



Expert paper #6

IMPLICATIONS OF TPPA FOR LOCAL GOVERNMENT

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Negotiations for the Trans-Pacific Partnership Agreement (TPPA) among twelve negotiating countries – Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States and Vietnam – were concluded in Atlanta, USA on 5 October 2015. The text was released on 5 November 2015. The agreement has 30 chapters and many annexes, with parties also adopting bilateral side-letters. The TPPA was signed on 4 February 2016 in New Zealand, which is the formal depositary. Each party to the negotiations must complete its own constitutional processes and requirements before it can take steps to adopt the agreement. The TPPA will come into force within two years if all original signatories notify that they have completed their domestic processes, or after 2 years and 3 months if at least six of them, including the US and Japan and several other large countries, have done so. This research paper is part of a series of expert peer-reviewed analyses of different aspects of the text.

IMPLICATIONS OF TPPA FOR LOCAL GOVERNMENT

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KEY POINTS

As democratically elected bodies, local authorities must be able to influence important decisions, be held accountable by their constituencies and have flexibility to respond to local needs and circumstances, which necessarily change over time.

Local governments internationally have found they have to exercise their mandates within strict policy and regulatory boundaries set by international trade and investment treaties they had no role in negotiating, and that decision-making is removed further from elected bodies who are responsible for the wellbeing of their regions.

The binding and enforceable rules of the TPPA go further than any previous such agreement and will impose new constraints on local governments' authority and autonomy to regulate and make decisions.

Every local authority will have to comply with complex rules across many chapters, and decisions they make that impact adversely on foreign investors will potentially be open to challenge through the investor-state dispute settlement (ISDS) mechanism.

The chapters on investment and cross-border services that apply directly to local government have the greatest potential impact, and the protections for key areas of local authority activity are limited.

Local government is not currently bound by the government procurement chapter and most rules in the state-owned enterprises chapter, but negotiations to include them are built into the Agreement. Extending these rules to local government level requires extensive in-depth study and democratic consultation, which has not occurred to date with the TPPA.

There are piecemeal and contingent exceptions and exclusions in the TPPA, which are complex and will make it very hard for local government to anticipate the legal risks when it exercises its powers.

Municipal activities that have the greatest potential to be affected are: policy making and planning decisions; bylaws and regulations governing permitted activities; technical standards, such as property development, construction, advertising, zoning and environmental quality; activities relating to finance; public procurement contracts, including public private partnerships (PPPs); utilities; and resource management rules and decisions.

Investors from TPPA countries will have the power to challenge local government decisions that damage their commercial interests, including disputed procurement or PPP contracts, planning and consent processes, or blocking price increases for utilities like water or sanitation.

Special rights for foreign investors can be enforced through the controversial ISDS process. Even where the local government believes it is legally correct the uncertainty and costs of defending a dispute can sap a government's resolve – known as the 'chilling effect'.

An investor from a TPPA country can also enforce an investment contract through ISDS, even they are not claiming a breach of the TPPA's investment chapter.

The text has not addressed the main objections that ISDS lacks the characteristics of a credible and independent legal process and can effectively bypass domestic courts.

The recent *Bilcon v Canada* dispute shows the risks of ISDS where a local authority rejects a resource application from a foreign investor because of community concerns. The dissenting arbitrator called the decision a ‘significant intrusion’ into domestic jurisdiction and a ‘remarkable step backwards’ in environmental protection.

Defending disputes is very costly. In recent Canadian disputes the government has proposed to recover the costs and any compensation from the provincial authority.

The contracting out of services, greater use of PPPs, including for water, and asset sales will intensify the exposure of local government to the TPPA and heighten the risks of investor-state disputes over disputed contracts.

Regulations, bylaws, administrative decisions, etc that give preferences to local firms, limit the quantity of services or suppliers, or impose special restrictions or performance requirements on foreign firms, cannot be tightened unless the New Zealand government has expressly reserved the right to do so.

Administration of local government measures affecting services from a TPPA supplier can be challenged as not being reasonable, objective or impartial.

The TPPA erodes the flexibility that local authorities need to promote economic development in their communities, and is not a sound basis for a progressive and sustainable 21st century economy that addresses climate change, social inequalities, environmental degradation and other challenges.

1. Exposure of local government in the TPPA

(i) General implications

Local authorities need flexibility to respond to local needs and circumstances, and views about their appropriate functions and priorities, which necessarily change over time. The role of local government is a heavily contested question and ebbs and flows in response to the prevailing political climate and changing local needs. Recent amendments to the Local Government Act 2002 reflect this dynamic, with a narrowing in the statutory purpose of local government from a focus on promotion of social, economic, environmental and cultural well-being of communities, present and future, to accountability and provision of infrastructure, public services and regulatory functions, with an emphasis on cost-effectiveness.¹ That emphasis can be expected to shift again under a future government.

The purpose of enabling democratic local decision making and action by and on behalf of communities has remained constant.² That recognises the constitutional imperative that local

¹ Section 3 and Section 10, Local Government Act 2002.

² Section 14 Local Government Act 2002.

authorities, as democratically elected bodies, must be able to influence important decisions and be held accountable for them by their constituencies.³ When discussing moves to define local authorities' responsibilities in terms of core services, Local Government New Zealand's principal policy adviser Mike Reid observed that

local government is part of a nation's constitutional framework and decisions that undermine local self-government effectively undermine its democratic framework. ... Actions that interfere with the relationship between voters and elected members can be problematic, as they have the potential to reduce elected members' decision-making sphere and undermine their accountability.⁴

The current legislation requires local authorities to be aware of the views of all their local communities, explicitly including Māori in making decisions,⁵ and take account of that diversity in making decisions.⁶ A sustainable development approach incorporates social, economic and cultural interests, the quality of the environment, and the needs of future generations.⁷ At the same time, local authorities must give effect to their priorities and outcomes in an efficient and effective manner, with commercial transactions that follow sound business practices.⁸ Where tensions arise between these purposes, the Act says open and democratically accountable conduct should prevail.⁹

The right to determine the balance between sustainable development and commercial imperatives at the domestic level through national legislation is distorted when local government is bound by enforceable international trade and investment agreements. The more these kinds of free trade, investment and intellectual property agreements reach 'behind the border' into the regulatory systems and traditional functions of government, the greater their impact on regional and local government will be.

(ii) Scope of the TPPA

While the stated purpose of the Trans-Pacific Partnership Agreement (TPPA) is to 'promote economic integration to liberalise trade and investment, economic growth and social benefits, create new opportunities for workers and businesses, contribute to raising living standards, benefit consumers, reduce poverty and promote sustainable growth', it does so through far-reaching rules that advance the commercial and strategic interests of participating states and

3 See generally, Dean Knight, 'Local Democracy and the Consideration of Community Views: Obligations and Observance', 284-317 in Claire Charters and Dean Knight, (eds) *We, The People(s). Participation in Governance*, VUW Press, 2011

4 Mike Reid, 'The Problem with Defining Core Services', *Policy Quarterly*, vol.5, issue 4, 2009, p.5

5 Sections 4 and 14(1)(d), Local Government Act 2002

6 Section 14(1)(b) and (c) Local Government Act 2002

7 Section 14(1)(h) Local Government Act 2002

8 Section 14(a)(ii), (f) and (g).

9 Section 14(2) Local Government Act 2002

their corporations. The risk is that the TPPA will lock in a model that prioritises those interests and pre-empts the ability to shift along the spectrum in the future.

The binding and enforceable rules of the TPPA go further than any previous agreement in constraining the authority and autonomy of local government to make regulations and decisions. Local authorities will also have to comply with special rules that protect foreign investors and investments from other TPPA countries. Negotiations to extend the rules in areas that are crucial for local government are built in to several chapters, notably on public procurement and state-owned enterprises (SOEs).

Many of the key rules on services and investment apply to government ‘measures’, which are very broadly defined to include any law, by-law or regulation, any procedure, requirement, or practice, or other activities, such as resource management decisions.¹⁰

Municipal activities that have the greatest potential to be affected are policy making and planning decisions; bylaws and regulations governing permitted activities; technical standards, such as property development, construction, advertising, zoning and environmental quality; activities relating to finance;¹¹ public procurement, including public private partnerships (PPPs); utilities; and resource management rules and decisions.

The impact of the TPPA will be most obvious for local authorities and their constituencies in the larger cities where foreign firms are likely to have the most commercial interest. But every local authority will have to comply with the complex rules across many chapters, and decisions they make that impact adversely on foreign firms will potentially be open to challenge through the ISDS mechanism.

(iii) Application to local government

The 12 countries that are party to the TPPA have very different allocations of responsibility between central, provincial or state, regional and local government. New Zealand, with a highly centralised system of government, sought parity with other countries where many responsibilities are decentralised and allocated to lower level public bodies. Achieving that equivalence was difficult because large powerful countries with federal systems, especially the US, cited constitutional limits on their ability to bind sub-federal governments.

The variable coverage of local government across the TPPA’s 30 chapters reflects these tensions:

- Chapter 9 Investment and Chapter 10 Cross-border Trade in Services baldly state that: “A Party’s obligations under this Chapter *shall apply* to measures adopted or maintained by the central, regional or local governments or authorities of that Party...”.¹²
- Chapter 8 Technical Barriers to Trade requires the central government to ‘*take reasonable*

10 TPPA Article 1.3

11 There are important issues relating to local government bonds and other financial instruments that are not addressed in this paper but will be covered in the expert paper on financial services and investments.

