

December 15, 2008

Ms. Martha Spiess
Save Our Water
P.O. Box 634
Kennebunk, Maine
04043

Dear Ms. Spiess:

Re: Proposed Long-Term Water Contract

You have asked for our views about the potential effect of international investment treaties on a proposed long-term water contract between Kennebunk, Kennebunkport and Wells Water District (“KKW”) and Nestlé Waters North America Inc. (“Nestlé”) dated May 28, 2008.

We have reviewed this proposed contract, which we understand has now been tabled for further review, and offer the following general comments.

As you may know, the United States has entered into several international investment treaties, which typically replicate the provisions of the investment rules which are set out in Chapter 11 of the North American Free Trade Agreement (NAFTA).

These treaties reflect a substantial expansion of the scope of international trade agreements to encompass broad areas of policy, programs and law which had previously only been matters of domestic and local concern.

The explicit extension of trade disciplines to state and local governments also represents a significant departure from the historic norms of international trade law. The combined effect of these developments has superimposed broad constraints on the authority of governments at all levels, that may be ignored only at the risk of retaliatory trade sanctions or damage awards made by foreign arbitral tribunals.

Unlike the treaties they supercede, the new generation of international trade agreements are binding *and* enforceable. Moreover, NAFTA investment rules accord foreign investors a virtually unqualified and unilateral right to initiate a claim for damages in regard to any alleged violation of the broadly-worded constraints established by these rules.

In the present case, it is likely that Nestlé would readily qualify as an “investor” under this trade agreement and the water-taking rights it might acquire under a contract with KKW as an



“investment”.¹ The result transforms a simple contract between KKW and Nestlé into an instrument that engages the application of international trade investment rules.

This in turn poses a difficult challenge for KKW and local regulatory bodies that might issue a water-taking permit to Nestlé. Now, due diligence requires that such local authorities seek expert advice about the potential consequences of granting water-taking rights to a company with the status of a foreign investor under NAFTA or like agreements.

It is beyond the scope of this letter to provide a detailed assessment of the potential application of international investment rules to the contract in question. However there are three important points we want to make.

The first is that the rights of a company such as Nestlé under NAFTA or another international investment treaty supercede those of any contract that it may negotiate with KKW. Thus, notwithstanding any dispute procedures set out in the proposed contract between the company and KKW, Nestlé would have the right to claim damages under the dispute procedures of an investment treaty like NAFTA, where it alleged that its rights as a foreign investor were infringed by an action taken by KKW, and this right to claim damages exists quite independently of any right it might also have under the contract itself.

The most likely way for such a conflict to arise would occur if KKW wished to curtail or terminate the water-taking rights Nestlé would acquire under the proposed contract. The right to invoke international dispute resolution exists notwithstanding the provisions of the proposed contract that concern an interruption to water-taking rights.

If such a claim is made, it will be resolved by a private international arbitral tribunal. Importantly, neither KKW or any other local public body would have standing in such proceedings. Rather a claim by Nestlé would be made against the federal government of the United States, and would be defended by it. For more information about the claims that have been made under Chapter 11 we would encourage those advising KKW to review the cases and materials that can be found on the U.S. Department of State website: <http://www.state.gov/s/l/c10986.htm>.

¹ Under the NAFTA Article 1139, “investment” is defined to include all forms of equity, debt and other interests, in both tangible and intangible property including:

interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise; ...

The second point is that under NAFTA investment rules, the need to conserve exhaustible natural resources is not a justifiable limitation on foreign investor rights. This is because the broad exception for conservation measures which is established by Article XX(g) of the General Agreement on Tariffs and Trade, and incorporated into NAFTA, does not apply to NAFTA investment disciplines.² In other words, pursuant to these rules, KKW is not entitled to curtail water-taking by Nestlé on the grounds that conservation justifies such a restriction. Yet the provisions of the proposed contract contemplate restrictions on Nestlé's water-taking rights for the purpose or ameliorating local water shortages.³ Under NAFTA rules, it would be left to a private international arbitral tribunal to determine whether Nestlé's rights as a foreign investor would prevail notwithstanding the explicit provisions of the proposed Agreement.

The third point is to note that NAFTA investment rules have been invoked on more than one occasion to challenge government measures to protect or conserve water resources. To date, only one of these claims has succeeded, and that case involved the impacts of a hazardous waste disposal facility on groundwater resources in rural Mexico.⁴ However, the use of NAFTA investment procedures to challenge government actions to curtail water taking under a government permit has recently been given serious and thorough treatment in an article published in one of Canada's most prestigious law journals⁵ and we recommend the article to those advising KKW for their careful review.

In sum:

It is clear that by entering into a contract with Nestlé that entitles the company to remove substantial volumes of freshwater, KKW would be opening the door to the application of international investment rules to the rights Nestlé would acquire under such an agreement. It is also clear that these rules may be invoked to challenge actions taken by KKW or state regulators to curtail water-taking under such an agreement.

It is impossible to speculate about how likely such a claim would be, but it seems unlikely that a company like Nestlé would risk the notoriety that such a water-related claim would provoke unless the stakes were high enough. That being said, in our view it would be imprudent for any public authority to enter into such a contract without serious consideration of the risk engendered by the international investment treaties entered into by the United States.

² See NAFTA Article 2101.

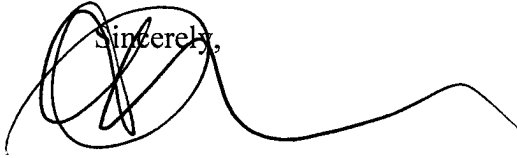
³ Proposed Agreement Article 3(e).

⁴ *Metalclad Corp. v. United Mexican States* (Notice of Arbitration, 2 January 1997), online at The U.S. Department of State: www.state.gov/documents/organization/3997.pdf (date accessed: 11 December 2002).

⁵ Joseph Cumming and Robert Froehlich, Chapter XI and Canada's Environmental Sovereignty: Investment Flows, Article 1110 and Alberta's Water Act, *University of Toronto Faculty of Law* (2007) 65(2) U.T. Fac. L. Rev 107 – 135.

Please let me know if there is anything further we can do to be of assistance.

Sincerely,

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Steven Shrybman
SS:lr/cope 343

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