target costs and key performance indicator measurements. In this way, Veolia is not unfairly penalized because of a City decision.^{vii}

Unilateral decisions where the City of Winnipeg must now consider Veolia’s interests include rate-setting and annual approval of the operating budget and capital budget.

In another example, it was recently revealed that Pierre-Marc Johnson, Quebec's chief CETA negotiator is working for the Veolia Environment Institute in Paris,^{viii} which is financed by the water company. The former premier has been criticized for this apparent direct conflict of interest with his responsibility to protect the public's interest as chief negotiator.^{ix}

If CETA were signed today with the current proposals on the table from the provinces, municipalities who choose a public private partnership for a water or wastewater facility become vulnerable to corporate lawsuits demanding compensation for lost profits under the investor-state dispute mechanism. City councils will further find it next to impossible to bring water and wastewater services back into the public sector without paying these corporations large compensation packages above and beyond the cost of their real investment in water systems. Municipalities are particularly vulnerable under these current conditions in the water and wastewater sector in Canada.

RECOMMENDATIONS

There's a simple solution which the provinces and territories have neglected to take, despite the risks. At the very least, Canada needs to amend its Annex II reservations to include drinking water and wastewater services as the European Union has signaled it would like to do. These CETA carve-outs should apply across the board to public services, in particular to all health and education services regardless of existing private investment in these sectors. But municipal services must be excluded also, such as transit, waste management, energy and other social services.

But more needs to be done to democratize the CETA negotiations, which are almost finished according to most accounts. Now that we have the leaked federal and provincial services and investment offers the public and opposition parties need time to study and respond, with room for more amendments to be decided by informed public debate. The federal and provincial-territorial governments should disclose their procurement offers to the EU and give individual municipal governments a direct say in the CETA negotiations.

Expanding Canada's trading options around the world makes sense to the extent that the agreements we sign are truly about trade. The new restrictions Canada is being asked to place on public services and public policy under the CETA prove this agreement is about much more than trade. As such, the federal and provincial governments need to give the public a full picture of the impacts their comprehensive economic pact with the EU will have on Canadian economic and social policy space.

TRANSMITTAL INFORMATION

ABOUT THE COUNCIL OF CANADIANS

Founded in 1985, the Council of Canadians is Canada's largest citizens' organization, with members and chapters across the country. They work locally, provincially, federally and internationally to promote progressive policies on fair trade, clean water, energy security, public health care, and other issues of social and economic concern to Canadians. The Council does not accept money from corporations or governments, and is sustained entirely by the volunteer energy and financial assistance of its members.

ABOUT THE CANADIAN UNION OF PUBLIC EMPLOYEES

The Canadian Union of Public Employees (CUPE), Canada's largest union, represents more than 615,000 women and men working in municipalities, health care, education, libraries, universities, social services, public utilities, transportation, emergency services and airlines. CUPE members are proud to deliver the majority of Canada's community drinking water and wastewater services.

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ⁱ Trade Justice Network (TJN) January 25, 2012. <http://tradejustice.ca/en/section/1>

ⁱⁱ Based on leaked documents.

ⁱⁱⁱ See Sinclair, Scott. The Proposed EU-Canada Trade Agreement Raises Health Concerns in Both Canada and European Union, CCPA report, July 2011: <http://www.policyalternatives.ca/publications/reports/proposed-eu-canada-trade-agreement-raises-health-concerns-both-canada-and-europ>

^{iv} Public Water for Sale: How Canada Will Privatize Our Public Water Systems, CUPE and Council of Canadians report, December 2010, pg 14: <http://canadians.org/trade/documents/CETA/water-report-1210.pdf>

^v Ibid, pg 17

^{vi} PPP Canada. <http://www.p3canada.ca/media-room.php>

^{vii} Winnipeg's Sewage Treatment Plant Upgrade and Expansion Program Summary Document Of the Program Agreement Signed on April 20, 2011 By the City of Winnipeg And

Veolia <http://winnipeg.ca/waterandwaste/pdfs/sewage/treatmentPlantUpgradesAndExpansion/agreementSummary.pdf>

^{viii} Institut Veolia, Comité de prospective. <http://www.institut.veolia.org/fr/biographies/pierre-marc-johnson.aspx>

^{ix} See video of Quebec Solidaire MLA Amir Khadir questioning Mr. Johnson in the Quebec legislature, December 8, 2011: http://www.quebecsolidaire.net/actualite_nationale/extrait_video_damir_khadir_depute_de_mercier_qui_questionne_pierre_marc_johnson_sur_laccord_economique_et_co

APPENDIX A

Myths about public private partnerships

On its web page PPP Canada pronounces that:

- Across Canada, governments have begun to recognize the value of engaging private-sector innovation to build more for less, where possible, and deliver savings that will help to fill the infrastructure gap.
- P3s provide on-time, on-budget projects which deliver effective infrastructure over their useful lives.
- P3s are a long-term performance-based approach for procuring public infrastructure where the private sector assumes a major share of the responsibility in terms of risk and financing for the delivery and the performance of the infrastructure, from design and structural planning, to long-term maintenance.
- Inadequate incentives and contractual discipline: contracts often do not include sufficient incentives for scope and cost discipline; cost-based contracts can, in fact, create perverse incentives for contractors to encourage change orders and cost increases.

Around the world and in Canada, Auditors General and other authorities have thrown doubt on all of these assumptions.