12 TPPA Article 9.2(a) and Article 10.1. This wording removes the flexibility in earlier agreements, including the General Agreement on Trade in Services (GATS), which required a central government to ‘take such reasonable measures as may be available to it’ to ensure conformity.

measures within its authority, to *encourage* local government bodies to observe' various provisions in the chapter, which mainly apply to disclosure and consultation.¹³

- Local government is covered in the government procurement chapter for the entities a country has specifically *included* in its schedule; New Zealand listed none.
- Countries had to explicitly *exclude* state-owned enterprises (SOE) and monopolies at the sub-central level from coverage under the SOE chapter; New Zealand excluded them all.
- *Future negotiations* to extend coverage are scheduled in 3 years for *government procurement* and not later than 5 years for *SOEs*.

Adding to this complexity, different terms are used in the text for levels below central government. New Zealand's Local Government Act defines '*local government*' as consisting of regional councils and territorial authorities.¹⁴ The TPPA treats *regional government* as a distinct level, which is defined by each country in chapter 1. New Zealand states that the term 'regional' level of government is not applicable, presumably because 'regional' is taken to mean state or provincial government in a federal context. So wherever the TPPA rule specifically refers to 'regional government' that part of the obligation does not apply to New Zealand.

However, the chapters on SOEs and government procurement refer to *all sub-central government*. Chapters on investment and cross-border services apply to *both regional and local government*, although there are some different rules for each. Chapter 8 Technical Barriers to Trade refers to '*local government bodies on the level directly below that of central government*'.¹⁵ The environment chapter and process rules in the transparency and regulatory coherence chapters are *silent* on level of coverage.

These variations mean the application of the TPPA to local government needs to be carefully reviewed on a chapter-by-chapter basis. At the same time, one activity such as a PPP or resource consent may be covered by several chapters, so it is also essential to understand how the different chapters interrelate as a whole.

3. International experience

The 'behind the border' rules of agreements like the TPPA aim to reduce the adverse effects on foreign companies when host governments adopt measures that impact on investments and cross-border services, e-transactions, public procurement or movement of people. In doing so they erode local and national control. Democratic control tends to be displaced in favour of purely commercial imperatives that ignore the social, environmental or other needs of the people who fund the government's operations and pay for privatised services.

13 TPPA Article 8.3.1bis Each Party shall take such reasonable measures, within its authority, to encourage observance by local government bodies on the level directly below that of the central government within its territory which are responsible for the preparation, adoption and application of technical regulations, standards and conformity assessment procedures with Articles 8.5 (International Standards, Guides and Recommendations), 8.6 (Conformity Assessment Procedures), 8.7 (Compliance Period for Technical Regulations and Conformity Assessment Procedures), and each of the Annexes to this Chapter.

14 Section 21, Local Government Act 2002

15 TPPA Article 8.3.1bis

Lower levels of government are increasingly bound by rules they had no role in negotiating. After several decades, local governments in Canada, Mexico and the USA have found the rules of the North American Free Trade Agreement (NAFTA), on which the TPPA is based, have undermined a number of traditional functions in favour of a minimalist, market-based model.¹⁶ These functions include:

- The special role of local government in creating and promoting economic development;
- Freedom to choose significant procurements using simple and inexpensive processes;
- Pursuit of socio-economic goals, such as building affordable housing, licensing certain businesses, provision of utilities, promoting of a living wage, and options for raising council income; and
- Providing public goods, such as developing and maintaining a safe and viable community, environmental protection, wise stewardship of public assets, supplying safe water and sanitation, and the ability to expropriate land for public purposes.

A legal opinion on the recent EU-Canada agreement warned the dramatic expansion of international rules to local governments meant their mandates now have to be exercised within strict policy and regulatory boundaries set by these international treaties. This rigidity stymies local authorities' ability to respond to future needs and necessary but unforeseen changes, or to take new opportunities and initiatives.

4. Special protections for TPPA Investors

The chapters on investment and cross-border services (which also covers foreign firms setting up inside New Zealand) have the most immediate significance for local government because all levels of government are bound by the rules.

The investment chapter creates special protections for investors from TPPA countries and their investments, except those from Australia,¹⁷ as described below. These protections do not apply to local firms, or investors from other countries unless New Zealand has a similar agreement with them. Some such agreements (eg China, Taiwan and South Korea) require New Zealand to pass on any better treatment it gives to investors under the TPPA.¹⁸

'Investment' is very broadly defined. It includes an enterprise, shares, bonds (including local government bonds), a construction contract or concession contract (PPPs, transport, water), a licenses, permit, authorisation, lease, etc.

¹⁶ William Kerr, May Yeung and Desaree Larson, 'A Space for Cities in Trade Agreements', Estey Centre for Law and Economics in International Trade, Saskatoon, Canada, January 2008; Stephen Shrybman, 'Opinion for Canadian Union of Public Employees on Canada-European Union: Comprehensive Economic and Trade Agreement (CETA)', Sack, Goldblatt & Mitchell, Ottawa, Canada, 10 April 2012.

¹⁷ A side-letter between New Zealand and Australia prevents their investors having recourse to ISDS for a dispute against the other country, consistent with the lack of enforcement mechanisms in the Australia New Zealand Closer Economic Relations Trade Agreement, although they could seek to establish a legal presence in one of the other TPPA countries.

¹⁸ Eg. Articles 107 and 139 of the New Zealand China Free Trade Agreement 2008

There are two principal investor protection rules of importance to local government: minimum standard of treatment, including ‘fair and equitable treatment’;¹⁹ and direct and indirect expropriation.²⁰ Both target policies, regulations and decisions that impact negatively on the value and profitability of an investment. The schedules of ‘non-conforming measures’ that limit New Zealand’s exposure to some of the investment chapter do not apply to these investor protection rules.²¹

Minimum standard of treatment is the most frequently invoked by foreign investors. Its open-ended description invites adventurist interpretations by the investment tribunals that hear the disputes. Investors commonly claim that one component, *fair and equitable treatment*, requires a stable regulatory environment from the time of their investment. The TPPA has attempted to tie that down but that is unlikely to be effective.²²

Direct expropriation, such as nationalisation, is prohibited unless it is non-discriminatory and conducted according to domestic law (eg the Public Works Act 1981) with prompt compensation at market value.²³ *Indirect expropriation* is more problematic. Sometimes referred to as regulatory takings, investors use it to challenge decisions that have a major impact on the value or profitability of their investment, such as new environmental regulations, closure of sites due to pollution, or toxic waste, changes to zoning, or revoking of a permit or consent. This is the international law equivalent of the right to compensation for ‘regulatory takings’ that the ACT Party promoted through the Regulatory Responsibility Bill, later the Regulatory Standards Bill.²⁴

A special annex on expropriation says regulatory actions for ‘legitimate public welfare objectives, such as public health, safety and the environment’, do not constitute indirect expropriations, except in ‘rare circumstances’ – a phrase that gives investment tribunals considerable latitude. That phrase is not used in the Annex on expropriation in New Zealand’s recent agreements with ASEAN, Taiwan and South Korea, but will now apply to them under the most-favoured-nation rule.²⁵

Investors from TPPA countries can use these protections to challenge local government decisions that affect their commercial interests, such as cancelling or requiring variations on disputed PPP contracts; planning and consent processes that produce outcomes the investor claims are unfair,

19 TPPA Article 9.6

20 TPPA Article 9.7

21 TPPA Article 9.12

22 Footnotes 4 and 5 to Article 9.6 say the ‘mere fact’ that an action, or withdrawal of a subsidy, may be inconsistent with an investor’s expectations does not constitute a breach of the article, even if there was a monetary loss. But frustrated expectations can still form part of a complaint by an investor.

23 TPPA Article 9.8

24 Clauses 6(2)(e) of the Regulatory Responsibility Bill 2006 and Clause 7(1)(c) of the Regulatory Standards Bill 2011

25 The most-favoured-nation rule in those agreements entitles their investors and service suppliers to any better treatment New Zealand gives those of other countries in future agreements.

arbitrary or contrary to their expectations; terminating concessions; or blocking an investor's proposal to increase tariffs for utilities like water or sanitation.

In addition, the TPPA contains an 'umbrella' clause that allows an investor from another TPPA country to enforce an investment agreement (such as a PPP contract or water concession) by using the investor-state enforcement mechanism, even if the investor is not claiming a breach of the rules of the TPPA's investment chapter.²⁶

An 'investment agreement' is defined as one that grants rights (inter alia) to a covered investor or investment with respect to exploration and extraction of natural resources, such as oil, natural gas and timber; to supply services on behalf of the government ... for power generation or distribution, water treatment or distribution, telecommunications, or other similar services ... for consumption by the general public,²⁷ and for infrastructure projects, such as roads, bridges and pipelines.²⁸ This option only applies to agreements made by central government, and that were entered into after the TPPA comes into force, but it would apply to a joint arrangement involving central and local government.

5. Investor-state dispute settlement (ISDS)

An investor from a TPPA country (except Australia) can enforce these special rights in the investment chapter through the ISDS mechanism. ISDS disputes frequently involve central and local government actions relating to natural resources, including recent cases involving climate change mitigation and renewable energy.²⁹

(i) Enforcement through ISDS

Investors can seek compensation even where the government claims good cause for taking the action complained of or when the matter could be pursued in the domestic court.³⁰ Even where the investor's claim is far-fetched, the costs of defending a dispute can sap a government's resolve – known as the 'chilling effect'.

The OECD put the cost in 2012 at an average of US\$8 million, but some cases have cost much more. The Australian government is reported to have spent over A\$50 million to successfully defend the plain packaging tobacco law.³¹ There is no guarantee the government will be fully

26 This option only applies where the agreement does not specify the dispute settlement forum.

27 It specifically excludes corrections, healthcare, education, childcare, welfare services or other similar social services

28 TPPA Article 9.1

29 Gus van Harten, 'Foreign investor Protection and Climate Protection: a new price tag for urgent policies', Osgoode Legal Studies Research Paper, no.66, vol 11, issue 14, 2015

30 TPPA Article 9.21.2(b)

31 Kyla Teinhaara, 'The dismissal of a case against plain cigarette packaging is good news for taxpayers', *The Age*, 20 December 2015

recompensed even though it won on a question of jurisdiction. Recent Canadian disputes show the government could seek to recover the costs and any compensation from the local authority.³²

The ISDS system faces a serious crisis of legitimacy,³³ with some governments terminating their investment-only agreements and the European Union refusing to accept a TPPA-style approach in its negotiations for a parallel agreement with the US.³⁴

The TPPA has not addressed the main objections that ISDS lacks the characteristics of a credible and independent legal process and effectively supplants national judicial processes as the appropriate legal forum for a privileged class of foreign investors.³⁵ Investment tribunals are still ad hoc, with the ‘judges’ selected by the parties. The TPPA says there will be a code of conduct for arbitrators, but it is not required until the agreement comes into force, so it is impossible to assess whether it will attempt to address the systemic conflicts of interest that arise when practicing investment lawyers also act as arbitrators.

Senior judges have expressed concern that decisions of domestic courts can be challenged under ISDS and domestic appeal processes by-passed.³⁶ There is no formal system of precedent, which means interpretation of open ended or novel text in the TPPA will be unpredictable, and there is no appeal even if the reasoning is clearly flawed. Awards can and do run into the hundreds of millions, and even more than a billion dollars, including compound interest. Costs of defending an action can be very high, again in the tens of millions of dollars.

(ii) ISDS cases against Canadian local government

Many investment disputes have challenged actions of provincial and local governments. However, such cases are brought against the central government, which decides whether and how to defend it.

32 Former Prime Minister Harper proposed creating a mechanism to reclaim money central government was forced to pay when provincial governments were found to have violated NAFTA. The provincial governments affected by ICSID cases have so far rejected claims they should pay. Bertrand Marotte, ‘Ottawa to pay \$17.3 million to Exxon, Murphy Oil for Nfd. Trade violation’, *Globe and Mail*, 23 March 2015

33 UNCTAD, ‘Reform of Investor-State Dispute Settlement: In search of a roadmap’, *IIA Issues Note* no.2, June 2013

34 European Commission, ‘EU Finalises Proposal for Investment Protection and Court System for TTIP’, Brussels, 12 November 2015

35 Amokura Kawharu, ‘TPPA: Chapter 9 Investment’, TPPA Expert Paper #2, tpplegal.wordpress.com; Jane Kelsey, ‘The TPPA: Treaty making, Parliamentary democracy, regulatory sovereignty and the rule of law’, Expert paper #1, tpplegal.wordpress.com, pp.30-31

36 Chief Justice of Australia RS French, ‘Investor-state dispute settlement: A cut above the court?’, Supreme and Federal Courts’ Judges Conference, Darwin, 9 July 2014; Chief Justice of New Zealand Sian Elias, ‘Barbarians at the Gate: Challenges of Globalisation to the Rule of Law’, World Bar Association Conference, Queenstown NZ, 4 September 2014, pp.3-4

The experience with NAFTA provides insights into how US companies might use the TPPA to challenge regulations, bylaws, regional plans and environmental and resource management decisions.³⁷

- Chemical giant Dow AgroSciences challenged Quebec’s ban of 2,4-D used in a lawn pesticide, claiming the ban was not based on a strict science-based test, although the Supreme Court had upheld bans on cosmetic pesticides as constitutional and legal, and many studies showed the pesticide was linked to cancer and cell damage. The Canadian government opted to settle in 2011 by publicly acknowledging that the chemical does not pose an “unacceptable risk” to human health, contradicting the government’s previous position.³⁸
- A NAFTA investment tribunal awarded C\$17.3 million in damages to US oil companies Exxon and Murphy Oil over a requirement by Newfoundland and Labrador that they spend additional research money related to their offshore oil projects in the province, after a local board concluded they were not meeting their R&D obligations. The companies had claimed \$60 million.³⁹ Other claims are pending.
- Canadian energy company Lone Pine is suing the Canadian government through its American affiliate for C\$250 million after Quebec introduced a moratorium on all fracking activities under the St. Lawrence River until further studies are completed.⁴⁰
- Mesa Power Group, an energy company owned by a Texan billionaire, is claiming C\$775 million in a challenge to Ontario’s Green Energy Act, which gives preferential access to local wind farm operators.⁴¹
- In 2008 pulp and paper company Bowater closed a mill that was a key contributor to the economy of Newfoundland, with the loss of some 800 jobs.⁴² The firm’s head office was in Montreal, but the parent was incorporated in Delaware, USA. The company retained numerous water and timber rights and hydropower assets. The provincial government passed legislation expropriating these assets in reliance on a 1905 lease agreement. Bowater threatened to bring a claim on behalf of itself and its Canadian affiliate under NAFTA’s investment chapter for expropriation, unless it was paid \$500 million in compensation. The Canadian government settled with a payment of \$130 million to ‘avoid potentially long and costly legal proceedings’.⁴³

37 Maude Barlow, ‘NAFTA’s ISDS: Why Canada is one of the most sued countries in the world’, Common Dreams, October 2015, <http://www.commondreams.org/views/2015/10/23/naftas-isds-why-canada-one-most-sued-countries-world>

38 *Dow Agrosciences v The Government of Canada*, Arbitration under Chapter 11 of the NAFTA, 25 May 2011

39 Bertrand Marotte, ‘Ottawa to pay \$17.3 million to Exxon, Murphy Oil for Nfd. Trade violation’, *Globe and Mail*, 23 March 2015

40 *Lone Pine Resources Inc v The Government of Canada*, Notice of Arbitration under the Arbitration rules of UNCITRAL and Chapter 11 of the NAFTA, 6 September 2013

41 These proceedings were unresolved as of end 2015: <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/mesa.aspx?lang=eng>

42 *AbtibiBowater v Canada* (ICSID Case No UNCT/10/11) 2010

43 Foreign Affairs and International Trade Canada: Issues statement on Abitibi Bowater settlement, 24 August 2010

(iii) **Bilcon v Canada**

In an August 2015 NAFTA decision, US quarrying company Bilcon successfully challenged the decision of a local environment panel to deny it a permit to build a basalt quarry and marine terminal in a sensitive coastal area of Nova Scotia.⁴⁴ The proposed 152-hectare project was located in a key breeding area for several endangered species, including the world's most endangered large whale.⁴⁵ Canada's Department of Fisheries and Oceans determined that blasting activity in this sensitive area raised environmental concerns and thus required a rigorous assessment. A joint federal-provincial review panel established under local environmental law heard submissions and denied the permit. The environmental review panel criticised Bilcon's poor consultation with indigenous peoples, fishers and other communities and found the project was contrary to 'community core values'.

The Clayton family, who owned Bilcon, objected that local officials had encouraged the project and said convening the joint review panel posed a 'rare, cumbersome and costly obstacle' to its investment. Rather than taking the matter on appeal through Canada's judicial process, Bilcon brought an investment dispute under NAFTA for C\$300 million. Bilcon claimed the panel's assessment was arbitrary, discriminatory, and unfair, breached the minimum standard of treatment it was entitled to under NAFTA, and was discriminatory.⁴⁶

In a split decision, the majority of the arbitral panel – the investor's nominee and the chair – said the review panel failed to provide the minimum standard of treatment required, because it denied Bilcon a fair hearing and failed to explore mitigation options short of rejecting the application.⁴⁷ The concept of 'core community values' was considered novel and too vague for Bilcon to respond to. The treatment of Bilcon was also discriminatory, because other panels in Canada had allowed similar projects to proceed subject to conditions.

The dissenting arbitrator described the decision as a 'significant intrusion' into domestic jurisdiction, where decisions about Canadian law end up being made by offshore investment tribunals.⁴⁸ He warned the dispute would be viewed a 'remarkable step backwards' in environmental protection and 'create a chill' among environmental review panels which would be reluctant to rule against projects that would cause undue harm to the environment or human health.⁴⁹

44 *William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc. v. Canada*, (UNCITRAL 1976 Rules; PCA Case No. 2009-04) (Bilcon v Canada)

45 Corporate Rights in Trade Agreements: Attacking the environment and community values', Bilcon Fast Sheet #4, Sierra Club, USA 2015

46 breaching the national treatment and most favoured nation obligations, discussed below.