P3s Cost Less than Traditional Procurement

Quebec and Ontario public auditors have questioned the methodology for comparing P3s with more traditional procurement. One of the most important assumptions used by P3 promoters is that governments do not borrow money to finance projects. The Ontario Auditor General said:

In comparing the design and construction costs of the two options, [William Osler Health Centre (WOHC)] assumed that there would be no financing if the government undertook the project itself, but that the [P3] arrangement would be financed over 25 years. It justified this assumption by noting that in the past, hospitals were required to have their share of project costs available before the Ministry would approve any projects.

Governments do have the capacity and the option of financing and typically obtain a lower debt interest rate than private-sector borrowers do. The province's 5.45% cost of borrowing at the time the agreement was executed was cheaper than the weighted average cost of capital charged by the private-sector consortium.

Had the province financed the design and construction costs under the same terms as the private-sector partner but used its lower rate, we estimate that the savings in financing costs would be approximately \$200 million (\$107 million in 2004 dollars) over the term of the agreement.¹

P3s transfer risk to the private sector

Auditors General in Quebec and Ontario have found that risk can be transferred in traditionally developed infrastructure projects and that P3 project analysis exaggerates the amount of risk involved.

Looking at a Quebec Hospital project, the Quebec Auditor General said:

Indeed, choosing a different conventional project delivery method - such as the turnkey approach - could also have improved public sector efficiency by giving a design and construction contract to a group of companies. It would also allow construction to be fast-tracked. In such a case, calls for tender are issued as soon as detailed plans and estimates for a lot are completed, thereby saving time.²

Looking at an Ontario hospital project, the Ontario Auditor General said:

Another concern we had was the \$67 million in transferred risks that was added to the November 2004 government design-and-build estimate. This amount was arrived at on the basis of the judgment and experience of management and consultants. Owing to the subjective nature of these estimates, it is virtually impossible to substantiate the validity and accuracy of the quantified amounts. We were concerned that the transferred risks for this project amounted to almost 13% of the November 2004 government design-and-build estimate of \$525 million. In comparison, actual cost overruns (a major component of risk transfer) in the design and construction of the Peterborough Regional Health Centre - a hospital built under the traditional procurement approach during the same period - were about 5% of the total contract value.³

On time and on budget?

Once again, P3 promoters can only make these claims with an elaborate set of assumptions. P3s may be delivered “on time” within the terms of the contract, but they take much longer to deliver than traditionally procured projects.

¹ Auditor General of Ontario, 2008 Annual Report, Chapter 3.03 Brampton Civic Hospital Public-private Partnerships Project, page 115.

² Rapport du Vérificateur général du Québec, paragraphe 5.67.

³ Auditor General of Ontario, 2008, page 112

The government of British Columbia acknowledged this in 2008 when it raised the threshold for consideration of P3s from \$20 million to \$50 million saying:

As part of the government's commitment to accelerate capital infrastructure projects the threshold has been increased for any provincially-funded capital project to be considered as a public private partnership.⁴

In terms of “on budget” virtually every P3 project has risen in cost substantially between the time of its announcement and the financial close of the project.

Traditional Projects lack “cost-discipline”

Economist Dr. Marvin Shaffer examined the Partnerships BC methodology for cost discipline and makes the following observation:

Bonding and warranty arrangements can be used to ensure cost and performance guarantees are met in more traditionally procured processes – that risks the builders can manage are effectively transferred. The model PBC has recently turned to, whereby the winning bidder must provide some equity, but the balance of the capital cost is financed by government can also ensure long term performance guarantees are met. PBC recognizes this is a lower cost arrangement than their preferred P3, particularly with the recent turmoil in the private capital markets, but alternatives like this aren't even considered in its standard methodology.

The point is that PBC's methodology makes no effort to determine the optimal procurement arrangement, one that minimizes cost to the taxpayer, while still achieving appropriate, cost-effective risk transfer and private sector participation in the project.⁵

P3s provide value for money through competition

Again, Auditors General have questioned this claim. With respect to a hospital project he said:

There was no formal analysis of whether the market had sufficient capacity and was competitive enough to support a P3 arrangement for the project. Our review of available information suggested that only a limited number of construction contractors in the province are able or willing to undertake a project of this size. The same construction companies would be involved in the bidding and work regardless of whether WOHC followed the traditional procurement or P3 approach.

⁴ http://www2.news.gov.bc.ca/news_releases_2005-2009/2008FIN0019-001677.pdf

⁵ Shaffer, PhD, Marvin, Review of Partnerships BC's Methodology for Quantitative Procurement Options: Discussion Draft, November 2009, page 3, http://www.cupe.bc.ca/sites/default/files/nov_19_shaffer_oct_09_pbc_evaluation_methodology.pdf

At the direction of the Ministry, WOHC was also asked to engage the private sector not only to design and build the new hospital, but also to provide maintenance and non-clinical services for it. As most private-sector companies specialize in providing either capital construction or operational support services, the mingling of the two further limited the number of companies qualified to deliver the P3 arrangement.⁶

The current approach to P3 procurement has also been questioned by the construction industry itself. Canadian Construction Association Chair Dee Miller told Business in Vancouver Magazine that P3s so far:

...have worked only for a handful of very large Canadian construction firms. Ninety percent of Canadian construction industry, however, is made up of small and medium sized firms.⁷

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⁶ Auditor General of Ontario, 2008, page 108

⁷ Martin, Brian, CCA Head sounds a warning, Business in Vancouver Magazine, Oct 11-17, 2011, page C16.