47 *Bilcon v Canada* pp.204-214. See also Luke Eric Peterson, 'Arbitrators in Clayton/Bilcon case align on jurisdictional questions, but fall out over Canada's liability for NAFTA breach in \$300 million quarry right', *IA Reporter*, 21 March 2015; Luke Eric Peterson, 'Majority of NAFTA chapter 11 tribunal finds national treatment and minimum standard breaches in environmental review of controversial Nova Scotia quarry', *IA Reporter*, 21 March 2015.

48 See also 'Bilcon Case leads to broad alarm over ISDS reach into domestic law', *Inside US Trade*, 9 April 2015

49 'NAFTA ruling in Nova Scotia quarry case sparks fears for future settlements', *Globe and Mail*, 24 March 2015

Damages have yet to be awarded, but the tribunal found both levels of government at fault, so both are expected to share the costs.⁵⁰

As discussed below, the Bilcon dispute illustrates the potential risks of an investor-state dispute where a decision of a local or regional authority, or another statutory board, rejects an application from a foreign investor because of community concerns. It is also very easy to see how a similar situation might arise in relation to Māori objections to a planning or resource consent, or in response to a Māori Advisory Board. The Treaty of Waitangi exception in the TPPA will not provide effective protection, because it only applies where Māori receive preferential treatment alongside other conditions.⁵¹

6. PPPs

Recent changes to New Zealand's local government legislation to promote privatisation through contracting out of services or use of PPPs, and renewed asset sales, will intensify local government's exposure to the TPPA.

(i) The New Zealand context

New Zealand initially took a cautious approach to PPPs. A report prepared for Treasury in 2006, under a Labour government that generally did not favour their use, warned that the advantages had to be weighed against the contractual complexities and rigidities, and suggested most of the advantages claimed for PPPs could be secured through conventional procurement methods.⁵² It concluded that PPPs may be a good means of producing services only if three conditions were all met: project outcomes can be specified in terms of service levels, performance can be measured objectively, and performance objectives are durable.

The National government has actively promoted the use of PPPs at central and local level.⁵³ Government agencies must now consider PPPs for projects costing more than \$25 million. Treasury is playing a lead role with a dedicated PPP team and a process that public sector entities are required to follow. Treasury's National Infrastructure Unit has a 30-year plan that suggests PPPs for roading, energy supply, and social assets such as schools, hospitals and prisons.⁵⁴

50 'Nova Scotia taxpayers may be on hook for NAFTA defeat', *CBC News*, 24 March 2015; 'Nova Scotia denies quarry deal, says province not liable for NAFTA damages', *CBC News*, 24 March 2015

51 See Carwyn Jones, Claire Charters, Andrew Erueti and Jane Kelsey, 'The TPPA and the Treaty of Waitangi', *Expert Paper #4*, January 2016, tpplegal.wordpress.com

52 Dieter Katz, 'Financing Infrastructure Projects: Public Private Partnerships', *Treasury policy perspectives Paper*, 06/02, March 2006.

53 Treasury defines a PPP as 'a long term contract for the delivery of a service, where the provision of the service requires the construction of a new asset, or the enhancement of an existing asset, that is financed from external (private) sources on a non-recourse basis and where full legal ownership of the asset is retained by the Crown.' Treasury, 'Public Private Partnership Programme. The New Zealand PPP Model and Policy: Setting the Scene. A guide for public sector entities', September 2015, p.1

54 New Zealand Infrastructure Plans, <http://www.infrastructure.govt.nz/plan>

Central or local governments embarking on a PPP normally advertise internationally to seek competitive bidding and experienced companies. In New Zealand's case international companies would win most such tenders by default, because there are very few New Zealand-owned international companies with relevant resources and expertise.

(ii) The international context

This policy comes at a time when PPPs are becoming less popular in some countries that have several decades of experience with them. In the United Kingdom, which was in the forefront of promoting PPPs (known there as Private Finance Initiatives) there appears to have been a decline in the number of contracts since 2008. That is partly because of concerns about the lack of transparency, the inflexibility of contracts, and perceived waste. A UK inquiry in 2011 identified the following weaknesses:

- Procurement processes are usually slow, expensive, and have led to increased costs with reduced value for money;
- Contracts are frequently inflexible, making alterations to the service requirements difficult;
- Inadequate transparency regarding future liabilities to the taxpayer and of investor returns; and
- High-risk factors for the private company carry a high-risk premium for the public.⁵⁵

Australia also has numerous examples of problems and failures in the use of PPPs relating to roads, tunnels, prisons and hospitals, especially at state level.⁵⁶

(iii) Local government and PPPs

At present there are few PPPs at local government level, although it is clearly the current government's intention that they become more common.

Auckland City seems increasingly likely to adopt more PPPs. It provides critical mass of area, population and infrastructure needs, and the government has strong oversight of developments in the region. The Mayor has clearly favoured them.⁵⁷ A report to Auckland Council in 2013 by consultants EY highlighted the potential for PPPs for water and wastewater, street lighting, leisure projects, regional parks, convention centres, transport, roads and footpaths, parking, stormwater and flood protection, ports and libraries.

The EY report focused on the 'attributes' of PPPs – notably risk transfer to the private sector, use of private sector finance, and operational efficiencies – while it minimised the difficulties and potential problems and the consequences of using PPPs for both the council and the public/ratepayers. These problems include the complex technicalities of contracts, especially when the

55 House of Commons Treasury Committee, *Private Finance Initiative*, 18 July 2011

56 'Funding the Future after the demise of PPPs', *The Conversation*, 7 October 2013, <http://theconversation.com/funding-the-future-after-the-demise-of-ppps-18869>

57 Mayor Len Brown's Speech to Public Private Partnership Summit, 29 April 2013, <http://www.aucklandcouncil.govt.nz/EN/newseventsculture/OurAuckland/mediareleases/Pages/Mayor'sSpeechPublicPrivatePartnershipSummit.aspx>

bidders are specialists in such deals, and the problems of enforcing liability and accountability of special purpose companies that are created for individual projects with minimal capitalisation.⁵⁸

Auckland Council would be required to undertake a qualitative and quantitative assessment of the monetary and non-monetary costs and benefits of each procurement option. However, assessing 'value for money' is not a scientific exercise. It is impossible to anticipate what 'whole of life' risks may be involved in a PPP and write them into the contract, as the consultants advise.⁵⁹ In reality, the political, reputational and fiscal risk remains with the local authority if the deal becomes problematic or falls over.

(iv) Risks under TPPA

Investors like PPP contracts because they provide a guaranteed income stream from governments for 15 to 30 years, and are notoriously difficult for governments to change or exit when they go wrong. A PPP contract with an entity from a TPPA country (except Australia) will be a covered investment and subject to the special rules, protections and enforcement mechanisms in the investment chapter. Any PPP contract on-sold in secondary markets, and debt instruments associated with the PPP will likewise be protected investments where owned by a non-Australian TPPA investor.

If central or local governments seek to terminate or renegotiate contracts with investors from a TPPA country they risk being challenged through ISDS for breaches of fair and equitable treatment and expropriation, discussed above.

The series of crises at the Serco-run remand prison in Auckland is a timely example.⁶⁰ The contract with Serco to run the private prison was terminated after a series of serious breaches, but the government decided to wait 15 months to use the break clause in the contract rather than terminate it for failure to perform. It seems likely this choice was driven, in part, by concerns about litigation. That risk would intensify greatly if Serco had access to ISDS.

The process for procurement of PPPs is not covered by the government procurement chapter when it is exclusively at the local government level, but it will be covered if a central government agency is also a party to the contract.⁶¹

7. Privatised Water

Financing and contracting-out work related to water supply, reticulation, purification and quality, and to wastewater, will be among the most significant issues for local authorities in coming decades. As the proposed bundling of catchment and supply areas provides for more bulk water

58 EY (Ernst Young) Mayor of Auckland's Position Paper on Public Private Partnerships, November 2013, Section 4.1

59 Ibid, Section 5

60 'Fears other prisons vulnerable as staff move to cover Mt Eden', *NZ Herald*, 10 December 2015

61 The central government entities covered by the chapter are set out in Annex 15A: Schedule of New Zealand, and include the Canterbury Earthquake Recovery Agency.

suppliers, which are especially attractive to foreign bidders, virtual control over New Zealand's water system could effectively be removed from local authority and public control. Introduction of a system of tradeable water rights would also lock in a market model of water allocation, irrespective of competing environmental, conservation, Treaty of Waitangi, public good and human rights considerations. Water contracts and tradeable water rights held by investors from TPPA countries are both protected investments under the TPPA and disputes will be subject to ISDS.

(i) The water privatisation controversy

Water, especially for potable and sanitary uses, is a paramount requirement for human existence. Most civilisations have required that water should be supplied as a public good, at the lowest possible cost, commonly by a local authority through public ownership. Any profit margin was taboo. Because water is essential to sustain human life, animals and crops, and recognised as a public good, whoever runs and controls water has control of the most important natural monopoly.

The most common type of water ownership and supply worldwide is still public, by local government. In many countries (for example Japan, Scandinavia, Pakistan, Egypt) there are no private water companies. Uruguay, Netherlands, and Nicaragua have all banned water privatisation in any form. In 2011 an Italian law favouring water privatisation was repealed following a referendum in which the overwhelming majority of Italians voted for repeal.⁶² In developed countries outside England and Wales, Chile, and some US cities full private ownership is fairly rare.

The increase in water privatisation initiatives has been a matter of concern and controversy both in New Zealand and internationally. Proponents of water privatisation argue that it leads to improved efficiency, service quality and increased investment. In some cases some or all of these points are correct. Opponents note that in many cases it leads to price increases, sometimes because of inefficiency and poor maintenance, but most of all because it is against the public interest to turn a public good into a private good.

Because such contracts are generally for long terms (often 25 to 50 years) and because PPPs are traditionally complex and inflexible, often lacking in transparency, and difficult to monitor, they frequently place the effective control and virtual 'temporary' ownership of water and wastewater in the hands of the company with the contract.

(ii) Risks of failed water privatisation

Section 136 of the Local Government Act allows local authorities to contract out the provision of water services for up to 35 years.⁶³ That figure could be changed up or down in the future, as could the responsibilities of local government for water. Treasury's National Infrastructure Unit planning for 2045 includes large-scale water operators servicing multiple catchments and regions beyond traditional local authority boundaries, presumably through concession contracts or

62 European Federation of Public Service Unions, 'EPSU welcomes the result of the Italian water referendum', 14 June 2011, <http://www.epsu.org/a/7715>

63 Increased from 15 years under the Local Government Act amendment in 2010

PPPs. It also promotes market allocation models for water, which likely means tradeable financial instruments.

Concession contracts or PPPs in the water industry have a very mixed performance. Local governments that have tried to address failures in service delivery or affordable access to potable water have been sued by large transnational water firms, including Suez and Bechtel, under investment treaties.

- The ‘Cochabamba water wars’ ignited international opposition to ISDS. In 2001 US energy and utilities company Bechtel brought an investment dispute against Bolivia seeking \$25 million in damages and \$25 million lost profits for termination of a water privatisation contract. Following a high-profile international campaign Bechtel eventually settled in 2006 for a token payment.⁶⁴
- Suez, Vivendi, Anglia Water and others had a concession to operate privatised water and waste-water services in Argentina. Following the financial crisis in 2001 the government rejected price increases and, after failing to renegotiate, terminated the contract and took the service back into public hands.⁶⁵ In 2015 the investment tribunal awarded US\$405 million against Argentina.⁶⁶

These high profile ISDS disputes have added to the legitimisation crisis facing the investment arbitration system.

New Zealand’s limited experience with water privatisation should ring warning bells of similar risks here. Papakura District Council entered into the first private water and wastewater concession in 1998. The Auditor-General’s report that year concluded that:

The use of a franchise agreement of this type can be a viable option for the delivery of local authority services. However, there are inherent risks which must be minimised through the actions of local authorities in the development, implementation, management and monitoring of such an agreement. Our audit has identified a number of these risks and we hope that other authorities will benefit from a greater awareness of the processes which need to be followed in order to make such an arrangement work.⁶⁷

However, the Kaipara District Council’s subsequent attempt to use this method to construct a wastewater system for Mangawhai led to a series of major and unfortunate failures and difficulties for the company, the council, the government, and the ratepayers.

64 Human Rights Advocates, ‘Economic, Social and Cultural Rights: The right to water’, UN Economic and Social Council, E/CN.4/2006/NGO/83, 28 February 2006, p.3

65 Lise Johnson, ‘Argentina on the hook for breach of fair and equitable treatment’, Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal v. Argentine Republic (ICSID Case No. ARB/03/19), Investment Treaty News, 23 September 2010

66 ‘Unanimous \$405m ICSID award issued in *Suez, et al. v Argentine Republic*, 13 April 2015’, Freshfields, Bruckhaus Deringer, http://www.freshfields.com/en/news/Unanimous_ICSID_award_issued/?LangId=2057

67 Report of the Controller and Auditor General on Papakura District Council: Water and Wastewater Franchise, Wellington, 1998, p.3

In her report on the Mangawhai scheme the Auditor General warned about local governments entering PPP contracts as a way to cut staff, defer debt and keep it off their balance sheet and transfer as much risk as possible onto the private sector. The Mangowhai PPP was part of a ‘systematic move to contract out much of the work so that [Kaipara District Council] was a very lean organisation’. Massive overspending left ratepayers liable for the blowout. The Auditor General reiterated that PPPs are very complex and the Council did not have the capacity to understand the details of the arrangements. She concluded that the Council ‘became too lean and did not have enough capability to monitor and control all that it was responsible for. This is a risk that many public entities need to consider.’⁶⁸

While there is an exception that gives local government full protection for all decisions related to present and future water ownership, sources and uses, for certain rules on services and investments, it does not apply to the minimum standard of treatment and expropriation rules that investors have mainly used in ISDS disputes over water. The general exception (discussed below) does not apply to the investment chapter, either.

(iii) Tradeable Water rights

Water scarcity is a growing problem, heightened by global warming. The rationing of water on a market basis means human rights and social needs compete with and are subordinated to the interests of those with commercial power. Companies in New Zealand, including foreign owned agribusinesses, already hold rights to extract or use water for irrigation, which are valuable investments that can be protected in the investment chapter through ISDS.

Tradeable water rights are financial instruments that are protected by the investment chapter against changes that negatively impact on their value, and are subject to the non-discrimination rules in the financial services chapter. A more extensive system of tradeable water rights would therefore become locked in through the TPPA.

8. Services and investment liberalisation

In addition to special protections for investors from TPPA countries, the chapters on investment and cross-border services impose a number of obligations on central and local governments when measures affect an investor or supplier of a service in New Zealand, or a firm that supplies a service from outside the country. Each party to the TPPA has a list of measures that are protected from some of these rules. The rules are outlined below, followed by the relevant entries in New Zealand’s list of protected ‘non-conforming measures’.

68 Office of the Auditor-General, Inquiry into the Mangawhai Community Wastewater Scheme, Office of the Auditor-General, Wellington, 2013, p.263.

(i) Core rules

- **No preferences to local firms and no special restrictions on foreign firms.** This rule is known as National Treatment⁶⁹ and says New Zealand cannot treat investors and their investments,⁷⁰ or services and service suppliers,⁷¹ from TPPA countries any less well than their New Zealand counterparts are treated in ‘like’ circumstances. This rule does not apply to subsidies or grants or to public procurement if it is for non-commercial government purposes.⁷²
- **No special requirements that foreign investors must perform as a condition of entry, expansion, operation or disposal of assets.**⁷³ A foreign investor may be required to locate production in a certain area, or train and employ workers as a condition of getting a subsidy or other advantage,⁷⁴ but it cannot be required to use locally produced goods or services, which would have flow-on benefits for local businesses and jobs.
- **Under ‘anti-localisation’ rules a firm or person supplying a service from offshore, eg. by a website or back office operation, cannot be required to have a local presence within New Zealand.**⁷⁵ Likewise, an investor or service supplier **cannot be required to locate its computing facilities in New Zealand** as a condition of doing business.⁷⁶ These rules make it much more difficult to require compliance with local standards and to hold the supplier accountable for the quality of the service it provides and for any failures, which potentially imposes costs on local authorities, consumers and communities.
- **A local authority cannot cap the number of service suppliers** (mega-stores, rubbish tips or liquor outlets) **or their service activities** (cruise ships docking in a day or rafting operations on a river), **ban a service activity altogether** (tourism resorts in certain areas or storage of toxic substances), require proof that the **area needs more suppliers of that service** (an ‘economic needs test’), or **operate a monopoly.**⁷⁷ These forms of limiting ‘market access’ apply whether they apply to the entire country or just one area, such as a local authority’s territory. Because the rules prevent limits on the total quantity of a service supplied, they apply across the board, not just to foreign services and suppliers.

69 TPPA Article 9.2(a) and Article 10.1. Article 9.4.3 makes it clear that ‘national treatment’ applies to a ‘regional’ level of government, which New Zealand says it has none; but this reference is ‘for greater certainty’, meaning it is not adding a new obligation. New Zealand’s regional councils would still be bound.

70 TPPA Article 9.4

71 TPPA Article 10.4

72 TPPA Article 9.11.6

73 TPPA Article 9.9

74 TPPA Article 9.9.3(a)

75 TPPA Article 10.6

76 TPPA Article 14.13

77 TPPA Article 10.5

- **A local government’s administration of a general measure that ‘affects’ services provided by a TPPA supplier can be challenged for not being reasonable, objective, and impartial.**⁷⁸ These open-ended terms could open local government to claims that their process and grounds for making decisions on construction, tourism, retail, advertising or environment were unreasonable, subjective or partisan.⁷⁹ The scope is very wide, because it applies to any regulatory measure that ‘affects’ commercial transactions between a TPPA services seller and a New Zealand consumer.
- **Licensing requirements or technical standards (eg advertising rules, zoning, water quality, carparking for retail developments, building standards) to be based on criteria that are transparent and objective.**⁸⁰ A local authority’s choice between several regulatory options might be challenged as being arbitrary because it was inconsistent with practices elsewhere, the evidence relied on was contested, or certain constituencies, values or views were favoured. This obligation is softer than the rule on administration of regulatory measures, as the government only has to ‘endeavour’ to ensure compliance.⁸¹

(ii) Protections for non-conforming measures

Blanket application of these rules would make many central and local authority activities impossible. While the TPPA ultimately aims for complete liberalisation, governments are allowed to maintain some ‘non-conforming measures’.⁸² These provide a defence the government can rely on if a measure is challenged. However, they are complex, only apply to certain rules and the wording often provides only partial protection.

Each government lists measures that do not conform to the rules in the paragraphs dealing with non-discrimination,⁸³ requiring a service supplier to have a presence in the country,⁸⁴ limits on the growth of the market,⁸⁵ imposing performance requirements on foreign investors,⁸⁶ and requiring local directors and senior managers⁸⁷.

New Zealand’s ‘non-conforming measures’ are listed in two annexes, which the other TPPA parties have agreed to. Annex I protects the status quo for the listed measures, but they cannot be made

78 TPPA Article 10.8.1

79 As discussed below, the Treaty of Waitangi exception only applies where Māori receive preferential treatment, not where recognition of their rights or concerns result in an adverse effect for another commercial interest.

80 TPPA Article 10.8.2

81 The constraints on domestic regulation affecting services are less rigorous than New Zealand wanted because of resistance, especially from the US, for constitutional reasons

82 TPPA Article 9.12 and Article 10.7

83 TPPA Articles 9.4 and 10.3 National Treatment and Articles 9.5 and 10.4 Most-Favoured-Nation Treatment

84 TPPA Article 10.6 Local Presence

85 TPPA Article 10.5 Market Access

86 TPPA Article 9.9 Performance requirements

87 TPPA Article 9.10

more restrictive in the future. Annex II allows more future proofing: it specifies the activities or sectors where the government can adopt measures that breach certain rules. This ‘negative list’ approach has the obvious problem that it binds central and local government to what is in the list, even if circumstances change, unforeseen problems arise, new technologies heighten the risks, or governments are elected with a mandate to pursue different policies

Local government received special treatment. All existing measures are automatically protected by Annex 1 without having to be listed.⁸⁸ That means the status quo can continue to apply. But local authorities can only tighten the rules or give more preferences to local businesses in the future where the government has preserved the right to do so in Annex II.⁸⁹ Any local government measure, activity or action not listed in Annex II is effectively locked in at the current level of liberalisation.

(iii) New Zealand’s non-conforming measures

The protections for policy and regulation of services and investment that New Zealand has listed for Annex II, which are of particular relevance to local government, are:

- Water, including allocation, collection, treatment and distribution of drinking water (but not wholesale and retail trade in bottled water);
- ‘Devolving’ (privatising) provision of a non-commercial monopoly service⁹⁰ by allowing the government to limit the number of providers, retain a wholly or partly owned government enterprise as the monopoly or authorised supplier, require there to be local directors and some local presence in New Zealand, and specify the supplier(s)’ legal form;
- measures with respect to public housing, public transport, public utilities, social welfare, health, childcare, but only ‘to the extent they are social services established for a public purpose’;⁹¹
- privatisation of a government owned or controlled enterprise by sale of shares or assets (eg. preferential sale of shares in the enterprise to locals);⁹²
- the categories of foreign investment that currently require approval⁹³ (eg assets and shares over a certain value and fisheries quotas) but not other forms of investment that are not currently vetted, such as tradeable water rights;
- control, management or use of protected areas or species;

88 TPPA Article 9.11.1(a)(iii)

89 TPPA Article 9.11.2 and Annex II: Non-conforming measures

90 It is very difficult to think of services that now fit that description.

91 It is very hard to disaggregate social service elements of a service that has a commercial element. The service must also have been ‘established’ for that purpose.

92 The entities listed do not include any local government entities or assets, but the list is ‘inclusive’.

93 Setting up or acquiring a business where total expenditure exceeds \$200 million; acquisition or control by a government source of 25% of voting power or shares where the transfer of assets exceeds \$100 million; acquiring 25% or more of shares in an entity where expenditure exceeds \$100 million, sensitive land, fishing quotas

- the foreshore and seabed, EEZ and territorial sea;
- film co-production arrangements;
- regulating gambling, betting and prostitution;
- cultural heritage, libraries and museums; and
- wholesale and retail sale of tobacco and alcohol products (but not for new restrictions on other services, eg such as banning alcohol advertising hoardings). In a separate exception,⁹⁴ tobacco control measures may also be shielded from ISDS by a special exception in the investment chapter, if the government elects to invoke it, but the same does not apply to alcohol policies.

These protections need to be read very carefully as the wording is technical and will be interpreted narrowly. Some of them only apply to some of the rules. In addition, the government has imported market access protections from its schedule in the WTO services agreement, which is structured in a totally different way, meaning the overall scope of the protections will be hard to predict with any certainty.

Moreover, these lists do NOT apply to the special investor protection rules on minimum standard of treatment and expropriation, described above, which are those that foreign investors mainly rely on when bringing an investor-state dispute.

9. Council Controlled Organisations (CCO) contracts

(i) The legislative framework

The Local Government Act promotes the corporatisation of local government activities through the use of CCOs – a feature of the arrangements imposed on Auckland through the Super City plan. These changes will significantly increase the exposure of local authorities to the TPPA, especially the investment chapter and ISDS.

In particular, Section 17A Delivery of services says a local authority must review the cost-effectiveness of current arrangements for meeting the needs of communities within its catchment for good-quality local infrastructure, local public services, and performance of regulatory functions. The review *must* consider devolving delivery to a council-controlled organisation that is wholly or partly owned by the local authority or to another local authority, person or agency (effectively privatisation). If the latter option is adopted, there must be a legally binding contract or agreement that includes funding mechanisms, performance criteria, risk management, and accountability,⁹⁵ unless those details are specified in the constitution or statement of intent of a CCO (which means they would have to be inferred into a PPP contract that became part of an ISDS dispute).

Such a review must take place two years before a contract or binding agreement for the delivery, service or regulatory function expires, or otherwise at no more than 6 yearly intervals. But the local authority does not need to conduct that review if the contract cannot be reasonably altered

⁹⁴ TPPA Article 29.5

⁹⁵ Serco's contract for the Mt Eden Prison had all of these features.

within the two years or the local authority is satisfied that the potential benefits of a review are outweighed by the costs. This approach not only encourages local authorities further down the privatisation track; it also invites foreign investors who hold such contracts to challenge any moves by a local authority to conduct a review the investor says is not necessary or to renegotiate or not renew the contract.

(ii) Added risks from the TPPA

Increased use of commercially focused CCOs moves crucial decisions over local infrastructure and services further from elected local authority politicians and the need to balance a range of commercial and non-commercial considerations. The Local Government Act requires local authorities to develop 10-year plans in relation to their assets and service levels.⁹⁶ These plans can be adjusted according to changing circumstances.

The 10-year plans could take on new meaning under the TPPA. An investor from a TPPA country who objects that changes will have a negative impact on its investment could argue the original plan created a legitimate expectation of how the investment would be treated, and hence has breached the right to fair and equitable treatment. Even though the Act says no person can require a local authority to implement the plan,⁹⁷ a promise or act of an officer could be cited as additional grounds for that expectation. Provided the investor can raise a further basis for complaint, for example a procedural issue or claim that another similar investor somewhere in the country was treated differently, it would not be relying on the 'mere fact' that an investor's expectations were not met and could bypass the restriction the TPPA puts on such complaints.⁹⁸

All these risks incurred by a CCO contribute to a shrinking democratic control by the public and the relevance and effectiveness of elected local government institutions.

Chapter 17 State-owned Enterprises and Designated Monopolies has no precedent in any previous Agreement and its implications will take some time to determine.

Crown Controlled Organisations are a form of state-owned enterprise (SOE).⁹⁹ Each Party to the TPPA could decide which rules in the chapter (except Article 17.3) would apply when it comes to an SOE owned or controlled by a sub-central level of government (meaning regional and local government) or a monopoly designated at that level. This is set out in Annex 17-D. New Zealand has said that none of the rules, aside from delegated authority in Article 17.3, applies to sub-central government enterprises.

However, Article 17.3 does apply to CCOs. All SOEs must comply with the central government's obligations in the agreement when exercising a delegated authority, such as the power to grant licenses, impose fees or charges, or expropriate assets. No SOEs, including CCOs, can be excluded

96 Section 93 Local Government Act 2002

97 Section 96(4) Local Government Act 2002

98 See above regarding footnote 4 of TPPA Article 9.6

99 'State-owned enterprise' is defined in Article 17.1 as an enterprise principally engaged in commercial activities in which the state directly owns more than 50% of shares or controls the exercise of more than 50% of voting rights or seats on the board.

from this obligation by any annexes to the chapter. This makes it clear that SOEs, including CCOs, must comply with the investment rules and the obligations under the cross-border services chapter, as well as those on Transparency and Regulatory Coherence covered below when exercising delegated responsibilities.

Where CCOs set up under statute or bylaws are authorised to enter into investment agreements, such as contracts or PPPs,¹⁰⁰ independently of the councils that own them, those contracts will become investments that are subject to the TPPA's rules and ISDS. Councils may have indirect liability if the case is lost or the central government settles to avoid a long and costly dispute.

There is a financial threshold of revenue derived from commercial activities below which an SOE does not need to comply with the remaining rules in the SOE chapter. That is about USD376 million at the time the agreement enters into force,¹⁰¹ and will be adjusted on a three-yearly basis.¹⁰² This threshold reinforces the point that Auckland City is likely to be the most affected in the medium term, although consolidation of other local authorities also increases the potential coverage.

Within 5 years after the TPPA entering into force the Parties must negotiate to extend the rules of the SOE Chapter to the CCOs and designated monopolies whose activities were listed in Annex 17-D.¹⁰³ They would then be required to:

- (i) adopt a purely commercial approach to buying and selling goods and services, subject to a complex exception when it is delivering on a public service mandate;¹⁰⁴ and
- (ii) not receive non-commercial advantages that have an adverse effect on the interests of another Party, but a service supplied only within the country is excluded.¹⁰⁵

Because most New Zealand CCOs operate only locally and their activities are limited to services, they are likely to fall within the rather complicated exceptions to these rules. However, activities like ports and airports could be covered.¹⁰⁶

Finally, CCOs are currently excluded from the obligations of the government procurement chapter. As discussed below, that exclusion is subject to a review 3 years after entry into force.

100 EY, Mayoral Position Paper on Public Private Partnerships, November 2013

101 Not likely to be earlier than two years after signing

102 TPPA Annex 17-A

103 TPPA Article 17.14 and Annex 17-C(a)

104 TPPA Article 17.4

105 TPPA Article 17.6

106 The definition of a CCO in section 6(4) of the Local Government Act 2002 is not relevant for the purpose of the SOE chapter.

10. Public procurement

Government procurement involves buying goods and services with public money. It is important for local government because it has frequently been used to support local and regional development and employment, with multiplier effects that benefit the broader community. Rules on government procurement appear in a number of TPPA chapters, and there are different definitions which can be confusing.

Chapter 1 defines ‘government procurement’ as government purchasing of goods and services *for its own non-commercial use*, such as furniture, accounting services and IT systems. Where a chapter does not provide a definition, this one applies. Hence, where it says in Chapter 10 Cross-border services and Chapter 17 State-owned Enterprises ‘this chapter shall not apply to government procurement’,¹⁰⁷ the exclusion has that very restricted meaning. The procurement of goods or services that are resold, or are inputs for goods or services that are on-sold, would be still be covered by the rules of those chapters.

Chapter 15 Government Procurement has its own definition and rules, which impose obligations of non-discrimination and disclosure, and define the procurement process. These rules apply when: a designated entity is procuring goods or services through a contractual process; the value is above a threshold;¹⁰⁸ and the procurement is not otherwise excluded from coverage in the Agreement.¹⁰⁹ Each TPPA party lists in an Annex its central and sub-central government entities that are designated ‘procurement entities’. New Zealand has listed no sub-central entities.¹¹⁰

However, that does not mean local government is excluded in the medium term. New negotiations must begin within 3 years of the TPPA coming into force with a view to expanding coverage, including of sub-central entities; parties could agree to bring them under the agreement before then.¹¹¹ Extending government procurement powers to sub-central government entities in the future would have a significant impact and require extensive in-depth study and democratic consultation, which has not occurred to date with the TPPA.

The rules on central government procurement could nevertheless have positive and negative implications for local government. Article 15.4 requires the procurement process and decision not to discriminate against suppliers from another TPPA country. As was apparent with the closure of the Hillside Engineering Workshops in Dunedin after KiwiRail procured new carriages from China,¹¹² decisions by central government and SOEs can cost jobs and impact negatively on

107 TPPA Article 10.2.3(b) and Article 17.2.7

108 Central government entities in Annex 15-A, Section A: Central government entities listed: SDR130,000 for Goods and Services (approx. NZ\$265,000) and SDR 5 million (just over NZ\$10 million) for construction services; Section C: other government entities: SDR400,000 for Goods and Services (approx. NZ\$820,000), and SDR 5 million (just over NZ\$10 million) for construction services. These thresholds will be adjusted biennially.

109 TPPA Article 15.2

110 TPPA Annex 15-A Section B

111 TPPA Article 15.7

112 ‘Hillside – End of an Era’, *Otago Daily Times*, 22 December 2012; KiwiRail, ‘Future of Hillside Workshops Resolved’, 15 November 2012

regional economic development. Problems of accountability and legal liability for the quality of the product of service can also arise when the suppliers are in another jurisdiction.

Conversely, more transparent processes and evaluation criteria for covered procurements could mean domestic tenderers are also more fairly treated, making it difficult for governments to do secretive deals as occurred with the SkyCity Convention Centre,¹¹³ or to ignore proper processes, such as the improper termination of the contract with the Problem Gambling Foundation to provide gambling services.¹¹⁴ The difference is that domestic entities have no champion to enforce the rules under the TPPA.

A procuring entity can also promote the labour rights set out in the Labour Chapter (which refers to a limited number of high level ILO instruments), provided it is not a means of ‘arbitrary or unjustified discrimination’ or a disguised restriction on trade.¹¹⁵ However, it would not cover rights outside those instruments, such as a requirement that a contractor pays a living wage.

Even where a local authority procurement contract is not subject to the Government Procurement chapter it is still an investment covered by the Investment chapter.¹¹⁶

11. Tangata whenua and te Tiriti o Waitangi

Since 2000 New Zealand governments have included a Treaty of Waitangi exception in free trade and investment agreements, including the TPPA.¹¹⁷ The clause applies to the entire agreement, but it is limited in what it protects. It can only apply where the government accepts there is Treaty obligation, or another legitimate policy objective relating to Māori, *and* is prepared to act on that in a manner that might contravene the TPPA, *and* then to defend its actions – or those of a local government – in a state-state or investor-state dispute. New Zealand governments do not have a strong track record on any of these three points, as controversies over the foreshore and seabed and water rights show.

Importantly, the Treaty exception only applies where the government’s action involves more favourable treatment to Māori.¹¹⁸ The claim before the Waitangi Tribunal challenging the TPPA argues that the exception would not protect a general measure, such as a ban on fracking, which is motivated in part by recognition of Tiriti rights and obligations, or situations where Māori would

113 Office of the Auditor General, *Inquiry into the Government’s Decision to Negotiate with SkyCity Entertainment Group Limited for an International Convention Centre*, Wellington, February 2013.

114 *Problem Gambling Foundation v Attorney-General*, [2015] NZHC 1701

115 TPPA Article 15.8.5

116 Changes to conditions that affect the profitability of contracts can be especially problematic. For example, French company Veolia (which operates in various parts of New Zealand) brought an investor-state dispute against Egypt claiming new labour legislation, including a rise in the minimum wage. Veolia claimed that violated its rights under an investment agreement. Benoit Breville and Martine Bullard, ‘The Injustice Industry’, *Le Monde Diplomatique*, 12 June 2014

117 TPPA Article 29.6

118 Paragraph 2 of TPPA Article 29.6

be predominantly affected by a generic public policy, such as progressing smokefree policies or bypassing an IP monopoly that makes diabetes medicines unaffordable. It also seems unlikely to protect decisions of government entities, including regional and local government bodies, where concerns of local hapu are part of the grounds for environmental or other planning decisions, even where their objections were the tipping point in a broader opposition to a proposal or application.

While the government's interpretation of the Treaty of Waitangi cannot be challenged using the state-state dispute mechanisms of the TPPA, it is unclear whether and how this applies to ISDS. Both states and affected investors from a TPPA country can still challenge the measure as 'arbitrary' or 'unjustified' discrimination. If one New Zealand government says it has no Treaty of Waitangi obligation regarding a matter and refuses to act, and a future government thinks differently and then seeks to rely on the Treaty exception, an investor could claim that was 'arbitrary'. Likewise, if local authorities treat similar activities or investments differently from those in another tribal rohe – an argument along these lines was raised in the Bilcon case. 'Unjustified' discrimination is an especially opaque and subjective term.

A measure that relies on the exception could also be challenged for being a disguised means to benefit local providers of goods, services and investment, even if it is also motivated by Tiriti or related objectives.

The adequacy of the exception is currently being reviewed as part of the Waitangi Tribunal claim that will be heard under urgency in mid-March 2016.

12. Economic development

The TPPA has been justified to the public on the basis of its economic benefits to New Zealand.¹¹⁹ The expert paper in this series that examines the economics of the TPPA concludes that the projected gains from the deal are modest and rely on economic modelling that uses unconvincing assumptions and assertions.¹²⁰ Moreover, an economic development model based on tariff cuts, unregulated foreign investment and strong monopoly rights over intellectual property is not a sound basis for a progressive and sustainable 21st century economy, especially one that addresses the challenges of climate change, social inequalities, environmental degradation, resource depletion and waste.

Traditionally, local authorities have responsibilities to enhance economic development in their areas, although that is currently contested. For cities and regions to flourish, investments, local and foreign, need to produce multiplier effects for local communities through jobs and new opportunities for local businesses. Local economic initiatives require planning, incentives and support, including from strategic use of procurement. Central and local government need the flexibility to address the serious regional economic disparities through positive investment and incentives. As noted earlier, requiring a foreign investor to locate production in a certain area,

119 'Economic Modelling on Estimated Effect of TPP on New Zealand Economy', MFAT, November 2015.

120 Barry Coates, Rod Oram, Dr Geoff Bertram and Professor Tim Hazledine, 'The Economics of the TPPA', Expert Paper #4, January 2016, tpplegal.wordpress.com

or train and employ workers as a condition of getting a subsidy or other advantage,¹²¹ does not guarantee they will use locally produced goods or services that would have flow-on benefits for local businesses and jobs.

Local authorities are ever-mindful of the need for efficiency and minimise wasteful expenditure, but as PPPs have shown, short term solutions may end up costing much more. Canada's experience shows there are real risks of a costly investment dispute under the TPPA, especially by US investors, especially if there is expanded use of PPPs and private concessions. Fear of legal challenges may reduce the confidence and willingness of local authorities to address problems, whether on environment and planning matters or with procurement contracts, such as IT systems or facilities management. The potential for greater long-term burdens on ratepayers and communities is also very real.

The TPPA will not be revenue neutral for councils. There will be added compliance costs in ensuring obligations are met by councils and CCOs and meeting any additional reporting requirements. Libraries and other facilities that use copyrighted material will face added expenditure, estimated by the government's own research at \$55 million nationally a year,¹²² with new responsibilities to monitor IP compliance by community facilities and their users. Growing fiscal pressures, coupled with a desire to keep rates and charges down, will heighten the incentives to privatise assets or enter into PPPs that involve off-balance sheet financing, and increase exposure of local government under the TPPA.

13. Sustainability

Ensuring sustainability within a responsive local government democracy requires local authorities to retain flexibility to respond to changing circumstances. Environmental challenges, including climate change and water shortages, will impact on the viability of existing economic activities, especially in rural communities. Population movements create dynamic changes in local economic activity, skills and employment, and influence demand for housing, utilities, transport and social infrastructure, as well as available revenue.

A separate expert paper on 'The Environment under TPPA Governance' concludes that

the environment is a significant casualty under the TPPA. There is a gross asymmetry in the rights and means accorded organisations that would seek to protect the commons for the public good, and rights and means accorded foreign investors to protect private wealth. Adopting the lens of the foreign investor when making broad governance changes through the TPPA has sidelined the opportunity to properly integrate management of the economy with management of other domains – such as the environment. The overall result for environmental governance is window dressing on the upside, and serious threats on the downside.¹²³

121 Article 9.9.3(a)

122 'Economic Modelling on Estimated Effect of Copyright Term Extension on New Zealand Economy', MFAT, November 2016.

123 Simon Terry, 'The Environment under TPPA Governance', Expert Paper #4, January 2016, p.4, www.tpplegal.wordpress.com

14. Decision making processes

The ‘behind the border’ disciplines imposed on governments in the TPPA also focus on processes and criteria for making policy, regulations and decisions. Chapter 26 Transparency has generic rules that cover public disclosure of existing and proposed measures and prior consultation with other state parties and interested persons. These provisions are largely exhortatory. However, there is a binding obligation to maintain independent tribunals or procedures for prompt review, and if necessary correction, of administrative action with respect to anything covered by the Agreement.¹²⁴

Individual chapters impose more specific and onerous transparency requirements that give foreign states and commercial interests opportunities to influence government decisions. The chapters that have potential relevance to local government include Technical Barriers to Trade,¹²⁵ Cross-border trade in services,¹²⁶ Financial services and investments,¹²⁷ and Intellectual Property.¹²⁸ The SOE chapter has particularly onerous requirements to respond to requests for information and the TPPA party making the request does not have to meet any objective and challengeable test when it does so. As noted, CCOs are currently excluded from most of the SOE chapter, but may be covered under future negotiations.¹²⁹

Domestic decision making processes and priorities are also targeted in Chapter 25 Regulatory Coherence. Governments promise to use ‘good regulatory practices’ in relation to those measures so as to further domestic policy objectives and promote trade and investment, economic growth and employment.¹³⁰ Each government must decide the scope of regulatory measures covered by the chapter within a year; that scope must be ‘significant’.

The Regulatory Coherence chapter is much less directive than the version leaked in 2011, which would have realigned governments’ institutional arrangements to ensure more centralised oversight and imposed presumptions of light-handed and least-burdensome regulation.¹³¹ New Zealand was a lead proponent of that version, which is similar to the current government’s regulatory management regime and the ‘Better Local Government’ programme. After a backlash from developing country governments the final chapter affirms the sovereign right of governments to set their regulatory priorities, and ‘encourages’ them to use regulatory impact assessments, and facilitate inter-agency coordination when creating and reviewing regulation.

124 TPPA Article 26.4

125 TPPA Article 8.7

126 TPPA Article 10.11

127 TPPA Article 11.3

128 TPPA Article 18.9

129 TPPA Article 17.10

130 TPPA Article 25.2

131 Jane Kelsey, ‘Preliminary Analysis of the Draft TPP Chapter on Regulatory Coherence’, 23 October 2011

The Regulatory Coherence chapter is not enforceable *per se*. However, investors could cite the expectations it creates when challenging a government measure. Investors have used similar mechanisms to build an evidence base to challenge decisions using ISDS.¹³² The consultation requirements and principles in section 82 of the Local Government Act as amended in 2014 would be an obvious source of such material.

15. Exceptions

Certain chapters of the Agreement provide exceptions and protections specific to those chapters or to particular rules. Most form part of the core text, often in footnotes or annexes. They need to be read carefully because they are often not what they seem.

The cross-border services chapter has a standard exclusion for ‘services supplied in the exercise of governmental authority’.¹³³ To qualify for this protection a public service must be *both* non-commercial *and* not be provided by a competitor – basically a non-commercial monopoly. Very few services provided by central or local government today would qualify.

The Preamble and Chapter 10 recognise ‘the right to regulate’.¹³⁴ However, this does not mean that governments have the right to *regulate as they see fit*. It means the government can regulate in ways that comply with the TPPA rules.¹³⁵

Other exceptions are listed in Annexes, such as the ‘non-conforming measures’ on cross-border services and investment. Their scope is limited to that chapter unless the text says otherwise. For example, libraries and museum services are protected from some of the rules on cross-border services and investment, but this does not apply to the obligations in the intellectual property chapter or the investor protection rules. Likewise, the Annex II right to adopt or maintain measures for protected areas, including heritage management and public recreation,¹³⁶ does not affect the rights of investors with a contract to operate those facilities from bringing an ISDS case claiming a breach of fair and equitable treatment or expropriation if there is a dispute.¹³⁷

132 Jane Kelsey, ‘The Trans-Pacific Partnership Agreement: A Gold-Plated Gift to the Global Tobacco Industry?’, *American Journal of Law and Medicine 2013 Symposium on The Future of Global Tobacco Control, Current Constitutional and Treaty-Based Challenges*, Boston University School of Law, January 2013.

133 TPPA Article 10.2.3(c) and Article 17.2.10 (some rules on SOEs)

134 TPPA Preamble and Article 10.8.2

135 The panel in the WTO dispute *US-Gambling* (para 6.316) said: ‘Members’ regulatory sovereignty is an essential pillar of the progressive liberalization of trade in services, but this sovereignty ends whenever rights of other Members under the GATS are impaired.’

136 TPPA Annex 2 NZ P.11: ‘Protected areas, being areas established under and subject to the control of legislation, including resources on land, interests in land or water, that are set up for heritage management purposes (both historic and natural heritage), public recreation, and scenery preservation’

137 A decision by the government of Ho Chi Minh City in Vietnam to terminate a contract for a dialysis clinic after a series of disputes with local health care authorities was subject to an ISDS dispute, which Vietnam won in November 2014. It is not clear whether Vietnam received any award of costs. *Dialasie SAS v Socialist Republic of Vietnam*, <http://investmentpolicyhub.unctad.org/ISDS/Details/423>

Chapter 29 Exceptions imports the general exceptions provisions from the World Trade Organization's agreements on goods and services into the TPPA.¹³⁸ These provisions look reassuring, as they appear to allow the government to adopt measures that are inconsistent with the TPPA rules for reasons of public health, environment, conservation, public order or morality. However, they only apply to certain chapters, and they do not apply to those on investment, intellectual property or government procurement. The exceptions also contain multi-layered requirements that are very difficult to fulfil. The government's choice of measures must satisfy a 'necessity' test, which requires justification of the measure adopted when less burdensome alternatives were arguably available. The defence can also fail if the measure is considered arbitrary or unjustifiable discrimination against a TPPA country or a disguised restriction against cross-border commerce. The general exception has fully succeeded in only one out of 44 cases where it was invoked as a defence in the WTO.¹³⁹

The Government Procurement chapter has a similar exception, but differs in scope. Article 15.3 provides a defence for measures to protect public morals, order or safety; human, animal or plant life or health; intellectual property protection; and goods or services produced by persons with disabilities, not-for-profits and prison labour. A 'necessity' test applies, as well as the rules on discrimination and disguised restrictions on international trade. Procurement of R&D and provision to the public of health, education and welfare services are also excluded.¹⁴⁰ At present, local government is excluded from obligations under this chapter. But the exception does not apply to investment disputes over a procurement contract.

This piecemeal and contingent set of exceptions and exclusions is extremely complex and will make it very difficult for local government to anticipate legal risks when it exercises its powers.

138 TPPA Article XX GATT and Article XIV GATS

139 'Only One of 44 Attempts to Use the GATT Article XX/GATS Article XIV "General Exception" has Ever Succeeded: Replicating the WTO Exception Construct Will Not Provide for an Effective TPP General Exception', Public Citizen, Washington DC, August 2015

140 TPPA Annex 15-A, Section E.

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